IN THE COMPETITION APPEAL TRIBUNAL

Case No: 1524-1525/1/12/22

Salisbury Square House
8 Salisbury Square
London EC4Y 8AP

Monday 6th November – Friday 1st December 2023

Before:

The Honourable Mr Justice Marcus Smith
Eamonn Doran
Professor Michael Waterson

(Sitting as a Tribunal in England and Wales)

BETWEEN:

Appellants

Pfizer Inc. and Pfizer Limited & Flynn Pharma Limited and Flynn Pharma (Holdings) Limited

V

Respondent

Competition & Markets Authority

A P P E A R AN C E S

Mark Brealey KC, Robert O'Donoghue KC & Tim Johnston (Instructed by Clifford Chance LLP) on behalf of Pfizer

Jemima Stratford KC, Tom Pascoe & Alastair Richardson (Instructed by Macfarlanes LLP) on behalf of Flynn

Josh Holmes KC, David Bailey, Jennifer MacLeod, Julianne Kerr Morrison & Conor McCarthy
On Behalf of the Competition & Markets Authority

Tuesday, 21 November 2023

(10.00 am)

(Proceedings delayed)

(10.10 am)

DR ADRIAN NIZAM MAJUMDAR (continued)

THE PRESIDENT: Good morning, Dr Majumdar, welcome back.

Mr Holmes, did you have any overnight thoughts?

MR HOLMES: No, sir. No, no.

THE PRESIDENT: Well, before Mr Brealey, you start, I did, so excuse me if we go back over a couple of points.

Questions by THE TRIBUNAL

THE PRESIDENT: You will recall that yesterday I asked you about what you derived from the drug tariff rate of the £30 that was agreed between Teva and the Department of Health?

A. Yes.

THE PRESIDENT: Your evidence -- and I stress I am paraphrasing here, we will of course be looking at the transcript and quoting from that -- but your evidence was that this rate provided a reliable informational input into your assessment of what prices in the market for capsules were the outcomes of workable competition.

A. Yes, there are two elements that I find this £30-value to be informative about. The first is it informs me that the maximum willingness to pay for tablets, which

I presume also carries over to capsules, was above £30, so as I mentioned yesterday I estimate that to be around £48, so this £30, because it was a negotiated constrained price, that tells me that the Department of Health's willingness to pay was in excess of £30.

As I say, I estimate that to be £48, so that is the first thing that it tells me, it tells me something about willingness to pay, maximum willingness to pay.

The second thing that it tells me, which is a related point, is that if the maximum willingness to pay is £48, that is also the monopoly price. So when Professor Waterson took the experts yesterday through this type of industry, there was agreement that the maximum willingness to pay and the monopoly price in this sort of industry would be more or less the same thing, and so given that this helps me or reaffirms my view that the monopoly price is materially above £30, I say £48, that then informs my assessment of workable competition, because I say, well, if the monopoly price is at 48, if the duopoly price, which is the period 2 price, is around 26, and then I am down at 13, which was my estimate for the Teva price during period 3, then we are a long way below the monopoly price, a long way below the duopoly price, which then gives me confidence that we are in a range of workable competition, we are

not up too close to the monopoly level. So those are the inferences that I am drawing from that information.

THE PRESIDENT: Yes, no, that is very helpful, and of course we have that in your reports and you have been cross-examined on it, and that is something which I am going to bank and take away so that we can think about it, but the underlying point is that you are deriving a good deal of conclusory judgment from this agreement between Teva and the Department of Health, this £30, as you have explained.

A. I certainly consider it to be useful evidence and valuable evidence. I would say that I am not only drawing on that, I am piecing together other strands of evidence. So, for example, the reason that I say £48 is my estimate of the monopoly price is because I observed lots of prices for 12 months, lots of drug tariff payments for 12 months, in excess of that, and then it was only at the £114 point that the intervention took place, and so I look at that separate evidence, and I say that looking at the data, that says to me that the Department of Health's willingness to pay was in excess of £48 because it was only the 114 that triggered it.

So that is a separate piece of evidence that I place weight on in addition to the £30.

So just to be clear --

THE PRESIDENT: Dr Majumdar, no one is suggesting, least of all me, that that is the only piece of information that you looked at.

A. Yes.

THE PRESIDENT: But it is one piece of information and it would be fair to say whatever label one attaches to it, it is material to your consideration.

A. Yes, absolutely.

THE PRESIDENT: Now, I do not think you go so far as to say that the outcome of the negotiations or discussions between Teva and DoH was the outcome of workable competition. I think you regard it as a form of outcome between a monopoly seller and a monopsonistic purchaser?

A. That is correct, sir, I do not say that this is a process of workable competition. I just say it is a constrained price as you say from --

THE PRESIDENT: Yes. So that leads me to the area that I do want to ask you about which is more generally the environment in which prices of pharmaceutical products emerge and the quantities in which such products are sold.

I think you would agree with me as a general proposition that this is a highly regulated environment?

A. Yes, I would.

THE PRESIDENT: What I am going to do is I am going to go

through a few examples that struck me as to why it is right to say that it is a highly regulated environment and then, when I have gone through my list, I will ask you to supplement or add any things which I am sure I have missed. So first aspect, pharmaceutical products can only be sold under marketing authorisation. You accept that?

A. Yes.

THE PRESIDENT: Secondly, where these products are prescription products, the patient cannot buy these products without a prescription?

A. That is my understanding, sir.

THE PRESIDENT: To be clear, it is the lame leading the blind here, I am sure both of us will be corrected by counsel in closing if we have mis-spoken, but with that qualification I will move on to the third one.

The doctor or healthcare professional doing the prescribing is insulated from cost when exercising that judgment?

A. I believe so, yes. I believe they have to make their decisions on the patient -- treating the patient --

THE PRESIDENT: Patient welfare.

A. Yes, thank you, yes.

THE PRESIDENT: Again, it is not a perfect insulation because we do know that there are, in the case of very

expensive drugs, we heard from the medical experts, there are controls where there are flags that come up on the system saying: are you sure, and: we really do not think you should be prescribing this without a very good reason. So insulation is a word I have used deliberately because we are not saying never; we are saying it is not operating in the way a market would operate.

A. I did not listen to the medical evidence, I cannot speak to that point, but I will take it as read that you listened to it very carefully, sir.

THE PRESIDENT: So when a patient pays a price, the prescription price, that price bears little or no relation to the actual price of the pharmaceutical product being prescribed?

A. Yes, that is my understanding. I think there is a regulated prescription amount which, as you say, is different from the wholesale price, distributor price and so on, yes.

THE PRESIDENT: The pharmacies that do the dispensing are remunerated for their services in selling pharmaceutical products and perhaps for other services by the difference between the drug tariff, or the reimbursement rate, and what they pay for the product coming into their stores?

A. Yes, that is my understanding. Putting to one side the clawback mechanism which I must confess I do not understand in great detail, but, yes, that is my understanding.

THE PRESIDENT: That is a very fair point.

The prices that they pay, the pharmacies, are subject to certain forms of price control over and above the drug tariff. We have heard of the PPRS and other voluntary schemes, again, without committing to the detail because you cannot give evidence on this, that is also your understanding?

A. Yes, my understanding is that branded products are in PPRS and that the tablets were in Scheme M, for example.

THE PRESIDENT: Yes. Over and above that, one has a general ability in the Secretary of State to review prices when they are outside the voluntary schemes?

A. That is my understanding, but here I am really -- I would not claim to be an expert on these features, sir.

THE PRESIDENT: No. Dr Majumdar, let me explain why I am asking you about this. You are absolutely right, I am taking you outside your expertise in the sense that this is a question of how this particular industry works, but it is necessary that you understand these constraints even if you cannot speak to them as an expert, because

the next question which I am about to come to requires us to at least have an understanding of these environmental questions in which pharmacies and doctors and patients and CCGs all operate. So whilst we may be corrected -- I am sure we will be -- in terms of the detail, provided we have the broad picture right, it does not undermine the premise of the question that I am about to come to. So you do not need to worry and I do not need to worry about misspeaking and getting the detail wrong, those corrections will follow. What does matter, though, is that we have an understanding of the broad outlines of the beast or the environment that we are trying to understand the significance of.

A. Understood.

THE PRESIDENT: So with that in mind, are there any big or material features that I have left out of account in the list I have given you that strike you?

A. In terms of regulation?

THE PRESIDENT: Yes, in terms of the regulatory environment in which the players operate.

A. Well, we have the guidance as well which is a form of regulation which one might also --

THE PRESIDENT: So you are talking about the guidance saying stick to similarly-manufactured products?

A. Yes, if one counts that as regulation, then --

THE PRESIDENT: No, I am very happy to add that in. That is extremely helpful. In a sense, that would be a broader category of guidance to clinicians as to how to prescribe, which is not related to money questions but related to patient benefit?

A. Yes.

THE PRESIDENT: One could throw in, I suppose, the whole QALY assessment that NICE undertake which we will be hearing about more from which acts as some kind of explanation for what is available to prescribe and what is not available to prescribe?

A. Yes, sir.

THE PRESIDENT: Is there anything else? Really, I just want to make sure that you have an opportunity to supplement my list. There is no trap there. I am just ensuring that you have had a chance to --

A. No, absolutely. I think that is all I can think of at the moment, sir, in terms of regulation.

THE PRESIDENT: Okay, so all that was a lead up to what is actually quite a very short question, and it is this: given this highly regulated environment which we have discussed, what makes you say that the outputs in that environment, the prices of pharmaceutical products and the quantities at which they are sold, represent the outcomes of workable competition at all?

A. So the reason is because my understanding of the mechanism by which prices fell in period 3 is that the process was a competitive process, that is to say that Teva, in the tablet market, had to lower its prices because its customers were threatening to switch to alternatives, be that Wockhardt or Milpharm. So that threatened -- you know, that threat: I will switch if you do not lower your price, strikes me as a process of competition.

I then observed the degree by which the prices fell, and I thought, well, they have fallen by such a degree and already from a position that was constrained by the prior intervention that the combination of those two features said to me: well, here is a process of competition that is taking prices to a level that I consider to be consistent with workable competition. So, yes, I agree that there are these constraints or these features of regulation that impact the market, absolutely, but I think they still left room for that process driving down the prices, hence my view that this was a period of workable competition.

THE PRESIDENT: But accepting, as we do, that all of these transactions and all of these changes in prices are occurring in this very detailed and very intrusive regulatory environment, is it a dangerous assumption to

say that simply looking at a part of it, those interactions are in fact the interactions of what you call workable competition?

I suppose what I am asking is are you making an assumption in looking at these segments or parts of the greater whole, an assumption that actually needs to be tested for and, if it does not, why not, and, if it does, how do you do that?

A. I see. I do not think I am making an implicit assumption. I think the answer that I just gave still applies, namely that I think throughout that period 3 there was this process of competition, customers playing off suppliers to get lower prices.

I think the -- I mean, there is -- prior to that point, I did mention that at the start of period 3, prices were already constrained by the Department of Health intervention, and so that lowered them to a level which was what I say is substantially below the monopoly price. So that is something that is a factual point that I think you would want to satisfy yourselves as a tribunal, which is a feature of the ability to intervene, but, no, I think the actual -- as I say, the actual process driving that price fall to my mind is a process of competition.

THE PRESIDENT: For that reason, you do not need to do

anything more to control for the regulatory environmental factors that we have been discussing a few moments ago?

A. I do not think so, no. I mean, I think, as I say, they still allowed for a process of competition to take place, yes.

THE PRESIDENT: Of course, had you considered that you needed to do something to control for these regulatory factors, it would have appeared in your report and one can infer that you have considered this and decided that it is safe to say that the data you are looking at is simply one that can be looked at in ordinary competition terms.

A. Yes, I think that is fair to say. I mean, I took the view that during period 3, Teva was not dominant, and so in that sense, yes, I think we can look at that in the ordinary meaning of dominance in competition terms, yes.

THE PRESIDENT: Thank you. That is very helpful.

I want to, if I may, try to approach the same question just from a different angle, and that is through the meaning that you attach to the phrase "workable competition". So I am afraid we are going to retread a little bit of old ground that we covered yesterday and during your teach-in, so forgive me if some of these questions are repetitions, there are some

new aspects which I hope we will come to.

So first of all, a nice easy one to start with: your understanding of "workable competition" is not coincident with an economist's definition of "perfect competition"?

A. That is correct.

THE PRESIDENT: Perfect competition has a number of characteristics, but one of them is an identity of the products sold and an environment where prices, because of an identity of products sold, amongst other things, tend to a cost plus a reasonable rate of return, thereby maximising consumer surplus?

A. So with perfect competition in the long run, and what I call the flat supply curve, which means in the long run the supply curve is flat, then wherever the demand curve intersects that supply curve will always have the same price, and because we are talking about the long run, it means that all factors of production are variable, which means that labour, capital, including the cost of capital, are variable. So if we are covering those costs, then essentially we are breaking even. So that is right, in the long run with perfect competition we have cost plus pricing.

THE PRESIDENT: The long run embeds in it a number of difficulties, including the problem of contestability.

I mean, one of the assumptions that perfect competition makes is that entry and exit is a cost-free process. You would agree with that?

A. Yes.

THE PRESIDENT: One of the costs of entry and exit is actually the time it takes to enter or exit?

A. In practice, yes, it takes time to enter in normal markets if you like, yes.

THE PRESIDENT: Yes. What I am just quibbling with you is whether the long run term that you used, very familiar to economists, is not one that is appropriate to perfect competition, and instead, the assumption one needs to make for perfect competition to work is in fact that it is instant, in other words, there is in fact no lag between a change and the consequences of that change; everything happens almost in a scintilla temporis at the same time.

A. So when we learn about perfect competition, we look at the short run and the long run. So in the short run, for example, you could have a demand shock that would increase price and create profitable opportunities, and then, because there are no entry barriers, firms would come in, push prices back down, and that process of entry would then expand output.

So you have short run -- you can have a short run

position where there is some profits available which attracts entry, and in the long run that profit is removed. I hope that is clear, so there are both short run and long run aspects to perfect competition.

THE PRESIDENT: Well, yes, what I am questioning is a very minor point, so I do not want to spend too long on it, but what I am questioning is whether in fact discussion of time in the context of perfect competition is actually helpful at all, because the moment you embed a question of time and distinguish between the short run and the long run, you are in fact incorporating into your thinking a certain incontestability, because you are saying in fact it is not possible to enter or leave without time and, therefore, money being a factor.

A. No, I think I would not say perfect competition is -- we should think of it as timeless. I think when we learn about it as economists, essentially the reason why we talk about the short run and the long run is because that allows us to model the impact of cost changes or demand changes, how they impact profit, so if there is a cost shock that reduced profit, we have exit, if there is demand increase that induces entry, we have entry demand expansion, and so I think it is useful at least from a teach-in perspective to think about the short run and the long run. So I would not avoid using those

timing terminologies.

THE PRESIDENT: Okay, but the point about perfect competition is that the prices trend to the price that will be charged by the most efficient competitor in the market, plus a reasonable rate of return to that entity.

A. So in -- prices do not necessarily trend to the most efficient firm in the market, it depends the shape of the long run supply curve. So if the long run supply curve is flat, then all firms have exactly the same cost of production. If it slopes upwards, then in long-run equilibrium where the demand and the supply curve intersects, the marginal firm, which is the firm that is producing, if you like, the final unit on the far right of your diagram where demand and supply intersect just breaks even and the other firms up to that point, because they have lower costs, will be making a profit at that price, is because the supply curve slopes up and so there will be a difference between their cost and the price in long-run equilibrium with an upward sloping supply curve.

So in that world, it would be the marginal firm that breaks even and other firms could still make supranormal profit.

THE PRESIDENT: I see. So how does that fit with the notion that the firms participating in our perfectly

competitive market are scalable in terms of what they produce? So why does not the most efficient firm in perfect competition expand its output so as to drive the less efficient firms out of the market, there being no costs in leaving?

A. Well, it is a very good question. I mean, in that example, sometimes one talks about -- I think they are called Ricardian rents. This is the idea that it may be producers have different plots of land and one land just turns out to be more productive than another person's land, and so there are constraints in the sense that someone only has a piece of land, but it is more efficient than someone else's and hence you get differences in production. But, yes, it is a good question in terms of -- if we move away from perfect competition and we think about dynamism and the ability to innovate and expand, then, yes, you would expect more efficient firms to expand and gain share.

I think in that world we are then moving away from textbook perfect competition.

THE PRESIDENT: Well, that is helpful. I do not want to spend any time writing a textbook, and in a sense perfect competition is a construct, and it depends upon the assumptions that one incorporates into the construct. So we are not actually describing something

that is real in any event, but you would agree with this, that workable competition, what you say is workable competition, involves a departure from the assumptions of perfect competition in a number of respects?

A. Yes, I would agree with that, yes.

THE PRESIDENT: What I am going to try and do is articulate, by reference to the categorisation in the *Hydrocortisone* case what those respects might be and incorporate your understanding of what is workable competition into that schema, and please do say when you disagree with how I am trying to shoehorn your thinking into that schema, because that is why I am asking the questions, I want your pushback.

So if we could bring up on to the EPE monitor {N2/29/156}, what I hope we have there -- if we could put the next page on the other side. Is that legible to you, Dr Majumdar?

A. I must confess, if you do not mind just expanding it a little bit.

THE PRESIDENT: No, let us stick with one page at a time. Let us start with the page {N2/29/156} and let us expand that so you can actually read 322. Do you want to cast your eye over that? I mean, I hope you have read it before.

A. I have read it, sir, but I would value the opportunity just to read it again, please.

THE PRESIDENT: No, of course. Please take your time and let the EPE controller know when you need to move on.

A. (Pause) If we could just go up to the quote bit -- sorry, I did not mean the next page, it was just there was some smaller text in the quote, if we could just expand that, please. Thank you.

(Pause) Okay, if we can go over the page, please {N2/29/157}.

(Pause) So I have read number (1).

THE PRESIDENT: You had better read (2) and (3) as well.

A. Okay. Apologies for my slow reading.

THE PRESIDENT: No, Dr Majumdar, do take your time. There is no rush. (Pause)

A. Thank you. Yes, I am ready for the next page, please {N2/29/158}. If you would not mind just expanding that, please. (Pause)

Thank you, sir, I have read to the bottom of that page.

THE PRESIDENT: A little more to go.

A. (Pause) Over the page, then, please. {N2/29/159}.

(Pause) So I have read to the end of "Case 1... Case 2 ...and Case 3..."

THE PRESIDENT: That is perfect. Thank you for bearing with

me, Dr Majumdar. I am very grateful to you.

So beginning with Case 1, which is one I think we can deal with relatively briefly, that deals with the situation where there is relative inefficiency between sellers, enabling, because of stickiness or inefficiencies in the market, inefficient sellers to remain in the market, they are not driven out, but thereby entitling the more efficient sellers to generate producer surplus over and above the reasonable return?

A. Yes, understood, yes.

THE PRESIDENT: That is why we were having a little debate about long and short run in perfect competition, because under the form of perfect competition envisioned in the *Hydrocortisone* judgment, you have a swiftness of entry and exit that is unreflective of the real world where one has a stickiness which enables, as I say, inefficient producers to stay in and, therefore, enables efficient producers to generate higher than normal profits?

A. Yes, I would agree, when you have different levels of efficiency, then you can -- the more efficient firms can earn supranormal profits, I would agree with that point.

THE PRESIDENT: So moving on to Case 2 and Case 3, and you will see if you look at -- I hope it is still on your screen, the opening words of paragraph 323, which you

have not read, but what is there said is that:

"The distinction between the Case 2 ([the] generation of distinctive value) and Case 3 ([the] generation of producer surplus without added value to Buyers) is by no means easy to draw."

Would it be fair to say that your term "workable competition" is seeking to articulate that which belongs in Case 2, and Case 3 is those instances where one is identifying factors which need to be excluded and removed from the analysis because they are not generative of added value to buyers although they do generate producer surplus in the seller?

A. So I had not thought about my definition of "workable competition" in relation to the *Hydrocortisone* Cases 2 and 3; I had thought about it more in terms of if you think about the definition of "competitive constraints", we normally say that we have existing competition, potential competition and buyer power, and I thought about workable competition as imagine starting off with a monopoly position where there is no buyer power, there is no existing competition and no potential competition and then allowing these competitive constraints to increase, allowing competition to increase, be that because there is a new entrant or because there is an exercise of buyer power.

As we increase these forces of competition, that will push down the price from a monopoly price down to, say, a dominant firm price, and then eventually we get below the dominant firm price into the range of workable competition, again, assuming no collusion.

So I had thought about it very much in terms of increasing competitive constraints, increasing existing competition, increasing potential competition, increasing buyer power or a combination thereof, getting us to the point where there is workable competition. I had not thought about how we would link workable competition to *Hydrocortisone* Case 2 or Case 3.

THE PRESIDENT: Indeed, and that is not a criticism, everyone has their own way of seeing the world, but one of the problems that we have in this sort of case is articulating a common language and a common framework for analysis, and you in a sense start from the position of a monopoly and work away from that. What this schema is doing is it is starting from a situation of perfect competition and moving towards a more realistic scenario in a different way, and what I am seeking to do is, this having been written, I am trying to understand how it fits with your different approach, and I am not saying one is better than the other, I am simply saying I want to understand how the two interrelate.

So if you take the differentiating factor in class 2 over and above perfect competition as being proper product differentiation through the generation of distinctive value which causes buyers to want to pay more, then does that come quite close to your articulation of workable competition?

One has an absence of dominance and an absence of collusive behaviour, which is the case in perfect competition, but one has this ability to differentiate one's offering to the market which is very much not the hallmark of perfect competition, but the hallmark of the real world where one of the ways in which the market operates is to encourage innovation, and the way it encourages innovation is by enabling the innovator to differentiate their product and charge a higher price in doing so.

A. Yes, so I think workable competition can cover different forms of competition, and I agree that it would include competition on quality or competition in innovation, just as you described, sir, where firms are seeking to offer differentiated products which, as you say, generate value for consumers and so at least some consumers prefer firm A's product over firm B which then allows firm A to generate a premium as a result of its differentiation. So I would agree that that would be

captured by my definition of workable competition.

THE PRESIDENT: Looking at the flipside -- we will be coming to, very briefly, cartels and abuse of dominance in a moment, the Case 3 is dealing with that case where you have factors in play which render competition, in your terminology, not workable competition. You understand the point I am making?

A. Yes, so factors in play that would render competition non-workable would be sufficiently strong barriers to entry, sufficiently weak existing competition. So that is how I would link those to my terminology of the three competitive constraints, and insufficient buyer power as well.

THE PRESIDENT: That is very helpful because I do not think anyone is suggesting that the list of matters that go into the generation of producer surplus without added value to buyers is a closed list, but I would like to get an idea of those factors that you say ought to belong in Case 3 and articulate a list.

So we have already, I think, got two factors that would, if they are the only reason for generating producer surplus, render it a Case 3 case: one is collusion between sellers. That renders competition not workable in your terminology; would that be right?

A. Collusion, yes, would be a reason that market power

would exist based on -- where competition is not workable, yes.

THE PRESIDENT: Yes. And abuse of a dominant position is another one?

A. Yes, if there is a dominant position that is being abused, that suggests that competition is not workable.

THE PRESIDENT: I think you mentioned a couple of others, and it would be helpful if we could expand on those. You suggested that incontestable markets was something which might render competition not workable, even if they are not due to a dominant position or collusion.

A. So I was speaking in respect of dominance there.

THE PRESIDENT: I see.

A. So I would say where barriers to entry are high enough, where existing competition is too weak and where there is no buyer power, that can create a dominant position, so I was linking that comment precisely to dominance.

THE PRESIDENT: I understand, that is very helpful to understand. So you are equating an absence of contestability to a presence of dominance?

A. Yes, in terms of my definition of "workable competition" that is right, yes.

THE PRESIDENT: That is very helpful. So it is not possible, then -- well, let us take it in stages.

Do you say that it is possible to have an

incontestable market without someone having a dominant position, or do the two always go hand in hand?

A. So they do not go hand in hand, so I give an example in an annex to my position paper where I take a fairly standard economic model, it is called the Cournot model, and essentially what that model presumes is that firms compete with identical products, and the way I have set it up, they had no capacity constraints, they had no switching costs, there is no collusion, and I have ten players competing.

There are barriers to entry, but there are ten players competing, so we have identical firms with a 10% market share, and what I show in that model is that when you have a high willingness to pay, which is essentially where the demand curve intersects the price axis, where that is very high relative to price, then workable competition -- so I say competition is workable even though there are entry barriers because you have ten firms competing with a 10% market share each, and I show that even in that scenario you can have a price that is very high relative to cost, and so I use that as an example of how workable competition in an imperfectly competitive market but one that nonetheless looks like it is pretty competitive, can still generate a high price relative to cost and hence cost plus would not be

a good way of thinking about where price should be in that sort of market.

THE PRESIDENT: That is helpful, and just to be clear, nothing in my questions is intended to go into what the relationship between price and cost can or should be. I am not asking about that, and it is not a necessary part, certainly of class 2 in this schema. What I am really just trying to get a feel for is how your workable competition maps on to the distinction between generation of distinctive value versus generation of producer surplus without added value. I think we have just got a list of two at the moment which are your attributes, negative attributes of workable competition, which is an absence of cartelist behaviour and an absence of an abuse of dominance?

A. Yes, sir.

THE PRESIDENT: Can you think of any others?

A. I mean, just to be clear, I did not explicitly say abuse, I just said that where there were factors of -- so my definition of "workable competition" does not imply -- does not speak to abuse, it just says that there is no dominance.

