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

Wednesday, 15 November 2023

(10.00 am)

Housekeeping

THE PRESIDENT: Ms Stratford, good morning.

MS STRATFORD: Good morning, sir. Good morning to the Tribunal.

One short bit of housekeeping, if I could, first, on behalf of Flynn.

THE PRESIDENT: Of course.

MS STRATFORD: I just want to hand up a one-pager that has gone into the Opus XO bundle.

THE PRESIDENT: Is it that?

MS STRATFORD: Yes, I am very grateful. How efficient of somebody. It should be at {XO/11} and it is a document that I may use in the course of cross-examination of Mr Harman, and so out of courtesy we wanted to ensure that the parties and the Tribunal have it available to them before this block of economic/accounting/industry expert evidence begins, so I was not going to seek to explain or go into it now.

THE PRESIDENT: No, thank you.

MS STRATFORD: But you may want to have it available, as I say, before the whole block begins.

THE PRESIDENT: That is very helpful, Ms Stratford. We have marked -- so {XO/11} is the reference?

MS STRATFORD: {XO/11}, thank you.

So, sir, then it has been agreed between counsel it would be most helpful for the Tribunal if I call Mr Williams first, who as you know, is the industry expert.

THE PRESIDENT: Yes.

MS STRATFORD: We thought that would be a good place to start.

THE PRESIDENT: We are very happy to begin there, thank you.

MR HOLMES: May I just check, this was not discussed with the CMA's counsel team.

MS STRATFORD: Oh, I am sorry.

MR HOLMES: Not at all. Can I just check, does this change the order in which you will be calling the witnesses as well, or is this only for the purposes of the --

MS STRATFORD: Well, they are our witnesses.

MR HOLMES: Yes.

MS STRATFORD: The fact that we are calling Mr Williams first --

MR HOLMES: But for the purposes of cross-examination, can I just confirm whether -- because obviously we had been preparing on the basis of the timetable.

MS STRATFORD: Yes. This began to be discussed when we were perhaps optimistically thinking that we might be beginning the teach-in yesterday, and Mr Williams was

here and there were availability difficulties for Dr Majumdar. I think we are in the Tribunal's hands, frankly, as to what would be most helpful, but we do see a certain logic in Mr Williams who gives general industry expertise that none of the other witness experts, with the greatest of respect -- it is just not their field, and in its nature it may be more introductory.

THE PRESIDENT: I understand. If it is a choice between discommoding the CMA's preparations and a convenient rational order, I would rather the CMA had their preparations not disrupted.

MR HOLMES: I am grateful, sir. We have absolutely no objection, I should say, to the order in which these teach-ins are done.

THE PRESIDENT: The teach-in does not matter?

MR HOLMES: Yes, but when it comes to cross-examination I think it may have implications for counsel availability and for that reason I think we would like to discuss amongst ourselves, if we may.

THE PRESIDENT: Do discuss, but Ms Stratford, if you can accommodate the CMA in that regard --

MS STRATFORD: Absolutely.

THE PRESIDENT: -- that would be, I think, appreciated.

MS STRATFORD: Absolutely. It is no skin off our nose, if

I may put it like that.

THE PRESIDENT: No, indeed. It is just that one can see that the allocation of workstreams within the CMA team is perhaps more than usually intricate, and --

MS STRATFORD: I appreciate that.

THE PRESIDENT: -- we need to ensure that that is respected so far as possible. If you have availability problems of witnesses, then that is a different matter, and we will have to work out how we navigate that, but if it is just marginal preference in terms of order, then I would rather we accommodated the other conveniences.

MS STRATFORD: Absolutely.

So then could I call Mr Richard Williams.

THE PRESIDENT: Thank you very much.

MR RICHARD FRANCIS HOWARD WILLIAMS (affirmed)

THE PRESIDENT: Mr Williams, do sit down, make yourself comfortable, there should be some water there, and you are in a slightly unusual situation in that teach-ins are not the normal way of dealing with matters, but we are very keen to hear from you. How your teach-in unspools is a matter for you and your counsel. We will listen with great interest.

Just so that you know, we will only swear you once, we will not swear you again, so you will remain under oath, but we will discuss the extent to which you should

speak to your legal team or can speak to your legal team in the course of your giving evidence just so that we are all clear, and just so that the parties know the position of the Tribunal, we consider that the purdah rule really should not apply during the course of teach-ins, nor indeed, particularly hot-tubbing unless anyone has very strong objection to the rule being suspended. I think we should proceed on the basis that you can talk to your experts either during teach-ins or during hot-tubbing, but not during proper cross-examination formally.

If we establish that as a ground rule, and I am seeing no objections, we will proceed in that way.

MS STRATFORD: I am very grateful, and that may be of particular practical assistance because there is some risk, as you may recall from correspondence, that the hot-tub may go over a weekend.

THE PRESIDENT: Exactly.

MS STRATFORD: I am very grateful.

THE PRESIDENT: Thank you.

Teach-in by MR WILLIAMS

MS STRATFORD: Thank you.

So Mr Williams, good morning. I am just going to ask you a couple of questions about your reports and the other papers that you have prepared during the course of

these proceedings.

Now, you have provided a total of seven expert reports.

A. That is true, yes.

Q. It is a sign of quite how long these proceedings have been going on, plus a joint report with Mr Harman and you have prepared your recent position paper.

A. That is correct.

Q. So just possibly for the Tribunal's assistance, your first four reports were prepared for the original appeal, and reports 5 to 7 for this remittal appeal?

A. Yes, and the joint statement was prepared for the original appeal as well.

Q. That is right. I am grateful.

I am just going to, sir, with your permission, the way I was proposing to do this, so it does not become unduly cumbersome, is to read out the Opus references for each of those reports and the joint statement and the position paper and then I will ask Mr Williams to confirm in the normal way.

THE PRESIDENT: Yes. I mean, if anyone has an objection to doing this, I, for my part, would be happy for this to be done in a pretty staccato way, in other words, I do not think we need take the witness to the start and end page of each document so that he can say what we all

know he is going to say, namely that these are his statements.

So for my part, if Mr Williams knows what you mean by reports 1 through 4 and reports 5 through 7 and the joint report and he is willing to say that those constitute his expert opinion then I am very happy to take it as that, unless I am -- no, I see shaking of heads.

So Ms Stratford, you may have done enough already.

MS STRATFORD: I am very grateful. All I was going to do, partly for Mr Williams, but partly, frankly, for the Tribunal, I was going to just read the Opus references into the transcript --

THE PRESIDENT: No, that makes good sense.

MS STRATFORD: -- at this point.

THE PRESIDENT: Yes.

MS STRATFORD: So the references for your report in the electronic bundles that I believe you are familiar with are -- all of these first references, I should say, are going to be in one bundle. Mr Williams is in the privileged position of having his own special bundle -- {XE2/1/1}; second report {XE2/2/1}, signature on page {XE2/2/19}; third report {XE2/3/1}, signature on page {XE2/3/26}; fourth report {XE2/4/1}, signature on page {XE2/4/11}; then moving on to the remittal appeal

reports they are at {XE2/5/1}, signature on page {XE2/5/24}; {XE2/6/1} signature on page {XE2/6/35}, and {XE2/7/1} with the signature on page {XE2/7/21}.

The only other thing I should say about all of those reports without going to it, there is one correction letter from the first appeal hearing or appeal process, which is at {XJ/1.1}, but it really is minor corrections.

The joint report with Mr Harman which was on cost allocation, so to some extent is history, to some extent, is at {XE5/1/1} which again is a rather special bundle because it contains nothing else. Finally the position paper, Mr Williams' position paper is at {XE6/5/1}.

So, Mr Williams, thank you for your patience and for understanding this rather labyrinthine lawyer-led process, but can you please confirm that the opinions expressed in these seven reports and in your part of the joint report with Mr Harman and your position paper represent your true and complete professional opinions on the matters to which they relate?

A. Yes, I am happy to confirm that.

Q. I am grateful, thank you very much.

Mr Williams, I believe you have prepared a teach-in presentation for the Tribunal.

A. I have.
Q. So I am going to hand over to you at this point, I am not going to ask you questions or bowl you easy underarms as Mr Johnston put it. Over to you.
A. That is fine.
Q. And the Tribunal.
A. Good morning, gentlemen.
Q. Oh, yes, I am so sorry, Mr Williams, just in case it helps the Tribunal, the Opus reference -- oh, it is up, I am grateful --
THE PRESIDENT: Ah yes, we have a --
Q. -- for the slides, but that is at {XE7/2}. These are Mr Williams' slides which he has prepared for his teach-in.
THE PRESIDENT: That is very helpful.
MS STRATFORD: I am very grateful.
A. Thank you, well good morning again, gentlemen.
I am in the unusual position of not being an economist. The President mentioned that we had wall-to-wall economists, and I am hoping in the teach-in to give my insight into the real world workings of the pharmaceutical industry, pricing, etc.
So if we could move to the next slide, please {XE7/2/2}. I am not an expert in competition economics, many others in this room are, I am not, but I do

consider myself, having worked within the pharmaceutical industry in the UK for, I hesitate to say it, more than 40 years now, an expert on the industry more generally, profit and price control mechanisms that the Department of Health and Social Care, who are, of course, in this country the monopsonist purchaser to all intents and purposes of prescription pharmaceuticals, I have an in-depth knowledge of the PPRS, its successor, and indeed the statutory and non-statutory interventions open to the Department were they to be unhappy with the price of any drugs.

I am also experienced in the returns made by industry, how they are measured, the relevance of return on capital and return on sales, how companies go about setting launch prices of new medicines, which I think is relevant to understand, what comparators are routinely used by the industry and by the Department, and, indeed, how the drug tariff works.

So all of my evidence I have approached from my real world experience, and that, I think, is one of the fundamental differences between the experts in this case, is that I have not based my evidence on economic theory, not least because I have no expertise in that, but I have based it on all the real world experience I have had over the course of my career. I am

a chartered accountant by background, so I obviously come from a finance background.

Can we have the next slide, please {XE7/2/3}.

So what I have tried to do this morning, clearly in my seven reports, I have covered a wealth of matters, but for this teach-in, not least because time is always against us, I have tried to consider three matters, which I consider to be key to understand.

The first of those is whether the returns earned by Flynn on capsules during the relevant period were typical from what I would have expected in the industry. If they were not, if they are unduly excessive, that would indeed indicate some cause for concern. So I have compared them against what I would have expected a company marketing a molecule of this type to make. So I have obviously looked at industry comparators and we will come on in the presentation to cover those.

The second thing I have addressed in this teach-in is whether the approach that Flynn took for pricing capsules at the date of launch was what I would have expected: did they do something in the norm or outside the norm, and so I will cover that in this presentation.

Finally, I have addressed the issue of the PPRS. It has raised its head throughout this hearing, through the evidence and in the previous one, the Pharmaceutical

Price Regulation Scheme, and what I have tried to answer is the question: does it tell us anything about pricing, profits, on branded and branded generic medicines that might be helpful? Is it in some probative way assisting us in reaching our conclusions.

Next slide, please {XE7/2/4}.

So where do I want to start? I want to start on how do pharmaceutical companies set the price of a generic medicine, and let us remember of course that a generic medicine is, by definition, essentially similar to something that already exists, typically an originator brand, but it may of course be a generic copy of a branded generic. So it is not new, it is not a new innovator medicine, and so when a company sets medicine pricing, and indeed, I was doing one of these applications in the course of the last fortnight, what does it look at? The first thing it looks at is what does the market tell me, what are the comparators, because that is a source of insight.

The drug tariff, which of course is the monthly publication published by the NHS business services unit, it publishes this report that basically goes through the reimbursement price to pharmacy of all the drugs that are available pretty well in the UK.

Now, the drug tariff price, as I think the Tribunal

will understand, is the amount that a pharmacy receives in reimbursement from Newcastle, which is where prescriptions go to be financed and refunded to pharmacies, prior to the clawback, so it is the gross price the pharmacist receives, and, therefore, if I am coming into the market with a new generic medicine, clearly that would set a ceiling on the price I could charge.

Now, I think that is important to recognise that that ceiling issue is somewhat different to what I read in the *Hydrocortisone* case where effectively that product was the drug tariff, and, therefore, as it moved up, the drug tariff moved up, but if there is a situation where there are already existing generics on the market, there will be a drug tariff, and that you, as a new supplier, will not affect that certainly in the short term, so you will have guidance from the drug tariff, but equally you will be aware that there are other people to feed in the chain, and they include the pharmacy and the wholesaler. So there is unlikely to be the situation that you would price at drug tariff. You are likely to price, if you certainly have priced above it, it is unlikely you will get sales at all absent medicine shortages or some unusual circumstance, but you will price below to allow for those additional actors in

the supply chain to receive their income.

The other thing, of course, that the pharmaceutical company will have an eye to is: well, given I know what my likely price benchmark is, can I make money at this supply price? Am I going to achieve the margins that I would expect to achieve on the ASPs that be likely to be available to me and it may be on some projects you basically conclude that the price you are able to anticipate as an ASP is not sufficient to be worth the candle of the investment.

THE PRESIDENT: You would be considering that before you ever embark upon the process of manufacturing the generic?

A. Indeed, sir, and probably before the process of then also applying for the marketing authorisation, doing all the studies, etc. There are some products where really there is just not sufficient margin to make that investment worthwhile.

Could we have the next slide, please {XE7/2/5}.

Now, equally, how don't pharmaceutical companies price a generic medicine? Now, I have been involved in pharmaceutical pricing for over 40 years, and I have never seen anyone reach for an economic theory textbook, it is just not something that is done, and I have equally never seen any of my clients refer to returns on

capital employed, indeed, without feeling in any way being disrespectful to them, I suspect most of my industry clients would not have a clue about what the returns on capital employed on a particular product would be, but equally I would be very surprised if they did not know exactly what the gross margins were, with a degree of certainty, because that is the way pharmaceutical companies focus and they run: they look at the margins that they are achieving.

THE PRESIDENT: Just to be clear, the margin is the difference between the aggregate revenue generated or expected to be generated through the sale of a product and the aggregate cost?

A. Yes, margin can be drawn at various levels in the income statement. At the most simple level, it will be gross margin which will be your aggregate revenues, as you say, less the purchase price potentially from your CMO. You can also look at margin a bit lower down after direct costs that are directly attributable to the selling, marketing, administration of that product, and you can indeed go down to return to operating profit which accounts for all the profits of the business.

MR DORAN: I can see why they would use gross margin; why would they not use the return on capital measure?

A. Well, as a matter of fact they do not. Firstly, I do

not think most people would know what capital was employed in the product.

MR DORAN: Right.

A. If you are what I have described in my evidence as a sales, marketing, distribution company, you are probably very asset light. You probably have next to no capital apart from working capital. Now, you might have -- it might be argued by the economist you might have sort of off-balance sheet capital: human capital, know-how, experience, goodwill, but certainly when pharmaceutical executives are pricing, they have no regard to that. They have regard to what gross margin they are going to make for one and whether it is, therefore, worth -- and of course, likely sales. I mean, you can make a wonderful gross margin, but if you are only going to get a 1% market share, again, it may not be worth the candle for the investment in getting the marketing authorisation and setting up your contract manufacturing organisation.

MR DORAN: So it is a margin and volume game?

A. Yes, it is, it is.

MR DORAN: Thank you.

A. The other thing, because it has been mentioned by other experts: I have never seen a company use an absolute margin, saying that, you know: if we buy -- if our cost

of production is 10 we will sell at 11; if our cost of production is 100 we will sell at 101. That is something I have never seen in practice in 40 years of doing this sort of work and consulting.

THE PRESIDENT: So by absolute margin you would, translating it into the terms of the CMA, you would say that is cost plus, in other words, where you are trying to get a defined band of profitability, the absolute margin over cost, would that be an appropriate translation, or have I --

A. I think you can probably put, sir, cost plus as either plus a percentage or plus a pound sterling figure.

THE PRESIDENT: Yes, indeed.

A. What I am referring to is a pound sterling figure.

THE PRESIDENT: I see, not a percentage, I am grateful.

A. Not a percentage, sir.

Could we have the next slide --

THE PRESIDENT: So you would use, to differentiate, absolute margin versus percentage margin as the two ways of doing it?

A. I would, sir.

THE PRESIDENT: And neither are used, would you say, or --

A. I would say gross margins are used.

THE PRESIDENT: Yes, but absolute margin and percentage margin not?

A. Well, I suppose, sir, that gross margin in a sense could, as a percentage, if you are defining it as that, could be the same as --

THE PRESIDENT: I see.

A. It is an absolute percentage, but it would obviously be a variable pound sterling figure depending on your input costs, your selling prices, etc.

PROFESSOR WATERSON: We would consider that alongside the volume, so in other words, you would consider -- if you think of the gross margin as a gap, then you would take that along with the likely sales?

A. Yes, Professor Waterson, you would, because I think that would be part of your thought process about whether to embark on the project, because if you are likely to, you think, get a good market share of a good market, that would obviously underwrite the costs of your development of the whole programme.

{XE7/2/6}. We have talked a little bit about how companies approach it. Now I just want to address how the Department of Health approach the pricing of a generic medicine.

THE PRESIDENT: Well, if you are moving on, can I ask you this: how far does an incoming generic supplier decide to contest the market to a limited extent? In other words, most pharmaceutical products, the market is

limited in terms of volume because you have only got so many people who have a medical need.

A. Yes, that is correct.

THE PRESIDENT: So let us say you have a market which is occupied by an incumbent that is the only producer, so they are, by definition, supplying 100,000 units to the market. If you are a competing generic, might you take the view that you would only contest 50% or less of the market with a view to maintaining price and so margin, or would you typically go in and contest the whole market, or is there no general rule?

A. No, I would suggest, sir, that your first scenario is more likely to be the case, in other words, you would not expect to be getting 100% of the market as the first generic entry, you would be looking for a percentage of the market. In fact, I was looking, as I mentioned a few minutes ago, at one this week, I think our model that was developed by the pharmaceutical company was looking at getting maybe a 15% market share, because what companies do not want to do is a race to the bottom.