THE PRESIDENT: I understand, so that is my mischaracterisation of your evidence, I apologise. Your definition of "workable competition" excludes the

existence of dominance --

A. Yes.

THE PRESIDENT: -- rather than distills upon an abuse of dominance which you see as a separate question?

A. Yes, absolutely, yes.

THE PRESIDENT: Okay, that is very helpful, thank you.

So we identify those two factors. Are there any others that we ought to be looking to, or is that it? Again, I am simply trying to make sure the record is complete so we can think about it later.

A. Well, I do think this point on value is important, and it goes back to the example that I just gave you. So whether we call this distinctive value or not I do not know, but in the example that I mentioned which is in the annex to my position paper of the model where you have ten competing firms each with a 10% market share, no switching costs, no capacity constraints, the interesting feature of that model is the structure is very competitive, and so I would say there is workable competition, but because the value of the product is so high, then workable competition delivers a price that is high relative to cost.

So I want to mention that point simply because one can query whether value is distinctive there because all firms are identical, but the point is that the value

placed on the market as a whole is high, and that is what generates -- all else being equal -- a high price relative to cost even though competition is workable.

THE PRESIDENT: Thank you.

So let me just suggest to you one factor that is not present in this schema, and it is our old friend the question of a highly regulated environment. So I said I was going to ask the same question in a different way, well, here is the same question in a different way.

To what extent would you agree with the proposition that this schema, as we have described it, this Case 1, Case 2, Case 3, is incomplete because it fails explicitly to take into account the highly regulated environment that we were discussing a few minutes ago?

A. I see. Well, I would agree that taking into account regulation is important because regulation can act as a constraint on price, and regulation can act on the -- regulation can create barriers to entry, it can impact barriers to expansion. So I think -- so on one level regulation can be taken into account as part of the dominance assessment, but then I think, yes, there is a separate question which is if regulation actually directly constrains a price, for example, then that is not explicitly covered in your -- sorry, in the *Hydrocortisone* framework, I think that is fair to say.

THE PRESIDENT: So -- and I appreciate this is not your schema -- having said that it is something that ought to be controlled for better, how would one go about that? How would one ensure that the regulatory environment was adequately reflected in this approach to the parsing of effectively market power?

A. I do not think I will be able to give you a complete answer to that, thinking on my feet. As I mentioned before, I think regulation can be taken into account where, for example, there is a price constraint, a price ceiling, and you can think about that. If the regulator is the buyer itself, you can think about that as a buyer power framework. If the regulator is just externally imposing a price, then I think that is a separate -- that is distinct from buyer power.

I am not sure I can actually create a Case 4 in regulation off the top of my head, I am afraid, sir. I would have to go away and think about that.

THE PRESIDENT: That is a perfectly fair response, Dr Majumdar.

I apologise for taking up so much of your time and indeed counsel's. That concludes my questions this morning.

Mr Holmes, if you have anything to ask out of that, then I think you are entitled to, before --

MR HOLMES: Sir, there is nothing arising out of that, we are content to proceed by way of submissions in relation to what has just been discussed.

THE PRESIDENT: Thank you.

In that case, Mr Brealey, over to you.

MR BREALEY: You will be pleased to know, everybody, I have no questions in re-examination.

THE PRESIDENT: Dr Majumdar, thank you so much for your time. You are released from the witness box with our thanks. Thank you very much.

THE WITNESS: Thank you.

MR HOLMES: Sir, if it were convenient, might we just take stock in terms of the timetable?

THE PRESIDENT: Yes.

MR HOLMES: The understanding was that today would be for oral examination by the CMA of the appellants' experts. It was obviously always going to be quite a tight timetable.

THE PRESIDENT: Yes, we have lost an hour.

MR HOLMES: I think there is a real risk that we will not be able to conclude our cross-examination today, given the time, so I just wanted to lay down a marker that I think we might find ourselves now in need of some of tomorrow morning in order to conclude the cross-examination of witnesses.

THE PRESIDENT: Mr Holmes, we had a timetable that started at 10.00, we are now at 11.00. We will find the extra hour somewhere.

MR HOLMES: I am grateful.

THE PRESIDENT: You certainly should not be prejudiced in any way by the Tribunal going off on a frolic of its own.

MR HOLMES: No, it is important that the Tribunal satisfies itself. Simply to make sure the practical time constraints were recognised.

THE PRESIDENT: We have that well in mind.

MR HOLMES: Another practical difficulty is that we are going to lose one of our counsel team who is heading to another trial, and she will be cross-examining Mr Williams. We have conferred on the Bar, and I understand that Flynn and Pfizer are happy to interpose Mr Williams so as to make sure that she can conduct the cross-examination of that witness.

I should say it is Ms MacLeod who is the counsel in question. So if that is all right, we might take Mr Williams ahead of Dr De Coninck.

THE PRESIDENT: If that does not discombobulate anyone else, should we proceed to Mr Williams now?

MR HOLMES: If the Tribunal is content.

THE PRESIDENT: Certainly, if no one else is objecting.

MS STRATFORD: Yes, we are being very accommodating. Originally we were going to have Mr Williams first, then, for the CMA's convenience we put him after Dr De Coninck, but we have now, on our feet, agreed we can move him back again, so that is no problem.

THE PRESIDENT: Ms Stratford, that is very helpful, in which case we will proceed to Mr Williams.

MS STRATFORD: Just before we do that, since we are talking about time, all I would do is to put down a marker, perhaps Mr Brealey would say the same thing if he were on his feet, I know that he needs a good amount of time with Ms Webster, I just want to put down a marker because of the way the timetable is working and the fact that we have a short week this week. I do need to ensure that Flynn has sufficient time to cross-examine Mr Harman.

THE PRESIDENT: Ms Stratford, I hope everyone appreciates that the Tribunal is very sensitive to the need to put your case, and that goes for everybody. So we will see how we go, but we are very conscious that there are vicissitudes that come into play in any cross-examination, some of them are in the form of Tribunal questions, others are in the form of things just not going as quickly as one would like, and you can take it that we will do our very best to ensure that you

have the ability to properly put whatever questions you need to put, and that, of course, goes for everyone.

So Mr Holmes has been reassured, but do not worry, we understand the problems that exist for you and for Mr Brealey.

MS STRATFORD: I am extremely grateful, thank you.

MR BREALEY: I do not think we have a problem. I do not think Ms Webster is on today, but we have tomorrow and we have Monday, so I think we have a lot of slack in the timetable.

THE PRESIDENT: I am grateful for that.

MS STRATFORD: I hope that is the case. I am being conservative.

THE PRESIDENT: You are being Cassandra, I am not sure what the opposite of Cassandra is --

MR BREALEY: Achilles.

THE PRESIDENT: -- but that is what Mr Brealey is being, and I am very grateful to both of you.

MS STRATFORD: I am grateful.

Obviously Mr Williams has already been sworn, but if --

THE PRESIDENT: Then, Mr Williams, if you come on up, then you will have some questions.

MR RICHARD WILLIAMS (recalled)

Cross-examination by MS MACLEOD

THE PRESIDENT: Mr Williams, do sit down. I think there is a glass there with water. As counsel has said, you are still under oath, the only difference now is that I will remind you again of this, but you are now in purdah, so when we have a break, please do not talk to anyone about your evidence, but with that, I will hand you over to counsel.

MS MACLEOD: Good morning, Mr Williams.

A. Good morning.

Q. As I think you know, my name is Jennifer MacLeod and I am here to ask questions on behalf of the CMA.

Your first report in this case is dated 2 December 2015, which is quite a long time ago. Am I right in saying you have been instructed by Flynn since at least then, is that right?

A. Yes, that is correct.

Q. And you were an expert for Advanz Pharma, one of the defendants in the *Liothyronine* proceedings, is that right?

A. Yes, in certain aspects of their proceedings, yes.

Q. Have you undertaken any further advisory or expert work for pharmaceutical companies subject to investigations for breaches of competition law?

A. I have had discussions with Aspen in relation to both their oncology portfolio, which was investigated by the

European Commission, but this was not an advisory role. I have had discussions with Aspen in relation to Fludrocortisone.

Q. What was that, sorry?

A. Fludrocortisone.

MS STRATFORD: I hesitate to rise so swiftly, but I do not know whether Mr Williams is confident that he should be -- that there is not any question of privilege here, whether he should be -- he is probably quite confident that he knows what he can talk about and what he should not talk about. I have no knowledge or agenda here, but I just thought it was appropriate to put the issue on the table.

THE PRESIDENT: No, Ms Stratford, that is helpful.

Mr Williams, I am on the alert to the avoidance of privilege being exposed, and I do not think we are close to that at all, but if you are uncomfortable about answering questions because of questions of confidentiality, do please say so. I am remarkably unsympathetic to questions of confidentiality, but I will certainly want to take a reasoned understanding of your difficulties. So if you have difficulties in answering questions for that reason, do please let me know and we will consider how to go.

A. Yes. On that basis I will happily proceed.

THE PRESIDENT: On that basis, do answer counsel's questions and if you have a problem, raise them.

A. Yes, so -- and the other thing that in relation to Fludrocortisone I was interviewed by the CMA under their various powers to do so in relation to my involvement in that original investigation. I think all of those matters have been settled.

MS MACLEOD: I want to start by picking up a very short point that you made in your evidence in the hot-tub yesterday in response to Professor Waterson.

Can we turn to, please, {Day9LH1/91:}. I want to turn to line {Day9LH1/91:12} which you can see in the middle of the page, where Professor Waterson states:

"... it is a puzzle that we see relatively more firms -- well, three firms at some point in the tablet market but only, I think, two in the capsules market, although the capsules market is bigger?"

Dr Majumdar goes first and then you come in at the end there, and you say:

"I need to check the chronology, but I am wondering whether the launch of the predecessor of these proceedings may have impacted that in that these [if we can go over the page] proceedings I think followed on -- or the first referral followed on fairly shortly after capsules had entered the market, and if there was

therefore some pricing uncertainty about the future direction of capsules pricing as a result of the allegations made, that would certainly be a deterrent effect to people entering the market."

Am I right to say, Mr Williams, that you were speculating there and that you do not in fact have evidence relating to NRIM's entry or other market suppliers' entry?

A. Yes, that is pure speculation on my part.

Q. I now want to make sure that we are on the same page about the basic facts in this case before we move on to their interpretation which I will come to, but just to go through these. So phenytoin capsules were not a new drug in 2012, were they? They had been commercialised since at least 1938?

A. Yes, as Epanutin.

Q. They had been as Epanutin long off-patent, so by the time that Pfizer acquired Epanutin in 2000, it was not subject to patent protection?

A. That is my understanding.

Q. Until September 2012, they were still branded and subject to the Pharmaceutical Price Regulation Scheme that existed at that time?

A. That is correct.

Q. The ASPs, we now know, since at least January 2003

until September 2012 were 51p for 25mg, 52 for 50 and £2.21 for 100mg and £2.20 for 300mg. Does that sound right?

A. It sounds right. I cannot check with my evidence, but it sounds absolutely right.

Q. I can turn it up if it is helpful.

A. No, I am sure you have it right.

Q. Then the drug tariff price, which is obviously the price that is in the public domain, is a little higher, so it is 66p for the 25mg, 67p for the 50mg and £2.83 for the 100mg and 300mg versions. Does that sound about right?

A. That sounds about right.

Q. Now, in September 2012, they were debranded and removed from the PPRS; is that correct?

A. That is correct.

Q. Can we just turn up {XA1/1/104} so that you are not having to take all of the figures from me, Mr Williams.

You see the figures we have just been discussing with the ASPs which is the first column on the left, and then you have the next column is Flynn's ASPs throughout the whole of the relevant period, and then you have Flynn's ASPs September 2012 to March 2014, so the first half of the period is the third column.

So just focusing on that third column, the price at which they were sold by Flynn after September 2012, so

after debranding, was that for 25mg capsules they were sold for £13.83. Does that look right to you?

A. Yes, it does.

Q. We are reading the same thing. If I can just point you down to table 2.6 which is on the same page, it is the column that is almost exactly below.

A. Yes.

Q. That is 2,612% higher, assuming the CMA has got its maths right, than the pre-September 2012 price; would you agree with that?

A. That is mathematically correct, but of course it is conflating two ownerships. You have the Pfizer ownership of Epanutin and Flynn's ownership of capsules and you cannot really just connect those two together. Flynn was never selling capsules at 51p or 52p or £2.21, etc; it was basically acquiring finished packs from Pfizer at a price materially greater than that.

So to try and draw a comparison between Pfizer's original price and Flynn's post-debranding price, I think is a false comparison, and it is mentioned in here that, you know, as if Flynn increased capsule prices; Flynn did not increase capsule prices, it set a price which then did not increase.

Q. So what I am going to do, Mr Williams, is I take that point, and what I am going to do is come back to it, but

if what I first might do is just set each of the four prices so that we have gone through each of the four prices.

A. I understand.

Q. I will come back to that point and if I do not, I am sure various people will jump up and make me come back to that point, but we understand what your position is in terms of comparing the price before and the price afterwards.

THE PRESIDENT: What you are saying, Mr Williams, is this: that when one is looking at Flynn's costs stack you have to look at the price that Flynn pays to Pfizer, otherwise you are leaving out of account a material question. What one does when one is looking at Pfizer's costs stack is different?

A. A different matter, yes.

THE PRESIDENT: Because what they receive from Flynn in payment of the packs they have received is emphatically not a cost to them; it is a cost only to Flynn?

A. Yes, that is absolutely correct. We have to look at Flynn's actual costs, Flynn's actual revenue, as you say, part of the costs stack. It would have been impossible for Flynn to carry on selling, for instance, 25mg tablets at 51p without making a thumping great loss.

THE PRESIDENT: So whilst you are going to be happy to agree the mathematics in table 2.6, we will proceed on the basis that we have well in mind that intervening stage. Counsel will come back to it as she fits.

A. The mathematics are correct; the inference is perhaps not correct.

THE PRESIDENT: Indeed. Well, if you proceed to answer counsel's questions on the basis that we have your point well on board, then --

A. I will, sir.

THE PRESIDENT: -- we will see where we go.

A. Yes.

MS MACLEOD: And I have the point well on board, sir, thank you.

Just turning to Flynn 50mg, it sold for £14.10 from September 2012 to March 2014, which was an increase of 2,599% from Pfizer's -- and we hear what you say about the distinction -- Pfizer's pre-September 2012 price; is that right?

A. That mathematics is correct.

Q. For 100mg, it is a £59.53 price, which is a price increase of 2,598%; is that right?

A. Again, the maths is correct.

Q. Thank you. Then we have the 300mg which is sold at £59.32 by Flynn, which is an increase of 2,599% to that

of Pfizer; is that right?

A. Again, the mathematics is correct.

Q. I want to come back to the inference that you draw from this and in particular, your point that Flynn takes the input price from Pfizer and prices on top of that. What I would like to start by doing is turning up the witness evidence of Mr Walters of Flynn, and that is at {XC2/3/1}. Can we turn to paragraph 16 which is at page {XC2/3/6}.

We have here, we see from the title, a meeting between Pfizer and Flynn on 1 June 2010, and we see from the first line:

"A further meeting was held between Pfizer and Flynn on 1 June 2010, at which Flynn presented its proposal for Epanutin. In short, Flynn proposed that Epanutin be debranded and sold as a generic product, thereby removing it from the PPRS and enabling prices to be increased from their existing levels."

If we can look at paragraph 17 we see that some slides were presented at that meeting, and at 17(b) we see:

"'Competitor products (tablets) are sold at [circa] 30x the price [of capsules]' and [Flynn, I think] proposed that tablets be used as a benchmark for Flynn's proposed capsule product. At this stage Flynn proposed

discounting the price of tablets by 50%."

Now, can we also turn up the Tribunal's first judgment which is at {XN1/2/143} and I would like to look at paragraph 457, Mr Williams. It is right at the bottom of the page.

A. Yes, I see that, thank you.

Q. "Finally, and critically, the evidence consistently showed that the strategy, which was jointly evolved between Pfizer and Flynn, to remove phenytoin sodium capsules from the PPRS and to price them at a much higher level (close to the then Drug Tariff Price of tablets), was based on a clear-sighted view, by both, of the increased profit that would flow to each from that arrangement: indeed that was the admitted purpose. Pfizer and Flynn expressly discussed a percentage split of that benefit, ultimately reaching a commercial solution based on a supply price which provided each with a satisfactory share of the increased profit. They did so, irrespective of the fact that Flynn was left free as a matter of contract law to determine precisely what price (above the Pfizer supply price and appropriate other costs) it actually set. Pricing was an integral part of the strategy radically to improve the profitability of the capsules."

So, Mr Williams, to say that Flynn just takes the

input price from Pfizer and adds a margin on top just masks the real world picture in this case which is that the price rise was planned and implemented by both parties, does it not?

A. As I understand it, Pfizer was selling Epanutin tablets unprofitably and, therefore, needed to find a solution that allowed continuity of supply, and this was a normal commercial arrangement between two parties. Small and speciality pharmaceutical companies acquire tail-end brands from larger companies all the time, and that will involve the larger company making something out of it and the smaller company making something out of it.

So as far as I understand, it is not at issue that there was no collusion between the parties on this, it was -- to my perspective, it was just a normal contract negotiation.

There was going to be profit, undoubtedly, for both parties in this type of transaction. What I looked at in my expert evidence is was the level of profit that Flynn made reasonable in the context of what other companies would have been looking to or other speciality pharmaceutical companies, but I do not dispute the fact that ultimately there was a profit increase in aggregate by this arrangement.

Q. I am going to pick up on one point that you mentioned

there, Mr Williams, because you mentioned that -- I am not sure I have the precise quote, but you tell me if I am mischaracterising your point -- is that Pfizer had been making a loss prior to the price rises. That was one of the factors that you mentioned, was it not?

A. I think from my understanding it was relatively unprofitable. I have not look at Pfizer's detailed accounts, but --

Q. That was going to be one of my questions.

A. -- I do not think it was making significant margins.

Q. So I think I am right in saying that you have not undertaken any analysis of Pfizer's costs?

A. I have not undertaken. I have only read what I have read in the various evidence.

Q. Can we turn up paragraph 6.14 of the Decision, please, which is at {XA1/1/248}. Paragraph 6.14 I think is the point that you were referring to. We see there that:

"Pfizer has submitted that the price increases it imposed in September 2012 were necessary to ensure the continued supply of Capsules to the UK market. In his evidence before the CAT, Mr Poulton stated that Pfizer's price increases were 'about putting this product back on a fair sustainable basis for the longer term' and 'the only way we could ... maintain [the product] would be to bring it to a level of profitability that would be

sustainable'."

I think that is the point that you were referring to; is that right, Mr Williams?

A. Yes, it is.

Q. Can I refer you to the next paragraph which is paragraph 6.15, and can I just ask you to read that paragraph, please.

A. Including the subparagraphs or just --

Q. Including the subparagraphs, please, yes. (Pause)

A. Yes, I have read that.

Q. That sets out that on the CMA's analysis, all potential historical losses were recovered within two months of Pfizer increasing its prices, and that was just at Pfizer's level of the supply chain.

Now, my understanding from what you said earlier about not looking at Pfizer's costs is that you have no basis to gainsay that; is that correct?

A. Absolutely. All I can read is what I can see there which did confirm in 6.15.1 any potential historical losses. There is an implication therefore that there were historical losses being made by Pfizer.

Q. But they were recovered?

A. And continues to say that they were recovered within two months, but it certainly confirms the point that Epanutin, according to that, was a loss-making product.

Q. Well, it says "any potential historical losses".
A. Yes, potentially a loss-making product.
Q. Indeed.
A. Yes, to get it exact.
MS MACLEOD: Now I would like to turn up Day 7 of the transcript if we could, please, although I am conscious of the transcript writer. I am happy to take a break now.
THE PRESIDENT: Ms MacLeod, we are in your hands when you reach a convenient moment. We are happy to be guided by you.
MS MACLEOD: We will have a break, sir.
THE PRESIDENT: Thank you. Thank you for raising it. It is 25-past. We will resume at 25-to. Thank you very much.
(11.26 am)
(A short break)
(11.38 am)
MS MACLEOD: Can we turn up Day 7 of the transcript, please, and turn to page {Day7LH1/43:}.
Mr Williams, just so you know what we are looking at, this is the end of your teach-in, and at {Day7LH1/43:3}, this is you speaking, and you are answering your second key question and your second key question is whether Flynn approached:
"... the pricing of capsules at launch in a way that

I would have expected a normal company to do, or any company to do, and the answer is, yes, I did."

So as I read that, this is exactly the point that you were making earlier, which is that you consider that Flynn's approach to pricing in 2012 was what, in your words, a normal company would have done or any company would have done?

A. I think that is correct, although I think perhaps in line 6 the word "I" should probably say "they". In other words, yes, they did.

Q. Yes, I was confused by that. I was not sure whether the answer was yes, I do, or yes, they did.

A. Yes, they did, and I believe they did.

Q. Thank you. Now, I want to interrogate that conclusion in a little bit of detail, Mr Williams, and I apologise but it is going to require me to go back through a couple of documents to see what other people were saying to come back to what your conclusion is.

A. That is no problem.

Q. The British Generic Manufacturers Association is a trade association which represents the generic industry; is that right?

A. That is correct.

Q. Their website says they represent around 85% of the total UK market by volume; does that sound about right

to you?

A. That sounds about right to me, yes.

Q. Can we turn up {XG/397.1/1}, please.

This is a reaction from the BGMA in respect of the CMA decision on the Pfizer/Flynn case in 2016. We sort of see that from the title in bold, but this page is not entirely clear, it does not make clear what the date is, but just so you know, this is the original Decision, this is from December 2016.

I just want to walk through this. So:

"Warwick Smith, Director General of the British Generic Manufacturers Association ... said: 'Pfizer's cynical behaviour flies in the face of the virtuous circle between innovator and generic companies which normally works extremely well in the interests of patients and the NHS.

"'In our view, the role of the so-called research based sector is precisely that: to innovate and develop new medicines to deal with currently unmet clinical need. The main job of the generic sector is to introduce competition when the innovators lose their monopoly due to patent expiry. This massively reduces the cost of medicines which frequently continue to be the gold standard for the majority of conditions; and competition also drives further innovation.

"'When originators put their resources into artificially increasing the commercial value of their older products by extending their monopoly, they not only cost the NHS more money, but fail to live up to their promise to society to deliver much needed new medicines.

"'Generic companies sometimes need to invest significantly in older medicines to keep them on the market, and to meet current regulatory standards. This might lead to increases in price, which would be justified in the interests of patients. But we would never support activity designed purely to artificially increase prices. This equally breaks the virtuous circle of which the industry in the UK, originators and the generic, can be rightly proud'."

Now, taking a step back from this, Mr Williams, it is clear that the BGMA is critical of Pfizer's position, it is condemning the actions of the originators; is that correct?

A. That is what the second line says.

Q. And it is also condemning, at least by implication, the approach of the generic company for increasing the price without justification, is it not?

A. I think this again goes back to the point we were talking about before the break. I think what

Warwick Smith, who I know well, was saying in this particular press release, he was looking at the Epanutin price to the debranded capsules price, and he was commenting on the overall -- I do not think he was making a comment as to whether Flynn's pricing was reasonable, because I am sure he did not actually know any of the details of the transfer or the supply price that Flynn was buying at.

So I think his general comment is in relation to what you were referring to at the beginning which is Pfizer's old price, capsules, launch price.

Q. So somebody who is representing 85% of the generics market, who does not, as you say, know the details, and I think given the dates he could not have known the details --

A. No, correct.

Q. -- he still feels able to condemn the overall picture as flying in the face of the virtuous circle?

A. That is what he says here.

Q. So that suggests that the trade body that represented generics manufacturers did not consider the overall position in this case to be normal, still less what any generic company would do, does it?

A. I think he said it is unusual. Again, I doubt Warwick really had the facts in terms of either the supply price

or maybe even the details of the comparator tablet price, but what he says here is fairly clear to understand.

Q. Mr Williams, have you had the opportunity to consider the witness evidence provided by the CCGs in this case?

A. I did listen to a little bit of the evidence. I think there were three representatives of CCGs.

Q. There were. I will turn you to the specific documents, then, I think it is important. I want to show you a letter that was written by nine CCGs in 2012, and if I could turn that up, please, it is at {XG/214/1}.

Now, we can see from the top of the page that this is a letter of 25 October 2012, and it is written to the chief pharmaceutical officer, and it is written as is clear from the first paragraph underneath the heading, that it is written:

"... collectively as a national group of 9 CCGs who work together to improve the quality of services to patients."

Again, I just want to read through this:

"Epanutin capsules (phenytoin sodium) are a vital treatment for some patients with epilepsy.

"Doctors and pharmacists in the UK have been advised that from 24 September 2012, the marketing and distribution of Epanutin capsules will transfer from

Pfizer to Flynn ...

"The letter to doctors and pharmacists from Flynn ... advises:

"'Please be assured that the Flynn Pharma product is identical to Epanutin. There are no differences in formulation and the site of manufacture remains unchanged. The capsules continue to contain the same identicode markings as Epanutin, including the word 'Epanutin'.

"We have grave concerns about the huge cost pressures for the NHS resulting from this change and the considerable logistical difficulties for GP practices and pharmacies as Epanutin ceases to be available and as the Flynn product enters the supply chain, which may ultimately cause inconvenience and concern for patients.

"Despite being the identical product, the prices for the Flynn products are approximately 24 times the price of Epanutin capsules. We seek to understand how this 24-fold price increase has been agreed. There is no other equivalent preparation available for us to use.

"Each of us will have to find up to £500K from our existing budgets to fund this cost increase."

And it goes over the page. {XG/214/2} It has the heading again and then it says:

"We estimate that the financial impact for the NHS

nationally is likely to be in the order of £43 million per year. This increase in cost will provide no additional health benefit for patients, but will undoubtedly compromise other services that we will not be able to afford to commission as a result."