Did that, sir, answer your --

THE PRESIDENT: It does. So the one sure way of getting a race to the bottom is to seek to contest 100% and to price accordingly, because if you price very

aggressively with a view to getting the whole market, the incumbent will have to respond and you get your race to the bottom?

A. Yes, sir.

PROFESSOR WATERSON: But you would nevertheless price at some discount, would you, in order to incentivise pharmacies to start taking your product?

A. Yes, most definitely, sir, otherwise you would be unlikely to replace the incumbent. It is just a question of what that discount would be. Typically for the first entrant into a generic market it might be 10% to 15% to try to secure some of the market, and that may progressively increase as more people enter the market. So I think we can go to the next slide, please {XE7/2/6}.

So coming on to how the Department of Health set the price of a generic medicine, this could have been a very short slide because in short, they do not. The assumption by the Department of Health on generics is that the market will ensure that there is fair prices paid by the NHS, but of course, the Department do have rights of intervention, both statutory and non-statutory, to intervene if they believe the price of the generic medicine is too high.

Now, to my knowledge, they have done that

infrequently, but they do have to agree prices, in contrast, for brands and branded generics. So if you have a brand name, even if you are a branded generic, you have to get specific approval from the Department of Health, their pricing committee, for your NHS list price.

THE PRESIDENT: Just pausing there, that does not appear to be the case here.

A. Correct, sir, because this was a generic.

THE PRESIDENT: Well, we have heard -- I do not know if you were in court for it, but we have certainly heard the use of the term "branded generic" in the case of phenytoin, and there was some form of branding of Pfizer phenytoin which -- one of the purposes of which -- there may have been others, but one of the purposes of which was to ensure continuity of supply so that those prescribing and dispensing it could ensure that you stuck to a single manufactured outcome, and one of the ways of doing that was to have Flynn branded on the product, but it has been the consistent evidence of those before us that there was no price control in that regard, so it may be that we need to be quite careful about how we define "branded generic" because it was a question that occurred to me: at what point do you leave the branding regime, and do you leave the branding

regime if you are saying you are generic but nevertheless branding it.

A. It is a very fair question, and I think anyone in your position would raise this question. The definition in the legislation of a brand for purposes of price control by the Department of Health is a product that does not contain within its title an invented name, and indeed, I was involved in some dialogue with the Department at the time this legislation was being drafted, and I asked them the very specific question of whether a company name was an invented name, and their very clear advice, and the position they have stuck to ever since, is that the addition of a company's name within the generic name -- so "Atorvastatin Mylan" is still treated for purposes of price and profit regulation as a generic.

THE PRESIDENT: I see.

A. Although from the MHRA's perspective it does give something that the MHRA call a unique identifier, so that you can write on a prescription the manufacturer's name and that product has to be dispensed. So it is in a slightly grey area: it is technically and legally a generic even though it has something within the title that you may have called a brand, it is actually just a unique identifier, and that is why, in all these hearings, people are correct in saying there was no

direct price control over capsules because they were a generic as defined in the legislation.

THE PRESIDENT: Well, that is very interesting, Mr Williams. Just as a general request to the parties, I think we have raised the question of what exactly is the legal definition of generic versus branded. We have had some extra flesh on the bones, and I am not expecting Mr Williams to add to that, but if you could take a note and see how far that very helpful description is contentious or uncontentious, I think that would assist us.

MR O'DONOGHUE: Sir, if I may, there is also, in our submission, a second approach, which is of course the MHRA actually approved the capsule as formulated in this case, so what was done in practice and what was in practice approved and why we would suggest is an important second adjunct to the underlying enquiry.

THE PRESIDENT: Well, what you mean is what was done was to a certain extent approved?

MR O'DONOGHUE: It was approved. The Epanutin name on the capsule was approved and we say required. So we would suggest that that second component is practically important.

THE PRESIDENT: We are very happy to expand our range of enquiry, but it does seem to us to be quite important in

terms of understanding how --

MR O'DONOGHUE: Yes.

THE PRESIDENT: -- the system was intended to operate, because what we are ending up with is a non-generic generic.

MR O'DONOGHUE: Yes.

THE PRESIDENT: It is quite an odd thing to have, where --

MR O'DONOGHUE: (inaudible) generic.

THE PRESIDENT: -- where the point is that you are expecting competition between generics, which means that they are almost, by definition, substitutable --

MR O'DONOGHUE: Yes.

THE PRESIDENT: -- and that is not this case.

MR O'DONOGHUE: Yes.

THE PRESIDENT: Thank you.

A. So what I suggest is that the approach taken by the Department on branded generics can be informative to how they might approach or how one might approach assessing the price of a generic generic, because the government, the Department, do have to approve the price of branded generics, and from a pharmacological point of view a branded generic and a generic generic are identical.

Now, the default approach adopted by the Department is to use a comparator. If you can go along with your new branded generic and say: we would like to price

at £10 a pack, the originator approved list price is £15, you will get approval on that pretty well by return email, or you could go along and say: the originator is 15, there is a branded generic in the market at 12, and we are proposing to price at 10. Again, you will get approval pretty well by return.

So if the Department can find a good comparator, and that would mean the same strength, the same indications for the medicine on its summary of product characteristics, etc, it will use a comparator, but if there is no comparator -- and that is in the situation, for instance, if you are launching a liquid, but there is already a tablet, or a depo injection and there is already a liquid, so in other words, there is no direct comparator, what the Department of Health will do under the rules of the PPRS, or now the VPAS for branded generics, is it will adopt an ROS approach and companies will be asked to submit forecasts for five-years going forward of the product sales, the costs, and the price will be assessed in the context of an allowable return on sales under the VPAS or the PPRS which was in force at the time of the relevant period, and, as I have said in my evidence, and I have explained why, the return on the PPRS in reality is not 6% but is closer to 19% as a minimum, and that is something I spoke to at some

length in the first appeals tribunal, Professor Waterson may well remember that.

I think another important thing to think about is in the whole context of the PPRS, and in the context of pricing, it is a one size fits all. The Department of Health have no regard to market size, what percentage of the market you are looking at, whether the product has a risk profile of high or medium or low, or your input costs. It is a simple mathematical exercise that takes no regard of any of those and it is the same regardless of the characteristics of those market size product risks and input costs.

Could we have the next slide, please {XE7/2/7} --

PROFESSOR WATERSON: Just can I ask just before this, when you are talking about what the Department of Health does, etc, are you talking about then or now or is there no material difference?

A. There is no material difference, sir.

Could we have the next slide again, please. {XE7/2/7}. Whilst this was not something that was covered in any of my seven reports, I have been asked to address in response to, I think, questions that the Tribunal put that may be covered in the hot-tub as well, to say a few words about the Pfizer-Flynn supply relationship.

It was sort of an exclusive up-down relationship, if I put it in those slightly simplistic terms, and I think the first thing it is very important to understand is that when a company has a marketing authorisation, that marketing authorisation contains within it a specification of both the source of the active pharmaceutical ingredient, the API, and also the manufacturing site. So you cannot change your manufacturing sites at a whim, a bit like you might your electricity supplier: it is an expensive process and I believe Dr Fakes in his evidence mentioned that in the course of him looking for a new manufacturing site for capsules, it was in the order of a budget of £2-4 million.

So some companies do have two sites mentioned within their marketing authorisation, but for niche pharmaceuticals in my experience it is almost invariably the case that it is single source because it is too expensive to add supplies from two sources.

The other thing to say is that a lot of the speciality pharmaceutical companies, which, as you will see later, are the companies that I have selected as my comparators, they acquire their marketing authorisations by purchasing them from larger pharmaceutical companies, effectively they buy what the big pharma calls tail-end

brands, and I have never seen one of those being purchased from a big pharma company that does not come within a manufacturing arrangement. It might be that you are taking over the manufacturing arrangements that big pharma was using already with a third party, or it might be that the pharmaceutical company was manufacturing itself in which case it will agree to continue to supply certainly for a period of time the purchaser of the MA.

So in practice, the MA holder in those circumstances is pretty well bound to the existing manufacturer because it costs time and money to move to a new manufacturer, get the site approved and get the MA varied, and equally, it is quite often the case that the manufacturer is bound to the new MA holder as well because he may well be using the manufacturer intellectual property that the buyer of the MA effectively owns.

Now, the supply price under this type of what I called acquired MA scenario will be a function of a couple of things. It certainly will have regard to whether there were any upfront milestones -- upfront payments or milestones paid when the licence was acquired, and my understanding that the capsules had a sort of nominal £1 acquisition cost, and it will

equally have regard to the supply price, and typically the bigger the upfronts and milestones, the lower the supply price and vice versa, as you would expect.

The negotiation between the MA holder, the new MA holder and the seller, effectively, will of course have regard to the target margins that the seller believes they can make on supply of this product as the new MA holder.

So in short, nothing strikes me as unusual in the exclusive upstream/downstream arrangements between Pfizer and Flynn. They are what I have seen many times before.

Next slide, please {XE7/2/8}.

I want to come on to talking a little bit about tablets. It was obviously covered fairly extensively and I was in court for Mr Brealey's opening which did cover some of this ground, but I want to give my perspective on why I think tablets are a useful comparator.

So we have tablets, an established product in the market at the time capsules were launched and I think it is agreed by all that from a regulatory and therapeutic perspective, the 100mg capsule and the 100mg tablet are identical, and, therefore, I believe any informed market participant would have looked at the tablet price as an

obvious comparator.

Now, the CMA and its expert disagree, and they say that tablets should be, in short, ignored, and I think I summarised the key reasons, firstly, that the tablet prices did not reflect conditions of normal and sufficiently effective competition. Well, this is an area of course I could clearly get out of my depth because I am not a competition economist, so that will be addressed, I have no doubt, by the wall of economists that we have, but I do note that the Department of Health did intervene and that in my experience is extremely unusual.

The Department of Health had the right to intervene in tablet prices if it wanted under something called Scheme M, which Teva was a member of, it was a scheme that basically said if the Department believe that normal market mechanisms are not working, we can intervene to basically put a price that we believe reflects what would be the case if normal market mechanisms were working. So I do think the fact that the tablet price was reduced materially from its high point of, I believe, over £100 a pack down to £30 and indeed, that that £30 was a product of some negotiation, even though it was not under Scheme M, or indeed any statutory powers that the Department may have, but more

on the power of: I am your only customer, I would like to talk to you about the price, please, I know the two gentlemen that hosted that meeting and I can imagine how it would have gone, I do believe it is an important -- the reduction in price needs to be contextualised with the criticism that the tablet price was not subject of normal and sufficiently effective competition.

A second criticism is that tablets and capsules could not be compared at the same point in the supply chain, and I respectfully suggest that I have done that in my, I believe, sixth and seventh reports, that I have compared them at the same ASP level, and the third criticism is tablets and capsules had different market sizes. It is true, but, as I have said in my reports, I do not believe tablets were an insignificant market. I think they sold about £10 million a year. Equally, of the four strengths of capsules, whilst the 100 was materially higher than the sales or 100 tablets, the 25 and the 50 were materially lower, they are much smaller market sizes, and the 300 was broadly the same. So I have hopefully in my -- particularly in my position paper, I have summarised why I believe those are not fair criticisms, and no reason to sort of throw the tablets away as a comparator.

I thought it would be useful in the next slide,

please {XE7/2/9} to just put a few numbers in context.

So whilst average selling prices, of course, companies do not know what the average selling price -- they may know the drug tariff price, but they will not know what the average selling price of the current market participants was, but in the evidence that has been presented by the CMA, albeit ex post, we can see what the ASPs were of the tablet suppliers prior to the launch of capsules, and the capsules, the 100mg capsules launch was 70p per capsule, which compares very favourably with what we now know was the ASPs of tablets of between 71p and 89p, so at the bottom end, in fact slightly below the bottom end.

Another way sometimes to look at pricing is to look at what is called the active pharmaceutical ingredient cost of different presentations, and this is typically done at a list price level, and this little table which is extracted from one of my reports basically shows that the drug tariff price of the tablets had a cost per milligram of API of £1.07, whereas the capsules, the 100 and 300 were 80p and the capsules, it should be, bear in mind, of those two strengths I believe from memory they were something like 80% of the capsules market, the 100 and 300.

The two smaller strengths you will see had greater

API costs per milligram than the tablets, or indeed the capsules, at £1.14 and £2.25, not something I find particularly unusual. It is quite frequent that low doses do not prorate price to high doses, not least they have smaller production runs and they may therefore have high unit costs of production, but that summarises the figures and why I believe those are all useful to demonstrate that at launch capsules really were compared very favourably with tablets.

If there are no questions on that I will move to the next slide, please. {XE7/2/10}.

So the thorny issue of return on capital employed versus ROS, which clearly goes to the heart of the differences between my evidence and that of the CMA and its expert.

I mentioned I have been working with the PPRS for over 40 years. The number of companies that are assessed in their profitability on ROCE is, I believe, currently none, and even during the relevant period was a handful out of maybe 200 members of the PPRS, and this is because the Department of Health recognise that for asset-light companies ROCE does not work: an 80% return on no capital is still no return, and therefore they have a rule that basically says if you are asset-light, and they define that as your sales to your capital are

greater than a ratio of 3.5 to 1, then you will be judged on the basis of return on sales, and of course, return on sales is always used for price assessments of non-comparable new entrants which I was talking about, your new branded generic. It is an ROS approach, it is never an ROCE approach.

So it seems to me if the industry regulator does not like it, and does not use it, and recognises its flaws, that is something that is important to note in evidence, and just for avoidance of doubt, Flynn, with or without capsules, and whatever price capsules were or should have been priced at, is most definitely an asset-light company and would have been judged in the PPRS under ROS rules, not ROCE.

The other problem, of course, I have identified is that for asset-light companies, returns on capital can vary very widely, and you can have two companies that are identical in every respect, except for their working capital policies and by that I mean how they pay their creditors, how quickly or slowly and how quickly or slowly they collect their debtors and how much buffer stock they want to maintain. They can have very widely different returns on capital, but they will have identical returns on sales, and my next slide which I do not want you to turn to quite yet has a simple example:

not a coffee shop but a pharmaceutical company or three pharmaceutical companies to demonstrate that.

I also did calculate the comparator returns on capital of the companies, the five companies, that I selected in my comparator group, and you can see they are all over the place.

Now, it is interesting to note that Alliance Pharma has a 10% return on capital which is indeed the ROCE rate that the CMA have used. Well, Alliance Pharma, within its capital base, has a most enormous amount of goodwill on acquisition of other companies. Were you to exclude the intangibles for Alliance Pharma I think the return on capital would be around 40%, and I have also not been completely clear about why, having criticised and identified problems in ROCE in the original Decision there has suddenly been a change in horses to ROCE in this decision. I have, I believe, always been consistent that for an asset-light company just ROCE has no place to -- and cannot really provide a sensible answer in terms of assessing reasonableness of a return.

If we could move to the next slide, here {XE7/2/11}. I have included this which I have extracted from one of my reports. It simply demonstrates that we have here company A and B, you will see basically the same sales, the same cost of goods sold, the same margins and the

same direct costs. The only difference is they have different policies in terms of how quickly they collect their debtors and how slowly they pay their creditors, and you can see company A, who manages to have done a good deal with its creditors and get 90-day payment terms, but is fairly brutal with its debtors and asks them to pay within 30-days, has no capital, no working capital employed at all, and if its other fixed capital is negligible because they have rented offices, they subcontract their distribution, they rent their company cars, you know, you end up with no capital employed at all, and therefore how do you determine a ROCE-based reasonable return?

Equally company B, it is far, far more lax on its debtors, and it is fairly prompt in paying its creditors. You know, it has 2 million of capital and has 150% return on capital employed. You will notice that both company A and company B have identical ROSs of 25%.

Company C basically decides to do something about its payment terms and offer its customers a 2% cash discount if they pay upfront, or pay, sorry, within 30 days, and, as you can see, that changes its capital employed -- return on capital employed to 282%, and unsurprisingly, its ROS has diminished because it is

giving 2% off its prices and its ROS has gone from 25 to 23.

So it just demonstrates that for asset-light companies where the majority of capital that is on the balance sheet is working capital, it can be a very unstable metric.

Could we move to the next slide, please {XE7/2/12}.

Having dealt with tablets as a comparator, I want to talk a bit about corporate comparators, and I think returns on comparable companies are very important to consider in terms of judging whether the return that Flynn made was normal or excessive, and having read around the subject, I can see that this is the approach that was adopted in *Napp* and also more recently in the Commission judgment in *Aspen*.

In each case, the comparators were not structured to get an exact mix of risk investment competition cost profiles, etc. The Commission in particular looked at companies that were similar, selling similar types of products, similar mix of products, but it looked at a pool of comparators in the round to decide a benchmark.

Now, I refined my comparators over the course of my seven reports and indeed my position paper. Of course, what I had access to was publicly available information,

typically accounts from Companies House. I also am familiar, having been working in the industry for so long, with the companies that are in my comparator groups. I have an insight into the type of things they are doing.

They are all non-innovators, they have a similar scale, a similar, what I would call, speciality product focus, in other words, they do not deal with commodity generics, you know, like atorvastatin, and they also outsource their activities in terms of manufacturing and that is important. I eliminated some companies because they in-house manufactured, so I have put them into what I have called SMDCs in my evidence, which is sales, marketing and distribution. That is their focus: they do not manufacture, they outsource that.

There is a limit on what evidence I can gather or what comparator information, and, as I said, it is based on Companies House public information. I have been criticised for not adjusting for risk, things such as that. I cannot do that on the information that is available to me, so I fully acknowledge that.

The CMA could, of course, get further information from any of my comparator companies if it chose to do so, but as far as I am aware, it has not.

I think the approach I have adopted actually follows

a very similar approach to that in the *Aspen* decision. I have taken a number of comparators, in fact, all of one also supplied AED medicines and I think they are a representative sample to judge, to benchmark Flynn against.

Could we have the next slide, please {XE7/2/13}.

So what does my comparator group analysis tell me? Well, it shows that typically returns on sales were in the sort of 30% area, gross margins in the 50% area, and those came as no surprise to me at all.

I can then look at what Flynn made on both capsules, and this is all on a CMA basis of calculation, the CMA's basis of allocating common costs. So capsules in the relevant period, 33%, gross margins 36%, and then comparing against Flynn's whole portfolio in 2015, 2016, the whole portfolio 24.5 and 45% of gross margin.

So very much I felt that this showed me that returns earned on capsules were very much in the sort of sweet spot of what I would expect the industry return, return to be made.

Now, if I contrast that with the CMA's outcome, they have calculated that a reasonable return is 1.35% on unadjusted capsule revenue. Just to make it clear that figures of 1.35% and 2% are mentioned, 2% is on the adjusted revenue of Flynn if that is adjusted by the

CMA's alleged excess. My 1.35 is on what the actual sales of phenytoin in the relevant period were.

I have just not been able to identify any industry comparator even close to that sort of return in the generics pharmaceutical industry, and equally, the CMA and its experts have not given me one to look at and to understand. I think in early submissions there were two mentioned, but they were withdrawn because I think they operated something I have described as a limited risk distributorship model, therefore the profits in their accounts were not reflective of the true end to end profits.

So I see the 1.35 or 2 as an outlier, and I think on the next slide I have summarised returns, if we could move to the next slide, please {XE7/2/14}.

The big difference between my analysis and that of the CMA is in the plus. It is not in the cost. There are differences. I continue to be slightly concerned about the volume of packs sold method of common cost allocation. I have put other approaches further forward, but the big number, the big delta between us, is the return applied to cost. You know, the vast majority of cost is an agreed number between the parties, so I have just summarised in this table, you know, all the evidence I have got: I have looked at

Flynn's whole portfolio, I have looked at Flynn's capsules per the CMA analysis, I have looked at my comparator companies, both on a median and weighted average basis, I have looked at *Aspen*, and I have looked at PPRS, and you notice I put there 19% which I put before. The Department of Health allow you a 50% excess over your target return before considering you are excessive and that is why I have put the band of 19 to 28.5.

The CMA, 1.35, you know, all the other comparators speak with one voice, which I have tried to triangulate. The 1.35% or the 2%, if you do it on adjusted revenues, does seem to me to be a complete outlier. For the purposes of my excess analysis, I have taken, which we will come to, a range of 19% to 30% return on sales.

If we could move to the next slide, please {XE7/2/15}.

Now, this is quite a busy table, and I have put red circles round just a few numbers that I want to draw the Tribunal's attention to. The calculated excess using volumes of packs sold as a common cost basis, is 47% according to the CMA.

Now, just by changing the CMA's rate of return to be 19% ROS, which is at the bottom of my range that I have calculated, that immediately goes down to 22%. Were

I to use the top of my range, 30%, the excess would go down to 5%. So the excess is clearly very sensitive to the return, the calculation of the reasonable return, and I would argue that 19% to 30% are very normal returns to assess the excess based on.

I have put the other basis of common cost allocations, my adjusted sales revenue. One I feel perhaps particularly strongly about is that if you are going to do volumes of packs sold, it would have been a good idea to normalise the volumes of packs, in other words, the fact that phenytoin is supplied in packs of 84 and tablets are supplied in packs of 28, you get a different common cost allocation had capsules happened to be in packs of 28. So my normalised volumes of packs sold adjusts and puts them as if they were sold in packs of 28 so obviously multiplies them by a factor of three.

The excess is eliminated entirely on my sensitised revenue basis, about 31.25% ROS. So that is the scenarios I have calculated.

If we move to the next slide, please, {XE7/2/16}. I said at the beginning of this presentation that I wanted to look at three questions, and the first one was basically were Flynn's returns out of line, and I think the table I have shown you indicates that capsules returns were entirely normal in the context of

what was expected in the industry. I did not find them an outlier at all.

I then asked my question: well, did they approach 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. I think they were particularly influenced by the fact that the drug tariff price of tablets was post-intervention, and also that of course the drug tariff price of tablets had been static for an extremely long time. After the 2007/2008 intervention I believe the drug tariff price of tablets actually stayed stable until 2016. That may have been due to an oversight by the Department, but that is something that obviously would not have been apparent to an industry observer.

Then can the PPRS help us? Well, the PPRS has lots of flaws. Firstly, it deals with brands and branded generics, it does not apply to generics, but it does give insight into what the industry regulator believes is the ROS has preeminence in assessing reasonable returns, not ROCE. As I said before, I believe there are no companies in the successor scheme to the PPRS which is call the VPAS that are judged on return on capital.

It gives insight into what levels of profitability

the Department of Health believe under the PPRS which does apply to branded generics is reasonable of between 19% and 28.5%.

It stresses the importance of comparators in setting launch prices, and it does also give us evidence of how prices are set when comparators do not exist, which is on an ROS basis.

If we could have the final slide {XE7/2/17}, I believe that probably says are there any further questions that the Tribunal might want?

THE PRESIDENT: Mr Williams, thank you very much. We have no further questions. We look forward to seeing you again at the [hot-tub].

THE WITNESS: Thank you, sir.

MS STRATFORD: Would it be a convenient moment for the shorthand writer to have a break or shall we --

THE PRESIDENT: I think you are absolutely right. We have been going an hour, we might as well take a break, then you can ensure that the proper files are up and the documents on screen for the next -- who is next, just as a matter of --

MS STRATFORD: Dr Majumdar, who is Pfizer's economic expert.

THE PRESIDENT: Dr Majumdar, yes indeed. Well, we will rise for ten minutes until a quarter-past.

(11.05 am)

(A short break)

(11.21 am)

MR BREALEY: Sir, it is my turn now.

Sir, I call Dr Majumdar.

THE PRESIDENT: Thank you.

DR ADRIAN NIZAM MAJUMDAR (affirmed)

THE PRESIDENT: Good morning, Dr Majumdar, do sit down, make yourself comfortable.

A. Thank you very much.

THE PRESIDENT: I am sure the files before you will be explained and I will leave you to unfurl your teach-in with counsel.

Teach-in by DR MAJUMDAR

MR BREALEY: Dr Majumdar, you prepared three reports. Just for the record I will go through them. That is the first report dated 12 October 2022 is at {XE1/4}. Your second report dated 6 April 2023 is at {XE1/5}. Then you have a position paper dated 25 September 2023 and that is at {XE6/3}, and without taking you to all these reports, can you just confirm that the opinions you have expressed in these three reports represent your true and complete professional opinions on the matters to which they relate?

A. Yes, I confirm that.

Q. Now, for the purposes of the teach-in, we have a slide

pack which I believe is at {XO/12}.

THE PRESIDENT: We certainly have something before us which says "Dr Majumdar teach-in presentation".

MR BREALEY: That must be the one, then. So with your permission then, sir, I will let Dr Majumdar take you through the slide pack.

THE PRESIDENT: Thank you very much, Mr Brealey.

A. Thank you, good morning.

So well, thanks for the opportunity to provide a teach-in. If we could go to the next slide, please, thank you (Slide 2).

So I propose to cover two main topics, the first of which will be workable competition and tablet comparators. I will start with an introduction just to the concept of workable competition and then I will talk about how one might estimate a range of prices consistent with workable competition in the tablet market. The second half of my presentation will then compare Pfizer's price to the tablet benchmarks.

So first of all I will explain what these tablet benchmarks are, then I will explain how we adjust Pfizer's price to take it to the same level of the supply chain to allow for a like-for-like comparison, and then finally I will mention the implications of my analysis.

On to the next slide, please (Slide 3).

So now we are just going to focus on the first half of that, so that is workable competition and tablet comparators.

Next slide, please (Slide 4).

Okay, so this is a conceptual introduction to workable competition, and so what we see here in this box is we have a range of prices, and if we look down at the bottom we have cost plus, and that is the lowest price consistent with workable competition.

As we work our way up that price line and we stay within the blue box, we get a range of prices consistent with workable competition. So the top of the blue box we can think of as the highest price consistent with workable competition, and the thing to note about that is that is substantially above cost, so with workable competition we can have a range of prices, and moreover, the top of the range can be substantially above cost.

THE PRESIDENT: You may be coming to this, and if you are, then please do not answer the question now, but if you are not, what defines the top of the range at the top of the blue box?

A. Well, I was not going to go into that in detail. I am happy to pick up that question.

THE PRESIDENT: Well, in a nutshell, what is the answer?

I mean, I understand the parameters that define the lower line, but what are the parameters that define the upper edge of the blue box?

A. Sure, okay. So conceptually, I think that the top of the range will not go higher than a price that would emerge if you had a market where you had a dominant firm exercising market power, so it would not be higher than that.

THE PRESIDENT: Right. So --

A. I think there is a margin for debate that one can have as to where the price stops. I think it is easier to say where, if you like, what is outside the range for workable competition, if that makes sense, than -- so the point I want to convey here is that with workable competition you can have a range of prices. The bottom of the range would be cost plus --

THE PRESIDENT: Yes.

A. -- the top of the range can be materially substantially above cost --

THE PRESIDENT: That I understand.

A. -- and the top of the range will be a lot lower than the maximum willingness to pay, which is the price that it extracts the entire surplus from the buyer.

THE PRESIDENT: Right. So why do you not define workable competition as the price that would pertain in

a reasonably competitive market which would, let us say, be defined as something where there is no collusion and no dominance?

A. I think you could define workable competition that way, sir, yes.

THE PRESIDENT: Right.

A. Without dominance and without collusion.

THE PRESIDENT: But is that a definition that you are happy to adopt, not happy to adopt, or have already adopted but just not expressed?

A. I am happy to adopt it. To be honest, I had not explicitly adopted that definition for the purposes of my analysis. In my analysis I have explained that one of the reasons why I believe that we had workable competition in period 3 of the tablet market is because there is not, in my opinion, any dominance during that time, which is entirely consistent, sir, with the point that you are making, but I have not explicitly expressed in my reports that this is the precise definition.

That said, I think the idea of saying that workable competition is consistent (a) with the absence of dominance and (b) the absence of collusion is a good definition.

MR DORAN: Sorry, are there factors which might influence where the top of the blue box is in different markets?

A. Yes, there are, sir. So, for example, in markets with low willingness to pay, so at the very top of this diagram I have said maximum willingness to pay, and that is the maximum amount a buyer would pay, and so if you priced at that much the buyer has no surplus left, they are indifferent between purchasing the product and not, and so I am saying the workable competition, the price must be lower than that, it must leave buyers some surplus.

So the next question is does that top of the range, if you like, does that flex with different types of markets, and I think it does. So, for example, the greater the value there is placed on the product, that will not only increase the willingness to pay, but that will also drag up the range consistent with workable competition. What you can think about what is going on there is as consumers value a product more then they are willing to pay more for it even in competitive markets where prices reflect that greater value, that will bring the price up and it will come up to a level higher than cost.

So the short answer to your question is, yes, this range does flex according to different markets, in particular as the valuation of the product goes up, then the top of the range will go up as well, sir.

MR DORAN: Does that correspond in any way to what Mr Williams was saying about price and volume?

A. In the sense of does the range of the prices consistent with workable competition flex according to the size of the market?

MR DORAN: Mm.

A. Yes, I think it can do. I think in smaller markets, for example, because fixed costs are spread over fewer units, that would be one reason why you might permit a higher price in a smaller market, for example, but I think, yes, I think the size of the market can be a factor that would impact the range of prices consistent with workable competition.

MR DORAN: But it is quite hard to place a sort of limit other than somewhere between the cost plus, as you have it here, and the maximum willingness to pay. You do not know where that is in any particular point?

A. Well, I think we -- I think the discussion I was just having with the President there, sir, suggests that we may have found a definition for defining where the top comes, and I think what we are saying is workable competition exists provided the market does not display dominance or collusion. So that would then help us understand where the top of the price comes.

MR DORAN: So then the question about, say, the size of the

market, which would also influence, that is a separate concept, it does not fit into either of those two points. That is why I was asking the --

A. Yes, so I think -- so when we tried to assess whether a market has got dominance or not, we take into account three factors: we take into account existing competition, potential competition and buyer power. So to the extent that the size of the market will impact on those three forces of competition, existing competition, potential competition and buyer power, that in principle then could affect where this line would be. Does that --

MR DORAN: That helps. Thank you very much.

A. Thank you.

Shall I go on to the next slide?

THE PRESIDENT: Please do.

A. Wonderful, okay, thank you. So that was a discussion of the conceptual notion if you like of workable competition. Now we are going to try to put some numbers around those (Slide 5).

What we are looking at here is period 1, and period 1 is a time in the tablet market when Teva was the only supplier, and this coral line that you see is the tablet -- drug tariff reimbursement price. So from October 2006 to October 2007 the price fluctuates,

it has a low point of about 48, a high point of about 62, so there is about 12 months fluctuation in that range, and then the price jumps up to £114, and that triggers a Department of Health intervention. Following that intervention, the drug tariff price drops to £40, then to £35 and then to £30, £30 in October 2008, where it stays for about -- well, over seven years.

Now, this £30 drug tariff price in the tablet market is a constrained price, so both Ms Webster and I agree that this is a constrained price, a price that is below the monopoly level because it has been constrained by the intervention of the Department of Health, so this is a constrained price at £30.

If we go to the next slide, please (Slide 6). What I have done here is I have added Teva's price. So Teva was the only tablet supplier at the time, and Teva's price is shown in blue, and in the data that we have, the highest Teva price arises at £51 in October 2007, and that is the point in time when the drug tariff price jumps up to £114. Then we have the Department of Health intervention, and the Teva price, we see, is constrained following that intervention at around £26. So from October 2008 onwards the price is around £26.

PROFESSOR WATERSON: Hold on. The constraint here is the constraint of allowing a margin for the later stages in

the chain, the whole --

A. That is right, sir. Yes, absolutely, yes.

PROFESSOR WATERSON: So it is constrained indirectly?

A. Yes, if you like. So we know that the Department of Health will not pay more than £30, and we know that pharmacies will need a margin and to the extent there is a wholesaler in the chain as well that wholesaler would need a margin which means that the Teva price could not be 30. As you say, there has to be a bit of a margin below that, yes, that is right.

PROFESSOR WATERSON: Incidentally, why did the drug tariff price rise right up to well over £105?

A. Why did it rise up to £114? That is a factual matter I do not precisely know the answer to. I know it triggered an intervention by the Department of Health. As to exactly why the price was going up I am afraid I do not have the factual information to give you a full answer.

PROFESSOR WATERSON: Okay.

A. Okay, next slide, then, please (Slide 7).

There is a lot going on here, so let me talk you through this.

This is period 2. So in period 2, which begins in October 2009, we have an entry by Wockhardt, and Wockhardt enters with -- and this price series is shown

in green, and the Teva price, as before, is in blue and there is a price series in red, which is the weighted average price, so that is just a volume weighted average of the green and the blue, the Wockhardt price and the Teva price.

So what does that mean? Essentially what happens is prices fluctuate around this £26 mark until December 2011. There is a few spikes in the series, this is quite normal. The data series are quite noisy, but if you take an average and ignore the spikes then what you see is prices were £26 on average for Teva and for Wockhardt until the end of December 2011.

Then something interesting happens. So if we look at the panel to the right that is called out in white and there is an intensification of price competition. This is just prior to the third entrant, Milpharm, coming in. So this is still in period 2. This is the first eight months of 2012, so January through to August 2012, and what we see is the blue line which is Teva's price falling by 14% and the market-wide ASP falls by 14% as well. So there is an intensification of competition at the end of period 2 and prices fall by 14%.

If we could go on to the next slide, please (Slide 8).

So now we are into period 3, and I believe or I say that period 3 is when we have workable competition. So the first part of period 3 is interesting. This is September 2012 when Milpharm enters, and Milpharm's price is shown in grey on your chart. So we have Wockhardt in green, Teva as always in blue, Milpharm in grey and the weighted average price in red.

So what is interesting is in the first four months of this period, we have a rapid price decline of about 33% in the case of Teva's price, so in the first four months, September to December 2012, prices fall by about 33%, a sharp price decline.

If we move on to the next slide, please (Slide 9), we are still now in period 3 and a period of workable competition, and what we see is after that sharp price decline, prices still continue to decline but at a slower rate than before, so they decline up until the point of November 2013, which is when the continuity of supply guidance comes in.

So that dashed line and there is a box calling it out, the dashed line above November 2013 is when the continuity of supply guidance comes in, and we see prices firstly falling sharply and then falling more gradually up to that point.

Now, one might expect that with the continuity of

supply guidance coming in, prices would suddenly shoot up. In fact, that is not what happens. There is a bit of noise around the price series, but by and large, prices do not rise, and, if anything, they probably fall a bit. So, for example, the Teva price is lower at the end of the period in July 2014 compared to November 2013, the market-wide average selling price is also lower in July 2014 compared to November 2013.

So this is the period 3 of workable competition in this three-player competition, and I would say that the entirety of that competition is subject to workable competition, so to go back to the question I was asked right at the beginning, I would say there is no dominance at any point in time during period 3, so we are looking at a price series that are generated without any dominant firm during this entirety of period 3.

So next slide, then, please (Slide 10).

PROFESSOR WATERSON: Are you going to show us volumes?

A. I was not going to comment on volumes, no.

PROFESSOR WATERSON: Okay.

A. I mean, I am happy to answer questions, if you had a question on volume.

PROFESSOR WATERSON: Yes. I mean I suppose it is implicit, but it becomes more difficult as you have three players as to what the relative volumes were?