If I can just get you to note, Mr Williams, that it is signed on behalf of a number of CCGs and one of them includes Somerset at the bottom?

A. Yes, I see that, yes.

Q. If we can now -- before I turn to Somerset, which is the reason I am flagging that for you, it is clear that as far as the CCGs are concerned, they have grave concerns about the price increase, do they not?

A. It is clear. Again, it goes back to the same point, they were looking at Epanutin old price and capsules new price.

Q. If we can turn to the witness statement of Shaun Green, please, that is at {XC1/4/1}. Now, we can see from the first paragraph that he is the deputy director of clinical effectiveness and medicines management for NHS Somerset which is the successor to the Somerset CCG, and if we go over the page, {XC/4/2} he has been in his current role for approximately 20 years.

If we go down to paragraph 2 we see:

"In these roles I have always been responsible for:

(i) the production of prescribing guidance for GP practices in Somerset ...; and (ii) the efficient use of Somerset CCG's prescribing budget from a safe, high quality and cost effective perspective."

So would you accept, Mr Williams, that from the consumer side he is experienced in considering the cost of medicines?

A. Yes, from the payer's side.

Q. On the payer's side?

A. Yes.

Q. Just to give you the context, Mr Green is, as he goes on to explain, one of the people who was responsible for the letter we have just seen, and I want to turn to paragraph 16, please, which is on page {XC1/4/5} at the bottom of the page.

He says:

"At the time [this is in 2012] there was a lot of anger from senior clinicians regarding the price increases to phenytoin sodium. That was at the time relatively unique. They were concerned that other drugs were in a similar position and therefore there was a risk that this was the start of something bigger. They felt they had to do something as quickly as possible, so it did not become a drain on NHS resources."

I want to go down to paragraph 19, which is a little bit further down on the page. He says:

"This type of action was totally out of the ordinary: as far as I am aware it was the first time that Somerset CCG had ever written such a letter (either individually or jointly), and I don't recall any other joint letters written by CCGs to complain about a price increase."

So it is fair to say that not only were these CCGs concerned, they considered that this was an almost unique situation, is it not, Mr Williams?

A. That is what that says.

Q. No doubt you can see where I am going with this Mr Williams, but I am going to go to one more CCG statement before we come back to your opinion.

A. I can see where you are going, yes.

Q. Can we turn to the second witness statement of Mr White, please, which is at {XC1/3/1}.

We see from the first paragraph that Mr White is currently the Chief Pharmacist at Lancashire and South Cumbria Integrated Care, and he was formerly the head of Medicines Optimisation at the NHS Greater Manchester Shared Service:

"... which supports the Greater Manchester Medicines Management Group ... [which] provides

a cross-organisational strategic approach to medicine management issues across the Greater Manchester region and is the coordinating group for decision-making around medicines and in particular high cost medicines for the 12 [CCGs] in [that area]..."

We see that he supported the GMMMG for approximately 18 years.

So again, Mr Williams, we can I think agree that Mr White is very experienced in evaluating the cost of medicines from the payer's perspective, and that was the distinction you made earlier with Mr Green?

A. Yes, in other words, the consumer is obviously the patient, but it is a technicality, but the payer's perspective, the CCGs fund it.

Q. Can we turn to paragraph 27, please, which is on page {XC1/3/7}. He says there:

"I have worked in the NHS since 2003 and I have never seen a more egregious case than the price increases for phenytoin capsules, given the scale of increases and lack of alternatives for patients. I considered the price increases to be an outrageous action. In my experience, it is possible that sometimes prices did increase, for instance due to cost increases in raw materials or a shortage of supply. However, the phenytoin capsules increase went substantially beyond

this and appeared completely unjustified."

Now, Mr White also wrote a letter in light of those price increases, and he describes that at paragraph 34 which is on page {XC1/3/9}. It is right at the bottom:

"It was the first time the GMMMG had written a letter regarding a price increase to a medicine. It is also the only time I believe that the GMMMG had written such a letter, with the only possible exception being a recent case in 2020 involving Priadel, a lithium-based medicine. In the lithium case (which had very similar niche use and no ability to safely switch patients) the near monopoly supplier -- Essential Pharma -- attempted to force a similar multiple times increase on to the NHS; an echo of this phenytoin capsules case. Due to widespread clinical outrage, swift Department of Health and CMA involvement this increase was not implemented and a reasonable cost increase negotiated."

Just to check, Mr Williams, Essential Pharma is one of your comparator companies, is that not right?

A. It is indeed, yes.

Q. We will come back to that.

However, just taking Mr White's statement as it is, it appears clear from this that Mr White considers this to be an almost unique situation and the most egregious

conduct that he has seen in 18 years.

A. You would like me to respond to that?

Q. If I may just put the point to you, Mr Williams.

A. Put the question, yes.

Q. Your evidence was that Flynn's approach to the pricing of capsules was the approach that you would have expected a normal company, or indeed any company, to take. I am putting it to you, Mr Williams, that is totally unsustainable because the price increase generated outrage, indeed, unique outrage, across both the industry and the person who ultimately had to pay for it, did it not?

A. My role and my evidence goes to the issue of, given the price that Flynn was paying for capsules, did it charge a reasonable price in line with what I would have expected? I was not asked to look at the end to end profitability of Pfizer and Flynn combined, indeed, I have not done any work on Pfizer's returns, I was simply looking at Flynn's returns. So the comments I made in terms of was Flynn doing what I would expect a normal company to do were in the context of its input price. All these letters and reports, and the evidence you have taken me to that has been adduced over the last, you know, 15, 20 minutes of our reaction, is based upon old Epanutin prices, new capsules pricing. It does

not look to apportion responsibility, it is just looking at, from the CCGs' perspective, that costs went up. Clearly it is a matter of fact that costs went up, but I was not looking at that beginning to end. I was simply looking at, given where Flynn began, was what it charged reasonable, and was it consistent with what I would have expected.

Q. If I may, Mr Williams, I think your evidence at least until this point has gone beyond that. So your evidence was that the pricing of capsules at launch -- so it is that moment in time that you are looking at, and you say that is normal, and that is why I am putting to you that at that moment in light of the context which was Pfizer and Flynn working together, it was not normal, and that is the reaction that we see from everybody else in the market.

A. I think it was normal in the sense that -- I looked at two things, I looked at if I was launching capsules as a new generic medicine that had never had a history, what would I be doing? I would be looking at tablets, that is the first thing I would be looking at. The second thing I would be looking at, margins: what sort of margins would I expect to make, and my comment on the reasonableness of Flynn's launch price is in the context of those two things I judge. It was not looking at it

in the context of, you know, some years before or even months before Epanutin was available at a particular price. I have looked at the Flynn end of the equation.

Q. But, Mr Williams, it was not a new medicine.

A. No, it was not a new medicine, but it was new to Flynn, and it was new as a generic. It had never been available as a generic medicine before, it had only been available as a brand, Epanutin.

So from Flynn's perspective, it was a new medicine to it, not to the marketplace, and all these comments which I understand, and I did listen to some of the CCG commentary and evidence in the court last week, is in the context of them just looking simply at the before and after and trying to do exactly what you did at the beginning of our discussion, which is to look at the 2,600 type per cents.

Q. So, Mr Williams, you said that the second part of your analysis was to look at the margins of other comparators.

A. Yes.

Q. I want to come on to that.

I am right in saying that you have had firsthand contact with all of the companies included in your comparator analysis; is that right?

A. Yes, to various extents.

Q. There are some that you know particularly well, I think you single out Alliance as one of the ones that you do know particularly well?
A. Yes.
Q. Presumably you would be very well aware of significant events that affected those companies; is that fair to say?
A. Yes, indeed. Not all, but certainly I am aware of some. I mean, my contact with Alliance has been in relation to specific aspects of their business rather than their business as a whole.
Q. When we were considering the evidence of Mr White, we saw that the only time he has had to deal with a situation of price increase as egregious as the one in this case was a price increase by Essential Pharma; were you aware of that situation?
A. Do you mean that there was an investigation and Department of Health instigated involvement? No, I was not. I was not aware of the Department of Health involvement with Essential.
Q. So you were not aware that the CMA launched an investigation into whether there was an abuse of a dominant position in Essential Pharma in October 2020?
A. In relation to Priadel?
Q. In relation to Priadel.

A. No, I have not looked at that.
Q. If I can just give you the context of it just very, very briefly, Mr Williams, so we are on the same page. This related to the supply of lithium-based medicines, which I think Priadel is one, and Essential Pharma proposed withdrawing the supply of Priadel, ultimately accepted commitments from the CMA in December 2020. I just want to be clear that you have the context so I am not being unfair to you, but your position is that you were not aware of that?
A. No, I was not aware of the specific details of that investigation.
Q. Okay. I want to come to another CMA investigation. Are you aware that the CMA issued a statement of objections in 2019 against companies in the Alliance Pharma group as well as Morningside Pharmaceuticals Ltd in respect of their conduct in the period you were considering, that is from 2014 to 2017, in nitrofurantoin?
A. -- furantoin, yes.
Q. I am probably getting it wrong, but were you aware of that?
A. I was aware of that, yes.
Q. So were you aware of the result of that investigation?
A. I do not know that that investigation has finally terminated yet.

Q. Well, I should let you know that it has, and it is closed on the grounds of administrative priority, so to be fair to you it was.
A. Yes, okay.
Q. You said you were aware of that investigation, which is into two of the comparator companies that you have put forward. Did you not think that that was something that was important to mention in your reports?
A. I think in the context of the broad portfolios they had -- and again, you have got to bear in mind that when I look at these companies, I can only look at them on the basis of public information. I do not know, for instance, whether Priadel was a material or an immaterial medicine to those in terms of their overall portfolio, and, again, this is why I took several companies; I did not just take one company. In fact, I think in one of my earlier reports, there was a company that made far more profitability than the comparators I chose, but by taking, hopefully, a broad selection of companies, you can see if there are outliers, I do not think it is fair to say that every single company in my portfolio had as a part of a major part of its portfolio products that had been subject to investigation by the CMA.
Q. I think it is right to say, Mr Williams, just taking

a step back, you have and you fairly accepted this at all times, only ever looked at a portfolio. You have not been able, because you have not had the data --

A. I have not been able to find that information.

Q. -- to look at it product by product?

A. No, I have not.

Q. But what you have done is you have chosen a number of companies which you say are very similar to Flynn?

A. Yes.

Q. On the basis that you have chosen, but you have never said that you can look at the input cost of each --

A. No.

Q. -- product, you have never said you can look at the volumes, you have never said that you can look at an individual product basis; you have never said that?

A. Never said that.

Q. So you are only looking at this on a portfolio basis and I very much understand that.

A. Yes, and that is of course exactly what the Department of Health do under the PPRS, they look at it on a portfolio basis.

Q. Which is for branded?

A. It is, and branded generic.

Q. Yes. Now, I want to consider a third investigation into your five comparator companies, and that is in respect

of prochlorperazine. Are you aware that the CMA has issued a decision which finds that Alliance Pharma entered into anti-competitive market exclusion agreements to keep out competitors in the supply of prochlorperazine in the period from 2013 to 2016?

A. Is this the investigation where there is also a proposal to disbar one of the directors? Is that the same investigation?

Q. There are various people in this room who will know that far better than I do, Mr Williams. I am seeing lots of nodding.

A. Mr Butterfield, yes, it is. I just could not remember the name of the drug, but, yes, I am familiar with the fact that that is an ongoing proceeding, or --

Q. Well, you are right to say it is an ongoing proceeding and again, to be fair to you, I want to make it clear that the CMA's decision has been appealed to this court, but are you aware that Alliance Pharma was fined £7.9 million in respect of that?

A. I could not remember the number, but I know that there was an order made against them.

Q. So as far as I am aware, Mr Williams, three of the five comparator companies that you have put forward in Williams 6 as suitable comparators for considering the returns that would be expected under normal and

sufficiently effective competition are either found by the CMA to have committed a breach of competition law, that is prochlorperazine, accepted commitments to end the CMA investigation into breaches of competition law, that is Essential Pharma, or been subject to a statement of objections in respect of a breach of competition law which was subsequently closed, as I have made clear, on the grounds of administrative priority, and that is nitrofurantoin.

You do not look, Mr Williams, to find a workably competitive benchmark at companies which are under investigation for anti-competitive practices, do you? That is the last place you would look.

A. It depends of course what percentage of their portfolio the drugs in question under investigation make.

Q. Which you do not know?

A. Which I do not know, and this is why I did not just look at five comparators, I also looked, for instance, at the *Aspen* decision where there were a range of comparator companies, I do not believe any of those were subject to anti-competition.

Q. As far as I am aware, Mr Williams -- I am sorry to interrupt you, but as I read that decision, I cannot work out what those comparator companies were at all?

A. No.

Q. So we do not know what they were at all, do we?
A. No, but again, it seems to be that the Commission in that case took a selection of comparators, so I triangulate from my own comparators, the Aspen comparators, and also the PPRS.
Q. Which, as we have agreed, that is in relation to branded?
A. And branded generics.
Q. But it does not apply directly in this case?
A. It does not apply directly to generics.
MS MACLEOD: I do not have any further questions for you, Mr Williams. Thank you very much.
THE PRESIDENT: We have no questions, Mr Williams. Is there any re-examination?
MR BREALEY: I wonder if I could ask just one question of Mr Williams?
THE PRESIDENT: Yes, of course.
MS MACLEOD: I am slightly confused, sir. I think last time Mr Williams was in the box, if Mr Brealey had questions --
THE PRESIDENT: That is right and we missed a trick, but do not worry, you will have an opportunity to ask anything further out of what Mr Brealey has to say, but I do not want to shut him out.
MS MACLEOD: I am grateful, thank you, sir.

MR BREALEY: I apologise, I was not sure we were cross-examining or asking questions from the hot-tub or the teach-in.

THE PRESIDENT: No, do feel free to ask away, Mr Brealey.

Cross-examination by MR BREALEY

MR BREALEY: It is just one question. I mean, Mr Williams does not know I am going to ask him a question.

It relates to the evidence you gave before, I think it was in the teach-in. Could we just go to transcript Day 9, and it is page {Day9LH1/59:}. This is one of the answers you gave to Professor Waterson.

On line {Day9LH1/59:12}, Professor Waterson -- one of the questions -- I do not know if you remember -- asked you why the £30 had stayed from essentially 2007 to 2016, and do you just want to refresh what you said there, and just go down to page {Day9LH1/60:7}. It is a very short answer.

You say you think it is in the evidence to suggest that it was basically a mistake, and then you go on to say it was hardcoded, and then if you go on, once you have read that, at the bottom you say:

"... but if I was an external observer looking at [the] £30 price that was fixed for a period of, you know, eight years, I would conclude one of two things: either there was not an underlying movement in ASPs

causing the price to be reduced, or [this is your second one] that, if there was, the Department was compensating for that by allowing a higher margin over and above ASP to get to the £30. That is what I would have concluded."

With that answer in mind, could you just go to a document that we saw in opening which is {XG/304}, and if you blow it up, please. You see where it says, that paragraph "That said ...", if you just blow that up. This is one of the pharmacists at the Department of Health, saying:

"That said, the current reimbursement price for these tablets is a Category M product which means there is probably considerable margin being pumped into the reimbursement price over their selling price -- although not necessarily because we do have some quirks in [category] M."

That was on 15 November 2013. So my question is, if you go back to your answer, you said there were two things:

"... I would conclude one of two things: either there was not an underlying movement in ASPs ... [or] the Department was compensating for that by allowing a higher margin..."

In the light of that document, are you able to tell

the Tribunal which one of those two things was actually happening?

A. No, the workings of Category M are very much a black box, as I think the chief pharmacist or the official from the Department of Health who you referred to or took me to, that email, made the point that not all Category M products are equal in terms of some have margin added, some do not have margin added. So the £30 I said, you know, if I was not aware -- I mean, firstly, in terms of the evidence I have seen that it was a mistake, that is obviously ex post evidence in terms of some email exchange between the CMA and officials with the Department of Health many years later, but if I had no knowledge from the outside of this special arrangement with tablets, I would have concluded that if it stayed -- if you have a flat price, I would be more inclined to conclude that there was no reduction in ASPs than I would be to determine there was a compensating increase in margin to offset exactly the reduction in ASPs.

Q. What did she mean by pumping margin?

A. So if you remember Professor Waterson's question to me in the hot-tub, I think it was, to try and explain why if ASPs were in the order of £50, why was the drug tariff £114, and what I explained is that within

Category M, the Department do allow a pharmacy margin to allow them to achieve their target which is the English pharmacies earn 800 million of procurement profit.

Now, they can make procurement profit either by buying at a discount, which is the point that has been mentioned by the Tribunal a number of times, in other words there is an incentive if you have a fixed drug tariff to buy as cheaply as possible, but also the government does pump in margin, in other words, it sets some Category M prices higher than they know the ASP, so it does deliver additional profit to pharmacies, and that is what I think that official meant by the words "pump in."

THE PRESIDENT: Just so that we have your answer on the record, this 800 million procurement profit, is that stated as an objective anywhere?

A. Yes, it is an agreement between what then was called the PSNC, which is the Pharmaceutical Society Negotiating Committee, colloquially the trade union of the pharmacies and Department of Health. So it is a specific written document that says: in addition to the profits you earn on dispensing and the fees and the container allowances and various other things how pharmacies get reimbursed, there is a specific written agreement that there would be 800 million of profit

delivered to pharmacies, and that is reviewed frequently, and if the profit is running ahead of schedule, you may see Category M prices reduce to try and claw some back and vice versa. So there is a specific document. If you would like me to find it, I will do so.

THE PRESIDENT: Not for now, but it might be helpful just to look at it on the basis that better in than out, but thank you.

PROFESSOR WATERSON: Just to carry on with that line, how would they choose where to pump in, as it were?

A. I wish I knew.

PROFESSOR WATERSON: Right.

A. In fact, they actually, to be honest with you, specifically wish you do not know because there is some concern of reverse-engineering by the industry. If it is clear that product X has a £1 margin added in and project Y, and it is a complicated formula, Category M, and it is not clear to external observers, it is highly confidential. It is not even clear to the PSNC or their successor body.

PROFESSOR WATERSON: Thank you.

MR BREALEY: I hope that is helpful.

Thank you, sir.

THE PRESIDENT: Ms MacLeod, do you want to take up anything

in respect of that?

MS MACLEOD: I do not, sir.

THE PRESIDENT: You do not.

Ms Stratford?

Re-examination by MS STRATFORD

MS STRATFORD: Thank you. I do have one very short point, if I may, in re-examination.

Mr Williams, you were asked a series of questions about selection of your comparators, your comparator companies. I think it might just be helpful for the Tribunal if you briefly walk them through the process by which you refined your selection of comparator companies. As Ms MacLeod pointed out, you have been involved for quite a long time and there has been a series of development of your companies.

A. Yes, I have refined, I have added to my comparators, but if I look at the overall approach I took in selecting comparators, the first thing I eliminated were innovator companies, none of these that I am looking at are innovator companies, nor is Flynn. They tend to be selling molecules that are old, may well have been owned by someone else before.

I eliminated companies that manufacture in-house because that obviously exposes the company, or gives the company that does manufacture in-house both the

manufacturing profit and maybe a retail profit, so I eliminated that.

I eliminated companies that were part of groups, virtually integrated groups, because, again, most pharmaceutical companies in this country, by number, operate something called a limited risk distributorship model whereby they earn a very small amount of profit because the majority of the profit is retained by the parent quite frequently offshore, in return for the parent effectively underwriting the risk of the operation, so I eliminated those.

I looked at companies that sold old, typically off-patent medicines, generics or branded generics, that was another criteria that I looked at, that they were operating as what I called SMDCs, which was my acronym for sales, marketing and distribution companies. They were not just box shifters, they were selling products, they were marketing products, they were MA holders of those products, they were not just doing what an Alliance Healthcare, different from Alliance Pharma, was doing, or AAH, which is a wholesale model, so I looked at that. As I progressed through the investigation, I was challenged that I had taken too narrow a period so I extended the period I think from two years to four years.

I also looked, a bit like the *Aspen* comparators, I tried to look at companies that sold AED medicines and I think four out of my final five comparators were selling AEDs, I think it was Alliance was the one that was not, or it did not materially affect my results.

So I tried to respond to criticisms by expanding or eliminating or paring down my comparators.

MS STRATFORD: Thank you.

I have no further questions, sir.

THE PRESIDENT: Well, Mr Williams, thank you very much for your time and your assistance, you are released from the witness box with our thanks. Thank you very much.

THE WITNESS: Thank you, sir.

MS MACLEOD: Sir, there is going to be a change of scene at the front.

THE PRESIDENT: Would it help if we rose, or are you able to effect the change without us doing that?

MS MACLEOD: Professor Bailey is good to go.

MS STRATFORD: Can Dr De Coninck please come back to the box, thank you.

DR RAPHAËL DE CONINCK (recalled)

THE PRESIDENT: Dr De Coninck, welcome back. Do take a seat. I hope you have an untouched glass there. If you have not, one will be provided. I think you do.

Before, Mr Bailey, you start, if there are any, as

it were, friendly fire questions from the person not calling the witness, we would probably get them done first.

I do not know, Mr Brealey, whether you have any questions for Dr De Coninck?

MR BREALEY: No, I have not, sir, thank you for that indulgence before.

THE PRESIDENT: Thank you. Mr Bailey.

Cross-examination by MR BAILEY

MR BAILEY: I am grateful.

Good afternoon, Dr De Coninck, thank you for joining us again. Can I just check that you have in front or available to you on your desk a large A3 spreadsheet?

A. I do.

Q. The Tribunal should also have a copy of those, and I have a couple of additional copies for the référendaires if that could be passed to them as well, please.

Just to explain what this is, this is the data that the CMA provided to the Tribunal in response to its first question in its letter of 28 September. The Opus reference is {XJ/35.1} and it is the tab "Relevant Period Summary".

Have you seen this spreadsheet before?

A. Yes.

Q. I am grateful. Your instructing solicitors have confirmed to the Tribunal that they do not dispute the accuracy of these figures, and the reason I am using this large hard copy is so that it is easy, I hope, for everyone to see the figures that I would like to take you through.

I am going to focus on the 100mg capsule because, as you noted yesterday, they were the most commonly prescribed strength during the relevant period, and I would like to start, if I could, with looking at row 17, column G, and what that shows is Flynn's total variable costs during the relevant period for 100mg, and that is a figure of £36.9 million. Do you see that?

A. So G?

Q. G, and it is row 17?

A. Yes.

Q. And a figure of 36.9 million?

A. Yes, I do.

Q. Do you agree?

A. Yes.

Q. What I want to do is I want to proceed in the way that the Tribunal indicated during the hot-tub it was thinking about the question of excessiveness, and so I would like to start with these costs -- in other words, Flynn's total variable costs -- because they do

not entail any subjectivities or judgment calls and just for the record that is {Day8LH1/115:}.

What I would like to do next is could we look at row 82, same column, and we can see here it is Flynn's revenues during the relevant period for the 100mg, and that is a figure of £52.7 million?

A. That is right.

Q. I apologise for asking you to do rudimentary mathematics, but the gap between Flynn's revenues and Flynn's total variable costs during the relevant period was about 15.8 million. Does that seem about right to you?

A. Yes.

Q. That equates to roughly 3.7 million a year?

A. Okay.

Q. I am grateful. Now last Thursday the Tribunal indicated during the hot-tub that one way of approaching the question of excessiveness is to consider whether the gap between price on the one hand and a very conservative measure of costs is demonstrably immodest. Do you recall that?

A. Yes.

Q. I am grateful. In assessing the extent of the gap, the President identified six factors or subjectivities that may be relevant to the size of the costs stack, and that

was at {Day8LH1/115:}.

I would like just to refresh both our memories, if I may, to go to page {Day8LH1/113:} of the hearing, please.

We can see the President says:

"So the question is this: we have been talking about the computation of the gap between cost [and it says profit but I think it may mean "price"], and we have identified, I think, at least five, possibly six, subjectivities ..."

Then very helpfully the President sets those out from line {Day8LH1/113:21} onwards:

"... we have [the] allocation of fixed costs [or common costs]; we have a question of costs that are at an un-market rate; we have a question of unrelated costs; we have the effect of expectations of future costs..."

Can we just go down, please:

"... we have the question of how one computes a return on profit; and we may [also] have a question on volumes."

So what I propose to do is go through each of those factors or subjectivities identified by the President, including the issue that of course Flynn says is at the heart of its appeal, the rate of return, and what I want

to do is sort of examine whether or not they apply to capsules because that is the product we are concerned with.

Before I do that, can I just check, during the hot-tub I think you agreed with the proposition that the calculation of costs should be conservative?

A. That is right.

Q. Yes. The main issue that is covered in your sixth and seventh reports is the return that Flynn is entitled to earn. Do you agree that that is the issue that you have focused on in particular in your evidence in this appeal?

A. Yes.

Q. I am grateful. Now, the first issue, then, is the allocation of common costs.

Now, in a sense, this is actually not a contentious issue because it is one that was traversed, as you may recall, during the first trial. The tribunal has ruled upon it at paragraph 351 of its original judgment, that is at {XN1/2/113}, and indeed, last month, your instructing solicitors confirmed the position as set out in the pleadings that Flynn does not challenge the CMA's approach in the attribution of common costs. For that reason, I am not going to ask you about this issue.

I should say that Flynn's solicitors have said that

they do not challenge the CMA's approach but they do say that they rely on it to test the reliability of cost plus, looking at Mr Williams' evidence, and they do say that it goes to the question of penalty, but they do not refer to your evidence, and so what I propose to do is simply, as part of our journey through looking at how the costs can be built up, I wish to ask you to go back to the spreadsheet, please, and this time could you look at row 54 {J/35.1}, column G again, and we are looking at Flynn's total fixed costs, and that is a figure of just over a million. Do you see that?