A. I mean, I think it is fair to say that Teva would have had the highest volumes throughout the entirety of the period of workable competition, but my point would be despite Teva having the highest volumes, the only way it hung on to those volumes was by very substantially lowering its price, and, therefore, I would say even if Teva had the largest volume market share, because it was only able to hang on to it by substantially lowering its price, first of all by 33% in four months and then continuing to lower its price, that does not strike me as a market that would be characterised by dominance, there is too much price competition going on.

So in terms, then, of how one might summarise that period 1, period 2, period 3 evolution, what we have on this chart here is the Teva price, so that is shown in blue, until we get to the final one which I will explain.

The highest price we see in the data series is £51.25 and that was the October 2007 price just prior to the Department of Health intervention. Then we see that prices drop, they almost half to £26 as a result of that intervention in period 1.

Prices continue to fall, so remember there was that 8-month period of price decline at the end of period 2 in the run-up to the start of period 3, and that took

prices down to £21.35 when period 3 starts, when three-player competition starts.

There was the sharp price decline by 33%, and that took the price from £21 down to £14, so at the start of January 2013 we have the price of £14, and then prices continued to fall but more gradually which means that when we look at the weighted average price for Teva across the entirety of period 3, the price is even lower at £12.96. So £12.96 is Teva's price, weighted across the entirety of period 3, which is a period that I say is consistent with workable competition.

I did some sensitivity tests which are shown by that fuzzy blue line. We will need to correct this chart: the fuzzy blue line should go no higher than £12.96. So I did some sensitivity tests around what the weighted average price would be, and that gives me a range of £9.63 to £12.96. On the chart before you, I do apologise, it looks like that fuzzy line is a bit on the high side, but it should be no higher than £12.96.

Now, a point I do want to emphasise, sir, is that I say if a market is subject to workable competition, then all players in that market are subject to workable competition, which means all prices in that market are telling us something about prices that are consistent with workable competition, hence Teva's price, although

it was the highest price of the three players during that three-player period, it is still a relevant price to consider because Teva was constrained, it was subject to workable competition. So I say this Teva price should not be ignored, it is an important price to consider.

I think we can go on to the next slide (Slide 11).

I just want to flag some areas that I am sure will come up in the hot-tub. An important area of dispute is that -- so Ms Webster and the CMA disagree that period 3 had workable competition, and, as I understand it, there are two main arguments. The first is that Ms Webster says that:

"There were both demand and supply side factors operating in the market for Tablets that can be expected to have limited the development of competition to a significant degree."

So the demand factor there would be the continuity of supply guidance and supply factors, an example would be supply constraints.

Ms Webster also says that:

"The 16-month three supplier period was not long enough for prices to become reflective of sufficiently effective competition."

Now, I disagree with those points for the following

reasons. The first, and I would emphasise is that in 2008 we had -- well, in 2007, actually, we had the Department of Health intervention which took effect by 2008, and that already, if you like, decontaminated the higher prices that existed in 2007, so the Department of Health intervention constrained Teva's price, in some sense it decontaminated the high peak in October 2007, and that is an important starting point.

Then prices fell further, so remember from January 2012 onwards, even before period 3 starts, there was that intensification of price competition and we had 8 months of price decline, a 14% price decline, over an 8-month period even prior to the three-supplier competition. So competition was occurring, starting to ramp up, even before workable competition took place, in my opinion, in period 3, and then when period 3 starts we have a 56% price fall, 56%.

So in my opinion, these substantial price falls are entirely consistent with workable competition, and actually, if we think about the amount of time prices were evolving from January 2012 to the end of period 3, that is 31 months, it is not 16 months, it is 31 months, and ultimately that gives rise to a 63% price decline, 63% price decline over 31 months. So to my mind this is entirely consistent with the notion that there was

effective or certainly workable competition taking place.

Next slide, please, unless there are any questions of course which I am happy to ...

THE PRESIDENT: No, thank you.

A. Okay. Next slide, please (Slide 12).

Now then having explained my views as to why there was workable competition in the tablet market during period 3, I am now going to talk about how we compare Pfizer's price to tablet benchmarks, so on to the next slide, please (Slide 13).

So what I have done here, this was the diagram that we saw earlier on and we had a discussion about. Now I have tried to put some numbers on this. I want to emphasise a couple of points: the Teva ASP is the market-wide average ASP for Teva, and I say that is a price consistent with workable competition. I want to be very, very clear about something. Sir, when we had that discussion about what should be the top of the range, and I said: well it is almost when you get to dominance, I absolutely am not suggesting that £12.96 is a price that a dominant firm would charge, just to be very clear. When I was doing my analysis of workable competition, I said that this is a price that is emerging from the market where there is no dominance, so

I just want to make this very clear. So in terms of where dominance would kick in, it would be very substantially above this £13, I do not know what the right number would be, I suspect it would be north of £26, I think it would be somewhere all the way up there, sir, just to be very clear.

THE PRESIDENT: How do you gauge that?

A. How would I gauge that? I would gauge that by looking at the history of the tablet market.

So when we had period 1 and the Department of Health intervention, we had a -- so Teva was the only supplier then, and Teva was charging a constrained price of £26, and that price was already constrained, so one might argue that actually the dominant firm price could be even higher than that, but let us say, for sake of argument, £26 is the sort of price a dominant firm might charge, actually, it might be higher than that if it was not constrained, but for sake of argument. So that is where I am gauging the £26, sir. That is where I am getting that number from.

THE PRESIDENT: To what extent, if at all, have you factored in the somewhat unusual nature of pharmaceutical markets generally, the fact that we have a range of controls and legislation and rules which might have a disputed effect but nevertheless some kind of effect in terms of not

merely the prices that people charge, but also, of course, constraints like the need for an MA in order to enter the market in the first place? So this is not a market in the way that one would start to define a market, it is very far from that, and so that may, to put it no higher than that, have an effect on the interaction between supply and demand. So when you say something is consistent with workable competition, have you adjusted for those factors, or have you simply taken the market as it is according to the rules as they applied during the relevant period?

A. Yes, okay, sir, let me try to answer that question. I think I have possibly two answers. The first answer is essentially I looked at period 3, I looked at the size of the price declines, which were 63%, starting from the beginning of 2012, so we have the 8-month price fall before we even get into period 3, so we have a 63% price fall from that point, and I assessed the market and thought: well, I do not believe that there is any dominance during period 3 for any of the players there. So that led me to the view that the entirety of period 3 was consistent with workable competition. So that is the first answer. That is a bit more of a generic answer.

Now, in terms of your question as to whether I made

any allowance for the specificities of, for example, the continuity of supply guidance, what I say in my first and second reports is that in some senses it is quite remarkable how much competition there was when one takes into account the continuity of supply guidance, because you will understand the words of the law better than I, but if I understand what that guidance says, to paraphrase it, it essentially says that if you are stabilised on a product, then you should not really switch, or it is not advisable from a medical perspective to switch.

Now, if we think about a market where there are very few new patients coming in because relatively few people are being prescribed, and so really your customer base is your existing customer base, and then some legislation comes in and says: by the way, your existing customer base should not be switched to someone else, then in essence you have a monopoly over your customer base, and so, if you like, from a purely theoretical perspective you suddenly create a monopoly position, you would expect to see prices shooting up if the monopoly power were to be exploited, but that is not what happened, actually prices, if anything, continue to fall a little bit.

So I do mention that both in my first and in my

second report and I say considering the theoretical impact that that continuity of supply guidance may have had, in some senses it is remarkable that prices, if anything, fell somewhat after that point.

THE PRESIDENT: Is that not precisely one of the problems that we have to grapple with, because my understanding is that all phenytoin products were subject to this continuity of supply directive, so you have immediately got a substitutability problem for tablets for capsules, and within those broad classifications, manufacturers of specific tablets and manufacturers of specific capsules. So, as you say, there is embedded for, I am sure very good reasons articulated in the guidance, a, as you say, monopoly, and that must affect not merely the price of the capsule, but also the price of, say, the tablet. You are nodding. You are agreeing?

A. Yes, sorry, I should have said out loud.

THE PRESIDENT: No, no, of course.

A. So you are right, sir, the continuity of supply guidance impacted on both the capsule and the tablet. However, I do not consider that that renders the tablet benchmark unusable because, despite that continuity of supply guidance we see all of those price falls that I mention.

Now, I did run a sensitivity test where I looked at the weighted average price from January 2013

until October 2013, ie to exclude the period after the continuity of supply guidance came in and instead of getting the weighted average price for Teva of £12.96, I got one of £12.53 or thereabouts, it is 40p less, plus or minus a couple of pence, sir, forgive me forgetting the exact number, but the point is I sensitivity tested that point and it in fact does not really make very much difference, just 40p.

THE PRESIDENT: We will obviously need to look at the history of the guidance, but my understanding is that the guidance, whilst dated 2012/2013, was a statement of what had gone before. So that is not something I am asking you to comment on; we will look to the evidence on that.

A. Sure.

THE PRESIDENT: What I am exploring with you, and let us take the period after the guidance came into force because we know it was in force and we know what it says, but in that period is not the constraint between manufacturers not that of a competitive market or workable competition as you call it, but in fact a monopoly which is in some degree imperfect to the extent that the guidance is not followed. I mean, no one is suggesting that the guidance was absolutely 100% in place. There is clearly some degree of substitution

between different products and differently manufactured products.

That being said, would you not say that if the constraint on substitutability were removed, you would have a greater downward effect on prices such that the downward effect that you have seen, the result of the imperfect competition because of the existence of the guidance, would in fact have been magnified and would have been far greater. Now, how do you assess for that in working out what is a price that is the outcome of workable competition?

A. Yes, sure. Okay, well, let me try and answer that question, sir.

So the first point you made was that even prior to the guidance coming in there was similar guidance in place, and that certainly is my recollection as well, sir, and so therefore I think it is highly informative that with, in effect, similar guidance already in place, we see the 63% price fall. So that is telling me that despite something that in theory limits competition, in theory creates a sort of quasi-monopoly position, in practice we had a remarkable amount of competition, very substantial price declines. So I think that is point number one. I think it is very important.

Your second question was, were it not the case -- if

one removes the continuity of supply guidance in November 2013 and then allowed competition to take place, could we have had lower prices, well, I think the answer is probably yes, if you removed that and not only removed it but removed the prior guidance as well and said, no, absolutely, it is fine to switch everybody around. I think you could have -- well, I think you would have had lower prices, but I do not think that detracts from the fact that we have seen this very substantial price decline up to that point. So to my mind, the fact that you see so much competition in this market is entirely consistent with it being workably competitive.

THE PRESIDENT: But given the definition of "workable competition" that we articulated at the beginning, is this not, by that definition, not workable competition because you have a constraint which is effectively rendering every participant in this market not just dominant but actually possibly super dominant?

A. Ah, so I would disagree with that, sir.

THE PRESIDENT: Right.

A. The reason being because I think we have a reasonable idea of what the monopoly price would be.

THE PRESIDENT: Okay, but --

A. And the prices are so far below that. So essentially

what we are saying is there is a tension between the theory and the evidence there. So we have evidence of prices that are substantially below the monopoly level, and so that evidence --

THE PRESIDENT: But are you not begging an enormous number of questions here, because let us assume we have a continuity of product supply constraint which has been applying at all times. What you have, therefore, is a situation where there is not, using our definition of "workable competition", there is not workable competition, so what you are saying is in the world where I only have data, in a situation where there is unworkable competition or competition affected by dominance, how do I work out in that rather hostile environment to competition what the workably competitive price would be? Now, of course you have a fall in price, but what I am puzzled about is how you can be so confident that it is the outcome of what you would call "workable competition" given that by definition that is what we do not have here?

A. Well, may I suggest --

THE PRESIDENT: Please do push back as hard as you like because, I mean, I am articulating this in that way.

A. Thank you. In that case, I will take you up on your offer, sir.

I think one way of thinking about this is what the continuity of supply guidance does. It does not create monopolies, it creates differentiation, so you can think about this as competition among differentiated products in the sense that even if from a sort of active ingredient perspective they are identical, they are differentiated in the sense that the clinical guidance says: well, look, if you have been stabilised on one, then you should not switch to another, so it differentiates the products in that way.

You can have workable competition with differentiated products. We do not need to call them monopolies, we can just say they are differentiated by the continuity of supply guidance.

THE PRESIDENT: But you accept that that has to be coloured, or that statement has to be coloured by the terms of the MHRA?

A. I would accept that, yes.

THE PRESIDENT: Let me just put to you where I am coming from --

A. Please.

THE PRESIDENT: -- and please, all of the experts should feel free to tell me in no uncertain terms when I am barking up the wrong tree because that is the purpose of these things, but if one looks at category 1 phenytoin

and others, for these drugs, doctors are advised to ensure that their patient is maintained on a specific manufacturer's product.

Now, if you were looking at a doctor facing a professional negligence suit having shifted my patient from one manufacturer's product to another without a very good reason, then I am not sure I would fancy my chances, so do we not have here something which is not merely an emphasis on product differentiation, one manufacturer rather than another, we know that, that exists in any competitive market, you have different manufacturers by definition. Here we have a situation where you are saying: it is not quite a monopoly, but you are being advised, you, the doctor, you, the professional, are being advised to ensure that the patient is maintained on a specific manufacturer's product.

Now, if that is not a position of dominance, well, please explain to me why it is not, and I would go further, please explain to me why it is not a position of super-dominance given that the very person prescribing is being told that they are advised to ensure that consistency of manufacturer is maintained.

A. Okay, so let me -- can I come back to your super-dominance question in a second?

THE PRESIDENT: Of course.

A. But make sure I do answer it. I just wanted to address the first point which is I think you asked the question with the continuity of supply guidance in place how can there be workable competition, and I think I would like to take us back to: let us ask ourselves what was the process that caused the price fall. The process that caused the price fall was that companies -- Teva, for example, was worried that if it did not lower its price, Boots or a wholesaler would switch to Milpharm or would switch to Wockhardt. So irrespective of the guidance being in place, there was a process of competition where the fear of not -- the fear of keeping prices high and losing volumes was what made the price come down.

So to my mind, that is quintessentially a process of competition, even though it may be strange that given the guidance that it took place, if we look at what actually happened, look what happened to price and try to understand well, why did that happen to price on the basis of the limited factual evidence I have seen, but as it is described in the CMA Decision and the references that I cite in my first two papers, you know, the reason why prices fell is because, for example, Teva was worried about its customers switching to Wockhardt or to Milpharm. That is quintessentially a process of

competition, so that is why I would say absolutely this is consistent with workable competition.

THE PRESIDENT: I will not forget about the definition of dominance.

A. The super-dominance one, yes.

THE PRESIDENT: We will come back to that point. The point that you are making is one that I entirely understand. What you are saying is you have this price fall, and you are articulating, entirely properly, what you see as its significance. The point I am pushing back on -- it is actually quite a minor point, but nevertheless an important one -- is that if one is operating in circumstances -- and I will let you push back on super dominance --

A. Please.

THE PRESIDENT: -- but in circumstances where there is super dominance of a particular manufacturer against a manufacturer of a drug that would otherwise be regarded as identical, but because of this guidance is not, you cannot presume that the drop in price is due to competitive elements, nor can you presume that the outcome would be different if you removed the element of super dominance. Now, it may very well be that that is right, but we have to surely tread with extraordinary care in working out what is the cause of this price drop

given the fact that we are not talking about a competitive market, at least as I have defined it?

A. Well, I think, sir, if that means that it is important to reassure oneself that the reason that the price fell was, for example, because Teva, for sake of argument, was worried that if it did not lower its price there would be switching, then I think that is certainly a good question to ask, and I mean, I struggle to think of another reason why prices would have fallen given that -- that seems to me the most likely explanation why prices fell so sharply by 33% in those first four months and indeed, continued to fall afterwards, and I think there is even some mention in the CMA's Decision about -- I cannot remember which of the companies, but one of the non-Teva companies trying to price aggressively hoping that some customers could be switched to them even prior to the November 2013 guidance coming in.

So if the answer to your question is: does it make sense to make sure we are very confident that the process causing the price decline was a process of competition, yes, I agree. I mean, I think it is, but I agree that that is an important question to -- just to confirm.

THE PRESIDENT: Let me just unpack so that everyone can

understand the concern I have.

If one has a situation of workable competition defined, as we have done, absence of collusion, absence of dominance, then the outcome of the price or the outcome of market operations which is the price is one that the court can just take. You know, it is factors of competition: the price is the price is the price, and we do not have to worry about it, we just suck it up, it is there.

The problem with situations where there is not workable competition is that that outcome is not a given, and yet it is the outcome that we attach considerable value to in order to understand what has gone wrong in a market that is affected by a cartel or by dominance. So one cannot just sit back and say: well the price is the price is the price, because one has this factor that is rendering the competition on our definition not workable.

So whereas in ordinary circumstances of workable competition you take the price fall and you say: market forces, do not have to worry about it, because it is workable competition, here we absolutely do, because it is not workable competition, and so we have, therefore got to test whether what you are saying is right, namely that it is in fact a decrease that is explicable by

effectively a proxy for market forces, because they are not market forces because we are proceeding on the basis of non-workable competition viz dominance, and again, I have not forgotten that you are going to push back on dominance, but let us proceed on the basis that this is not workable competition.

So that is why I am probing into your reasoning, because it is reasoning that becomes important precisely because we are not in a situation where we do not have to worry about it. We do have to worry about it, and that is why your evidence really matters.

So unpicking why you say it has happened and why you say it is, therefore, a proxy for workable competition matters hugely to the reasoning that will inform our judgment.

A. I see, thank you very much for the explanation, sir. I understand.

So may I just -- just to make sure I have understood, may I try and summarise?

THE PRESIDENT: Please.

A. You are saying because of the continuity of supply guidance, which on its face might suggest that you really should not see much switching, it is very important for the Tribunal to understand the process that caused that price decline. So you accept, yes,

there is a price decline, of course, we can see it in the data, but it is very important to understand why and whether the forces causing the price decline can be forces that satisfy you as sufficiently proxies for workable competition, and, if so --

THE PRESIDENT: Yes.