A. Yes.

Q. So what I propose to do is I am going to add that figure to Flynn's total variable costs, so the £36.9 million, and so we get a total figure of £37.9 million. Do you agree with that?

A. Yes.

Q. We can actually see that sum is done in row 63. So now the gap --

THE PRESIDENT: Just pausing there, Mr Bailey, so that we are keeping up with you, this is total fixed costs, not in any way allocated or allocated to the capsules?

MR BAILEY: As I understand it, these are the allocation of the common costs for the supply of capsules.

THE PRESIDENT: I am grateful.

MR BAILEY: For the Tribunal's reference, the CMA sets out in some detail in Annex I how the CMA approached the question of common costs, and that is at {XA1/2/79} onwards, and various methodologies were looked at, and, as I say, this is the figure that the CMA has used, and so what I want to do, just building it up from the bottom, is now add in that proportion of costs.

If we now look at the gap between Flynn's revenues, so the £52.7 million figure, and its total variable and fixed costs, the £37.9 million figure, for 100mg, do you agree with me that that produces £14.8 million as the gap?

A. Yes.

Q. I am grateful.

Now, the second factor that was identified by the President was how one might treat costs that are incurred other than at the market rate, or, if I may summarise in a word, inefficiencies.

Now, would you agree with me that the only potential point to consider here is the input cost that Flynn paid to Pfizer? And I emphasise "potential point".

A. Can you repeat that question?

Q. Of course. Do you agree with me in relation to the second subjectivity the Tribunal identified -- so costs not at the market rate -- the only potential point for

us to consider is the input cost that Flynn paid to Pfizer for the capsules?

A. I mean, the way I recall the discussion with the President was a little bit different in that respect. I think we were talking in particular with respect of ROCE and how you take into account some of the cost of capital in that context. So I think it was a different question than on the input cost.

THE PRESIDENT: Dr De Coninck, that may well be the case, but I think counsel is perfectly entitled to reframe the question, and provided it is within your area of expertise to answer then I would like you to answer.

A. Then, yes, we can -- yes.

MR BAILEY: You agree with the proposition. So I would like to go back to the spreadsheet, please, and now I with like to look at Pfizer's total costs for the 100mg capsule, and we can pick that up in row 60, and we can see it is a figure of £4.4 million. Do you see that?

A. Mm-hmm.

Q. If we then compare that figure with Flynn's cost of goods, that is back at row 15, the £36.7 million, the difference between Flynn's COGS and Pfizer's total costs is roughly £32.4 million, is it not?

A. Right, yes.

Q. I apologise, the door meant I could not hear your

answer.

A. Yes.

Q. I am grateful. So that implies a mark-up on Pfizer's costs of roughly 736%, does it not?

A. That seems to be right, yes.

Q. So that is the 32.4 gap divided by Pfizer's total costs, 4.4, multiplied by 100?

A. Yes, that is right.

Q. I am grateful. That seems quite a significant mark-up, does it not?

A. Yes.

Q. Yes, I am grateful. I am not going to ask you whether Pfizer's supply price is unfair, but I am going to suggest that this is a potential source of inefficiency. The terminology used during the hot-tub: it is a cost that may not have been incurred at the market rate.

Now, to see that, I would like us to do a quick comparison, if we may, and go to table 2 in the CRA position statement. That is at {XE6/4/19}. Could we increase the size of the table, please, thank you.

What we can see here, you have helpfully set out the ASP costs and the percentage and absolute margin, and I do promise that I will come back to the percentage margin and absolute margin later.

For now, I would like to just look at the costs for

84 pack. So what we can see here is that Flynn's costs for 84 pack during period 3, which I think this is concerned, is that right?

A. Yes.

Q. This is showing the costs during period 3?

A. That is right.

Q. Are £40.86, and that is roughly four times the size of Wockhardt's costs, is it not?

A. Yes, that is right.

Q. The Teva figure is said to be confidential, but we can see the comparison, can we not, with Flynn's costs as well?

A. Yes.

Q. Yes. Now, based on your view that the tablet market was workably competitive during period 3 -- and I am going to come back to that and as you know the CMA does not accept that, but let's just assume you are right about that -- would it not follow that this suggests there is a potential inefficiency in the level of Flynn's costs?

A. I mean, this suggests that Flynn's costs are materially higher than the ones that we just mentioned in the tablet.

Q. Well, they are four times higher, so I would repeat the question: do you not accept that it does suggest a potential inefficiency?

A. So we have to think about the meaning of the word, of course, and have to be precise when we talk about inefficiency we are talking about a marginal cost which is higher than others which can lead to inefficiencies.

Q. If Flynn had been operating in the tablet market facing these competitors with those costs, would you not expect Flynn's costs to be significantly lower in order to remain viable in that market?

A. Well, that is a strange way to put it, so if Flynn was in the tablet market you would expect it to have significantly lower cost, I mean, I do not know what the cost of Flynn would be in the tablet market.

Q. I am going to take you to paragraph 31 of your position statement, and it is a point that you make, and happily the CMA and yourself are agreed about this point, but it is an important one for reasons I will come on to. If we can look at paragraph 31, it is on page {XE6/4/10} of this document, please.

Here you explain, halfway down the paragraph:

"Second, an assessment of the profitability of Capsules for Flynn cannot be assessed based on Pfizer's hypothetical lower prices as calculated by the CMA in its hypothetical counterfactual. Rather, it must be based on Pfizer's actual prices as actually incurred by Flynn."

Now, it is right, is it not, that the decision in calculating cost plus was based on the costs that Flynn actually incurred in the real world, including Pfizer's supply prices?

A. For the -- yes, for the cost plus, yes.

Q. Yes, it did. On this specific issue the CMA did exactly what you said it should in assessing profitability, just on this specific issue?

A. Well, that is -- I do not think that is entirely right in the sense that the CMA, in assessing whether this price is excessive, then does take into account the fact that -- or does pay regard to the lower cost that Pfizer has.

Q. Well, if we can just go, please, to Decision paragraph 5.207 at {XA1/1/193}, in the calculation of Flynn's direct costs, and it is the table you can see there, 5.9. We can see that the costs that have been included -- 5.207, so at page 193, yes, at the bottom:

"Flynn identified the following direct costs in relation to Flynn's Products:

"Cost of goods [5.207.1] ... (...the supply prices it pays for Pfizer's Products)..."

It is right, is it not, that those costs were included in the CMA's cost plus calculation, that is the only point --

A. Yes, so just to be clear in the calculation.
Q. So we are on the same page, yes, you agree with that?
A. Yes.
Q. I am grateful. By including Pfizer's actual supply price in Flynn's direct costs, what the CMA necessarily is doing is giving Flynn a larger costs stack, is it not?
A. No, it is allowing for its real cost to be --
Q. It certainly narrows the gap between the cost that it incurs and Flynn's prices, does it not? It is a conservative approach. It is not saying: let us work out some hypothetical efficient level of costs; it is just saying, let us use the costs, whether they are efficient or inefficient, that Flynn actually incurred. That is the conservative approach the CMA adopted?
A. Well, that is the -- they are taking the real cost, so I think anything else would not be conservative.
Q. If the CMA had adjusted Flynn's costs stack to remove what seems to be an inefficiency, that would have reduced Flynn's COGS and it would have increased the gap between costs and price, would it not?
A. If they had done that, of course, but that would not make sense.
Q. Can we go back to the spreadsheet, and I want to see how this affects the size of the gap. I want to see the

materiality of the supply price. If we could go, please, to row 15, just picking it up again to refresh our memory, here we have the COGS for Flynn for 100mg, £36.8 million. Then just below it, row 16, we have Flynn's own distribution costs which are in the region of 172,000, and the total is £36.9 million in row 17. Do you agree with me that 99.5% of Flynn's direct costs were the prices that Flynn paid to Pfizer?

A. Yes.

Q. I am grateful. I would like to -- let us see the significance of that for the gap. Given that we know that Flynn's revenues for 100mg are £52.7 million, that is row 82, and what I want to do is I want to park what Flynn was paying to Pfizer for a moment just so we can see what difference this makes to the gap. So if you can just follow me through, we have Flynn's distribution costs, 172,000, and we want to add to that Flynn's total fixed costs, roughly £1 million, and I want to then take that away from Flynn's revenues of £52.7 million, so we get a gap of about £51.5 million; do you agree with that calculation?

A. So just to make sure, you take the revenue of £52.7 million?

Q. Indeed.

A. Then you take out the £1 million on line 54, £1,015,000?

Q. Correct, and then I take out the 172 because that is the distribution costs.
A. Take out the 172, okay.
Q. You get a figure of roughly 51.5 million?
A. Okay, yes.
Q. Yes. Then if we look at Pfizer's costs now for 100mg, the total costs, which is row 60, is roughly £4.4 million. Do you see that in row 60, total Pfizer costs?
A. Sorry, I don't see it.
Q. It is about halfway down, column G, row 60, £4.4 million.
A. Yes.
Q. So what I want to do now is I want to -- again, just leaving the supply price to one side for a minute, if we take out Pfizer's total costs from the revenues, that produces a gap of around £47 million, does it not?
A. Yes.
Q. The point is this: when you remove the mark-up being applied by Pfizer, the gap is what we have just agreed, £47 million. When you include Pfizer's supply price and work out the gap, as we agreed earlier, the gap is about £14.8 million; do you agree?
A. That is right, yes.
Q. This shows, does it not, how much the gap is affected by

how much Flynn was paying to Pfizer for the product?

A. Yes.

Q. I would suggest to you it shows you how conservative the CMA's approach was to costs when it included the actual costs incurred by Flynn?

A. I do not think that should be described as particularly conservative, they are just using Flynn's own cost.

Q. It was realistic; would you agree with me about that?

A. I think these are the costs that to be taken into account.

Q. So it was a reasonable approach for the CMA to adopt?

A. So I think here we are just on the calculation part of course.

Q. We are, we are, and I promise you we will come on to the return and what have you.

A. Yes.

Q. So I would like to move to the third subjectivity, and that related to the question of unrelated costs, and you helpfully addressed that issue in the hot-tub and it would be helpful if we could bring that up, please. That is at {Day8LH1/99:}. It is lines {Day8LH1/99:11-19}. Could I ask you and the Tribunal to read what you have to say from "So it is a very difficult question", as many are in this case. (Pause)

A. Right, yes.

Q. I just have two questions coming out of that. I do not think in any of your seven reports that you have ever suggested that Flynn incurred costs that were unrelated to capsules but should be included in the costs stack for capsules?

A. That -- no.

Q. No, agreed. And although here you do refer to portfolio pricing, which as we know is sometimes common in the pharmaceutical sector, the point you were making was a more general one because we know in this case for this product, Flynn set its prices by reference to the drug tariff for tablets not on a portfolio basis. That is correct, is it not?

A. So I think that is correct. I just want to add the point that looking at portfolio in general is still useful when you focus on products and you want to know whether they are excessive or not, because obviously the point that I was making here is that some products end up ex post being more successful than others and end up having more of a return and that is why when looking at the product level, one has to somehow account for this possibility, which is a point that I made here.

Q. But you have not suggested in your reports that Flynn was specifically pricing capsules in order to recover the losses on other products?

A. No.

Q. No, thank you.

The fourth factor or subjectivity raised by the Tribunal was the expectation of future costs to be incurred, and the point arose, as you may recall last week, in the course of discussing the profitability of that fictional coffee chain, Apple Coffee, and whether one should take the rent in the first year of its premises only or perhaps an average of three years, and I would just like to show you something that the President said and then show you what you said and then just ask you a couple of questions about it.

So if we can go, please, to {Day8LH1/61:}, and it is lines {Day8LH1/61:18-24}. The President was actually speaking to Mr Harman at the time:

"I think what you are saying is that expectations are a relevant factor in terms of the cost price inter-relationship and in particular, you ought to take into account the expectations of the undertaking in terms of their future costs in order to work out why they are pricing at a certain level, subject only to this qualification: you would only want to factor in reasonable expectations and you would want to exclude unreasonable expectations for whatever reason ..."

Before we come to your intervention, can I just

check, do you agree with the President about that as a general proposition?

A. Yes.

Q. I am grateful.

Then you intervened on page {Day8LH1/66:}, and at line {Day8LH1/66:14} you say:

"Maybe I should add that ... I share Dr Majumdar's view ..."

Just in case you want to look at that, in fairness, the view that Dr Majumdar expressed is on page {Day8LH1/53:}. I apologise for jumping around but I think in fairness to you that you can see what you agree with. If we go to page 53 and we see at {Day8LH1/53:12-17}, although Dr Majumdar finished with "I hope was not a cop-out answer", he actually gave a very clear answer and you agreed with it.

A. Mm-hmm.

Q. Then if we go back to what you said on page {Day8LH1/66:} you said although the example was concerned only with year 1 of the lease at that point, there may be, as you put it, strong linkages between the years and for that reason you might factor in future expected costs; is that right?

A. That is right.

Q. That is right, thank you.

I would like to then consider how that issue is relevant, if at all, to the calculation of the costs of capsules.

Can we go, please, to paragraph 2.391 of the Decision. That is at {XA1/1/125}.

This, as you can see from the heading, is about Flynn's efforts to increase the robustness of the supply chain. We can see at paragraph 2.391 that Flynn told the Department of Health in November of 2012 that it was seeking to identify an alternative source of supply of API to Pfizer. Are you aware of that contention?

A. Yes.

Q. Yes. We can see from the next paragraph that Flynn took some initial steps to explore the idea but in fact it did not incur any material costs in pursuing these strategies or this alternative route. Do you agree with that or do you accept that?

A. I am not aware of costs at that time.

Q. You are not aware of any costs incurred. It may well be that we can short-circuit this discussion, but just to round off what actually happened, if we look at paragraph 2.394, we can see that Flynn downed tools, it stopped its engagement around the end of 2012. You can then see there was actually a discussion about the possible second source of API with Pfizer until

a meeting in January 2014, and could I just ask you to read the extract of the notes of that meeting which carries over the page. So if you could just indicate when you have read the --

A. Just the end of --

Q. Yes, just the notes of the meeting I would like you to look at, please.

A. Okay.

Q. Then if you can just read the rest of the extract. {XA1/1/126}. (Pause)

A. Okay.

Q. So it would not be reasonable, would it, to include in Flynn's costs stack the uncertain prospect of future costs of an alternative source of API which Pfizer had specifically objected to; do you agree with that?

A. Yes, I am -- I do not see -- I do not see -- I do not see those costs in what Pfizer has done -- sorry, in the Flynn data, so I have not --

Q. Do you agree with me that you would not include any costs in costs stack relating to an alternative source of API?

A. So I think I agree that to the extent that we do not have clear expected costs for a certain activity that is, you know, envisioned, we would not include it in the stack. Of course it may be a consideration that is --

that comes back at a later stage.

Q. When you say it may be a consideration that comes back at a later stage, what exactly do you mean by that?

A. So I think what I mean is that if you are considering costs that are not established and you cannot clearly foresee, you just do not include them in your cost base to calculate the return. That is what I mean.

Of course, it is not because they are not foreseen at this stage that they would not come and become an important consideration later on.

Q. I understand. So what you are really saying is that there may come a day in the future where there is a reasonable expectation and you have incurred costs and you will have to revisit what the costs stack is, is that right?

A. Yes.

Q. I would like to move then to the fifth factor, the subjectivity, and this, of course, is central to Flynn's appeal and your most recent evidence, the issue of return.

Before we come to what is reasonable in terms of rate of return, I would like to come back to our beloved spreadsheet, please, and just look again at the costs and revenues {J/35.1}, if you have that to hand.

If we look now in the total column, so I am now in

column I, and we look at the total revenue that Flynn generated over the relevant period, so some £111.4 million, that is in row 82 -- have you got that?

A. Yes.

Q. -- and if we deduct the total costs which are in row 63, that is 74.2 million. Have you got that?

A. Yes.

Q. So that produces a grand total of 37.2 million, does it not?

A. Yes.

Q. That is about 8.7 million in a year.

A. Okay.

Q. That translates to a return on sales of roughly 33%; does that sound right to you?

A. Yes.

Q. Yes. Your view -- and please correct me if I have this wrong -- but your view is that is a reasonable rate of return when you compare it to the margins of Flynn's other products, the margins of Mr Williams' comparator companies, the margins of the companies in *Aspen* and the percentage margins of the tablet suppliers; is that correct?

A. That is correct.

Q. Yes. I know you have done many comparisons, but would it be fair to say that your view that Flynn's ASPs are

justified is based on various percentage margin comparisons?

A. That is right.

Q. Yes. Because they are all looking at the same kind of metric, are they not, the margin comparison?

A. Mm-hm.

Q. Sorry, you have to say "yes".

A. Yes.

Q. Thank you very much. Would it be right to say in very simple terms that what we are doing when we are looking at margins is calculating return, a numerator, divided by cost plus return, the denominator?

A. Yes.

Q. We are setting returns against costs essentially.

A. Mm-hm.

Q. I am sorry, if you could just say yes?

A. Yes.

Q. Thank you very much -- well, if you do agree, of course.

You show the return on sales of Flynn's products including phenytoin in several of your reports. I am just going to go to figure 2 of your sixth report, if I may. That is at {XE1/11/23}.

Could we bring up, please, the note underneath the lovely bar chart? Thank you very much. What you explain in the note is that you -- in calculating the

return on sales -- it is note 2 -- you took account of the following costs, and the first one is COGS. Just reverting to our discussion earlier this afternoon, that means that Flynn's return on sales are being set against a costs stack that includes what at best might be described as an inefficient cost item, does it not?

A. I would say that it is return based on its real cost.

Q. We can perhaps agree to disagree about that, but what I would like to do, therefore, is look at the implications of setting Flynn's returns on phenytoin against a lower, and I am going to put it to you, arguably more efficient input cost. What I am going to suggest is -- and I know it will not be a surprise, but I am going to suggest that it will have the consequence the margins will be higher.

So if we can go to table 9 in your seventh report, please, that is at {XE1/12/45}, I think this is the same table you have in your position statement, and if we can bring up the table again, and again, we are going to proceed on the basis of your view the tablet market is workably competitive, and I would like us to imagine that Flynn does have the same level of costs as the most efficient tablet supplier shown here, so let us take Wockhardt's costs, £10.20 per equivalent 84-pack. We know that Flynn's ASP is £58.16 for period 3, and so

that would mean that Flynn would have earned an absolute margin of £47.96, just mathematically?

A. Yes, that is right.

Q. Yes. That would have meant that Flynn's percentage margin would have been 82% rather than 33%, would it not?

A. So, yes, I mean those margins here are, you know, estimates, so in terms of the Wockhardt one I would be cautious, but I think if you are to that order of magnitude, yes.

Q. Yes, I am grateful. I know you say in your reports that the high input price will affect the numerator and the denominator in the return on sales metric; do you recall making that point or I can show it to you if you would prefer?

A. Sorry, that -- yes, yes, of course.

Q. You make it at paragraph 74 of your seventh report, which for the record is at {XE1/12/26}.

What I would like to do, if I may, is just go through with you, just so I have understood it correctly, how input prices and the return on sales measure relate to one another.

I would like to do that, if I may, by looking at the formula which you helpfully set out in your third report at paragraph 45, and that is at {XE1/8/16}. It is the

formula at the bottom, please.

Just so I can check that I have understood this correctly, what you are doing here is you are setting out the return on sales percentage formula, and you have broken the revenues and costs down, so what you have is you have the price -- p is the price per unit, c is the per unit cost, q is the quantity sold, K is the fixed cost. Do you agree that all else being equal if c, costs, are higher, the numerator is going to be lower?

A. Yes.

Q. And that will mean that the ROS percentage will also be lower?

A. Yes.

Q. When you make the point that the high input costs affect the numerator and the denominator, am I right in thinking that your evidence is that as c increases, p must also increase, because the denominator is a function of price?

A. So, yes, the price will reflect the cost.

Q. Price goes up as cost goes up?

A. Yes.

Q. Yes. Am I also right in saying mathematically that the increase in price must be greater than the increase in cost in order to maintain the same return in percentage terms?

A. That the increase in price must be greater than the increase in cost to maintain the same return?
Q. Just mathematically.
A. Yes, I think that is right, yes.
Q. We can actually have a look, because -- and I will make this the last point before lunch -- you had an example that you gave in your seventh report, and I would like to go to that, please, at paragraph 24. It is at {XE1/12/10}. It might be right that you should just have a chance to refresh your memory. So it is -- you are talking here about the CMA's use of absolute return, and then you give an example halfway down, and actually I just want to walk through this with you, but it works like this.

I am going to use the same prices as your example and the same costs. Imagine that David buys widgets from Raphaël at 30 pence, and David sells the widgets at £2.30, and David earns an absolute margin of £2. That would equate to a return on sales of roughly 87%. Do you agree with that?

A. Yes.
Q. £2 divided by £2.30 times 100. So whilst the return on sales is high, the absolute profit is relatively low. Do you agree?
A. Yes.

Q. Now let us vary the example. So imagine that Raphaël increases his input price to £10. Now, just as before, assume that David earns an absolute margin of £2 and assume that the cost increase is fully passed on so that David's price is now £12.

In that case, the return on sales would now be roughly 17%. Does that sound right to you?

A. Yes.

Q. So these examples show, do they not, that the return on sales percentage can be affected by a change in the level of input costs?

A. Yes.

Q. If David wanted to earn the same return on sales of roughly 87%, when David is paying Raphaël's input cost of £10, that would have required David to charge a price of roughly £77?

A. Yes.

Q. So when there is a cost increase from 30 pence to £10 there is a price increase of roughly £65?

A. In that example.

Q. In that example. Do you agree?

A. Yes.

Q. So that equates to a pass-on rate roughly of 770%?

A. Okay.

Q. You can take it from me, but if you do not have that

rate of pass on, do you agree with me that the margin is going to change, is it not?

A. Yes.

Q. There really is not any justification for David having that rate of pass on, is there?

A. Well, that is not at all the point of the example that I was making, so, you know, I am not going to speak about the justification for the rate of pass on in this particular example. I think the point that I was making is much simpler, is just that if you focus on absolute returns, then you would look at a margin of €2 and think -- of £2, sorry about that, look at a margin of £2 and think that, you know, it is appropriate or not without taking into account the level of cost that this relates to, and my point here is that this is just not something that is reasonable to do.

Q. My point is that, all else being equal, as unit costs increase, the required return is going to fall in order to maintain returns in absolute terms.

A. But I think that is the discussion here, is, you know, what is an adequate return? Is it an absolute return that ignores the cost or not? I think that is the discussion we are having.

MR BAILEY: I should say those are fictional characters, and that is the end of that example, and I see the time, if

that is convenient to the Tribunal.

THE PRESIDENT: Yes, indeed, Mr Bailey. How are you doing? It looks like we are making reasonably good progress through the witnesses today.

MR BAILEY: I am making reasonable progress, and I am cautiously optimistic that we should be able to complete the CMA's cross-examination today, but if I may, I would like to update the Tribunal halfway through the afternoon, because of course I have quite a lot to cover, both on excessive and Dr De Coninck also looks at tablets as well.

THE PRESIDENT: Yes, of course. Would it assist if we started at 1.45?

MR BAILEY: Yes, it would assist.

THE PRESIDENT: We will probably need, given we are running to 5.00, two breaks in the afternoon for the shorthand writer, but will, subject to those, resume at 1.45.

MR BAILEY: I am grateful.

THE PRESIDENT: Thank you.

(1.01 pm)

(The short adjournment)

(1.45 pm)

(Proceedings delayed)

(1.51 pm)

THE PRESIDENT: Mr Bailey, good afternoon.

MR BAILEY: Good afternoon, sir, members of the Tribunal, Dr De Coninck.

I would like us to turn to look at the return on sales measure a bit more generally, if I may. I would like us to look at an OECD report on methodologies to measure market competition which is at {XO/18/1}, and I should just ask if you have seen this document before?

A. Yes.

Q. You have. So if we just turn, for the benefit of the Tribunal, to page {XO/18/7} just so we can see what this document is all about, we can see in the fourth paragraph it is explaining what it is doing is looking at methodologies to measure market competition for competition authorities, and in particular, in the sixth paragraph, we can see that Section 3 of this document presents "the most commonly applied methods to measure market competition in the economic literature, and assesses their advantages and limitations (both conceptual and practical)".

So that is broadly what it is doing, and there is a particular section that I would like to discuss with you, if I may, and that is at section 3.2.2 on page {XO/18/22} which is headed "Profits".

If we could just enlarge the bottom half of the page, please, thank you very much, and we can see here

that the OECD begins by saying:

"In a competitive market, firms would generally not be able to make more than the level of profit needed to justify keeping the capital employed by a firm (ie the 'normal' level of profits)."

Do you agree with the OECD about that?

A. So I think this is a very general statement, so if you understand it as perfect competition, then I agree; if you are considering real world competition, I do not think that is correct.

Q. It does not say "perfect competition" but what it goes on to say in the second sentence is that:

"... profits persistently above [that normal] level among a significant number of firms in a market may indicate problems with competition."

Would you agree with that statement?

A. Yes, so I want to qualify, of course, so the "may" of course is important here, that is the first point. Then I think we are talking about firms here, not about specific products, and also this may, in some instances, be very relevant, so if we are looking at capital-intensive firms, this is typically, you know, a good measure to apply, and not in other contexts, in particular in asset-light businesses.

Q. If we go over the page, please {XO/18/23} we see the

OECD both discusses return on capital employed as a commonly-used profitability indicator and return on sales, and I would just like to ask you to read, please, the paragraph that begins:

"The return on sales measure ..."