A. Okay. Thank you very much for the explanation, sir. I think I understand.

So to your second question that I have not been dodging deliberately --

THE PRESIDENT: No, no, we -- assuming dominance, super-dominance, or whatever, now, by all means, knock it out of the park that it is not the case of dominance or whatever.

A. I suppose this is almost an extension of the discussion that we have just been having, sir.

I mean, I suppose what I was going to say was that: well, look, if one calls it super-dominance, is it not remarkable that prices did not go up, or, put a different way, that position of super-dominance was not being exploited or was not being -- well, was not being exploited, in which case I think one could argue that the price is still a relevant benchmark.

THE PRESIDENT: Yes. I think what you are saying, and let me repackage what you are saying and you can tell me how

far I have got that right -- this is, in essence, a factual question of just how significant in terms of the medical practice this guidance was, and we heard yesterday, I do not know if you were in court for it, but Professor Sander said that this was not the first document that he would take with him on a desert island. Indeed, I very much got the sense that it was probably the last document he would take with him on a desert island, and in a sense, that is what you are saying: we need to be satisfied that the strict wording that I have read out to you actually was informing the market, and what you are saying -- and this is where your data may come in as being relevant -- you are saying: well, look, the data in fact is inconsistent with physicians applying this guidance with a force that perhaps a lawyer, putting themselves in the doctor's position, a very dangerous thing to do, might say would inform the doctor's conduct, and of course you are absolutely right that is something on which you cannot help and I need to listen to the totality of the evidence in order to reach a view about that factor.

So if you are saying the label "non-workable competition", "dominance", "super-dominance", "monopoly" very much turns on the totality of the factual evidence then I completely agree, I think that must be right.

A. Thank you. Thank you for the summary, sir.
THE PRESIDENT: You are happy with that formulation of your view?
A. At the risk of going backwards and forwards, I mean, I think -- I would not say -- I would not say there was dominance during period 3 at all, in my opinion, but that is my take on the basis of the data.
THE PRESIDENT: Yes.
A. But as we have discussed, I fully accept and understand and agree with your point that you as a Tribunal of course need to satisfy yourself the cause of that price decline.
THE PRESIDENT: What you were saying, and I understand that, but let us get it out on the table so that we can analyse it, you are saying that the price drop that you have shown in your graphs is inconsistent with this rather stentorian directive being applied in the market with the force that I have articulated?
A. Yes, sir, yes, that is right.
THE PRESIDENT: Therefore, because that is the case the label "dominance", "super-dominance", "monopoly" is inappropriate?
A. Yes, very well put. Just one point on that. I think it is inconsistent with it being applied strictly. It is possible that from a Teva perspective, Teva believed

there was a big enough threat that the switching would occur. So even if the switching did not occur, it would be sufficient -- and by the way, this is a point to test when you review the facts, sir, but I just want to make the point that even if switching does not occur, if Teva perceived the threat, the risk, that switching would occur if it did not lower its price, then that would also be a competitive force, if you like.

THE PRESIDENT: Yes, of course. I mean, that is this point of decisions being based upon anticipated decisions of others who are anticipating decisions of others, and so you get an endless regression where you are trying to predict not what the market will do but what the person you are buying from will do and that is informed by what they think the market will do, and so what you are saying is what matters is not what this actually means but what Teva thought doctors thought it meant.

A. Yes, sir, yes.

Very good, okay, so next slide, please (Slide 14).

So I think for the purpose of the next slide shall we just proceed on the basis that £12.96 is consistent with workable competition?

THE PRESIDENT: I am very happy to assume that, yes.

A. Then I will just explain my framework. Okay, wonderful, thank you.

So what we have on this slide is we have two benchmarks. So we have at the top the £30 drug tariff, and what I say in my reports is, because that is a constrained price that is constrained by the Department of Health intervention, what that says to me -- and I appreciate this is a factual point, again, sir, that you will test, but what it says to me is that the Department of Health gained some value above that or, put differently, the Department of Health had a maximum willingness to pay that was in excess of £30.

So to my mind, this £30 is a conservative estimate of the maximum willingness to pay, because the Department of Health stepped in, negotiated an outcome that presumably at least left it some surplus. So that is why I say it is a conservative estimate of Department of Health willingness to pay, so that is the first benchmark.

The second one then is the Teva average selling price which for the purpose of this discussion we are going to take as given is consistent with workable competition, and then at the bottom of this chart I have put the Pfizer average selling price of £12.52.

We cannot compare them on a like-for-like basis just yet because Pfizer was upstream of Flynn, so we need to add a distribution margin. So what I am going to do on

the next three slides is add three different distribution margins just to show you what happens.

So if we could go to the next slide, please (Slide 15).

The first thing that I add on here is 76p. Now, where does this 76p come from? 76p is in essence what the CMA says is sufficient for Flynn to earn at the distribution level to cover all of its costs and earn a reasonable margin other than the cost of buying the tablet itself. So what I have done here is I have taken Pfizer's £12.52 supply price to Flynn, I have added on 76p which is, if you like, the CMA cost plus, and that takes me to £13.28, and so what I say in my first two reports, AM1 and the other reports, I say: well, this £13.28 is only 32p outside £12.96 which we are taking for this purpose of discussion is consistent with workable competition, and I say, well, that is 32p difference, that is close enough to be consistent with workable competition, it is within a margin for error.

Not only do I say it is close to £12.96, I also say it is a long way below £30, and, therefore, leaving considerable surplus for those further down the supply chain, be they wholesalers, pharmacies or the Department of Health itself. So that is what I say, and this is what I call in my reports the "Pfizer-adjusted price",

and just to be clear, the reason why we adjust it upwards is to make sure we can compare it with the Teva price on a like-for-like basis.

On the next slide (Slide 16), I appreciate that there is dispute about how generous the CMA should be in terms of allowing Flynn a distributor margin, so this is just a hypothetical adjustment, and I am asking the question: well, look, okay, supposing we say 76p is not really generous enough to Flynn, they should be given an extra pound. This would then be a pound of pure profit, it would generate an extra £700,000 a year plus or minus, and what would happen? Well, essentially the diagram, the picture, looks more or less the same. So the adjusted price would be £14.28 instead of £13.28. That would still be very close to £12.96. The difference would be £1.32, and it would be a long, long way below that £30 benchmark, that that £30 -- my estimate of what -- my conservative estimate of Department of Health willingness to pay, so it would still leave surplus for those further downstream.

If we go on one more slide (Slide 17), an obvious question is: well, what if we adjust Pfizer's price all the way up to Flynn's price, and so what would we do there? So Flynn's actually ASP averaged across the relevant period is £18.13, and that is £5.17 above the

Teva average selling price, so that is the top of the light blue bar that you see there on the chart.

What I would point out there is even that is a lot closer to the workable competition price than the £30, so that price is still leaving considerable surplus further downstream for wholesalers, pharmacies and the Department of Health.

So to the final slide, please (Slide 18).

What I have presented in my reports is I have focused on Pfizer's price, and I asked myself the question: well given that Pfizer's price is an input to Flynn, does Pfizer's price allow Flynn to earn a sufficient mark-up and still charge a price that I as an economist view to be not unfair, and I came to the view the answer is, yes, that Pfizer's price is low enough at £12.52 to allow Flynn to earn a sufficient mark-up and still itself charge a price that is not unfair. It can certainly cover its costs, and I would say even the Flynn price itself, because it is close enough to a workably competitive price and far enough away from that £30 benchmark to allow considerable surplus further down the supply chain.

So for that reason, sir, that is why I concluded that Pfizer's price was not unfair.

THE PRESIDENT: We have no further questions, I think we

have tortured you enough, Dr Majumdar. Thank you very much for your time, and we look forward to seeing you again when you will be cross-examined by the CMA.

Thank you very much.

THE WITNESS: Thank you.

MS STRATFORD: Sir, again, I am conscious of the time. We are in your hands. We are very happy to start with Dr De Coninck.

THE PRESIDENT: I think we should certainly start. Should we rise for five minutes to allow the second break because we had a long morning and then see how far we get with the next expert. I am afraid we will have to rise promptly at 1.00 because I have a mid-short adjournment meeting which will not delay us at 2.00, but I do not think we can abbreviate lunch shorter than the hour.

MS STRATFORD: We will get going on Dr De Coninck after five minutes.

THE PRESIDENT: We will do that now. We will rise for five minutes.

(12.26 pm)

(A short break)

(12.34 pm)

MS STRATFORD: I call Dr De Coninck.

DR RAPHAËL DE CONINCK (affirmed)

THE PRESIDENT: Do sit down, make yourself comfortable. You will be asked some questions about your evidence-in-chief and then we will go to the teach-in.

Teach-in by DR DE CONINCK

MS STRATFORD: Thank you, sir.

Dr De Coninck, I am just going to ask you a couple of questions about the content of your reports and paper that you have prepared during the course of the proceedings, and you have provided a total of seven expert reports, and you more recently prepared a position paper, and, as I did this morning, I am just going to read out the references to the electronic bundles of that series of reports and the position paper.

So {XE1/6/1-19}; {XE1/7/1-33}; {XE1/8/1-22}; {XE1/9/1-9}; {XE1/10/1-43}, that is your fifth report which was your first report in this remittal appeal. {XE1/11/1-43}, that is your second report in this remittal, also known as CRA-6. Finally of your reports {XE1/12/1-50}, and that is referred to as CRA-7. Your position paper is at {XE6/4/1}.

So Dr De Coninck, can you confirm that the opinions expressed in the seven reports and in your position paper represent your true and complete professional

opinions on the matters to which they relate?

A. I do.

Q. Thank you very much.

Now, Dr De Coninck, I believe you have prepared a teach-in presentation for the Tribunal now with some slides. Again, for convenience, the slides are in the Opus bundle now at {XE7/1}, but the operator will assist you with that, Dr De Coninck, as you go through it.

A. Okay. Perfect. I will start, and we can go to the next slide {XE7/1/2}.

The three main points that I plan to cover in this teach-in presentation. First, a few thoughts on the CAT *Lio* and *Hydro* judgment as they relate and compare to these proceedings, and I must underline that I was not involved in the *Lio* and *Hydro* judgments, but nonetheless there are some interesting comparisons to be made, which I will briefly make first.

Then I will focus on the second point on my presentation on the measures used by the CMA, in particular the return on capital employed and absolute profits, then I will turn to comparator markets and in particular tablets.

All right, we can go to the next slide {XE7/1/3}, so the first point on the *Hydro* and *Lio* judgment. So next {XE7/1/4}. I have here a few comparison points that

I would like to make and differences between the cases. At a very high level, I think those are extremely, extremely different cases, in particular when we think about a potential excess.

So in *Lio* and *Hydro*, there was a focus on price cost differentials, so just to remind everyone, the price cost differential takes into account -- it is basically the difference between revenue and operating and financial cost or the operating and the financial costs, so that is really a measure about how much the price is above the cost including costs of capital, and what we have there in those two judgments were differentials that were extremely important, I will come back to that in the next slide, but in several cases in thousands of per cents.

Now, here when we take that approach in the case of Flynn, we find very modest price cost differentials which are in the tens of per cents and not in the thousands of per cents, so that is the very first high level difference that I think is important.

Second point is of course -- and it will be much debated, I am sure, but it is the treatment of comparators where in that case there was no -- in the *Lio* and *Hydro* case there was in the end no adequate comparators that were found.

Now, what I will argue here is that there are many, many comparators that should be considered for phenytoin, so I will discuss and come back to that later in the presentation, but there are of course the other products from Flynn, industry returns, tablet markets and those, I would argue, are not contaminated by an excessive pricing infringement.

So the third difference that I would like to highlight is the evolution of prices. If we look at the *Lio* Decision we see that the lio tablet prices rose to a peak and then decreased and continued decreasing. Now what we have in phenytoin when we look at tablets we see that even though there is a decrease after generic entry, you have a stabilisation of the prices that is observed then, and I think that is important for considering a potential comparator market.

In 4, the fourth point is that in *Hydro* and *Lio* the high returns and margins were observed independently of which specific metric is used. So the finding of excessiveness did not only rely on using as a metric the return on capital employed.

This case here for Flynn is very different, because the CMA's case crucially depends on using ROCE as the measure, but if you use other measures, which are in my view valid, you do not find high returns, and the

reason, and I explain that in more detail, is because the measure of return on capital employed relies, and is entirely dependent to the level of capital which is in this case very low in the sense that the driver and the denominator in the formula is the result and is driven primarily by the cost of capital, and so if you have a low cost of capital, you can have very high return on capital without necessarily having high price, and this is particularly a problem also in satellite businesses and when the capital employed is not measured precisely as in this case.

So that is the fourth main difference.

The final one is that from my reading on the *Hydro* and the *Lio* case I see there was a buffer that was applied by the CMA before finding that prices were abusive and I do not find this buffer in the Flynn case.

So those are the high level differences. We can go to the --

THE PRESIDENT: That is very interesting, Dr De Coninck. Just to be clear, both *Liothyronine* and *Hydrocortisone* make certain statements or adopt certain approaches of what I would call economic fact, and I hope everyone will be aware from what we have already said that all of the economic experts should feel free to push back and say that our approach was wrong or took account of wrong

factors, that sort of thing, because we do not regard the statements of economic approach as matters of law which would have a high persuasive effect but as matters which are informed or to be informed by the evidence before us.

So if and to the extent you want to say that the Tribunal on that sort of question took a wrong turn, then everyone should feel free to do so, and the only reason I mention it is because the facts you have highlighted here are matters of narrow factual difference which I understand, but you should feel entirely free, and ignore the fact that there are participants from both tribunals here on this Tribunal. We have no problem in being told that the Tribunal has that sort of question wrong and we would welcome it rather than not. So just so that is clear to you and anybody else.

A. Thank you.

So we can then go on the next slide {XE7/1/5} where I detail a bit more of the differences in price cost differentials between the three cases, and in *Lio* and *Hydro* of course they were different numbers depending on the exact period considered, but I present here on average on this graph the differential in *Lio* was 1,671%, 879% in *Hydro*, and you can compare that to the

47% in phenytoin. So we are really at a question about excess, are we in an excessive case, is there strong evidence of excess? So what I would argue is that if you want to intervene for excessive prices, you would have to see whether there is something out of the ordinary that is really taking place in the case in terms of pricing which I do not see by looking at this differential which again is the method that was used in *Lio* and *Hydro*, and in addition, as I mentioned before there was a buffer, so if we were to apply the same buffer than in *Lio* and *Hydro* essentially a differential that would be under 200% would fall below that buffer, and I have more details in the annex if necessary.

PROFESSOR WATERSON: Can I check here, Dr De Coninck, what period are you talking about in the case of the present case, phenytoin? So you have these three figures: £23.6, £34.7 and the 47% which comes from those. £23.6 over what period, £34.7 over what period?

A. It must be the relevant period. I don't see any reason why it would not be the relevant period of the case. I think it is what we -- you should define as the relevant period, but I can confirm that.

PROFESSOR WATERSON: Okay.

A. So we can then go to the next slide {XE7/1/6}, which then does the breakdown of this differential, price cost

differential over the previous years partly to answer also the question if you wanted to have a further breakdown, here using the data from Flynn and calculating, just calculating what this price cost differential would be in the case of Flynn's other products.

So just as a reminder, that is not the approach that I took in my first papers, I focused more on return on sales, but just as a first highlighting, well, you know, how does this case compare to what was done in *Lio* and *Hydro*, if we take this measure of price cost differential, we have this measure of around 50%, very slightly over the years, but not too much. How does it compare to the other products of Flynn? And we see that this price cost differential is very well within the distribution of the price cost differential that you observe for the other product of Flynn.

So I do not think that using that measure would support the conclusion that prices are excessive in the case of Flynn's phenytoin capsules.

All right, so we can go to the next slide {XE7/1/7}. Okay, now I will focus here on the return on capital employed and the absolute profit measures that are used by the CMA, so let us go to the next slide {XE7/1/8}.

On ROCE, so of course we are aware that there was

a change in how the CMA approached the measure of return on capital employed. First, it was not considered meaningful, at most a cross-check; now, it is really the centre of the case of the CMA, and I think that this measure is absolutely not appropriate for a case like this one and for Flynn in particular.

The reason is that Flynn is an asset-light business, and the issue is that you measure all the returns with respect to the capital that are employed. So if you employ limited number of capital, mechanically your return will be quite high, even if your prices are not.

The additional difficulty is that when you have intangible assets, in particular, when human capital is important for the business, this is something that cannot be reliably estimated and then understates the cost of capital as in the case of capsules. So that is why I think this is really not an appropriate measure, and I just want to highlight once again that if you use other measures you do not find that there is anything out of the ordinary in terms of Flynn's margins.

So if you apply also this measure to the other products from Flynn, you would also find that they tend to be excessive.

So of course the CMA also mentions some other indicators. I just want to highlight once again that

absolute returns in themselves are not an adequate indicator. Some products may have high absolute returns, others less, but if they are a different product that does not tell you anything about excessiveness and for that reason, economists tend to use percentage returns when they look at profitability, but if you look also at the absolute returns per pack for Flynn in its portfolio, there is nothing exceptional for phenytoin.

The second point that I want to make is that there are references to return on sales by the CMA, but those are not real measures of actual returns. What the CMA does when it considers return on sales is actually link it to the ROCE, so the return that is allowed by the CMA when using a return on sales measure is actually a ROCE-based measure, the return on capital of the WACC that is built in the measure of the return on sales, so the return on sales threshold that the CMA uses as cross-checks are not independent measures of return, and even less so, you know, measures of returns that you would observe by firms in similar industries or in comparator markets. This just goes back to this measure of return of capital which is allowed and then added to the cost to be the return on sales measure. So that is why I think the CMA's indicators, the measure of

excessiveness, are not convincing.