About halfway down above the bullets, and then could you read through the bullets and the paragraph after that, please, that ends "within a sector". (Pause)

A. Yes.

Q. So the OECD seem to be making three points and I would like to see if you agree with them. The first point is the OECD say that the return on sales measure does not relate the amount of profit earned to the capital employed in a firm. Do you agree with that?

A. Yes.

Q. Yes. The second is that a return on sales measure does not in itself have a normative value. Do you agree with that?

A. I agree with that.

Q. The third, which we can see from the final sentence, is that:

"... ROS figures can only be used in a meaningful way for profitability comparisons of firms within a sector."

So my question is: do you agree that the return on

sales approach requires us to identify products that are sufficiently similar to the product that you are looking at?

A. So I think that we -- you know, I think I agree that it needs to be -- that when you compare a return on sales measure, you need to do it within the same sector, I agree with that.

Q. Yes, but it is challenging, is it not, to find a product with which to compare a percentage margin if you observe a large variation of returns on different products, even if they are in the same sector?

A. Well, that is actually a very important point. So I think the focus should not be on an average. One needs to take into account the distribution that we see to see whether in the context of an excessive pricing case there is something that is out of the ordinary.

Q. So if we go back to figure 2 in your sixth report which is at {XE1/11/23}, what we can see is that there is a wide range of margins that Flynn earned across the portfolio. Do you agree with that?

A. I agree with that.

Q. Yes. You explain at paragraph 24 of the CRA position statement which is at {XE6/4/9} that it is natural to start a benchmarking analysis with Flynn's other products because their prices are all set by the same

company, and in this case, like capsules, many are amortised products.

A. I agree.

Q. If we start the benchmarking analysis there, I would like to see if you agree with me about several additional criteria for selecting suitable comparator benchmarks. To do that I would like us to look at the Oxera report that you cite on assessing profitability in competition policy. That is at {XF1/51} and it is at page {XF1/51/125}, please.

We can see the heading there:

"Industry comparators."

What this section is doing -- it is the bottom half of the page, please -- is it is discussing the selection of comparator benchmarks for assessing economic profitability, and I was going to ask if you could read paragraph 7.33 which is over the page, please {XF1/51/126}, but I just wanted to show you the section so you can see what is being -- it is the very first paragraph: "The critical issue ..." (Pause).

Do you agree that the aim of seeking to select suitable comparators is to compare the profit measure of an activity with that which would be achieved in a fully competitive environment?

A. If by "fully competitive environment" --

Q. We mean workable competition.
A. I think what -- I think the purpose of the comparators -- when we think about what information can we get about comparators, I think it is best used to tell us what are margins in this case that would be typically observed, which therefore would be an indicator of what could be observed in an infringement-less case, so in a but-for world, so in that sense, I do not think that comparators need to be fully competitive to be informative.
Q. Would you agree that they would at least need to be workably competitive in order for them to be informative?
A. So there needs to be, indeed, competition working in those comparators.
Q. Because when you chose tablets as a comparator, one of the points that you make about it is that you are looking at their margins in tablets because you consider that market to be workably competitive. That is right, is it not?
A. That is right.
Q. Yes. If we can go, please, to paragraph 7.35 -- we can see it on this page -- we can see that Oxera explain the selection should be based on good reasons to believe that the comparators are subject to some degree of

competitive pressure; do you agree with that?

A. So I think -- I think I want to be careful here, just going back to the exercise that I carry looking at Flynn's portfolio. I think there my concern is really to see whether the test that the CMA applies would lead to false positives, and I test that on that basis. So on the basis that I do not believe that there is a reason to think that there is an infringement in those markets.

Q. In relation to paragraph 7.41, so we can just go over the page, please, I think it is actually {XF1/51/128}, we can just see that here Oxera are sort of summarising it, and we have seen, actually, them say the first two sentences.

Then in the third sentence it says:

"The selection should be based on good reasons to believe that the comparators are subject to some degree of competitive pressure ..."

That is consistent with what we have just seen, and then it says:

"... and operate in industries with similar cost structures and risk profiles."

Do you agree with that statement?

A. So again, I want to slightly qualify. I do not want to think that comparators need to be rejected on the basis

that they do not match precisely the marketing focus.

What I want to check is whether there is any indication that there is excessive pricing on those markets and, if not, I think that they can give us information on what could be likely prices in the absence of excessive pricing.

Q. Forgive me, Dr De Coninck, it does not say "match precisely", it just simply says "operate in industries with similar cost structures and risk profiles". So we are not here a counsel of perfection saying they have to be identical; do you agree that they should have similar?

A. So again that -- I think, you know, it depends what the purpose of your indicator is. So if, as in my report, I want to see whether the type of test that the CMA applies to see whether a price is excessive applies across the board of the portfolio, I think the comparators are particularly helpful within that context without checking precisely the risk profile of those comparators.

Q. We can just go to look at Flynn's other products, back to figure 2 in your sixth report at {XE1/11/23}. You looked at all 13 products in the portfolio; correct?

A. That is right.

Q. But you did not analyse the degree of competition,

workable competition or otherwise, faced by each of those products?

A. That is right.

Q. That is right, thank you. Would it be fair to say, therefore, you took a slightly different approach to Flynn's other products from the one that you took to tablets, because one of the reasons you chose tablets as a valid comparator was because it was subject to workable competition in your view, but you did not look at that when it came to choosing Flynn's other products?

A. So the reason for that is that of course tablet is a very close product to capsules, so it is a reason why the additional work of analysing the level of competition on that market has been carried out; why not for the portfolio?

Q. Would you agree, therefore, that tablets is actually a better comparator as opposed to Flynn's products, because, as you said yourself, it is actually a much, much more similar product than any of these other products?

A. So, again, what does a better comparator mean? I think it depends, the purpose and how you are using those comparators. If you are looking at comparators to know whether the CMA's analysis leads to false positive and the extent to which I think that the setoff portfolio

product in Flynn's comparator is very informative. Now, in terms of tablets it is a very close product, and we do an assessment of the degree of competition in that market just to gain additional confidence in the analysis.

Q. When looking at Flynn's portfolio for a moment, I focused on figure 2, but to be fair in figure 3 on page {XE1/11/24} we do see that you actually refine the comparison here in relation to six to eight other products on the basis that they share with phenytoin the characteristic of zero promotion and amortisation cost. That is correct, is it not?

A. Yes, that is correct.

Q. You describe that as a sensitivity in your position statement.

A. That is right.

Q. Yes. But subject to that tweak, you have not sought to restrict your comparison of return on sales to those Flynn products that are similar to phenytoin in terms of input costs or sales volumes, have you?

A. So, no, because I -- as I say, I look at return on sales as a percentage, which I think is the right measure to focus on, and I think that those products in that context provide good comparisons.

Q. Okay, well, let us have a look at the relevance of

volumes, that is the sixth subjectivity that the President identified, and you were very clear, if I may say so in your evidence during the hot-tub, you said volumes are not relevant to the choice of comparisons. Is that your evidence, just so I am clear about it?

A. So I was saying that volumes are not relevant to assess the profitability measure which I expressed -- I mean, which are of this type, so in terms of percentage margins. I think if you go to --

Q. Yes, shall we have a look at what you said? I think this will be the best way to deal with this. At {Day8LH1/111:20-23}, and you say:

"If I may say, sir, I think ... volumes are not an additional criteria that we should take into account when determining excessiveness beyond the calculation of the cost plus price comparison."

Is that your view?

A. Yes, and if I may qualify it, what I have in mind when I reply this is when looking at the measure that I use, which is the percentage return on sales for Flynn.

Q. You discuss the relationship between the return on sales and volumes in your fourth report, and I would like us to look at that, please, at {XE1/9/6}. What I would like to do if I may is just check that I have correctly understood your evidence as you set it out very

helpfully in paragraph 11 at the bottom.

So my understanding here is you are having a debate with Mr Harman about whether there is an inverse relationship between return on sales and the level of volumes, and perhaps I should allow you, if you would like, to re-read paragraph 11.

A. Yes, thank you.

Q. Of course. (Pause)

A. Yes.

Q. I am grateful. Have I understood this correctly: if you have a business and it's got a fixed component of capital, so that is not going to vary in volumes, an example might be intangibles, and it has some working capital, then the more units you sell, you would expect the fixed capital to be spread across more units and the required return would be lower; is that correct?

A. Okay, so what do you mean by the required return?

Q. The return that is required in order to cover your costs.

A. Okay, so now we are getting back at, you know, investment, so here we are in a setting where you have a fixed of capital, what is the required return to cover this fixed amount of investment, and of course, if that is the question that is asked, if you have few sales to recover this capital, you would need a higher return.

Q. So is the answer to my question "yes"?
A. Could you remind the way you phrased your question, please?
Q. Of course. I asked if a business has a fixed component of capital that does not vary in volumes and it has working capital, then the more units you sell, you would expect that fixed capital to be spread across more units and the required return will be lower?
A. So, again, yes if the question is what is the amount that is required to cover the fixed cost.
Q. I am grateful. So would you agree that the return on sales benchmark is a function of volumes in the sense that the higher the number of units you sell, the lower the margin per unit needs to be in order to cover total costs where there is an element of fixed cost?
A. So I think I reply to that in -- or I address this point in this paragraph or the following one maybe, which is to say that these relationships that you were describing would not be material in the case where fixed costs are not large and that is a point I cover here.
Q. Indeed. You do make that point about it might be less pronounced, but do you accept the basic premise -- I accept your point about it is a question of degree, but do you accept the basic premise that the ROS benchmark is a function of volumes in the sense that

I have described?

A. So I think one has to be careful again, because the question is the required return, that is to obtain your return on capital. So there is also an empirical question on whether we do see ROS that is materially lower for higher volumes and I do not think that that is a statement that I can make.

Q. But as a general proposition, I will only try one more time, do you agree with me that the ROS benchmark is a function of volumes in the sense that the higher the number of units you sell, the lower the margin needs to be in order to cover the total costs where there is an element of fixed cost?

A. Again, I think that I cannot agree with that generally because the question is what is -- if the question is what is the return on sales that you need to obtain based on a certain volume, then I agree with you -- that I agree with you, but I do not think that there is any general proposition or general empirical evidence showing that return on sales is, as a matter of evidence, lower when you have more volumes.

Q. You mentioned about the need to look at it empirically, so perhaps we should have a look at a figure that is no doubt familiar. So if we go to figure 6.3 of Mr Harman's third report, please, that is at

{XE1/15/79}. What this shows is on the vertical axis we have the number of packs sold and on the horizontal axis we have the gross margin per pack, pound per pack, over the financial years 2013 to 2016.

Now, it is true, is it not, that no product in the Flynn portfolio sells in comparable volumes to phenytoin and makes similar returns per unit as phenytoin?

A. That is true.

Q. It is true also, is it not, that the products that achieve similar gross margins per pack as phenytoin sell nowhere near the number of packs of phenytoin?

A. Yes. I think I want to add to that, of course, because it is a graph that we discussed before and in the previous case, when it was in front of the Tribunal, we had a lot of exchanges on this. I think first point that I want to make on this graph is that first it is based on gross margin per pack, I think that is the wrong measure, and obviously the gross margin, which is -- sorry, the gross margin is per pack in pounds, right, so that is a very important point, it is not a percentage margin.

So basically what this shows is that phenytoin has a gross margin that is more important than a certain number of other products, but it does not control in any way for the cost and the input cost that Flynn has to

pay. So if -- you know, this for me is certainly a reason why this graph is not informative.

Q. So it is an important point that we addressed earlier today, that we are back to the importance of the input cost that Flynn was paying to Pfizer; correct?

A. I agree.

Q. You agree. But is it not right to say that when we look at this diagram, subject to the points you have just made, that phenytoin is highly unusual in combining a high sales volume, in terms of packs sold, and a high gross margin. Do you agree with me about that?

A. I would qualify that. So the question is highly unusual. I think when we see whether -- when the question is, is there a reason -- or is phenytoin standing out in the portfolio of Flynn? So I have looked at that, you know, in different ways. My conclusion has always been that phenytoin does not stand out compared to the other products in the portfolio of Flynn.

Now, with this graph, one is combining two factors, looking at the wrong measure, in a way, ignoring the cost that phenytoin paid to make, you know, phenytoin stand out from some other products. I do not think this is in any way the right way to look at this.

Q. So it is right that you have looked at other Flynn

products, and you have identified ones that share either high input costs or high sales volumes, but am I right in saying that you have not identified another product in Flynn's portfolio that shares both similar unit costs and high sales volumes. "And", it is the conjunctive that I am keen to...

A. Yes, I mean, within Flynn's portfolio phenytoin is one of the higher volumes product, it does not mean that it is a high volume product in general, but within the portfolio, that is right. Although there are other high volume products within Flynn's portfolio, and I have looked at that also. It is only if you focus on this margin per pack in pounds not controlling that for the input cost that you would think that phenytoin is different from other products.

THE PRESIDENT: Just taking a step back and away from the specifics of this case, it was put to you that phenytoin is highly unusual in combining a high sales volume and a high gross margin.

Now, moving away from, certainly capsules, sodium phenytoin and perhaps even pharmaceuticals, is there a trend that your margin falls as your volume increases in terms of a general rule, or is that something which is just random?

A. I think you could -- can see a reason why to some extent

it could happen in terms of if you have -- you want to have a certain required return on capital that you invest, but as a general statement, this is not a proposition that I have support for, and also, you know, a lot of the products that we see with high margins within Flynn's portfolio do not have capital invested in them, so this argument does not hold.

THE PRESIDENT: I am not interested in the specifics this time, I am interested in trying to understand the general proposition, it was put to you as a general proposition.

A. Yes, as a general proposition I do not think we can make the case that return on sales empirically is lower for larger products.

THE PRESIDENT: I see. Does your answer change according as to whether the costs are fixed or variable in the product?

A. So when you have costs that are fixed, you can have a weak relationship between the volumes and the return. You know, I am not saying that you do not have that possibility. What I am saying is there is no basis based on volumes to consider that the products which have high margins in Flynn's portfolio should be excluded as comparators.

THE PRESIDENT: Okay.

I am sorry, Mr Bailey.

MR BAILEY: I am going to turn to the topic of absolute returns, and you have clearly explained in your sixth report, paragraphs 48 to 50 at {XE1/11/17}, that in your view absolute margins are not suitable to help assess successfulness. That is right, is it not?

A. That is right.

Q. But can I just chart with a more general proposition: if we apply the same margin to a product with high costs and higher volumes, that will lead to higher total returns in monetary terms, will it not? Do you agree with that as a general proposition?

A. If we apply the same --

Q. If we apply the same margin to a product.

A. If we apply the same margin, by margin you mean absolute or --

Q. I mean percentage margin, to a product with higher costs and higher volumes --

A. Yes.

Q. That would -- yes? I am grateful.

Can we look then, please, at the absolute returns on capsules and Flynn's other products. That is at figure 4.2 of Mr Harman's third report at {XE1/15/56}. It is the diagram at the top, please.

I do not believe you have disputed the accuracy of

the figures shown here, have you?

A. No.

Q. And I do not think you have disputed that Flynn earned returns on capsules that were more than double the returns on its 13 other products combined as a matter of fact.

A. I do not think I have contested that, no.

Q. No, I am grateful. We know that Flynn, like any business, considered both absolute and percentage returns, and I would like, if I may, just to show you a couple of pieces of factual evidence that sort of make good that proposition. The first is paragraph 22 of Mr Walters' second statement. That is at {XC2/4/7}, please. This is where Mr Walters is replying to something the CMA had said in its defence in the first appeal. It is paragraph 22, and it is {XC2/4/7}, please, and it is the paragraph at the bottom. (Pause)

Do you agree that the bottom line in monetary terms is what one would expect Flynn, like any profit-maximising business to care about?

A. Okay, so I think I would say that obviously a firm cares about its absolute profits, I think there is no discussion about that point.

My point is if you are trying to figure out whether prices are excessive, I do not think the absolute profit

measure is informative because obviously it depends on how much you sell on your volumes, so if you consider an absolute profit measure without seeing to what volume this relates, that does not tell you anything about pricing and whether prices are excessive.

Q. Can we have a look at what Mr Walters -- his oral evidence during the first trial? That is at {XM/15.1/203} and he was asked about absolute returns generated by different rates of return.

Could I ask you -- I apologise it is in grey, but hopefully you will be able to read it -- could I ask you to read from line 11 on this page to line 8 on the following page, and just tell the -- Opus when you are ready. (Pause)

A. Yes, next --

Q. Do you agree with Mr Walters that a return on sales of 5% would have been sufficient to incentivise Flynn to supply capsules for 960,000 a year? I am putting to you both the percentage rate of return on sales together with the absolute return. Do you agree that would be sufficient to incentivise Flynn to supply capsules?

A. I do not feel comfortable commenting on that because it depends on a lot of factors that I would not necessarily know.

Q. What factors do you think it would depend upon?

A. Well, one has to take into account the risk, for example, that Flynn takes with incurring that activity, so I have not considered whether they would have done that.
Q. We are going to come on to the question of risk, so rest assured we will deal with that. Is there any other factor you think is relevant, or ...?
A. So, I mean, there is -- once product is taken, there are cost investments that are made, there is capital that is taken into account, so there is risk, there is capital, there is uncertainty about market developments that may affect how this may develop in the future. So I just do not know, I just do not make a -- you know, that I would be --
Q. But phenytoin is not a product in which Flynn invested heavily, is it?
A. So it is not a product in which Flynn invested heavily, I think that is clear.
Q. Yes.
A. But we are talking about small amounts here, so we should not discard either, you know, the working capital that Flynn would need for that.
Q. So although Mr Walters as a businessperson said he probably would have sold capsules at a 5% return on sales that would have given Flynn an absolute return of

3.6 million between the period September 2012 and June 2016, you do not feel, as a matter of economic analysis, that you can say whether or not that return is sufficient to incentivise Flynn to supply capsules?

A. Yes, I mean, I think that is a question for the business ultimately.

Q. I am grateful. At paragraph 25 of the CRA position statement, it is {XE6/4/9}, you say that:

"... between 7 and 11 of 13 of Flynn's non-Capsule products [the other products] per year are flagged as excessive under the CMA's ROCE analysis..."

And if we can go, please, to figure 2 in this statement at {XE6/4/13}, what you do here is to show the differentials between your calculations of the ROCE figures for Flynn's other products and their selling prices; is that correct?

A. So what I do here, yes, I want to see how the differential would look like for the other products of Flynn.

Q. Yes, and you are doing that by looking at the differential between your calculation of the ROCE figures for Flynn's other products and their selling prices; correct?

A. So I do this by calculating a differential being defined as the price minus cost plus, over cost plus where cost

plus is defined by the method of the CMA based on ROCE.

Q. Indeed, and although you cannot see it on here -- and by all means if we can just show the bottom there is a note where the CRA position statement explains that.

Now, Mr Harman has done the same thing, but rather than show percentage differentials he has shown it in absolute terms, and I am going to put to you that it is important to look at both. I know you object on the grounds of type 1 errors looking at just absolute returns; the CMA has not done that. It is important to look at both, and we are going to see why, because, if we go to figure 4.3 in Mr Harman's third report, {XE1/15/56}, please, this is taking the percentage differentials where you say they are flagged as excessive, and at various other points you have gone as far as to say they are actually being regarded as excessive, but if we do what the CMA did in the Decision, which is to cross-check by reference to absolute returns, that is what Mr Harman has done here.

Can you go over the page, please, it is figure 4.3 {XE1/15/57}. I am grateful. That is the equivalent figure to the one we were just looking at.

What we can see, quite clearly, is that the absolute level of excess earned on Flynn's other products pales in comparison to phenytoin, does it not? That is just

in terms of a visual. Do you agree with me about that, there is a massive difference between the absolute returns on phenytoin and the absolute returns on Flynn's other products?

A. So this is much lower indeed because those products have lower volumes.

Q. Is it not also right to say that when we look at both the percentage differentials together with the absolute returns, we would not be looking, even the most zealous competition authority would not be looking at any of the other products here, other than phenytoin, and say that they are excessive, would they? The absolute return cross-check is ensuring that we do not make a type 1 error, is it not?

A. I do not think so, because this does not in any way control for the volumes of the products, so I do not know on what -- how the CMA or another authority would decide on that basis of just excess return in pounds not as a percentage, to not engage in excessive pricing.

Q. Would you accept that expressing profits in monetary terms provides an indication of the relative scale of any profits in excess of the cost of capital earned by those firms, as a general proposition?

A. So if it allows to -- sorry?

Q. Where you express profits as monetary amounts, do you

accept that provides an indication of the relative scale of any profits in excess of the cost of capital earned by firms?

A. So this gives you indeed an indication on the profits over the cost plus but does not in any way control for the costs, so, again, if you have a product that has an excess of 10, it is a very different situation whether, you know, this is based on the cost of 1 or a differential of 10, whether it is based on a cost of 1 or 100. So what this absolute excess measure does is it does not in any way relate the differential to the cost that is incurred. So this is not, you know, a meaningful calculation to know whether there is excessive price.

So you are going to say: well, here I have an excess of 5 million or 1 million or 10 million, how do you know whether that is actually excessive? I think that a good measure to decide whether a price is excessive is to look at how much they charge over their costs, not, you know, absolute level of profits.

Q. But no one is suggesting that one looks at absolute profits in isolation. The CMA looked at absolute profits in conjunction with the cost plus framework, that is to what we are going to come, we have been looking at the metric you preferred, return on sales,

and so I would like to move to the CMA's approach, because I know you do disagree with it.

Before I do, can I just check if you agree with me as a general --

THE PRESIDENT: I am sorry, Mr Bailey, do you mind if I interrupt?

MR BAILEY: Not at all.

THE PRESIDENT: Are you moving away from ROS to --

MR BAILEY: I am moving away from ROS.

THE PRESIDENT: Dr De Coninck, you have made the point that when you are working out what is an excessive price, you principally want to look to costs, and I do not think anyone is saying that that is not a relevant factor, clearly it is, but just looking at absolute levels of profit and whether that does tell us anything, let me give you an example of a product that costs £3 and sells for £10 versus a product that costs £30 and sells for £100.

Now, the percentage return is the same in each case, but the absolute return is much more in one than the other. Does that tell you something about what percentage versus absolute measures tells you in that the bigger the absolute figure, ie my second example, a profit of 70, does that tell you something more when it is a larger absolute figure than when it is a small

absolute figure and vice versa when one is looking at percentages? In other words, does one not have to look at everything in the round in order to work out what is a proper return over cost, or do you think it is just a fixed percentage or absolute figure as a return over cost?

A. I think if what you want to do is to determine whether prices are excessive, the percentage figure is much more informative because it relates the margins to the costs. Otherwise there is no basis to know whether 7 or 70 is excessive. So especially when you are thinking about, you know, comparators, you want to somehow take -- compare to the extent that you can control for the costs of those products when you compare, you know, a price to know whether it is excessive. So if you are just looking at an absolute profit level of 7 or 70, I do not see what you can conclude from that.

THE PRESIDENT: Right, you do not regard it as a significant figure, but you would regard the percentage return on sales as the thing you should look to?

A. Yes.

THE PRESIDENT: Even though the profit is ten times more in absolute terms than the percentage figure?

A. Yes.

THE PRESIDENT: Just to throw in how volume features in

this, does your answer differ according as to whether one is selling the low priced product, say one is selling millions of those, versus selling very few of the expensive product, so that you are in the aggregate making far more out of the lower priced product, again, do you still, when determining an excessive price, only look or predominantly look to the percentage?

A. Yes, absolutely, to the percentage, and I think looking at total profitability is -- so you can look at absolute profit per unit, you can look at, you know, total profitability for all the sales, but I think that is absolutely, you know, not informative because in addition to not controlling for the costs, you also, you know, ignore that this amount is just the result of how much you sell, so the more you sell, the more aggregate profit you have, does not mean that it is more excessive.

THE PRESIDENT: I suppose that is my point. I mean, I have kept in all of these examples the percentage return on sale constant. Because I am presuming a fixed relative differential between cost and price, the percentage figure is going to be absolutely the same. What you are saying is that that is all one really needs to look at, I do not need to worry about the absolute figures even if they are high because the individual price is high or

even if those absolute profits are high because the volume of sales are high, I just do not need to worry about that?

A. Exactly.

THE PRESIDENT: Okay, thank you.

PROFESSOR WATERSON: Could I come in here? So supposing a firm is thinking of making an investment in an activity, and it looks at that activity, and it looks at the likely volume of sales that it will make, it looks at its variable costs, the likely price that it will sell at, but it will also have to put in some costs in order to introduce that product.

A. Yes.

PROFESSOR WATERSON: So in that case, will the volumes matter?

A. I mean, I think that is a discussion we had before. I think the matter for the recoupment of the investment, I think, you know, it is not a major concern -- the point I was making is that it is not a major concern here given that would allow us to disregard comparators that have lower volumes because we are not in a situation where they have high investment costs in this particular case.

PROFESSOR WATERSON: Right, so you agree with it as a general proposition but not in this particular case?

A. Yes.
PROFESSOR WATERSON: Thank you.
THE PRESIDENT: Thank you, Mr Bailey.
MR BAILEY: Out of interest, Dr De Coninck, if we quadrupled the input cost for capsules, so it goes from £36.8 million and becomes £147 million-odd, is it your view that Flynn would still be entitled to include a margin of around 30% regardless of how high the selling price would be?
A. So the -- I think that one has to consider whether there is a need for -- so what we are considering here is whether there is a need for intervention on the basis of excessive pricing, so there I would consider the input cost that Flynn actually has to pay. If that is actually the input cost that Flynn has to pay, this is what I would take into account indeed, yes.
Q. I think -- but obviously correct me if I have this wrong -- I think the answer to my question is "yes"?
A. Mm-hmm.
Q. Forgive me, I do not think you have hit the transcript.
A. Yes.
Q. Thank you very much. I would like to move on to return on capital employed, and in your reports and also in your teach-in, you have explained that you do not consider a return on capital employed approach as well

suited to measuring the financial performance of Flynn which you consider to be an asset-light business. Is that an accurate summary of your position?