All right, we can go to the next slide {XE7/1/9}. All right, so here I go a little bit more in detail in thinking about, you know, what this measure of return on capital employed means, the threshold of 10% that is used by the CMA, is it informative or not. So what I do is then I calculate this measure for the different products of Flynn and see what the return on capital is and whether it bears any resemblance to this threshold of 10% that the CMA apply and I find that it does not.

I am sure we will have a discussion and there have been exchanges in the reports on what is the exact right way to measure the return on capital employed, and we certainly will have some disagreements about that, but the point that I want to make is that the general point that I make here is not dependent on that, so that is why in this graph I present different methods for allocating licence values and intangibles. Mr Harman has, you know, in the past contested some of the measures that were used to account for that, so I take net book value, I take gross book value, you know, just to cover the different methodologies that have been proposed, and that does not change the picture.

So if you look at the graph you will see that most of the products have a return on capital employed that

is well above the 10% threshold that is set by the CMA, and also there is a huge variation among the different products, so that raises a question about how informative this 10% is, and I would argue based on that that it is just not informative at all to decide whether a product is priced excessively.

We can then go to my next slide {XE7/1/10}.

Yes?

MS STRATFORD: Sorry to interrupt, Dr De Coninck. I see the time.

We are in your hands, but I am mindful of your meeting, sir.

THE PRESIDENT: Yes, indeed. You are about to start a new topic, Dr De Coninck?

THE WITNESS: Yes.

THE PRESIDENT: Well, in that case, that probably is a good time.

MS STRATFORD: Sir, just before we do that, in case it is helpful for Professor Waterson, there was the question about what was the period and Dr De Coninck said it was the relevant period. That is completely right. If you wanted a reference for where those figures come from -- I hope it is acceptable for me to assist on that?

THE PRESIDENT: Of course.

MS STRATFORD: -- it is in Dr De Coninck's position paper at

{XE6/4/4} paragraphs 6 to 8 and footnote 4.

THE PRESIDENT: Thank you very much.

MS STRATFORD: I am grateful.

THE PRESIDENT: We are very much obliged to you, Ms Stratford.

Dr De Coninck, you are not in purdah, you will remain under oath, but if you want to talk to your team, then you are entirely at liberty to do so. You may not want to, of course, but that is a different matter.

MS STRATFORD: He may not want to. He might prefer a peaceful lunchtime.

THE PRESIDENT: We will rise, then, until 2.00. Thank you very much.

(12.57 pm)

(The short adjournment)

(2.00 pm)

(Proceedings delayed)

(2.08 pm)

THE PRESIDENT: Good afternoon, Dr De Coninck. Back to your presentation.

A. Thank you. {XE7/1/10}.

Okay, so we covered already two of the three points that I had in my presentation, so just to situate where we are, first I have made some comments on comparison between this case and *Lio* and *Hydro* and the stark

differences, then I discussed how the return measures, in particular, the return on capital employed measure used by the CMA is not informative in this case for determining whether prices are excessive, and now I will turn to the third point that I want to cover, which is the comparators that can be used to assess whether the prices charged by Flynn are excessive {XE7/1/11}.

So there are three different sets that I have considered: first, the other products sold by Flynn, first set, then I make a reference here to industry returns, in particular, those that were considered in the European Commission *Aspen* decision, and then I will talk about the tablets.

If I can go to the next slide {XE7/1/12}.

Right, so here we have the different products that are sold by Flynn. You will recognise on the right-hand side, that is the side that I showed already with a cost plus differential comparison for the different products, so we have covered that already. Here what I show on the left is the return on sales calculation for phenytoin compared to the other products in Flynn's portfolio.

We see phenytoin there in orange is really within the distribution of the return on sales that you observe for the other Flynn products, so that means there is

nothing striking as extraordinary in terms of returns on sales for phenytoin, it is very much in line with what you observe for the products, also highlighting that for a number of products it is negative. It is positive for phenytoin but well within the distribution. So there is nothing that strikes one as considering that the price based on this evidence for phenytoin would be excessive.

So we can go to the next slide {XE7/1/13}, which is then the industry comparators used in the European Commission *Aspen* decision.

So the approach that was taken by the European Commission in that case, in the *Aspen* case, is very different of course from what the CMA has done here. What the European Commission has done is to look at comparators and to look at gross margin and EBITDA for other similar companies to determine whether the prices and the margins that were earned by Aspen in those cases were excessive, right, so it is really a comparator-based analysis, so we can look at what the comparators were in that case, and we see that the gross margins that was coming from there was 54% in the Commission's decision, EBITDA of 23%, and the Commission considered both as alternative measures.

The Commission, and I think that is important, explicitly allowed for margin of tolerance above what it

observes as the average gross margin and EBITDA of its comparators and that is important. Why is that important, and it is exclusively recognised in the European Commission decision is that, well, you are looking at a number of comparators, if you calculate an average, you will invariably have a number that are above that. Does that mean that they are excessive? Well, not necessarily, right. So you have to allow for some margin of tolerance which is 10% to 20% in a decision, so if you factor that within the gross margin and EBITDA calculation the allowable numbers based on that decision would be 58% to 62% for gross margin and 30% to 36% for EBITDA, and then if you compare that to what Flynn's gross margin or EBITDA was during the relevant period you see that Flynn was either below that range or within that range, so for the gross margin it was at 36% to 39% compared to the 58% to 62% that would be allowed under the *Aspen* decision and for EBITDA it would be 33% to 36% which is also within the allowable range, and here I want to emphasise that I use the allocation methods for cost. That is the one that is preferred by the CMA, so that is conservative.

So that is the point I wanted to make with respect to the *Aspen* decision, so we can go to the next slide {XE7/1/14} and then I will turn to tablets.

First, why I consider -- so I consider that tablets do provide a suitable comparator market, it is of course a very similar market to capsules, then the question that was addressed in some of the CMA's experts' report is whether there is sufficient competition in tablets for it to be considered a suitable comparator market.

Now, what I think is very clear, and that evidence has been touched upon already and covered already in the morning, is that when you have had entry of Milpharm in 2012 you have had a very strong decline in the price of tablets, and thereafter you have had a stabilisation of the tablet price.

So the way I interpret this evidence is that it is evidence that competition has been working in this market because prices have declined significantly and then provide an indication of a market with sufficient competition that I can take into account further.

Then I go to my last slide {XE7/1/15} which then looks at the margins and compares the margins on the tablet market, so Flynn's margin for capsules and compare that to the margins that I have calculated, that my team has calculated for the tablets, of course based on a number of assumptions that I describe in the reports because this is based on the available evidence, but I think what is clear should be uncontroversial is

that if you compare the margins that Flynn is earning to the margins that are earned on tablets, Flynn's margins are significantly under the margins in the tablet market, including for firms at a similar level in the supply chain such as Wockhardt and Accord-UK.

So what I consider just in terms of conclusion is that the reason that the CMA considers that the price of Flynn is excessive is because it reduces the whole analysis to return on capital employed and there is limited capital employed by Flynn in this business. Also the capital employed that is used in the calculation does not capture and is not precisely calculated and likely underestimates the real capital employed, so we are basically in a situation where the CMA looks at returns based on very little capital. Those numbers are high. It then concludes that this is excessive, but that does not tell you whether the prices are excessive. The only reason why this is is because the basis to which they report those returns are to a very small base {XE7/1/16}.

That is my presentation.

THE PRESIDENT: Thank you.

PROFESSOR WATERSON: This is a very small question, but just going back to your immediately previous slide {XE7/1/15}. This is for the 100?

A. Yes.

PROFESSOR WATERSON: Thank you.

THE PRESIDENT: Thank you very much, Dr De Coninck. I have no further questions for you. We are very grateful to you, and we will see you shortly in cross-examination, hot-tub indeed.

MR HOLMES: Sir, I think we have come to Ms Webster, one of the CMA's two experts.

MS RACHEL WEBSTER (affirmed)

THE PRESIDENT: Ms Webster, good afternoon. Do sit down, make yourself comfortable. Mr Holmes will have some questions for you and we will listen to your teach-in.

Teach-in by MS WEBSTER

MR HOLMES: Ms Webster, you have produced one expert report in these proceedings and one position paper. For the transcript, the expert report is at {XE1/16}, and can I ask you whether the opinions in your report and the position paper represent your true and complete professional opinion on the matters to which they relate?

A. They do.

Q. I am grateful. I think we can proceed, then, immediately to your presentation. I think you have a slide deck prepared. Is that correct?

A. I do.

MR BREALEY: Do you have hard copies?

MR HOLMES: We do. That is to be found at {XE7/4}. I think the EPE will control the slides whenever you are ready to move through them.

A. Good afternoon, thank you very much for the opportunity to give this teach-in.

Perhaps if we could go on, it might be two slides and one more, please {XE7/4/4}.

Just by way of introduction in terms of what I would like to cover today, there are two things. One, I would like to set out my view on the questions that the Tribunal has asked prior to today, and then I would like to talk through what I see as the main areas of disagreement between the other experts and myself on the matters which I think are important for the Tribunal in this case.

In order to set the scene for those areas of disagreement, perhaps it is worth me -- they relate to the comparator analysis which has been the focus of my expert evidence and in particular, whether looking at comparators in this case leads to the CMA's findings that the parties' prices were unfair in themselves and excessive, whether that finding can be undermined by looking at comparators. So that is the sort of context for my work.

Now, what I have focused on in thinking about the validity of comparators is I set out two criteria which I understand are broadly accepted by the other experts.

The first criteria for a comparator to be relevant is that it should be comparator product that is sufficiently similar to the protocol in question, in this case capsules, that one would expect under normal competition for the prices of the comparator product to be similar to that of the focal product, capsules in this case. So there is a similarity criterion.

Then the second criterion is that the prices observed in the comparator market should be consistent with normal and sufficiently effective competition. I will then come to the disagreements between the experts as I see them.

The first three of these relate to tablet ASPs as a potential comparator. The first area of disagreement there is how should normal and sufficiently effective competition be defined, whether then the prices, the tablet ASPs, were at any point consistent with normal and sufficiently effective competition, and then, thirdly in relation to tablets, if one were to do a comparison, how would one construct a tablet ASP benchmark, and then what would a comparison of that benchmark with capsule ASPs show?

I will spend the majority of my presentation in relation to those three issues which I think are sort of primary consideration, and reflect the teach-ins for the other experts.

THE PRESIDENT: Thank you. Just a quick question.

A. Yes.

THE PRESIDENT: If you are coming to it later, do say and answer it when you wish, but you identified as your second proposition on the significance of comparators that prices should be consistent with normal and sufficient competition.

Now, does that mean that you have an a priori view as to prices converging to cost in a case where there is normal and sufficient competition? Is that your premise?

A. Yes, and I will come to that and explain.

So just to finish on this slide, I will at the end turn to two areas that we also disagree on: one is the value of the drug tariff price of tablets as a comparator, and then the value of the reimbursement prices of other AEDs.

Perhaps if we could go on one slide {XE7/4/5}. That is the running order. Let us go on another two slides, I believe {XE7/4/7}.

Before I turn to the question which you have just

asked, this is a comment on the first question which came from your note to inform expert discussion which was around whether the nexus between the upstream and downstream markets in the supply of capsules affects how one should think about the analysis in this case and whether those markets should be considered as one, and I make two points here.

I think there is benefit from starting an analysis of looking at a single product. Basically we have an upstream and a downstream entity, Pfizer and Flynn, and they are engaged in the production and distribution of a single product to market. I think it is, therefore, instructive from looking at comparators to look at the end price that the customers pay for that product, that single product, so I am talking here about the prices to pharmacists and wholesalers, and to look at that in comparison with other products. So that would suggest we look at the Flynn ASP and compare that with tablet ASPs, also measured at the same level of the supply chain, and I think that is a helpful starting point. It is agnostic to how -- the organisation within the supply chain for capsules, and I turn to that on slide 20 and show you what that shows.

It is also clear that Pfizer and Flynn were independent entities doing separate activities in the

supply of that product and it could be the case that to the extent that the end price paid by pharmacists and wholesalers appears to be unfair that could be caused by either Pfizer's price or Flynn's price or some combination of the two, and so I understand that it is necessary in these proceedings to look also at a comparison of Pfizer's price with comparators, if there are good ones available, and Flynn's price, and then to try to answer that question about which of those prices could have caused any unfair prices, and I will come to that as well.

Please could we turn to the next slide {XE7/4/8}.

Coming to your second question, which is whether continuity of supply guidance in this case would lead us to think of phenytoin as a case 2 product under the *Hydro* framework or whether alternatively it would be case 3. My view is that phenytoin capsules is one of those products that straddles the two, which I think you allowed for in that framework.

There are elements, in my view, about phenytoin capsules that could cause you to characterise it as a case 2 product. When there is continuity of supply guidance in place it is important -- sorry, I can see that it would be important that reliability of supply is available, is invested in. So manufacturing capacity is

kept open and operational and there is not a disruption to supply.

In that sense, there could be some value. It is also the case that continuity of supply guidance leads there to be lock-in for customers who are stabilised on Pfizer-manufactured capsules, and that creates an opportunity for prices to be high, reflecting monopoly supply, and that is sort of where case 3 is relevant.

So in terms of how I then think about it as an economist, I think it comes to the question which I think you have raised which is what should be the relationship between price and cost if competition is working well, and so I will provide my view on that in the next slide.

I think that that analysis can only get you a certain way to identifying an abusive price, and I consider that the difference between what economics can tell you and then where you get to as an abusive price is likely to be determined -- well, case-specific, likely to be relevant to policy considerations, sorry, policy considerations may inform that, and I will come to that.

THE PRESIDENT: That is helpful. Just to nail a possible ambiguity about straddling of case 2 and case 3, now, we have no problem in your reframing what falls in case 2

and case 3, that is one of the reasons you are here, but just to be clear about what we think *Hydrocortisone* says, is that case 3 is that case where there is no product differentiation and where the producer surplus is created solely through a failure to add value.

Case 2 is where there is some value added, no matter how small, and the reason for that distinction is because Hydrocortisone says nothing about how high or high far above cost plus a return price can go. All it does is say it can go above cost plus.

So in the case of case 3, because there is no generation of additional value, the line of an acceptable price should track cost, whereas in -- or cost plus, whereas in case 2, how far above that line you can go is a matter which Hydrocortisone explicitly does not answer, and that is where, according to my reading of the judgment, that is where the debate comes, if it is a case 2 case, but certainly allocation of a case to case 2 does not say you can price as you wish. That is, as I see it, the question that is open in these proceedings and is not answered in any way by *Hydrocortisone*.

The reason I say that is because I think it is important you understand what I understand by the Decision and you should feel absolutely free to

say: well, that is not a categorisation that works for me, you need to rethink for whatever reasons, or, if you are happy with it, then you can articulate why you say the push-up that class 2 recognises as a potential is one that should be limited in this case because you say the value added by way of product differentiation is small, and I am sure other people will say it is large and we can have that debate, but that is a different debate to the nature of class 2.

A. Thank you, that is very helpful.

If I may go to the next slide {XE7/4/9}, so actually just to pick up on something which you have said -- and again, it may be that I have not read *Hydro* in the correct way or not interpreted it in the correct way -- my understanding is that the *Hydro* framework is grounded in -- the starting point is what you would expect in perfect competition, and then there is a deviation from perfect competition that enables firms to charge a price which would be different from that which would arise in a perfectly competitive market.

So my reading of case 2 is such that you could end up with a firm, with a product with some differentiation. It charges a price which is above that which would result from perfect competition, it will be above the marginal costs that would be implied by that,

but it would still be located around cost plus.

So the situation that I see in case 2 is -- take a differentiated product: the differentiation, we are saying, comes with value. My starting point is that that value is created by some activity, and that would typically -- I do not know, investment in innovation, investment in brand, investment in manufacturing capability or investment in keeping manufacturing capability open. It attracts a cost. That cost generates value. If the consumers or customers in the market really value that, they will pay a price which will enable the firm to recoup that cost.

THE PRESIDENT: Yes, but I mean, let us take an absolutely clear case 2 example. Let us take a patent that is market-significant, I mean, there are any number of patents out there, most of them do not matter two hoots, because you can circumvent them, or they are just not worth very much, but let us take a genuinely market-changing patent and you get your near 20-year monopoly, and clearly given those assumptions, this is an unequivocal case 2 case. So you are, according to the logic of *Hydrocortisone 1*, entitled to charge at above cost plus.

Now, that is where I think the analysis in *Hydrocortisone 1* stops. How high you can go is

explicitly not answered in *Hydrocortisone 1*. The only thing that I think is answered is that the price level is not tethered to cost plus, but that is I think as far as it goes, and you may want to push back on that, feel free, but that is what I think the Decision is saying.

A. So in which case I may now rephrase what I was saying earlier to say I think actually in this case, then, with that understanding, it is more likely that we should think about capsules as a case 3 product, because I think if I go back to this example, there is some investment that is made by the company. There is no patent. We are considering a situation where there is normal, sufficiently effective competition.

If a price that has -- if a firm that has created a product which has some value, and it needed some costs to go in to create that value, it might be in the short term that firm can charge a price which is more than enough to recoup those costs, and it makes extra profit, but that extra profit will attract entry if competition is working well and there are not barriers that stop that happening. It might take some time, but over time competitors will come in, any existing competitors will expand, they will copy, and that will bring downward pressure on prices.

THE PRESIDENT: That is what we call the face mask example

in *Hydrocortisone*.

A. Exactly, yes.

THE PRESIDENT: But that is not every case, and let me just articulate why one might say this was not a case 3 but is a case 2 situation to see what you say. It is our old friend the MHRA guidance. Do you want to see it?

A. The continuity of supply guidance?

THE PRESIDENT: Yes.

A. I am probably sufficiently aware of it.

THE PRESIDENT: Well, if you want to see it, shout and we can bring it up.

A. Okay.

THE PRESIDENT: But what one gets from that, depending on how one reads it -- and you will have seen the debate I had this morning, but let us assume it is read in the literal way that I am reading it without prejudice to that not being a right reading. What one has in effect is a medically-induced or medically-motivated near monopoly because what it is saying to the doctor is: you should ensure that you stay not on a product but on a specifically-manufactured product, unless there is a really very good reason not to.

So let us suppose that is what the proper medical advice is. Is not the value one that is created by the manufacturer by simply staying in business --

A. Yes.

THE PRESIDENT: -- and they are entitled therefore to say for that reason, just staying in business: I am in case 2. The stinger is that, however high the prices go, you do not get the attraction of new entrants because by definition, the new entrants cannot turn themselves into that particular manufacturer, and so the face mask example at that point fails, and the high price does not attract new competition.

Now, that is, on that analysis, allocating or locating this capsule product firmly in class 2, but the question of just how high you can go and for how long is something which needs to be thought about quite carefully because the normal contestable market attractions where, you know, I can charge £50 for a face mask, well, that is great, but I will probably only be able to do it for a very, very short period in time because that price is going to attract everyone to shift from making, you know, napkins to face masks, but that almost by definition, assuming the reading of this, cannot happen.

A. That is right. So I think perhaps the way to cut through is to say irrespective of whether it is case 2 or case 3, what would I expect the relationship to be between price and cost plus in conditions of normal and

sufficiently effective competition, and my view there is that the costs that would have been incurred by, let us say, Pfizer in this case in maintaining reliable manufacturing supply, all of those costs can be measured in the cost plus, and I would expect sort of in equilibrium, long term, under normal competition, for prices to sort of tend towards that cost level, so it is probably a cost level that is different from perfect competition, so I am not imagining that. I am saying let us measure costs and investments in the real world and let us -- if competition is working well, then prices should sort of tend towards that level of cost plus. So that would be my proposition. That is as far as economics can get you.

There is then a question about sort of what you might then add before you got to a finding of an abusive price.

THE PRESIDENT: Well, does economics even get you that far? I mean, let us go back to the genuinely inventive patent where the market is for nearly 20 years not contestable. So you can charge what you like unless competition law engages to stop. What you are saying is that the trend of a competitive market ought to be to drive the price that the owner of the patent can charge down towards cost, and I confess I do not see that as following.

A. So I think the patent example is different than the situation that we have in relation to capsules.

THE PRESIDENT: Okay. Why?

A. Because in relation to capsules, you have a product that has been developed a long time ago. The differentiation here comes from quite a specific activity which is keeping open the manufacturing capability, and we can then look at what the cost is of keeping that manufacturing capability in the market, and that will equate to its value.

THE PRESIDENT: Sorry to interrupt, of course you can, but why does that follow as a matter of necessary economic analysis? I mean, the whole point about property rights -- and this is a bit like a property right -- the whole point about property rights is excludability, and what it does is it gives you the ability to say: you cannot do this with my property unless I agree, and I may, if I so choose, extract a price for you to access my property, and here we have a property in the form of a capsule. The MHRA restriction adds value in that it drives people to that product, but you are still entitled to say: well, if you want my product I can charge what the market bears, and I confess I am not sure I understand why it is that the outcome of my saying for a capsule in this area: if you want it, then

you have to pay what I charge, why that is any different from the case of a patent where you say: well, I have done the R&D, I have a state-sanctioned monopoly and I can charge what I like.

Now, of course those two cases are different, but they are only different if you are importing a kind of embedded value judgment in that patents are good and this exploitation of the MHRA guidance is in some way to be qualified so that you are to be forced to go down to a price that trends to cost.

A. Yes, so the difference that I see is when we are talking about a patent, there is an investment made by the company in developing something that is genuinely new and innovative, and will have attracted lots of costs associated in order to get there, and the patent exists in order that the company can recoup that and it will exist for a period of time which is judged enough sufficient for those costs to be recouped and to incentivise the other companies presumably to engage in similar innovative activities.

What we have in this situation with continuity of supply is a market regulation that comes in that says: we do not want patients to be switched once they are stabilised because there are health benefits of doing that, and so rather than there having been

investment in something which is genuinely new, innovative, we just have a regulation which says there is a lock-in for these customers.

So I think the source of the value is different in those two cases. Now, where I really think there is value, or potential value, is the investment that Pfizer then makes in ensuring that it can deliver against the continuity of supply guidance. It is making sure that it has the reliability of that supply, and that brings value.

Now, the question -- so to my mind what we are saying is we are having to almost conceive, are we not, of what would happen under normal competition, because, as I have understood it from the test that I have been described, we want to make sure that when we are assessing whether a firm has set an abusive price, it is whether they reaped benefits that would not have been available under normal and sufficiently effective competition.

So I am hypothesising that, if you like, the lock-in part of the continuity of supply does not -- I am sort of setting that to one side, if you like, because it allows for a higher price to be charged which is equivalent to gouging, and I am trying to say if competition were working normally, what would be the

value that people would be willing to pay for the fact that Pfizer has kept its manufacturing open, and that would tend to be the level of costs it has had to invest in order to do that.

THE PRESIDENT: You have made, if I may say so, an excellent point, but I think it is uncovering a deficiency in the workable competition definition that I was discussing with Dr Majumdar this morning.

There we settled pro tem, and I certainly reserve the position to resile from it at any point in time, and I think I am about to do so, we settled on a definition of "workable competition" or "normal and sufficient competition" which I think we can -- equates to the same thing, as a state of competitive affairs which excluded the cartel and excluded the dominant position.

Now, what was omitted from the definition, and what I think we may need to factor in, is that actually the Chapter II prohibition is not triggered solely by dominance. Dominance is the gateway through which one must pass before one is entitled to ask whether there is an abuse.

So it may be the case that actually a state of affairs of dominance is consistent with sufficient and workable competition. Now, if that is the case, then you cannot magic away the dominance, you have to ask

yourself what happens if I magic away the abuse, and the trouble with that is in price cases, the magicking away of the abuse is circular because what you are doing is you are saying: well, the price is excessive, therefore I must magic away the excessive price, but you do not know what the excessive price is because you have not magicked it away.

If you have another sort of abuse, like an agreement to control access to a market, for example, that is something which you can quantify more easily by reference to price disadvantage or price advantage.

Here, the difficulty is that if you are dominant, it gives you a certain degree of market power, but that market power may or may not be legitimate, and so it may be that the magicking away of dominance involves the magicking away of the very thing that one is investigating, namely the patent or the medically-induced buyer from a single manufacturer restriction.

A. I suppose what I have -- if we call this magicking away dominance. I am trying to answer the question about whether the price that would be charged would allow the firm to reap a benefit that would not be available in normal and sufficiently effective competition -- under normal and sufficiently effective competition, and so

I am hypothesising what happens in markets where competition is working normally, and perhaps the simple point that I am making is that when competition is working normally -- and I will come on to this further -- there will not be barriers that get in the way of entry and expansion.

So your face mask example is a good one, that is a market that is working normally, and when I look at that type of market in the long run -- so in the short run you might have prices that are above cost plus, but in the long run I would expect prices to tend towards cost, and that will also reflect where that cost reflects the investment made in the added value.

THE PRESIDENT: The face mask example is to that extent a very easy one, because the time period in which one can render oneself a competitor is pretty short. The problems arise when one has an embedded form of non-contestability of which the patent is probably the best example but the present case, I suspect, is also a very good example, but let us take something where -- let us take a mobile phone network. Let us take a situation where you are over the years establishing the technology, working out what works, what does not. All the while there is no revenue coming in. You build up, eventually, the infrastructure to actually launch

a vaguely saleable commodity. Now, you have spent millions, tens of millions on this, and you then get an ability to say: well, come and use my network, and at that point you work out how you are going to charge this, and the marginal cost that you are going to charge to the first user of your network, it is not going to be 100 million quid, is it, because I do not think you will get many people coming in; it is going to be a certain level that will attract people in which will actually have no bearing on cost at all. It will be as much as you think you can get in order to achieve network viability, in other words, you are balancing the use to the user of the network against its price, and, as your network gets more successful and you attract more and you roll it out to more people and its usefulness increases, so too the marginal rate you are charging becomes a rate that is significantly above cost so that you are, if you are really successful, getting to a stage where actually the marginal cost is tiny because you have recovered all your millions spent and in fact the 30p per minute or per second that you are charging is pure profit.

Now, at that point, you have a very detached relationship between cost and profit which is also true of the patent, because you have a situation where you

have your near 20 years' monopoly, you can, subject to the restraints of competition law, charge what you like, and there is no necessary correlation between cost and price except what you are importing, and that is what I am really pressing you on, which is why is it, on what basis do you say that competition law creates this cap? Where is the ceiling?

At the moment the range I have is somewhere above cost plus to the gross national product of the world, and it has to be lower than that, but how one articulates that ceiling is something which is rather difficult.

You are saying: let us pretend the patent does not have the duration that it has, or let us pretend that you have not invested the years of work, let us have a price which is in some way calibrated to the costs you have spent in your service and let us make sure that you are capped at a certain point where you have managed to recover your costs and a reasonable rate of return.

So if, for instance, in my 20-year patent I have recovered my costs on that basis after year 10, you would say competition law should bring down the shutters and push the licensing rates for the patent down to essentially cost plus at that point in time.

I understand why you are saying that, but I do not

understand how you get there.

A. Okay, so perhaps we should go on in the slides --

THE PRESIDENT: No, no, of course, I am so sorry.

A. -- which I think will help.

THE PRESIDENT: I will shut up and you take your own course.

A. That is fine. On the telecoms example, certainly I agree with your characterisation of price likely being divorced from marginal cost. I mean, I do not know whether that would be the case in relation to a measure of cost plus as applied to that industry and to that firm. My point is a more general one about just the operation of competitive markets is if firms are at some point able to make sort of supernormal profits, that will attract entry and that will change the competitive dynamic and over time, one returns to this sort of level of prices which is perhaps broadly consistent with cost plus, but perhaps if I can go on to my next slide and I will be able to put this in more context, so if we could turn to the next slide {XE7/4/10}, and actually let us go to the slide beyond that {XE7/4/11}.

Just to summarise I think where I have got to. I am starting with these red shaded boxes: direct costs of production per unit supplied and then a margin to cover investment costs and a reasonable rate of return.

So my understanding -- you know, if that is done

well and properly and fully inclusive, that is what cost plus is measuring, so it is not the sort of direct cost of production only, and it is not even just the marginal cost of production where prices would be if we were in perfect competition.

So my starting point is that a price that is consistent with appropriately measured cost plus, so it is the lowest dashed blue line, would be one that is consistent with normal and sufficiently effective competition in equilibrium, so over a sort of longer term period, and in my view I would not be saying that prices above that are naturally abusive. So in your patent example, if a firm has recovered all of the costs and then is making supernormal profits for the next 10 years of the patent that remains, that would not then lead to a position where you found that to be abusive and you ask for the price to come down.

I think there is a range which is shown here in the grey box where you would say: okay, a price can be above cost plus and still not be abusive, and then I think that is probably case-specific, and it may be governed by legal or policy factors.

An example of case-specific reason for having a largish grey box could be that it has not been possible to measure cost plus with accuracy so there

needs to be a margin of error.

Another reason could be that -- actually, we are just seeing this as a temporary phenomenon, so you may get quite a large grey box if you just think actually over time we have an expectation that these profits, when observed by others in the market, will lead to entry, will lead to competition. That is competition in action, and the price will come down, so you might not want to intervene in such situations.

Then you may have -- you know, this is the policy around what is the level of tolerance that you want to build into the system. So where that sort of leads me to is I cannot tell you as an economist where this middle blue line lies, where a price stops being allowed and becomes abusive. That middle dashed blue line is going to be different in different cases and it will be a judgment.

Where I think that gets me to in this case is I am interested in where the price actually was and how far above the cost plus is it. The further it is above cost plus, the more likely I am to be concerned that it would be abusive, and the longer it stays there, and that would also lead me to a conclusion that it is more likely to be abusive.

THE PRESIDENT: Yes, I see. Do you mind a question?

A. No, not at all.

THE PRESIDENT: My question is this: so the upper line -- the dashed blue line labelled "Illustrative focal product price" is the price actually charged by our allegedly infringing party, so that is the price. What we are asking ourselves is, is that price excessive and unfair.

Now, the way you are approaching it is you are saying: look, let us say that the price at your lowest blue dotted line is the floor of a legitimate range. Indeed, if you go below that, you might be arguably undercutting other people in the market, but let us not go there, it is the floor.

A. If I may just, on that point.

THE PRESIDENT: No, of course.

A. I think that in reality, I suspect there will be a range of prices around that bottom dash.

THE PRESIDENT: Yes.

A. So at some point prices will go a bit below that, it may then force someone out of the market, then the price goes up a bit. It is a process, is it not?

THE PRESIDENT: I quite accept the dynamism and I am certainly not holding you to a flat level line over time, but what you are saying is that between your upper and your lower lines, we have a ceiling and a floor.

A. Yes.

THE PRESIDENT: What we are talking about is where the mezzanine should go.

A. Yes.

THE PRESIDENT: You are starting your articulation of the mezzanine from your low blue line, from the floor, because what you are saying --

A. Is your mezzanine separate from the ceiling?

THE PRESIDENT: My mezzanine is a floating line between the floor and the ceiling, but it is not tethered to either at the moment, but what I am suggesting to you is that your mezzanine, the middle blue line --

A. Ah yes, thank you.

THE PRESIDENT: -- is tethered to cost plus, in other words, what you are saying is that the mezzanine should in some way correlate to the floor. You are saying, of course, that that correlation is less than perfect because of the whole range of factors contained in your grey box.

A. Yes.

THE PRESIDENT: What I am putting to you is, is that putting it the wrong way round? Given that we are talking about a price that is presumptively legitimate -- in other words, we are not presuming abuse, we are simply ascertaining dominance and asking whether the price is abusive -- whether one ought to start at the ceiling and

ask whether there are factors which cause the need for the ceiling to be adjusted downwards by the interpolation of a mezzanine which is above the floor by definition but below the ceiling, but you compute how far below the ceiling the mezzanine goes by reference to the sort of policy factors that you are articulating.

So in a sense, I am doing what you are doing but starting at the other end because what you are doing is I think you have -- it is not quite a presumption, but a weight being attached to the floor which I am not sure is justifiable, and what I am doing, by this example, is I am attaching a weight to the ceiling because that is the price in a dominant situation, but I am not saying that that price is immutable, what I am saying is that price may be too high and then all we need to do -- by "all" I am putting that in quotes because it is a very difficult job -- but all we need to do is ascertain the factors that cause a competition court to say that the ceiling is at the wrong level and that the right level is a mezzanine moving down from the ceiling.

Is that an articulation that you -- well, how unhappy are you with it?

A. Perhaps I can answer that by explaining why I have started from the floor, which is going back to the guidance which I have been given on the relevant test,

which is to say: is this firm that is charging an allegedly abusive price reaping benefits that would not be available under conditions of normal and sufficiently effective competition? So I see as a starting point trying to get a handle on what would be the price under those conditions, and cost plus is one measure that we can use to get a handle on that.

I think the comparator analysis is another measure, and in the ideal, one would find other comparator products and prices which also lend weight to understanding where this bottom blue line lies.

So that is my motivation, if you like, for grounding it in that way. Perhaps my other observation is when we take a product where it is an essential product to the customer and demand is very inelastic, the ceiling can be very high indeed, the actual price can be very high indeed, and I think that is another reason for thinking: well, you know, by how much do we then need to see that reduce? That is where I think the test comes in again: well, we need to be focusing on what would be achievable under normal competition.

Does that answer your question?

THE PRESIDENT: Maybe to about 60%.

I think the first reason you did not get a perfect or 100 is because you, in your answer -- I just have it

on the transcript -- you said:

"... I can answer that by explaining why I have started from the floor, which is going back to the guidance which I have been given on the relevant test..."

Now, I think, if I may, with great respect to those who have given you guidance, ask you to jettison that because my sense is that the relevant law is in a state of sufficient uncertainty for us not to be wanting to commit to a particular guidance in terms of floor. Now that is something that we can have an argument about in closing, but it is not an argument I want to have with you. So I think I am going to ever so politely invite you to abandon that reason for starting from the floor and to instead try to articulate what, as an expert economist, is the better place to start given that I think we are at a stage where your ceiling price is the price that is arising out of the conduct of a dominant but not necessarily abusive undertaking, and if that is the approach, well, does that inform your floor or ceiling differently? The second point I would make and it is more clarification on my part, when I am saying that there is a tether to the floor or the ceiling, what I am saying is that that is representing your starting point. I am not saying that you need to

have your mezzanine tied by any fixed amount of margin between either the floor or the ceiling. The tether, I am imagining, is as a starting point, but if you imagine the mezzanine floating from the ceiling by a very elastic set of bands which enables you, by reference to factors that we have yet to articulate, to push the mezzanine down towards the floor by whatever amount is appropriate, can I regauge your unhappiness with the way I am putting it?

A. So I think I would then go to the second reason that I expressed a moment ago, which is when we are looking at a product where it is an essential product with very inelastic demand, that price can go very high indeed, I need some way to think what would be reasonable, non-abusive. It is not gouging of customers.

Then I will look to the set of comparators that are available, and what I want -- and so cost plus then is still one of those comparators, and the other comparator could be the price of other products, and what I would then be looking for in the price of those other products are situations where there is equally no gouging of customers as a result of firms in those comparator markets having market power.

THE PRESIDENT: It may be that the answer is this: you have identified as -- go back to your -- let us push the

floor up, so we will go with your framing of matters. So the mezzanine is tethered to the floor, contrary to what I have been putting to you a moment ago. What factors, apart from cost and cost and comparators I am including in that, what factors cause the mezzanine to move up from the floor apart from that one which you have articulated? Can you give me a few other examples of what I ought to be, and my colleagues ought to be thinking about when we are locating the mezzanine?