A. Yes.

Q. I am grateful. Now, in light of that criticism, I would like to look, please, at the two inputs for a ROCE approach. The first of those is to look at working capital, and look first, briefly, at the tangible assets relevant to the capital employed by Flynn in supplying capsules. Can we go, please, to the Decision at paragraph 5.235 at {XA1/1/199}. We can see here, paragraph 5.235, that the CMA does a calculation that Flynn held buffer stocks of capsules in order to guard against interruptions in supply; that is correct, is it not?

A. Yes.

Q. You have not taken issue with Flynn's working capital being worth in the region of £3.5 million, have you?

A. In Flynn's working capital, no.

Q. Flynn's working capital, no. The CMA's cost plus allows Flynn to earn the required return on that capital employed in holding those buffer stocks, does it not?

A. Yes.

Q. Yes. Now we discussed earlier that Flynn did not spend anything on a second source of supply, so I am going to

put that to one side, but I would like to turn to intangible assets because that of course is an important point that you make, and in your sixth report you say at paragraph 12, which for Opus is {XE1/11/7}, that the key difficulty of a ROCE approach is to accurately estimate all of the different intangibles and especially intangible assets, and you make similar reports in your fifth -- similar points in your fifth and seventh reports.

A. That is right.

Q. Can I first see if we can agree on a few basic principles for the inclusion of intangible assets in the capital employed. Can we go, please, for that to the Decision again at {XA1/1/201} at paragraph 5.248, and you will see at the bottom it says:

"The CMA's criteria for [recognising] intangible assets in [the] capital employed [as opposed to] recognising expenses within costs, are..."

Tantalisingly, over the page, please, {XA1/1/202}, that they must first:

"... comprise a cost that has been incurred primarily to obtain earnings in the future."

The cost secondly:

"... must be additional to [those] necessarily incurred [in the ordinary] running [of] the business..."

And third:

"... it must be identifiable as creating ... such an asset separate from any arising from the general running of the business."

Do you agree that those are reasonable criteria to consider whether intangibles should be capitalised?

A. So I think -- can you go up to the previous --

Q. Of course, yes, can we go to the previous page, please, {XA1/1/201} so that Dr De Coninck can see what is being said.

A. So what I would say on this is that ideally we would want to know what, and be able to measure the intangibles. It is in practice extremely, an extremely difficult matter to do. So the question is if you are using a return on capital employed approach, how are you going to do it, what are you going to put in there.

Q. I hesitate to interrupt, and by all means continue your thought, I just want to clarify one point: these are criteria for identifying as opposed to quantifying intangible assets in capital employed, so I want to sort of take it in stages.

Do you agree that these criteria are reasonable and suitable for identifying intangible assets in capital employed, and then we can come on to your question of measurement?

A. Okay, yes.
Q. You do agree about that?
A. Yes.
Q. I am grateful. Of course, when we are doing that initial question about identifying intangible assets, if we decide that it is not to be included in the capital base, that does not mean, does it, that it gets ignored; the cost would then be taken into account as part of operating costs. That is right, is it not?
A. It depends what you are referring to here. If you are referring to about the, for example, labour costs?
Q. Well, I am going to come on to human capital because I know that that is a particular point that you mention, but I thought out of fairness, you have given seven reports, we should perhaps go through the various examples of intangibles that you have identified during the course of your evidence, so I have identified several candidates that you have put forward, and I would like to discuss them with you, if I may.

The first in your third report at paragraph 21 at {XE1/8/10}, you say this:

"Intangible assets such as patents, licences and know-how, which are important in the pharmaceutical sector are hard to value."

Of course, that is the measurement point that you

have just made. But do you agree with me that capsules have been long off-patent, have they not?

A. Yes.

Q. Flynn did not create any know-how for capsules, did it?

A. So not know-how for -- I mean, what do you mean by know-how for capsules? Of course they have know-how on how to operate their business with respect to capsules.

Q. Forgive me just one moment. (Pause)

Flynn incurred no costs in relation to selling, promotion and amortisation of capsules; that is right, is it not?

A. That is right, yes.

Q. The second intangible that you identified related to security of supply, and that is something that is covered obviously in the context of building up buffer stocks, is it not?

A. Yes.

Q. I think you accepted earlier, but just for the benefit of clarity, Flynn did not invest heavily in any of the activities related to capsules, did it, during the relevant period?

A. Yes, that is right.

Q. Yes, that is right. I hope it is fair to say that your primary candidate for an intangible asset is Flynn's human capital, that is right, is it not?

A. That is right.
Q. You describe it in your sixth report as a "people-intensive business"?
A. That is right.
Q. I would just like to start at a general level just to see if we can agree about how one goes about deciding whether to capitalise labour.

So as a general proposition, do you agree that businesses will employ staff with a mix of experience and expertise?
A. Yes.
Q. Generally speaking again, there may be exceptions, but generally speaking, companies pay for that labour through a combination of wages and salaries and director emoluments?
A. That is right.
Q. Yes. While there are exceptions, do you agree that those costs generally are necessary for the day-to-day running of the business?
A. Yes.
Q. Now, if we want to see if staff costs should be capitalised, the incurring of those costs would need, at a very minimum, to create an asset. Do you agree with that?
A. Yes.

Q. Yes. The creation of an asset might be thought of as something that can be sold to someone else separate from the business. Do you agree with that? It is a separate identifiable asset that you could sell to a third party.
A. I am not sure -- I am not sure you are always able to sell your assets, but of course if you --
Q. So let us have a look at an example in the context of labour --
A. Yes.
Q. -- a skilled workforce. Football players. We know that football players can be bought and sold for sometimes what might seem eye-watering amounts of money, and when one is sold, like Paris St-Germain sell Lionel Messi to Inter Miami, that is separate from the general business of a football club, is it not?
A. Separate from the general business of a football club?
Q. Well, Paris St-Germain continues to play football even though there is Lionel Messi, one of the star players, has moved to Inter Miami; that is the point I am making.
A. He has to continue to play football, maybe not in the same way.
Q. Well, indeed, I do not think that it would be a controversial statement, we agree. But if we then look at Flynn's workforce, you could not sell that to another company separately from the business as a whole,

could you?

A. So selling separately phenytoin, you mean?

Q. No, no, take Flynn's -- so the analogy I am making is that where Paris St-Germain sell Lionel Messi to Inter Miami he is regarded as an asset and is often capitalised by the football clubs that employ him, but the football club continues separately thereafter, there is a life after Messi. When it comes to Flynn's workforce, if you were to try and sell that to another company, you could not really do that separately from the business itself, could you? It is not a separate asset.

A. Well, I mean, the -- I think -- I do not know whether you could sell that or not, but the point I think is that you have a lot of value that is created by the people working at Flynn. So what is driving the value of the business of Flynn? Is it the capital that we know is relatively limited, although not necessarily precisely estimable, or is it the people who work there and I think that, you know, the question of whether you can dismantle the work that is done at Flynn, whether the rest of the business at Flynn to sell it as an asset, I do not think that is necessarily the right question because the work and the human capital is directly linked to the business that is operating.

Q. When you speak about the value that is created by Flynn's staff, why is it not an appropriate way of taking that into account the costs that are incurred on the wages, the salaries, the director emoluments, no doubt the training costs? You just take that into account as operating costs, do you not?

A. That is part of operating cost indeed, but of course that does not mean that this is the value that is created. Somehow the operating costs are what Flynn pays to the employee which is a minimum. Of course they would -- that is a minimum of the value, because they would not pay less than the value that those people create for the business, but it is not reflective of the entire value.

Q. In this case, the CMA allocated, did it not, some £2.5 million in employment costs to capsules?

A. As part of the --

Q. As part of the cost plus. Do you agree that that is what the CMA did?

A. That is part of the cost plus, yes.

Q. If we could just go back to Decision paragraph 5.248, please on {XA1/1/201}, so these were the criteria we are looking at, and just go over the page, please, to {XA1/1/202}. It is right, is it not, that you have not considered whether Flynn's expenditure on staff meets

any of these criteria for identifying an intangible asset?

A. So, sorry --

Q. So my question is in all of your reports, you have not considered any of these criteria for whether Flynn's expenditure on staff should be identified as an intangible asset to be included in capital employed?

A. So I have not gone through those criteria one by one, but I think that clearly there is value for those -- that is created within the people working at Flynn, and that is what is driving the business. What is driving the business is not the capital that is invested in the business. So that is why I think that the ROCE measure is really inadequate because it does relate the profits that are made just to the capital that is employed and does not relate that to anything else, and I think that is the main issue that I have with ROCE.

So I am not saying that we should employ ROCE, that we should go through an exercise of assessing what the intangibles are for Flynn, putting that into ROCE and using the ROCE corrected for that in the analysis.

Q. One of your criticisms of ROCE is that there are intangibles which you say are missing, that have not been identified, and you say have not been taken into account which leads you to say that it is an asset-light

business, and my point being put to you is insofar as you describe it, the value created within the people working at Flynn, well, the CMA did take into account that value, and it is reflected in the wages and the salaries and the training costs, all taken into account as operating costs.

A. That is only taken into account in the operating costs, that is my point. I think the major issue here is that we are looking -- when we do this ROCE profitability measure, we look at profits and we relate that to the capital that is employed. So the question is, well, you know, does that make sense, and we all know those are -- that those measures of capital do not carry -- do not allow one to properly capture what is driving those companies. So there are intangibles. My contention is not that you should try to measure these intangibles, because that is going to be an extremely difficult exercise that is going to be not easily done and subject to a lot of criticism either way. So I do not think that the approach is to use a ROCE and correct it by adding intangibles. My point is there are other measures if you want to put in, you know, the cost of capital in the mix in addition to the return on sales measure that I was using, you can look at the differential, and you do that, but you do not relate all

those profits to -- or calculate them as a percentage of the capital employed.

THE PRESIDENT: Sorry, just to ask a clarificatory question, is your issue with return on capital employed that the return, whatever it may be, be it absolute or percentage, however it is calculated, that the return is calculated by reference to a specific type of cost, ie capital versus other sorts of cost?

A. Yes, so my concern is that when you have a return on capital employed, you are looking at your profits and you divide that by your employed capital, and that is your measure of return on capital employed.

THE PRESIDENT: Yes.

A. So this denominator is the issue.

THE PRESIDENT: Right, and what your concern is, is that there are certain costs, non-capital costs, which are not fed into a calculation of the return. That is your issue with it. Have I got that right?

A. I mean, conceptually, that is of course an important limit of the exercise. What I would say is that there are other measures that, you know, are more informative to focus on the return that firms make and not to relate it to the capital employed. I mean, I think we --

THE PRESIDENT: Yes, excuse me for interrupting, but of course we all know that you are considering that the

appropriate metric is the return on sales, and I understand that, we have discussed that. What I am trying to understand is, first of all, what your issue is in relation to return on capital employed, and my understanding -- but do correct me if I am wrong -- is that you do not like that the costs by reference to which a return is assessed are confined to capital costs.

A. In the denominator, because you are looking at the profitability in the numerator, which is the difference between the revenue and the --

THE PRESIDENT: We are talking about a ratio between costs and profit.

A. Yes, yes.

THE PRESIDENT: Your problem is that the costs definition is too narrow.

A. That is right.

THE PRESIDENT: Yes, okay. So why is not the answer from your point of view to say that one should look at a return on costs generally? In other words, one does not look at return on sales; one looks, however, at the costs that are incurred, whatever they may be -- and I am assuming that they are reasonable, proper costs, including, let us say for the sake of argument, labour costs -- and you say, well, a proper return on all of

these costs ought to be X, but you do not confine the denominator, as you call it, to capital employed, you expand it to all of the costs that are incurred properly in the running of the enterprise.

Now, that is not a return on sales, it is not a return on capital employed. Why do you say, if you do, it is not an effective measure for -- a measure for excess profits?

A. Right, I actually do not quite say that, I present --

THE PRESIDENT: Well, no, I do not think I put it to you that way; what I am asking is what is wrong with it? Do not worry if you have not said anything about it in your reports.

A. No, actually, I present -- those are the differentials that I present in my last report, position statement, so I have those figures where I look at the differential and it is exactly that, it is the revenue minus the cost plus over the cost plus, so that includes those cost plus defined as the CMA does so, the return on the capital based on their measure. So basically that measure is what you are describing, because you take into account the different costs, also on the denominator.

So I think this is a measure that I understand is also informative, it is not perfect because then we can

of course have a discussion on other part on the plus and the return you have on your capital, within those costs, but it has much less of an impact. The point is that since now in the denominator you are using, you know, all the costs and not just the capital employed, then the measure is not as sensitive to errors in the capital employed.

So this is a measure that was not my initial measure. It has some limitations, but I think it is an informative measure.

Now, I look at it in a very different way as the CMA because the CMA look at this measure as what is excess, and I do not define it that way. I think that calling it a differential is a much more neutral measure. You look at this measure, so how much profits you have over all your costs, and you look at whether this is something that is out of the ordinary or not to determine whether it is excessive or not.

THE PRESIDENT: Thank you.

MR BAILEY: Just reverting to the question of measurement. Would you agree as a general proposition, if you were right that Flynn's workforce should be regarded as an intangible asset, we should reflect their current value to the business in measuring it?

A. Sorry, can you repeat?

Q. Yes. If Flynn's workforce were an intangible asset, what we should be trying to do is reflect their current value to the business?
A. So we should try to reflect their current value to the business, yes.
Q. Yes. One way to measure that current value would be the replacement cost of the staff, would it not?
A. If you can replace them in achieving the same results, which is of course not the same as just replacing one person.
Q. Would you agree that salaries and training costs might be a reasonable proxy for that replacement cost?
A. Well, if you are replacing an entire -- so you have to consider, you know, replacing an entire team which means, you know, replacing an entire business, so I think this is something that goes beyond what you would consider to replace and train individual people, because you have a lot of knowledge and value that are contained within a team.
Q. Let us assume you are right that there are some missing human capital. Do you agree that one way to mitigate the risk of a type 1 error is to carry out some form of cross-check?
A. So I think you can, of course, try that. I think my more general point, and I just want to -- maybe I am

just a bit conscious of repeating myself, but the question is, you know, if you relate your entire measure of profitability to capital employed, which is a measure that is very badly proxied, you are not going to obtain reasonable results and, therefore, I think it is much more informative to look at your profitability measure as a function either of sales or total cost and not just the capital employed.

Now, you can of course do sensitivity analysis. The question is how far this will bring you and how sensitive the results will be to changes to that.

Q. Can we go to {XA1/1/239}, please, the Decision paragraph 5.412. This uses return on sales, and I want to park our disagreement about whether the level of the return on sales rate is the right one or a reasonable one. What I want to do is look at the results of the CMA's rate of return cross-check, and they are set out in table 5.19 and that is over the page, please {XA1/1/240}.

We can see in table 5.19 in the final column under the column headed "Total" that the allowance for reasonable return of 6% return on sales is 4.7 million, and you have not objected to the accuracy of that calculation, have you?

A. So this is --

Q. This is a rate of return of 6% return on sales, so in other words, mathematically about 6.38% times Flynn's total costs, which produces 4.7 million.
A. Mm-hm. Okay.
Q. So you agree that that is the figure produced by a return on sales of 6%?
A. So we have the -- on the cost plus, yes.
Q. Do you agree that the same level of return would be given by applying a 10% weighted average cost of capital to a total capital employed figure of £11 million? You take the £11 million multiplied by a 10% WACC multiplied by 4.3 years of the relevant period to produce £4.7 million.
A. Okay, yes.
Q. You agree with that?
A. Yes.
Q. Yes. So a 6% return on sales is equivalent to applying a 10% WACC to a total capital employed by Flynn of roughly £11 million a year; are we agreed?
A. Yes.
Q. Now, given Flynn's actual working capital requirements were 3.5 million, what this cross-check is therefore doing is testing for the inclusion of an extra £7.5 million in Flynn's capital employed; correct?
A. So it is a cross-check taking into account the return on

capital employed which, as I explained, is a bad measure and is not -- because of -- it relates all the profits to the capital employed, so I do not think this is, you know, the right way to look at returns in this industry, in particular for these products.

Q. I take that, but one of the criticisms you have made of the ROCE measure is that it underestimates the value of any human capital in Flynn's business, and so what this is doing is that this is taking three times the value of the employment costs which the CMA allocated to phenytoin, that is £2.5 million, and it is saying: right, we are going to capitalise that in the form of £7.5 million, and then we are going to see what difference that makes to what you regard as differentials, what I might call excesses, and I would like to see the implications of this cross-check, if we may, so can we start, then, by looking here at the final row. Can I just ask you to look at what the percentages are for each of the strengths and in total?

So it ranges from 31% on 100mg to 133% on 25mg, and the total is 41%; correct?

A. Yes.

Q. Yes. If we then look at Table 5.17 on page {XA1/1/236}, please, this sets out the CMA's base case again using a 10% WACC, this time of course only having a capital

employed of 3.5 million, and if we look at the bottom row, "Excess", we can see that the lower bound is 100mg again, 37% and the higher bound is 25mg, 139%, and the total excess is 47%.

There is not a material difference, is there, in the excesses found by the CMA's base case and the cross-check that included an additional £7.5 million as a capital asset?

A. Yes. Yes.

Q. You agree with me there is no material difference?

A. It is limited.

Q. Yes. So it is fair to say, I would suggest, that the CMA evaluated each and every intangible asset that either you or Flynn identified as being relevant for the supply of capsules, did it not?

A. So, again, you know, I do not know how we should, you know, consider -- I mean, which specific intangibles we would -- we should really take into account. I am sure there is -- I think there is a lot of potential discussion on this to be had. I mean, I think the point that you make is that in any case, we allow for a cross-check that, you know, increases whatever amount we are starting from based on the capital employed and the question is, you know, whether we can have confidence that this cross-check tells us much about the

results.

I think ROCE in itself remains a bad measure even with those cross-checks because it ignores the other costs of the business in the denominator.

Q. We have looked at costs relating to various intangibles. I want to move to another area of criticism that you make of the ROCE approach. This time you made it in your fifth report at paragraph 16. That is at {XE1/10/8}. In particular you say here at point (2) that the:

"... ROCE approach and the CMA's analysis more generally fail to take into account..."

We have dealt with point 1, happily. At point 2:

"... the risks inherent to Flynn's activity."

Indeed, you mentioned risks in your evidence earlier today.

What I would like to do as a baseline is have a look at what those risks were and see what your views about them are, and for that purpose I would like to start, please, with Mr Harman's third report at paragraph 4.6.6 at {XE1/15/45}, and what he does helpfully is set out a series of possible risks, and I want to gain your reaction to them.

There are a number of Roman numerals here, but let us just start with Roman numeral (I) and the point that

is being made here by Mr Harman is:

"Flynn should have been less concerned with demand risks ..."

So he is on the demand side, because of course given the guidance on continuity of supply actually one would expect capsules to be supplied on an ongoing steady basis to patients that are already taking them, and you can see he says there the customer base is to a large extent guaranteed. So just taking that point on its own, do you agree that the risks for Flynn on the demand side were relatively low for this reason?

A. I think it may limit some of the risks. I do not think it does mean that risks are particularly low.

Q. Well, if you had a business and you were told: do not worry, your customer's base is guaranteed to a significant degree and there is no switching -- it is either going to be unlikely or limited, would you not be saying yes, that is pretty low risk?

A. I would not, no. I mean, especially in this case, if we take the reality of this case, which is one in which there is a question about how stringent this -- how strictly this continuity of supply is applied, that is one point, the uncertainty then about potential entry and then you could also have potential risks. I mean, this concerns an immense (inaudible) also have risk

(inaudible).

Q. You have not evaluated any of those risks, have you?

A. No.

Q. No, no. If we take points (II), (III) and (V) together and just have a quick look at them, these are on the supply side, and we can see that in (II):

"The level of investment required to market and promote the product was low ..."

That is a point you agreed with earlier; that is right, is it not?

A. Sorry?

Q. The level of investment to market and promote the product was low?

A. Yes.

Q. Yes:

"Flynn only acted as a distributor of the ... Capsules ..."

It therefore did not face any manufacturing risk; that is right as well, is it not?

A. That is right.

Q. Yes. If we go over the page, please, to point (V), we can see that:

"Phenytoin Capsules were de-branded, off-patent ... [no] additional investment to innovate..."

That is also right, is it not?

A. Yes.
Q. We can see in passing in point (IV) Mr Harman notes that the NHS is ultimately footing the bill so there is no risk of any bad debt, so again that pushes the risk down, does it not?
A. They are factors that can limit the risk, yes.
Q. Yes. So this is also an issue that the tribunal itself addressed in its original judgment, and I would actually like us to look at that together, if we may. It is at {XN1/2/112}, and it is paragraph 346 of the CAT judgment.

It is a long paragraph, but could I ask you to read essentially from the beginning of "We prefer the CMA's view", to the end, please. (Pause)

So you can see actually the final sentence is precisely the point Mr Harman was making in his third report, is it not? The continuity of supply meant --
A. To a significant degree, right.
Q. Sorry?
A. The sentence mentions to a significant degree, so I think --
Q. Yes, but you would not disagree with the Tribunal about that, would you?
A. As I said, I think this is a factor that can limit risk.
Q. So the tribunal is right, was it not, first time round:

Flynn took very little business risk in becoming involved in the supply of capsules, for the reasons set out in this paragraph?

A. Well, you know, I think -- I mean, I did not in my evidence present evidence on specific risks that Flynn incurred. I just know -- I am just saying that, you know, there is risk involved in this type of activity can be more or less of course depending on specific arguments. It does not mean that there is no risk in the activity.

Q. Well, the tribunal concluded -- the tribunal in this case -- obviously it is a different panel in this appeal -- but in the original appeal it concluded that it meant Flynn was taking very little business risk.

In your reports, you identify the risks of Flynn being a marketing authorisation holder; that is correct, is it not?

A. Yes.

Q. But you do not analyse the commercial risks that Flynn took in that respect?

A. No.

Q. No. You also identify the risks of Flynn starting a new business venture, but again, you do not analyse the nature and extent of those risks, do you?

A. That is right.

Q. Let us just assume that you are right about there being some risk factors that have been, perhaps, inadvertently omitted from the CMA's base case. We looked earlier at the cross-check relating to return of 6% return on sales, and we can, just for convenience, bring that up: {XA1/1/239}, please. Do you agree -- it is the paragraph 5.412, it is the final sentence. Do you agree that the absolute return given by a 6% return on sales is the same, at least mathematically, as applying a weighted average cost of capital of 31% to Flynn's capital employed balance?

A. Yes.

Q. A return of 31% on every pound invested, that is a pretty high return, is it not?

A. You know, I explained before, I do not think the right metric to look at profitability in this case is to relate it to the capital invested in the business. Now, you say that, you know, you mentioned the 6% return on sales as a cross-check. You know, I do not see how this is a useful cross-check. Basically, it is using return on sales with a 6% return, it is an arbitrary number that is not based on real market returns. So I do not see what one gains from such a cross-check. I do not think it is really informative. It is just probably said in the previous case where this focus was on 6%

return on sales and the ROCE was the cross-check. Here I see that now that ROCE is the main one and the return on sales of 6% is the cross-check.

You know, I don't see any basis for that to be a meaningful cross-check.

MR BAILEY: I have an eye on the time, sir, and I realise we did start at 1.45.

I have a small topic related to the WACC which we could perhaps do in about sort of 3 to 5 minutes and then that would be a natural point to break, if that is okay with the transcript writer.

So you have made various criticisms of the level of the weighted average cost of capital. You say it cannot be a relevant benchmark, and there are really just two points I would like to put to you about that.

I would like to go back to that OECD paper, if I may, at {XO/18/23}, please.

If we can just enlarge the middle, please. If we just look four paragraphs down, the one that begins "The return on capital employed", and if you could just read the last sentence -- it is down at the bottom now, it is the sentence that reads:

"The appropriate benchmark for the ROCE indicator is the weighted average cost of capital (WACC) as it also focuses on the total capital invested in a firm (and it

is often industry specific)."

So do you agree with the OECD about that?

A. I think I need to explain this.

So first here we are talking about ROCE and WACC at the firm level, the total capital invested in a firm. There is nowhere in there that talks about product level analysis for ROCE, it is just not what it is applied for, certainly not to determine whether prices are excessive for a given product, it is all about company level measure. That is the first point.

Then the second point here that I want to make is what is this benchmark that we are talking about here? So I think the CMA has used WACC as benchmark as the minimum return that an investor would want to earn on its investment, and in that sense it goes to the cost of capital, so on the firm side, the WACC is the cost of capital. So we can discuss about what one is trying to achieve with a benchmark, so when we say the appropriate benchmark, but if the purpose of the exercise is to assess whether a price is excessive, ROCE is not an appropriate benchmark, I would argue, because in that case, ROCE set at a WACC, because then this just goes to cover the cost of capital for the firm.

So the benchmark that is taken -- if the WACC is taken as a benchmark, then we just are at a level of

cost plus where the plus is coming from this WACC benchmark, which is essentially for the firm the cost of capital. So we are at a cost plus which corresponds to cost, including remuneration of capital.

So is that an appropriate benchmark to determine whether price is excessive? Well, it essentially means that your benchmark is cost including the cost of capital. So I do not think that cost is a particularly useful benchmark to determine whether prices are excessive. I mean, obviously if prices are below cost you wouldn't be worried about excessive prices, but if the point is to identify when a price can be excessive, then this is not the appropriate benchmark.

Q. Can I take your two points in turn? I will take one of them before the break, and tantalisingly, we will deal with the other after the break.

So your first point is about this is talking about firm level, not product level. So you have not tried to estimate the cost of capital employed in Flynn's capsule business, have you?

A. No.

Q. No. But are you aware Mr Harman has done a bottom-up assessment of the cost of capital for capsules?

A. Can you remind me what it is?

Q. Of course, yes. So if we go to {XE1/15/68} this is

Mr Harman's third report, and this is where he sets out the results of his bottom-up calculation of the cost of capital for capsules, and we can see that it falls in the low end of the range, 6.2%, and the high end of the range, 10%.

In your reports, you have not disagreed with Mr Harman's estimates for the cost of equity or the cost of debt or the notional gearing or, indeed, the range for Flynn's pre-tax WACC, have you?

A. Yes, I have disagreed with using WACC as a benchmark.

Q. Indeed. That was not my question. My question was you do not dispute these figures, do you?

A. I have not disputed the figures.

Q. Yes, or Mr Harman's calculations?

A. I think it totally irrelevant for determining a benchmark.

Q. But the figure the CMA used of a 10% WACC is at the top end of Mr Harman's range for phenytoin's cost of capital, is it not?

A. Which number are you referring to now?

Q. In the high at the bottom, in bold, the 10%, so he calculated a range 6.2% to 10%, taking a conservative approach, the CMA went for a 10% pre-tax WACC in part of its cost of cost plus framework.

A. Yes, so again, totally irrelevant benchmark to assess

whether the prices are excessive.

Q. Your second point was, if I may put it I hope succinctly, there is no plus in cost plus, is the point that you were making?

A. Yes, yes.

MR BAILEY: Yes, and I would like to return to that topic, if I may, after the break.

THE PRESIDENT: Of course, Mr Bailey. It is half past. We will resume in ten minutes, thank you.

(3.28 pm)

(A short break)

(3.48 pm)

THE PRESIDENT: Mr Bailey.

MR BAILEY: I promised before the break to come back to the topic of whether there is a plus in the CMA's cost plus and I would like to do that, if I may, by looking at a decision on which you have warm words and that is the European Commission's commitment decision in *Aspen*, and we can find that at {XN6/7/31}, please.

At recital 154, which has the red mark, we see that:

"... the Commission recognises that companies are entitled to make a reasonable rate of return, in order to cover their cost of capital. In fact, the Commission's preliminary assessment of the Products' profitability on the basis of a cost-plus analysis ...

accounts for a reasonable rate of return, in line with the industry's average performance, by adding a 'plus' element to the costs based on the Comparator Profitability. That 'plus' element allows recovering the costs of capital. In principle, no further recognition of the remuneration of the capital employed in the Products is therefore required."

So the Commission is right, is it not: the plus in cost plus allows for the recovery of the cost of capital?

A. That is right.

Q. As the Commission says, there is no need for further recognition of the remuneration of the capital employed, is there?

A. So I think you cover -- I think the point is when you have a plus that covers the return on capital, that is just essentially -- you are just essentially covering -- considering a level that covers your economic costs. So if you are looking at whether a return is, you know, excessive, this cannot be the benchmark that is taken. That is my point.

Q. What you say in your reports and position statement is that the gross margins and the ROS earned by Flynn on capsules are consistent with the margins that are referred to by the European Commission. That is right,

is it not?

A. Yes, that is right.

Q. Yes. What I would like to do, if I may, is just have a look, please, at the comparator companies that were used by the Commission for that purpose, and we can start at recital 129 which is at {XN6/7/25}, please. We can see here the criteria -- sorry, can we just enlarge recital 129 at the bottom?

The Commission identified a set of companies based on a number of objective criteria, and they were whether the company earns at least €1 million in revenues generated through off-patent branded or generic products, at least 70% of the total revenues reported in the IQVIA, that is the healthcare data provider, earned by off-patent branded or generic products, and could we turn over the page, please, and then enlarge the top, please? And then thirdly, at least €100,000 earned by products listed in the antineoplastics, that is the World Health Organisation category for medications to treat cancer.

Do you agree with that?

A. Yes.

Q. Yes. It is right, is it not, that those comparator companies in *Aspen* were chosen because they had a similar profile to Aspen, both in terms of off-patent

pharmaceutical products and also because they sold similar cancer medicines?

A. Yes, so they are chosen, as you can see, from the three criteria: 70% must be off-patent generics, so that is clearly a key factor for determining the comparator base to have companies that are mostly selling, you know, generics off-patent drugs, not necessarily 100%, but that must be the main focus of their portfolio, and then you have this third condition that at least some sales relate to the category, ATC-2 category in question, yes.

Q. I would like to drill down, if we may, into these comparator companies.

Could we look, please, at footnote 89 on page {XN6/7/26} because this describes the data set that -- we might need to enlarge the bottom of the page, thank you.

We can see here in footnote 89 that:

"The sample of Profitability Comparators consists of companies for which profitability data was available on the Bloomberg database for the period 2013 to 2018."

Pausing there, we do not know who these companies were, do we?

A. No, we do not.

Q. No. If we just read on, we can see that:

"The list of companies with available data was

manually verified."

So good.

"As a result of this verification exercise, three companies were excluded from the sample, either because they were not suppliers but merely distributors of medicines [within the category for cancer medicines] or because their products [like in *Hydrocortisone*] had ... protected 'orphan' status."

So we know, do we not, that three of the companies were excluded because they were not suppliers but merely distributors. Flynn is a distributor, is it not?

A. Yes, if I am reading this right, the three companies that were excluded were distributors of -- in the ATC-2 category, so I do not know in terms of their product portfolio.

Q. I am grateful. What we can see is, if we just go up on this page, please, it sets out the median levels of margin for the comparator companies in Aspen, and we can see that in table 3, and we can see what the gross margin was, 54% median, and the EBITDA margin was at 23%.

Now, do you agree that the median company-wide EBITDA and gross margins are not informative of the returns made by an individual product?

A. So I agree that the median company-wide is one data

point in the distribution, so you have to take into account that you will have a broader variation along those lines, both across companies and if you were to do an assessment, at the product level within the companies.

Q. We saw from figure 2 in your sixth report that Flynn itself has products with a wide range of return on sales, did we not?

A. Yes, that is right.

Q. So what we are really dealing with in *Aspen* is 23 companies that have a median gross margin of 54%. We do not know who they are, we do not know what products they sold, we do not know what conditions on the marketplace that they sold under, we do not even know whether the products that they sold included some that were similar to phenytoin, and so, in light of all of that, does that not mean we should place no weight or at least very limited weight on these margin levels as a benchmark for the return on phenytoin?

A. So I disagree with that. Those are mostly generic branded companies that were considered in this case as providing an indicator of margins within the same industry as we are looking at. There is no indication from the Commission that some were excluded because of -- or there is no indication from the Commission that

prices were excessive or under investigation in any of those companies. So what we know is that the European Commission considers that for the generic company it was focusing on at the time those were providing a good indication of the returns you would have in the industry.

So I think, you know, the question really is do we need to base our benchmark when we are trying to see whether a price is excessive just on return on capital or on what you can observe in the industry, and I think this is a very important data point that allows us to assess whether the margins that we observe for Flynn are in any way, you know, out of the ordinary or immoderate by respect to real world comparators.

Now, those comparators may not be perfect, may not share all the characteristics of the product in question. Still, the question is do they provide value in assessing whether the margin that we observe for Flynn are immoderate, as we were discussing in the terms earlier. Is there something really out of the ordinary for this industry?

Now, this may not be exactly the same in all conditions as Flynn. Is it a reason to exclude them and not take them into account? I would disagree with that.

Q. I would like to turn to a topic that you mentioned when

having a discussion with the President in relation to the differentials that you calculated in your position statement, and you were comparing the *Hydrocortisone* case, the *Liothyronine* case and this case.

Can I ask, please, for your position statement to be brought up? It is at {XE6/4/4}, and what you explain in paragraph 9 is the figure I am about to show, and here you explain that it depicts the differentials for each of liothyronine, hydrocortisone and capsules, and you say there is a huge difference between the implied differentials in those cases and in this case.

Can we look at figure 1 over the page, please {XE6/4/5}, thank you, and just maybe enlarge the -- thank you very much.

Now, first of all, do you agree that there is a significant difference between the average cost plus figure for phenytoin, £23.60, and liothyronine £4.90, and indeed hydrocortisone, £3.90?

A. I agree.

Q. You have not shown the breakdown for Pfizer and Flynn, but can I ask to show side by side table 5.6 in the Decision, please, at {XA1/1/188}? What this will show is the actual cost plus figures for Pfizer, and what we can see -- no, hold on. Can I have {XA1/1/188}, please, thank you. Table 5.6.

So if we look on the right-hand side, we can see for Pfizer the cost plus per pack ranges from £3.51 for 50mg to a maximum of £4.92 for 300mg, and then if we just cast our eye back to the left-hand side we can see that actually that range is pretty much within the ballpark of the average cost plus figures that you have calculated for liothyronine and hydrocortisone, are they not?

A. Yes.

Q. If we then just focus on figure 1, please, we can remove the right-hand side {XE6/4/5}, we can see that Flynn's ASP was actually higher than Auden McKenzie's ASP in *Hydrocortisone*, can we not? It is £34.70, hydrocortisone, £34.

A. Yes.

Q. The reason why Flynn's differential -- that is the grey bar that you show here at 47% -- is smaller is simply because its average cost plus figure per unit is much higher?

A. Yes, that is of course its costs that are higher and that is an important market fact they have to take into account.

Q. It is important but it is almost a recurring theme, is it not, of our discussion this afternoon because really what it is showing is that Flynn's percentage excesses

are lower because its input costs are a lot higher; that is right, is it not?

A. I mean, Flynn does have high input costs, I think there is no possible way to contest that.

Q. Indeed, and going back to another point we traversed earlier today, I put it to you that it is important to look not only at the percentage differentials, but we should also look at the absolute differentials, we should take the two together to get a more well rounded analysis of profitability. Here you have looked at percentage differentials; correct?

A. Yes, that is right.

Q. Yes. Can we have a look at the differentials in absolute terms and there should be a sheet in front of you, and it has also been handed up to the Tribunal. For the transcript it is at {XO/19/1}.

It is hopefully a compliment that what we have tried to do is take the numbers and the analysis that you did for the purposes of figure 1 in your position statement and then what we have tried to do is map out what they are in absolute terms -- absolute returns.

Of course, we know that the infringement periods in each of the cases are different. In *Hydrocortisone*, it was around ten years, in *Liothyronine*, it was around eight years, and in this case, it is around four years.

So we cannot simply compare total, absolute excesses, so what we, the CMA, has done is it has calculated the average annual excess in each case, effectively taking the total revenue differential in each infringement and divide it by the number of years. Do you agree that that is what has been done?

A. Mm-hmm.

Q. We can see the results both in the table and we have shown the result for phenytoin as a whole -- as if the single undertaking, but I know Flynn objects to that, so we have also shown Pfizer and Flynn, so we have gone a little bit further than you did in figure 1 but just for the purposes of seeing the results.

Now, as one would expect, there is still a difference between the differentials, but the orders of magnitude that you refer to in your position statement are actually quite different when one looks at absolute amounts, and I would like to raise three points with you about this comparison.

First, if we start with Pfizer, Pfizer's average annual differential is actually higher than Advanz's in *Liothyronine*, do you agree?

A. Based on that figure, I mean, I have a lot of criticism of that figure coming after, but just if you are telling me that is what the figure is saying, yes, I agree.

Q. Yes, if we can proceed on the basis that the calculations are correct, and of course if there is an error, then that will affect this, but on the basis that the calculations are correct.

A. No, I mean -- yes, yes, but -- and also I will come back after on my views on that.

Q. Of course, I will give you an opportunity to do that.

Second, on top of the Pfizer average annual excess we have got Flynn's average annual excess, and the figure there is only 1.6 times less than the average annual excess in *Liothyronine*. If I am right about the maths, that is a lot closer, is it not, than the 20 to 50 times that you have referred to in your position statement?

A. It is closer, the question is whether it is relevant.

Q. Third, if we look at the excess in phenytoin as a whole in absolute terms, we can actually see it is more than in *Liothyronine* and it is actually not that different from *Hydrocortisone*. That is right, is it not?

A. Based on the graph again, but I do not think that is relevant.

Q. Yes, and so what I would suggest is that this is an illustration of why it is really important not to look simply at percentage differentials, as you have sought to provide in figure 1, but also to look at absolute

1 excesses to get a more complete, well-rounded picture of
2 profitability?
3 A. Okay, so it is my turn to comment?
4 Q. It is certainly your turn.
5 A. Okay.
6 Interesting. So first point before we go into the
7 figures, just terminology, you will see I mention --
8 I call this differential and here the CMA calls it
9 excess. I think it does matter, it does matter, because
10 when you call in excess --
11 THE PRESIDENT: Dr De Coninck, I think you can take it from
12 me it does not matter.
13 A. Okay.
14 THE PRESIDENT: We are very well able to deal with the
15 nuances or not so nuanced use of language by the
16 advocates; they are advocates for a reason.
17 A. Okay, perfect, thank you.
18 Then I think my comment on the graph is that it
19 actually is problematic because it does not control for
20 volumes in any way. So you are looking here in this
21 figure, which is the annual excess at a total amount in
22 million pounds, but, you know, there it is not --
23 you know, it is of course relevant to know whether you
24 sell little or more of those to see whether this £25
25 million or whatever it is on the graph is -- would

actually be problematic in terms of excessive pricing.

So I do not think this -- that not controlling for volume in this context tells us anything about excessive pricing. That is the first comment.

Then the second point is we have this distinction between percentage and absolute. I think indeed, you know, that is a key distinction, and my view, I think it is clear, is that Flynn pays the higher input cost, that is the right input cost on which it should be allowed to earn a return.

Now, the point that was made here is that, well, if you look at the excess in absolute, and not in percentage, the numbers are much closer. Well, I think they are still quite different even in absolute level. I mean, I think there is no question that they are completely in a different ballpark in percentage level, but if you look at Lio, you see a cost of £4.9, and the ASP of £101, so you have £96 absolute difference there. If you look at phenytoin on this graph, in absolute terms, you have between £23.6 and £34.9, so you are at around £11, so you are, you know, still, even in absolute terms, ten times higher per unit.

So if you just control for the volume, that is what it does when you look at it per unit, but then even in absolute terms, you are much higher in Lio.

So I really do not think that this graph that mixes -- that does not control for volume, and that is based on absolute return, is informative as to whether price is excessive.

MR BAILEY: I would like to move on, if I may, to discuss with you another aspect of your evidence, and that relates to the question of the tablet comparator.

I would like to begin with how Flynn's ASP compares with the tablet ASPs during period 3. Can we go, please, to table 2 in the CRA position statement at {XE6/4/19}, and we looked at this earlier today. Can we enlarge the table, please?

So this table is showing, just so I have understood it correctly, the average selling price for the whole of period 3?

A. That is right.

Q. And it shows prices for Teva, Wockhardt, Milpharm and Accord and that is for an equivalent pack of 84 tablets, so it is comparable with capsules; correct?

A. That is right.

Q. We see Flynn's ASP at £58.16?

A. Indeed.

Q. And Flynn's ASP is 58% higher than Wockhardt's?

A. Yes.

Q. Flynn's ASP is 118% higher than Milpharm's?

A. Mm-hmm.
Q. I am sorry, is that a yes or a --
A. Yes, yes.
Q. Flynn's ASP was 50% higher than Teva's?
A. Sorry -- sorry.
Q. I apologise, Flynn's ASP is 50% higher than Teva's?
A. Flynn's average ASP is 50% higher than Teva's? Sorry, I was looking at the -- I was not checking the maths. It seemed -- it does not seem to add up.
Q. Yes, it is £58.16 minus £38.88 divided by £38.88. Do you agree it is 50% higher?
A. Yes, roughly.
Q. In her first report, Ms Webster calculated the weighted average of the Teva/Wockhardt/Milpharm ASPs for period 3. That was a figure of £36.02. Does that sound about right to you?
A. Yes.
Q. Yes. That means that Flynn's ASP for 100mg capsules was on average 51% above the weighted average tablet ASP during period 3, was it not?
A. Not taking into account Accord UK, I think, right?
Q. Not taking into -- no, indeed, but on that basis do you agree?
A. On that basis.
Q. On that basis, so you do or you do not?

A. On that basis, yes.
Q. Yes, thank you. So if we look at the tablet ASPs, they do not suggest that Flynn's ASP was fair, do they? I know you have other points to make about percentage and absolute margins, but if we just focus on tablet ASPs, they do not suggest Flynn's price was fair, do they?
A. You know, I think you need more information than just looking at the ASP to take this decision -- to make this conclusion, to take this conclusion. You are clearly above the average by around 50%, you calculate it. Is that in itself conclusive? I do not think I would be confident making that conclusion based only on that information.
Q. Just to clarify, when you say "conclusive", do you mean conclusive that Flynn's price is unfair, or do you mean conclusive that it does not mean that Flynn's price is fair?
A. I think that if you compare a price of £58 for Flynn in capsules to prices that range from £26 to £58.11, if you include Accord UK, around £38.88. If you do not, you can conclude that Flynn's price is not fair.
Q. Yes, you mention Accord UK and you have objected to it being ignored, but there are at least two material differences, are there not, between Accord UK and Flynn?

I mean, in terms of their market position, we know that Accord UK represented about 1% of the tablets market, do we not?

A. I think that is right.

Q. And Flynn supplied between 64% and 90% of all Pfizer-manufactured capsules, did it not?

A. I think so.

Q. Yes, so there is a world of difference between their market position, is there not?

A. Their market positions are different, yes.

Q. We also can see that Accord was exerting no pressure on the Teva/Wockhardt/Milpharm prices because we can see that Accord's ASP -- we can see it from this -- is way up, £58.11, so there is no way that it was competing with or constraining the other tablet suppliers, is there?

A. So I guess that is -- the question of the strength of Accord UK as a constraint on the tablet market was indeed probably that strong, but I think the question that was put to me before was whether one could conclude by just comparing the average selling price of Flynn's capsule with the average selling price of tablet that Flynn's -- on that basis that Flynn's average selling price would be unfair. I do not think that is supported by that data and those average selling prices.

Q. Insofar as Accord was reliant on Wockhardt for product, it would not really have competed or constrained Wockhardt in that respect, would it?
A. So the constraint would have been less strong, of course, in that context. I think just to be clear I think here we take for Accord UK the supply by Milpharm, the period where they are supplied by Milpharm.
Q. I am grateful. Now, in your position statement you contend at paragraphs 50 to 53 at {XE6/4/15}, the tablet market provides a useful comparator in three key respects, and I would like to go through those with you, if I may.
The first is Flynn's use of the drug tariff price for tablets, but actually you explain -- and you confirmed yesterday -- that that is not an economic issue?
A. Yes, that is right.
Q. So I am not going to ask you about that because it does not fall within your expertise. The second is percentage margins, and I am sure you will be pleased to hear that I am going to ask you about that.
Before we get to the margins themselves, do you agree with me the comparison depends upon whether the tablet market exhibited normal and sufficiently

effective competition at some point?

A. Yes, so I think we want -- so we are comparing the market to tablets, and we are focusing here on a period in which I believed it was normal and sufficiently effective competition.

Q. I am grateful. A point that you explain in your position statement is at paragraph 55 at {XE6/4/16} and you rightly say that an important question in this context is the point at which the market became sufficiently competitive to serve as a useful comparator, and so if I may, I would like to sort of respectfully agree with you and then look in context at how the tablet market evolved.

Like with -- were you in court yesterday?

A. Yes.

Q. So like you saw with Dr Majumdar, I would like to sort of start from the beginning, where else, and just briskly go through how the tablet market changed.

So in what the Decision refers to as period 1, so January 2005-September 2009, Teva was the monopolist of tablets, was it not?

A. Yes.

Q. We know, do we not, that the Teva ASP went from around £2.67 in 2005 to around £51.25 in 2007?

A. Yes.

Q. So it is a price rise roughly of about 1,800%, is it not?
A. That is right.
Q. Thank you very much. We know thereafter, of course, that the Teva ASP does come down as was referred to yesterday after the meeting between Teva and the Department of Health in October 2007, and the ASP stabilised at roughly £26 from 2008 to April 2012. That is right, is it not?
A. Yes.
Q. That ASP of £26 is still 870% higher than the Teva ASP in 2005, is it not?
A. Yes.
Q. If we can go to {Day9LH1/146:}. This is Dr Majumdar's evidence yesterday, and if we pick it up at {Day9LH1/146:12-15}:

"Question: And it is therefore right to say that Teva's earlier price increases have not been competed away in this period, have they?

"Answer: Correct ..."

Do you agree with Dr Majumdar?

A. Yes.
Q. I am grateful. So we now move to period 2 and that begins with Wockhardt entering in October 2009.
Can I ask us to go to figure 6.4, please at {XA1/1/325}.

What is explained here -- actually I would like to look at the text above the figure, please, and could we just start actually on the previous page at the bottom, I apologise, it just has some relevant text {XA1/1/324}. So at the bottom, you can see that it explains what happened to Teva and Wockhardt's ASPs. Generally they remained high, stable and very similar, and it says although it fell from:

"... Teva's ASP fell from [£25-odd] in March 2012 to [£21-odd] in August 2012 ([that] may have been a result of a strategy to gain market share before [if we turn the page, please] the MHRA guidance was introduced."{XA/1/325}.

We can then see that Teva's ASP during period 2 was nevertheless £25.94. That is what its ASP was. Then we look at Wockhardt's ASP and we are told it was £25.82.

So what we can see, can we not, is that the CMA is right to describe these prices as high, stable and very similar to one another?

A. So they are certainly relatively stable and as you noted there is a decline of Teva at the end of the period, and the question of whether they are high is of course a comparison -- in comparison to what.

Q. Yes, yes, they are high in comparison to Teva's ASP in 2005 of £2.67.

A. That is right.
Q. Yes. Can we go, please, to {Day9LH1/146:19-20}. Actually pick it up with a question at {Day9LH1/146:16}.
"Question: ... as regards period 2, you do not contend that there was workable competition in this period, do you?"
Then he goes on at line 19:
"Answer: I do not contend that period 2 was a period of workable competition ..."
Do you agree with Dr Majumdar?
A. Yes, I agree.
Q. So your reports focus on period 3, we are not concerned with periods 1 and 2, but an important point that you make in your position statement is that at the beginning, the first six months of period 3, there is, as you describe at paragraph 55 of your position statement, {XE6/4/16}, that:
"... Teva and Wockhardt lowered their prices by 39% and 53%, respectively. This large drop [you say] is a sign of the functional forces of market competition."
It is fair to say, is it not, that the prices within the first six months of Milpharm entering the market are falling from levels that we have both accepted are distorted by a lack of effective competition during periods 1 and 2?

A. So they are falling from a higher level in a period in which there was less competition than in period 3.
Q. Well, less competition; you agreed with me that during period 1 there was a monopoly, during period 2, there was a stable duopoly, so it is actually quite a stark difference, is it not? They are falling from a level where there really was not much competition at all?
A. They are indeed falling very starkly during period 3, yes.
Q. From a level that was brought about --
A. From a high level, and they do so very rapidly, which is quite remarkable indeed. So I said, yes, I said yes, and they do so very rapidly. So they fall from a higher level of a less competitive period, and they do so very rapidly.
Q. A manifestly less competitive period. There is quite a difference between the two.
A. Yes.
Q. Yes, and if we look actually just at Dr Majumdar's evidence again in {Day9LH1/173:}, this is really perhaps more for the Tribunal's benefit but just to see what Dr Majumdar said about the same issue, at {Day9LH1/173:3} he has just been asked about whether on a journey coming from monopoly to duopoly to what Dr Majumdar refers to as a triopoly, which is a new term

to me, but it is handy here, he says:

"Answer: ... I agree that the sharp price falls at the beginning of period 3 were moving us to, if you like, from a duopoly to a triopoly position."

So what this is explaining is that that initial period of period 3 is about eroding what were previously duopolistic prices; do you agree with that?

A. I think it shows the working of competition coming indeed from a higher level where you had two firms. I think that is really remarkable that it -- the speed at which it happened, and that is why -- one of the reasons why I think that this period 3 displays normal and sufficient competition.

Q. We are only talking about the first six months at the moment, so we are only talking about the beginning.

A. Yes, yes.

Q. At paragraph 58 of your position statement you contrast the price falls in *Liothyronine* with the ASPs of tablets stabilising after this initial drop, so the first six months from September 2012 to February 2013, and you show a figure in your statement taken from the remittal statement of objections --

A. That is right.

Q. -- which actually showed movement of ASPs over about a 12-year period. I would like us to focus on period 3,

because that is the one we are concerned with, and so I would like to look at a figure in the CMA's skeleton, please, at {XL/3/25}, and can we enlarge the figure, please?

This is showing period 3. Teva is the blue line. Wockhardt is the yellow line. Milpharm is the grey line. What I would like to do is start our review of this after the initial price drop, so in other words from February 2013, and I would like to start with the entrants.

If we look at Wockhardt's ASP, so that is the yellow line, it went down month on month for all but one of the next eight months of 2013, did it not?

A. Yes.

Q. Wockhardt's ASPs did not stabilise, did they?

A. And so -- what do you mean they did not stabilise? They went down on this to £8.

Q. If it would help, we can look at the underlying data if you wish, but you can just take from me what happened to the Wockhardt ASP. In February 2013 it was £12.08 for a pack of 28 tablets, and in October 2013, it had fallen to £6.66 for a pack of 28 tablets.

A. Yes.

Q. So that is not stable, is it? That is not stabilised; it is almost halved?

A. It is a decrease which I think is a strong sign of competition during that period.
Q. But your point was the ASPs of tablets stabilised at levels reached following their initial drop after the entry of Wockhardt and subsequently Milpharm. My point is we do not observe any stabilisation of Wockhardt's ASP. It is on a journey, the journey is downwards and the journey has not yet been finished, so the Wockhardt ASP is not stabilised, is it?
A. So I think I mentioned a period where it may have sold some of its short shelf life supply before the exit, that is one of the -- after the entry of Milpharm and of course before the exit, but I think overall I think we are not in a situation where we have a continuous decline of the overall price. You have of course a very strong decline at the beginning. Then if you are to make a trend during -- for the prices, you may see a smaller trend in the data. But I think what is -- to me what it says is that you have firms that are competing and if you consider the end of the period --
Q. I am going to come to the end of the period, I promise, I am going to do it in a sort of time series.
A. Yes.
Q. Just to pick up the point you have just made, because it is a point you make in your seventh report at

paragraph 113, the idea that Wockhardt might have been selling off short-dated stock before its exit and you say it might even have happened in 2013, which is obviously what we are looking at now. If Wockhardt had done that, do you agree with me, we would expect the volumes to have gone up significantly? If it had sought to shell off short-dated excess stock in 2013, we would expect the volumes to go up, would we not?

A. There are a lot of factors that can affect how volumes evolved.

Q. If they have too much stock and it is short-dated and they want to sell it to the market, surely the volume they supply goes up?

A. I mean, as I said, you need to look at -- if you look just at the overall amount that they sell, I mean, I think that it may not be sufficient information to conclude on that.

Q. Well, let us look at the information. So if we can go to {XJ/42.1}. Just for the Opus operator this is a spreadsheet, so when you go to it can you click on the link, and I cross my fingers that you will be able to open it. Lovely.

Could we go to the tab "Tablet (100mg) ASPs & Volumes", please. Thank you. I want to focus on volumes, and we have to note that Wockhardt is column M

for volumes and then we need to go down, please, to -- can we keep going down until we get to the period we are looking at which is essentially the beginning of 2013. You have gone too far. You have gone way, way, way too far. Can you go to January 2013? Lovely, right.

So we can see -- actually it is February 2013 to be fair, because you say six months is the initial price drop. So if we have a look there, we can see that on average we can see that Wockhardt was selling in February 2013 about 3,700 packs, and then if you just cast your eye down to see how that changes over the period of 2013, roughly speaking, they hover between a bound -- the figure of -- well, in January 2,800 and the high point is in September which is 5,600, and if you do the calculation to market shares, that is roughly between 12-14% share of volumes on a quarterly basis.

So we do not see, do we, any significant uptick in the volume sold by Wockhardt during 2013?

A. You do not see a significant uptick. I mean, there is variation -- there is variation, you know, that I do not know the explanation for, so you will see in some months that it increases. So I do not have the information to say whether this is consistent or not with selling of -- selling some of the products that arrive towards the end of the shelf life.

Q. Yes, so in other words, we cannot be sure, can we, based upon this, that actually the supposition of them selling short-dated stock in 2013, we just cannot see that from the data?

A. I think either way you cannot make a conclusion based on the volumes that would allow you to make a determination.

Q. I am grateful. Now, I would just like to go back to looking at the trajectory of the ASPs and see if they had stabilised. Can we go back to {XL/3/25}, please, and enlarge the diagram. So we had had a look at Wockhardt, and we could see that it was on a journey downwards, and I would like to suggest that Milpharm's ASPs are on a similar journey downwards and they do not stabilise after the initial six months.

To make good that proposition -- it is the grey line -- the figures -- in February 2013, Milpharm's ASP was £10.24. Nine months -- well, no, less than that -- in September 2013, Milpharm's ASP had fallen to £6.40, and then it bumps up and down reaching a final point in December of £7.28.

So it is clear, is it not, that again, the ASP does not stabilise, it is going down, and in fact it is going down and down and down, and we are just seeing competition playing out, but we know it is a process, we

know it takes time, and so they had not stabilised, had they?

A. So, you know, I think we are in a period where you have three players. They indeed compete. They stabilise at some point during the period. I think the point that I am making is this is a period where you have three suppliers, they are clearly competing, I consider that this is a sufficiently competitive market, so the point that I think you are asking about is: well, what about the transition from the higher price period. I think you have a very significant and strong drop in the first six months, and then after you have a process of competition that leads at some point to more -- to stable prices.

Q. If we could just turn to Teva, just in terms of whether it was subject to this development. It is the blue line, and stubbornly, for the most part, it is always at the top, and what is interesting about Teva's journey is that we can see that it basically goes down, initially at least, from February to July, and I can give you the figures, it goes from £13.16 down to £11.77, but then interestingly in the last quarter it then starts to move back up and finishes at £12.98 in December.

So it is fair to say, is it not, that not only is Teva's ASPs above Wockhardt's and Milpharm's, actually

towards the end of 2013 they go up while its competitors go down?

A. Right, so when I look at this graph I see --

Q. I apologise, do you agree -- just --

A. Sorry, I mean, you have some variation, some months going up, some months going down, you see that for the different suppliers, so I would not read too much into, you know, a short-term variation in price.

Q. Well, it is not just short-term variation, what we actually see is that the Teva ASP is going down between February and July, but we then see that it actually steadily goes back up in the last quarter of 2013, and the point I put to you was Teva's ASPs start to rise at the same time as when its competitors' prices are continuing to fall; that is right, is it not?

A. So you have, as I said, short-term variation and in the particular months that you mentioned you see a rise in Teva's price, that is correct.

Q. Now, as Professor Waterson observed yesterday, it is important and interesting to look also at what was happening to market shares at the same time, so we do not just focus purely on the movement of ASPs.

Now, the figures I am about to give you are taken from {XJ/42.1}, "Tablets (100mg) ASPs & volumes". Teva's market share on average during 2013 was 67%,

Wockhardt's average market share during the same time was 13%, and Milpharm's market share on average was 20% during 2013.

Now, based on what I have just told you, Teva clearly maintained a market share that was more than double the combined share of Wockhardt and Milpharm even though it had the more expensive product. That is right, is it not?

A. I have not checked the numbers, but I take them from you, yes.

Q. I am grateful.

If you take it from me that Milpharm started 2013 with a market share of 20% in the first quarter and finished the year with a market share of 18% in the fourth quarter, that means that Milpharm had the lowest market share even though it had the cheapest product, does it not?

A. Yes.

Q. I would like to move to 2014 now and look at the last seven months of period 3. To set the scene could we look at Decision at paragraph 6.376 at {XA1/1/337}. Could I ask you just to read that paragraph to yourself.

A. 337? 377?

Q. The one that begins "In January 2014", thank you.

A. All right. (Pause)

Q. If we assume, as the President indicated to Dr Majumdar yesterday, that this is true as a matter of fact, it is obviously a matter for the Tribunal whether that is in fact the case, but if we assume that the CMA is right that this is what happened to Wockhardt in 2014, do you agree with me that it ceased to be an effective competitor from January 2014 onwards?

A. So it was still on the market, it was still selling on the market, if I understand correctly what it says here, but its presence was illusory?

Q. Yes, I mean, it was still on the market, but it had just over two months' stock to supply, and it had told customers that it could not supply them and it finally then left the market in July. So my point is --

A. So --

Q. -- given those circumstances.

A. -- given those circumstances, I would consider that it is likely a less effective competitor indeed.

Q. Indeed, if we look at {Day9LH1/117:}, please, at lines {Day9LH1/117:17-23} we can see Mr Holmes KC is asking Dr Majumdar about a statement in his first report, and the statement is:

" ... I acknowledge that Wockhardt's importance declined in 2014 as its volumes tailed off."

And Dr Majumdar acknowledged that. Do you agree

with Dr Majumdar about that?

A. Yes.

Q. Yes. One of the issues on which you and Ms Webster disagree are the supply issues experienced by Wockhardt and Milpharm. Can we just, as a baseline, can we agree that Wockhardt had issues with the stability and dissolution of its tablet pretty much throughout its time on the tablet market; correct?

A. I think so.

Q. I would like to proceed on the basis that that is a factual proposition that is correct. Similarly I would like to proceed on the basis that Milpharm told the CMA its supply chain was hit and miss when it entered the market.

Now, on the basis of those two circumstances, is it not right that those kinds of supply issues would have hindered -- I do not mean prevented but hindered -- their ability to produce and compete for additional sales in the market?

A. So I think here we have two competitors, then if we have, you know, some limitations on them, that could mean that they are indeed less effective competitors, that does not mean that they are not effective competitors.

Q. Agreed. Another issue upon which you and Ms Webster

disagree and indeed you mentioned yesterday in the hot-tub, relates to the guidance on the continuity of supply.

Now, like Mr Holmes did yesterday with Dr Majumdar, can I just clarify that we both understand this guidance in the same way. The guidance in simple terms says doctors and pharmacies should maintain epilepsy patients on a particular manufacturer's product; correct?

A. Correct.

Q. You are not aware of any difference in the way the guidance applies to tablets as opposed to capsules?

A. No.

Q. But what you say in your seventh report, we may as well just bring it up {XE1/12/39} at paragraph 114, is you say that:

"... given the drastic decrease in Tablet prices only one year after the entry of Milpharm, it is not obvious at all that the guidance on continuity of supply had any tangible effect on ... [selling] Tablet stock."

Now, yesterday in the hot-tub you addressed this issue and I would like to show you what you said and then again just to sort of confirm what your position is. So that is {Day9LH1/96:8-13}, please. You helpfully -- you say:

"I think I will just put it in a slightly different

way in the sense that my emphasis is the continuity of supply does not seem to be an absolute restriction and constraint in any way, but of course I am also not saying that it has no effect at all on the case."

So I agree with you it is not an absolute concept, but do you agree with me that the continuity of supply guidance had a material effect in limiting the extent of switching by pharmacies from one manufacturer's product to another?

A. I do not know how material the effect is. What I observe in the data is a very strong decline in prices when you have Milpharm's entry, so that suggests a limitation in how strict a constraint this is. I cannot say how material it is.

Q. Well, let us have a look, and I would like to do this on the basis that the President indicated to Dr Majumdar: we are going to assume what the party told the CMA is correct, and then I just want to discuss the implications of that for your analysis. Can we go to {XH/144/1}, and as you were in court yesterday you may be familiar with this document. This is a note of a call that took place between the CMA and Wockhardt on 17 November 2020, but have you seen this document before?

A. I was here when it was discussed, but I did not have it

on the screen in front of me, so I have not read it.

Q. Understood. If we go, please, over the page {XH/144/2}, there is a little section that appears at the top under the heading "Continuity of supply", and we can see that the Wockhardt national sales manager essentially makes two points.

At paragraph 8 we see that he says:

"Due to the nature of the therapeutic area, patients should not switch from one product to another. So even if [and that is Aurobindo, that is Milpharm] began to challenge Wockhardt's prices and Wockhardt's Tablets were priced higher, patients should stay with the original formulation that they are on."

On the basis that is correct, it implies a limitation on the ability of a new entrant to sell its product, does it not?

A. It is a limitation, yes.

Q. Yes. We can see the same point in paragraph 10 where it says that:

"... big wholesalers are likely to be more 'ethical' and take account of the guidance and therapeutic area of Tablets."

Would you not agree that that suggests a tangible effect hindering the ability of a new entrant to sell to the big wholesalers like AH and Alliance?

A. That would be a limitation.
Q. Yes. So Wockhardt's experience, was it not, that the guidance was a barrier to effective competition in the tablet market?
A. I mean, would I call it a barrier? Again, we are into semantics, but it would somehow limit the switching that would happen.
Q. And therefore limit the ability of Wockhardt to compete?
A. It would provide -- it would -- I mean, I do not know to what extent, but that would be a factor that would limit, yes.
Q. Just for the clarity on the transcript, do you agree with me that the guidance on continuity of supply would be a factor that would limit Wockhardt's ability to compete?
A. That is what I said, yes.
Q. I am very grateful.

The second entrant, Milpharm, made a similar point to the CMA, and we can see that at {XG/462/1}, and this is a note of a call between the CMA and Milpharm on 25 February 2021, and if we could turn to page {XG/462/2}, please, we can see under the heading "Impact of NICE and MHRA guidance". Could I just ask you to read, please, paragraphs 12 and 13? (Pause)

A. Yes.

Q. It is the same point. We can see from Milpharm's perspective that the guidance meant customers were resistant to switching suppliers, were they not?
A. I think that some would be resisting switching, yes.
Q. Yes. One more document, if I may, on this topic, and that is at {XG/367/2}.

Now, this, to be clear, is a document that was sent after period 3, but it is talking about the guidance that was issued during period 3. Please could we enlarge the middle of the page. It is an internal email we can see that is being sent, and we can see from the bottom it is from Milpharm, and we can see that they are talking about, in the second paragraph:

"... some information from the MHRA that you may find useful regarding Phenytoin. It details in very plain language that in order for a patient to remain stable it encourages continuity and not for switching from product brand or manufacturer/s.

"It may shine further light on why Teva hold such a majority market share (you quoted 80% on Friday 300k packs?).

"I can personally add that the newly formed 'Well group' (Co-op) would not switch product to ours purely on a commercial offering as their superintendent [pharmacist] had the final call on all AEDs."

If we could go up, please, to an email that appears in response to this, we can see the response where it is said:

"During the last Commercial meeting the team believed that Teva will continue to dominate and grow given that they are present in all big and small chains and they have an existing patient base and they [also] have a lot of stock in the grey to compete with our prices."

So that shows, does it not, that Teva continued to dominate the market, that was Milpharm's perspective, and one of the reasons why it was hindered from competing was the continuity of supply guidance?

A. Yes, so I understand that is what Milpharm puts here. I would also add that, you know, I have agreed with you that the continuity of supply is one limitation on the ability to compete. I have not made a statement on how material it is, but what I can see in the data is that you did have a strong price reaction from Teva following the entry that is still in my view consistent with effective competition taking into account this constraint.

MR BAILEY: I am grateful.

Sir, you indicated at lunchtime that it would be appropriate, not least mindful of the transcript writer

to have two breaks this afternoon. I can see it is 4.50, and I obviously do sense that not everyone wants to be here forever. I am pleased to say that I have four pages left of my script. There are two topics. I believe they are dear to Dr De Coninck's heart. They are about tablet percentage margins and tablet absolute margins. I am in your hands as to how you would like to proceed. I am very happy, if the transcript writer would like a break to have a break now. It will not take very long for me to finish today, but I realise that that means we would go beyond 5.00 and therefore I am mindful of other people's commitments.

THE PRESIDENT: Sorry, if we do not break, what are the prospects of your finishing at 5.00?

MR BAILEY: Slightly depending on the answers, but reasonably good. I think it might take me about 15 minutes.

I am incredibly grateful.

THE PRESIDENT: We are incredibly grateful. We appreciate we are placing a lot of burden on you so thank you very much.

I think on that basis, proceed, Mr Bailey.

MR BAILEY: I am grateful. So we are going to turn to tablet percentage margins which is a point that you have emphasised, and we have already discussed now whether

the tablets market was workably competitive.

Could we go back, please, and have a look at table 2 in your position statement, and that is at {XE6/4/19}.

The point that you make in relation to the percentage margin is that Wockhardt and Teva's percentages are much higher than Flynn's; correct?

A. The point that I made is that Wockhardt and --

Q. Teva's.

A. -- Teva's and Accord UK, yes.

Q. Yes. So I am going to suggest to you that this is yet another direct consequence of the very high supply price Flynn was paying to Pfizer. I would like to illustrate that by looking at a paragraph in Dr Majumdar's report at paragraph 106. That is at {XE1/4/32}.

I should be clear that the CMA does not accept the accuracy of Dr Majumdar's estimates of its competitive prices, but I would like to use them for illustrative purposes.

Now, what we can see here is that the third bullet sets out Dr Majumdar's highest estimate that he identified for a price consistent with workable competition, and we see that is a price of £12.96 per pack of 28 tablets; do you see that?

A. Mm-hmm.

Q. So what I would like to do is use that and see how that

affects this percentage margin comparison.

If we go back to table 9, please -- table 2, I apologise, so {XE6/4/19}, we can see that Flynn's ASP over period 3 was £58.16.

Now, one of the things we need to do is that Dr Majumdar calculated his highest estimate based on a pack size of 28 tablets, so to compare like with like, we have to work out what would the equivalent 84-pack be. Please take it from me that it would be £38.88.

Then, if we compare that workably competitive price according to Pfizer's expert with Flynn's ASP, we can see that it exceeded Dr Majumdar's highest estimate for a workably competitive price by some £19.28. That is right, is it not?

A. That is right.

Q. Does that mean that you consider Flynn was entitled to charge roughly £19 per pack more than Dr Majumdar said was his highest estimate for a price consistent with workable competition?

A. I think when you have to -- when you look at the average selling price of Flynn's capsule and compare it to tablet, you have to look at what the tablet prices are in that market. You have a range, as we have discussed before, some very low, like Milpharm, some very high, some that are more similar to Flynn, like Accord UK.

So I think that based on that, I cannot conclude that the price that Flynn charges would be out of line with the others, but I think that the price comparison for Flynn is not particularly informative because of the high cost, of course that we keep coming back to.

Q. Indeed, we do. Would you agree as a general proposition that in the presence of inefficient costs, an excessive price will not necessarily lead to excessive margins, will it, as a general proposition?

A. So you keep calling it an inefficient cost, I think, so I mean you have a -- what is the best way to answer to your question? I think here we have a high cost, so the question is whether a high cost necessarily leads to a high margin. Is that your question?

Q. It is just simply that where costs are higher than they ought to be at an efficient level, when you then look at margins, you are not going to see an excessive margin because the high cost is going to essentially mask that, and so that, therefore, causes a potential type 2 error where you might therefore miss the fact that there is an excessive price?

A. I think that is a fundamental disagreement on how to view this case. So here we are in a case where Flynn is facing a high input cost, and it applies a margin on it as it does for the rest of its business. So the

argument that is made here is that: oh, that cost is inefficient, then that leads to too high absolute margin. What I am just saying here is that what Flynn is doing is just what it is doing in normal circumstances, looking at its cost, the cost that it bears, applies a margin to it, and that is where we end up.

Q. So we are in the final furlong and the final topic relates to actually the third key respect in which you say that a tablet market is a useful comparator, and you make that point at paragraph 53 of your position statement, which is at {XE6/4/15}, and indeed actually for good value you make it again at paragraph 68, and the point that you make, as I understand it, is that you compare using the CMA's analysis the ASP of capsules over the relevant period as being approximately 8p per capsule, and you say: whoa, that is way below the ASP of tablets which is 43p per tablet; is that right?

A. Yes.

Q. Yes. To make sure I have understood this correctly, you have taken the average sale price of tablets both across the period of the alleged abuses, that is the relevant period, which was roughly about £12.13, and you also looked at a similar price point during period 3; correct? This is how you reached the calculation?

A. Yes.
Q. It may help, actually, just to have it in front of you to be fair, paragraph 115 of your sixth report which is at {XE1/11/40}, because this is where you are explaining where you got the calculations you make in your position statement. It is a long paragraph, paragraph 115.
Now, what you have then done is you have taken on average tablets were sold at an ASP of roughly £12 a pack, and then you have divided that by the number of tablets in a pack -- 28 -- and that gives you your estimated price of 43p per tablet; correct?
A. Correct.
Q. Yes. Then what you did for the capsule is you calculated a cost plus price for Pfizer using a 10% return on sales and a cost plus price for Flynn using a 10% WACC, and that is how you got to 8p; correct?
A. Yes.
Q. Per capsule. Now, in arriving at your 8p per capsule, you used the CMA's cost plus calculation, did you not?
A. Yes.
Q. Yes. But you did not use that measure of cost to decide whether Flynn's ASP -- the CMA did not use that measure of cost to decide whether Flynn's ASPs were excessive, did it?
I apologise, can I take the two questions back and

start again, please?

A. Okay.

Q. In arriving at your 8p per capsule, you used the CMA's cost plus calculation for Pfizer; that is right, is it not?

A. That is right.

Q. Yes. So you are therefore looking at Pfizer's supply costs plus 10% ROS?

A. Yes.

Q. Yes. But we agreed earlier the CMA did not do that, did it? The CMA used the actual costs that Flynn actually incurred in calculating cost plus, so just in terms of did the CMA do that?

A. I think it is an implication of the -- so it is not that the CMA directly did that, but the reason I do that here is because it is an implication that if you are to not take into account the real input price that Flynn is facing, that would be the implication.

Q. But your view is that we should take into account the real --

A. Absolutely.

Q. Right, so let us do that. If we redo the robustness check, as you described it, working in the real world where Flynn is paying the supply prices that it actually paid to Pfizer, what we can -- and you will have to take

the maths from me. The direct costs in that situation would be £38.12, that is set out in table 5.9 which is at {XA1/1/194}; the allocation of common costs, £1.05, set out in table 5.10 at {XA1/1/196}; the CMA's reasonable rate of return, that is based on a 10% WACC, is 68 pence, table 5.12 at {XA1/1/209}. What that does is it calculates a cost plus per pack of 84 capsules at £39.84.

If we divide that by 84, we get a cost plus per capsule of 47 pence, and so my final question is the price per tablet of 43 pence which you calculated does not suggest that Flynn's ASPs were fair when the cost plus per capsule, using Flynn's actual costs, is 47 pence. That is right, is it not?

A. So that is a process in this question. So you are saying that -- you are asking if the 47p is not fair?

Q. I have done exactly the same calculations as you except that I used Flynn's actual costs, which, as you set out in paragraph 31 of your position statement, is what should be done.

So I have taken your approach to it and then run the calculation and produced a cost plus per capsule figure of 47 pence, and so my simple point is, when you compare that cost plus price per capsule of 47 pence, it is above the price per tablet that you calculated of 43

pence, and so one cannot say that therefore that renders Flynn's price per capsule fair, can one?

A. That the cost plus at 47 is higher than the 43, you are saying?

Q. Indeed.

A. Yes, so what are you asking about this?

Q. Your comparison is to say, well, look, if you run cost plus for Pfizer and cost plus for Flynn, one ends up with a derisory amount, which Flynn has then relied on in its argument, of 8 pence per capsule. I am taking issue with that simply on the basis that, if you did what the CMA did, which is to use Flynn's actual costs, which you yourself, Dr De Coninck, also say should be done, you get a much higher cost plus per capsule of 47 pence.

So actually, just in terms of whether it is derisory or not, it is actually higher than the price per tablet. That is my simple point.

A. Okay, yes.

Q. So we cannot really take anything away from the 8 pence figure that you calculated, can we?

A. No, that -- I disagree with that.

MR BAILEY: That concludes, shortly after 5.00, my questions for Dr De Coninck, and I am very grateful to the Tribunal and the transcript writer.

THE PRESIDENT: Thank you very much, Mr Bailey. We have no further questions.

Ms Stratford, is there any re-examination?

MS STRATFORD: No, sir, I think not least Dr De Coninck probably will be relieved to hear. I think he has been in the box for quite long enough.

THE PRESIDENT: Thank you. Thank you very much, Dr De Coninck. You are released from the witness box and with our thanks.

We have Ms Webster tomorrow. She is in the box all day.

MS STRATFORD: Subject to the usual vagaries. I think more than a day was originally allowed in the timetable for Ms Webster. Mr Brealey will be cross-examining her first. I will be following in his tail wind.

THE PRESIDENT: I am concerned simply because this will be the first witness who will be in the box all day and I do think that is something which we need to factor in. We will obviously see what she says, but I will invite counsel to bear in mind just how we are going, because this is dense stuff.

10.00 start. We are debating whether we should start earlier, but that does not seem, given what we have said about time --

MR HOLMES: Sir, if I might make a submission on behalf of

Ms Webster, I think an earlier start would place an oppressive burden on the witness.

THE PRESIDENT: I am not going to suggest it.

MR HOLMES: I am grateful.

THE PRESIDENT: Thank you.

MS STRATFORD: I was not going to suggest an earlier start.

MR BREALEY: I am content with a 10.30 start, but I am in the Tribunal's hands. I mean, 10.30 to 5.00, it is a long day.

THE PRESIDENT: It is a long day. Well, Mr Brealey, we will have a 10.00 start, but if you can finish sooner than that, then I am sure we will all -- the witness and the shorthand writer -- be very grateful if that can be done, but at the end of the day we want everyone to have an appropriate amount of time with the witness as they need, and I know you will have that in mind most fundamentally.

MS STRATFORD: I will need a bit of time with Ms Webster --

THE PRESIDENT: Of course.

MS STRATFORD: -- and I am sure she would want to be finished by the end of tomorrow, so that is the other thing we are thinking about.

THE PRESIDENT: That is right, but if either she says or we think that she is not doing herself credit in the way that she would if she was alert, then we will bounce

whatever remains of the cross-examination into next week.

MR BREALEY: We have Monday morning, yes.

THE PRESIDENT: Indeed, thank you.

One other thing just by way of information. I am speaking at an event tonight on pharmaceutical products and competition law. I suspect there will be some attendances from at least firms related to those before us. I will obviously make sure that I confine myself to avoiding any discussion about this case, and I am not talking on a subject about this case, but you ought to know that that is what I am doing, but that is for information only.

MS STRATFORD: Thank you for letting us know.

THE PRESIDENT: No, thank you, Ms Stratford. I am very grateful to you all. Thank you again for sitting for so long. We will resume at 10.00 tomorrow morning. Thank you very much.

(5.07 pm)

(The hearing adjourned until 10.00 am on Wednesday, 22 November 2023)