A. So the degree of confidence that one would have in the measurement of cost plus. So are there any categories of cost that it would be reasonable to include that have not been included, the way in which cost plus has been done, has it taken the most conservative measures of cost plus, and sort of erred towards getting the lowest cost plus measure that would be possible, where there would be other interpretation, it could be slightly higher. So that is one, that is the measurement of cost plus.

I think another one brings in the temporal dimension. So is there a situation where the price is high for a period but it is clear that the operation of the market is such that entry and expansion can happen and that competitive forces can then bring down that price? For me that would mean that I would want to see

the grey box being larger because I would not want to intervene in a way that then gets in the way of the competitive process working, so that would be a second.

A third, which is nothing to do with economics at all, would just be the degree of tolerance that the decision-makers want to embed in the system.

THE PRESIDENT: Can I suggest two other factors, because at the moment most of your factors are very closely tied to cost, and I am wondering whether there is space in your conception for factors that go beyond cost, that are nothing to do with cost.

What about simply -- I know I am opening a new can of worms -- what about economic value? Another one: what about need? Are these things that ought to be considered when locating the mezzanine, or are they not something that ought to feature in your conception of how this works?

A. So in my view, the economic value can be captured within cost plus. So the value typically -- you know, it will not be the case if we are talking about Pavarotti, but value typically comes from the investment that companies will make. So there will be investment in innovation, new product design, customer relationships, and brand, and those costs are then measurable and would be included and can be included in a cost plus measure.

THE PRESIDENT: Okay, I probably should have been clearer. I am talking about the value that the consumer derives. So by definition, the consumer is paying a price which they are prepared to pay, assuming they have the cash to pay it, and that represents the minimum of the value that they are deriving from it, and it is only a minimum because there will, except in the ultimately marginal consumer, there will be a consumer surplus above that line, and that is what I am looking at when I am talking about value. I am saying there is a reason people are paying the top line price. That is because in some cases they want to pay it. They obviously would want to pay less if they are halfway rational, but they are paying that price, otherwise the transactions would not happen.

So there is obviously a value there that is not related to the costs of the supplier. The value is related to why it is that the consumer is paying this amount of money, and what I am asking is, is the assessment of the value that is derived to the consumer something that ought to apply in informing where the mezzanine should sit?

A. So it might help if I think of an example. I have a customer, a set of customers, and let us say they have high willingness to pay for this product. That high

willingness to pay would imply that if they have no alternative option, they will pay a very high price indeed for a product in question because of the value that it brings to them.

Now I consider, let us say, the same product, the same set of customers, but I am imagining, I do not know, three or four firms all producing this same -- well, let us say two of the firms have invested and produce a valuable product, and two of them offer something which is sort of a bit more bog standard.

The customers in that situation have a choice between paying for the product where there has been an investment in this value, or they could choose not to, and they buy the bog standard, but they have choice, and then what I would expect is that the premium that the firms that have invested in the more valuable product would be able to charge will be limited by the extent to which there is choice, and if there is proper competition over that value creation then in the long term it would not be possible to price the value added product in a way that derives profit above sort of cost plus in equilibrium, so competition over the valuable product, whatever, where customers have choice between more suppliers, they will pay for the value, yes, but they will not pay more than that.

THE PRESIDENT: Well, they will never pay more than what they value.

A. Sorry, what I mean is they will not -- let me see if I can explain this better. When a customer has no choice then the firm that is producing this product, which will have some value, the firm can price to reflect that customer's value and some element of that is there is giving the customer real value and some element of it is gouging, because they can, because the customer is not going to go elsewhere.

What happens when you introduce competition in relation to this product that has value is that the competition between the firms who are bringing this valuable product will mean that the price of the product will come down to a level which is necessary for them to recover their costs.

So, again, it is the competitive process which means that even when there is value, the value will be reflected in a price that rewards the firms for having invested in it but no more.

THE PRESIDENT: Let us put a little bit of meat on the bones of that and let us take a non-needs-based example of a product that attracts a premium payment that is not necessarily correlated to price, and although I am going to use, because it helps us visualise the example,

although I am going to use an example, I stress it is hypothetical, but let us take a Rolls-Royce, something which has a huge prestige, and let us assume -- I have no idea if this is right or not, but let us assume that in the luxury car market, Rolls-Royce have a nicely dominant position of, say, 60% of the luxury car market and we are defining the relevant market as the luxury car market and we have two other brands and because in my hypothetical example they are inferior I will call them A and B rather than identifying anything else. So we have Rolls-Royce, A and B, and Rolls-Royce is charging well above cost. They are, if you like, but I think it is a tendentious way of putting it, they are gouging the market, they are charging a million and a half for a car that costs £300,000 to make, and they are doing it because they can, and that is the upper price, the ceiling, that they are in fact charging, and obviously by definition there are enough consumers out there who are willing to pay a million and a half for this car because they are doing so. We can say, therefore, that they are getting value to that monetary amount plus some, we do not know how much more because this is all subjective, but we can say at the very least that they are getting value monetised to the tune of a million and a half.

Now, do you say that there are any circumstances in which that price can be an abusive price?

A. I think it comes down to the extent to which the customers have choice.

THE PRESIDENT: Right.

A. If the customers have choice and have chosen to pay that, then that says something about --

THE PRESIDENT: It says something about value.

A. It says a lot about the value, but I think that they have to have choice in order that I am satisfied that that would be not abusive.

THE PRESIDENT: Right, okay. So I have postulated the two other manufacturers A and B. They are substitutes because they are in the same market, but they are, let us say, charging not a million and a half but they are charging £500,000, so there is something different, and in this market the consumers are choosing, because that is the profit maximising price for Rolls-Royce, they are choosing to pay a million and a half, and Rolls-Royce will have applied their mind to what is the best price, should it be higher, should it be lower, and the consumer is applying their mind to what pleases them --

A. Yes.

THE PRESIDENT: -- but they can always shunt to A or B --

A. Yes.

THE PRESIDENT: -- and that is their choice, but they are choosing not to in this particular example. So in this particular example, does competition law have any role at all?

A. So, again -- and we should add in another factor. So if the customers are not choosing A or B, it might be because they consider A and B to be such poor substitutes that in effect they are not credible alternatives to them, so I think that would be one consideration. Is that the reality of what we are seeing?

The other dimension which I would add in is, let us say A and B are really poor substitutes. Then we have a situation of Rolls-Royce being able to charge what it wants for its product and there being limited constraint from the others in the market.

If one is then thinking: well, what happens under normal competition if it is working well, I mean, there are obviously huge rents which are being made by Rolls-Royce and one would expect that to attract entry.

So if we assume competition is working well, there are not barriers to that entry, that means others can come in and invest in a brand and potentially do better than A and B, so one might expect the returns that Rolls-Royce are making to be short-lived until that

entry becomes established.

One might otherwise say, well, look, actually, developing a brand that is capable of competing with Rolls-Royce is really very, very difficult, and the barriers are insurmountable, then that is a different state of the world in which Rolls-Royce is protected from competition.

THE PRESIDENT: Well, bear in mind in this example we are postulating that if you applied a SSNIP to the Rolls-Royce people would default to A and B, because otherwise they would not be in the same market. So we have a situation where Rolls-Royce are pricing at the limit, an increase in price is not going to enable them to maximise their revenue and so their profit, so they are, on that definition, A and B are substitutes and that is just --

A. Although that could result from the cellophane fallacy where they have pushed their price to such an extent that the next movement would be unprofitable, but --

THE PRESIDENT: I can see that, and obviously one would have to test for that.

A. Yes.

THE PRESIDENT: But let us assume that I am not the Supreme Court in that particular case in the United States, but I have actually got my market

definition right.

Now, it may be that you are saying that the example is an improbable one, and I am not sure I would disagree with that, but my point is that on the fact constellation I have given you, there are substitutes because otherwise I would be defining A and B out of the market, and so what I am giving you is an example -- maybe it is improbable, but nevertheless an example, where your tethering of the mezzanine level to cost is not working, at least on this example, because what I am putting to you is a situation where actually Rolls-Royce are charging way above cost, way above what their substitutes are going for, and yet people are paying, and what I am saying is, is that consumer value, given the choice, a relevant factor that ought to ensure that my mezzanine is in fact at the higher end, closer to the ceiling than it otherwise would be?

A. I think I could agree with that in the sense that this situation that you have described is clearly identifying that there is a value, that customers can see the value in the Rolls-Royce, and that is the reason why the premium is paid, I agree with that.

So where one can clearly pinpoint value, know the source of that value, know that consumers have chosen to pay that price, reflecting that value, knowing that

there are alternatives for them, I think that could then be a relevant consideration, yes.

THE PRESIDENT: Thank you. So we have added one other factor at least to cost.

A. Yes.

THE PRESIDENT: Can I float another one which I suspect you are going to agree with rather more quickly which is this: need. Let us take a situation where the product is such that you do not value it because you want to have it but you value it because you need it, and it will be hard, I think, to construct an example like the Rolls-Royce example because need implies a tethering or a tying of the consumer to the product which eliminates substitutes.

A. Yes.

THE PRESIDENT: But we can all try and think of an example that involves competitors, but I do not think it matters for the present sake of argument. What I am saying is that if one has a situation where there is need rather than desire, would that be a factor that would cause the mezzanine to push much closer down to cost rather than as with the value example, push the mezzanine much closer to the ceiling?

A. Yes, I would agree with that.

THE PRESIDENT: Again, need is not something that is located

in the cost base of the supplier; need is something that is located in the needs of the consumer. So I think what I am putting to you, and what I think you are agreeing with, but do push back because that is the point of these teach-ins, what I think I am suggesting to you is that although for sake of argument I am prepared to accept that cost is a relevant factor in locating the mezzanine, there are a whole range of factors that arise out of the state of the consumer's position which are independent of cost to the supplier but which are relevant to benefit to the consumer that we also need to factor in when we are locating our mezzanine between these two extremes. Would you accept that as a framing of the factors that go to the location of the mezzanine?

A. Yes, I think I can accept that.

THE PRESIDENT: I think I am going to try and shut up now, I also think we need a shorthand break, but can I just reassure the parties that I hope there is a benefit to everyone that -- I appreciate one might say that Ms Webster is getting an unfair shake of the dice in terms of the time that she is getting in front of the court, I am not sure she would necessarily agree with that, but everyone is getting a signal as to what is concerning us, and to be clear, there are a number of

the points that we have discussed which arise out of the Mr Holmes' inspired coffee shop example that we will be coming on to I suspect now tomorrow, and we will ensure, Ms Webster, that you have less to say about that and the other experts more, because I have a very clear understanding of where you are coming from, but I do not want anyone to feel that we are inappropriately monopolising Ms Webster's time, and I know the CMA will not have that problem, but I am thinking about everybody else.

We will rise for 10 minutes until a quarter-to. Thank you very much.

(3.35 pm)

(A short break)

(3.52 pm)

THE PRESIDENT: Ms Webster.

A. Thank you very much.

THE PRESIDENT: We had better bring up the page that we were on last. I confess -- here we are {XE7/4/11}.

A. Thank you. So I think that concludes my comments that I wanted to make on the questions that you had posed leading up to today.

If we could turn now, I think, two slides on, please {XE7/4/13}. Brilliant.

I will now talk through the analysis which I had

done and my views as set out in my expert report. These focus, as I say, on the question of what can be learned from comparators in this case. What I have done here is just to provide an overview which we can then use as a route map for what I will talk through. There are three comparators in this case that I have considered following what is in the CMA Decision and also in the parties' notices of appeal.

The first is tablet ASPs, the second is the £30 drug tariff price for tablets, and then the third, weighted average reimbursement prices of other AEDs.

In each case, I have considered the two criteria that I set out at the beginning of this teach-in: do I think the comparator product is sufficiently similar to capsules such that looking at the price of the comparator products will be informative? Then, second, thinking about whether the comparator prices themselves that have been put forward are ones that are consistent with normal and sufficiently effective competition.

If I take tablet ASPs first, just to summarise my position, we have heard evidence I think already, or opinion, that tablets really were very similar to capsules in terms of their effect, and I do not see any reason why they are not a good comparator given the similarity. I would note one thing, which I think also

Dr Majumdar mentioned earlier, which is it is clear that the tablet market was smaller than the capsule market, and I think by a factor of four, so it is quarter the size, and that may have a bearing on a price in relation to tablets that is associated with normal and sufficiently effective competition that may be higher than the price one would expect for capsules under normal and sufficiently effective competition.

THE PRESIDENT: You do not have any insight into why that proportion exists, four to one?

A. No, I do not, but I work on the -- and I cannot say in this case whether the small market size per tablet, the smaller market size, would lead to a price under normal and sufficiently effective competition that was higher than it would have been for capsules. I note that it is a possibility, so I proceed on the basis that it is probably a sufficiently good comparator from the perspective of similarity of product.

So then turning to my view on whether the tablet prices, ASPs, would have been consistent with normal and sufficiently effective competition, and here my view is no, and I base this -- and in fact, everything shown on this slide and my analysis is based on what I have taken from the Decision, the remittal Decision. I have not looked at the underlying primary evidence that the CMA

collected, so I am relying on what I have read in the Decision. I think I have looked at one call note in particular because it was something that was raised by Dr De Coninck.

So in relation to tablet ASPs, based on what I have read in the remittal Decision, I think there are two factors that are important for me. One is it appears that at all times in the tablet market there were barriers that limited competition, and my view, having understood the nature of those barriers, is that even in period 3 when there were three suppliers in the market, I considered them to have been such that one would expect competition to be limited to a substantial degree.

The second is that period 3, when competition did appear to be taking off, it was intensifying, it was a relatively short period, and starting from a point where there was not effective competition, that period then when competition started and it intensified I have suggested that is 16 months. That is quite a short period relative to what certainly the Oxera study found in relation to the time it takes for generic competition to develop to a point at which prices are probably consistent with normal and sufficiently effective competition.

I think I observed in the Oxera report, prices are still transitioning over sort of eight quarters, so 24 months rather than the 16 months here, so I think that would be another factor that causes me to doubt that prices developed to a point that would be consistent with normal competition, so that is tablets' ASPs.

In relation to the drug tariff price and the relevance of that as a comparator, it is the same position in relation to similarity of product as I have described for the tablet ASPs, obviously the same product. In this case, in relation to whether this price is consistent with normal and sufficiently effective competition then my answer to that is no, my view is that it was not a price consistent with normal and sufficiently effective competition, and firstly, that is because it arose through a process of bilateral negotiation between two parties: a monopoly supplier and a monopsony buyer, and the context previously was a drug tariff price of £114. They landed on 30, but, you know, that is just where they landed. There is nothing which says that that price would be at a level consistent with what one would expect if competition were working well.

THE PRESIDENT: It is not the outcome of competitive forces.

A. Yes, and nor would I expect that bilateral negotiation

to land on a price that would be consistent with the price that would result from competitive forces.

Then indeed, when I then compare the drug tariff price with the tablet ASPs, there is clearly a big difference, and I will show that later in the pack. So that is my position on the drug tariff price.

In relation to the prices of other AEDs, based on the CMA's -- what is written in the CMA remittal Decision, and I have also looked at the CAT judgment from the first appeal, which I think comments on sort of less similarity between other AEDs and capsules as compared to the similarity that exists between tablets and capsules, based on what I have seen I can only take the view that -- sorry, I cannot be certain that there are sufficient similarities in these products for them to be good comparators.

I also then am worried that -- sorry, "worried" is the wrong word -- my view is that the prices that have been put forward in the Pfizer notice of appeal which prices for five other AEDs, these are prices which are a blend of the generic price and the branded price. The generic prices, assuming there was sufficient competition in those markets, which I do not know, is not elaborated on in any of the evidence that I have seen, it is possible that the generic prices are

consistent with normal and sufficiently effective competition.

My view is that the branded prices will not be. These are reimbursement prices, they are not the price that was necessarily charged by the brand to wholesalers or pharmacies, it is the price which is set under PPRS that determines reimbursement. For that reason I think those prices that are put forward as comparator prices would not be appropriate prices.

I then look at the generic prices for those five other AEDs, and I find those to be below the level of capsule pricing, so, again, I will come to that.

The main area of disagreement between Dr Majumdar, Dr De Coninck and myself is in relation to the sort of second half of the table and the view on whether these comparator prices are consistent with normal and sufficiently effective competition.

So perhaps I will turn now to expand on my points in relation to tablet ASPs, so if we could go to the next slide, please {XE7/4/14}.

This may be relatively quick given our discussion earlier. I set out my view -- this is the first element of the disagreement in relation to tablet ASPs, is how one should define normal and sufficiently effective competition. It does not have a specific meaning in

economics, it is perfect competition at one end, there is monopoly supply at the other end, normal competition is somewhere between, I would argue closer towards perfect competition than to monopoly supply, but it is a matter of judgment, and my view is that a market stops being consistent with normal and sufficiently effective competition when one observes that there are barriers that limit competition in the market to a substantial degree. They get in the way of customers being able to switch to have genuine choice. They get in the way of profits being whittled down because entrants come in, they replicate, they expand capacity. It is something which stops that competitive process -- firms responding to other firms, responding to the customer needs -- gets in the way of that process happening.

So any market which is characterised by substantial barriers to competition I would say is not normal and sufficiently effective competition. I think there can be a degree to which there are some barriers, some frictions, there will be some product differentiation, so I am not saying we need a benchmark here which is perfect competition at all. It is just in my view it is not right that we bake in substantial barriers to competition.

This is where I differ in my view, as I understand

it, from the other experts who would say we need a benchmark for normal and sufficiently effective competition that is realistic, so it is the competition that can exist in a market given the constraints that operate in that market, and I have added a quote in the slides from Dr Majumdar, but my view is that does not seem to be the right benchmark in the case of trying to assess whether there is abusive pricing.

So it is likely that the abuse in any market comes about because there are barriers to competition. If I then find a benchmark market which has similar barriers to competition, I similarly might expect prices in that comparator market to be above a level consistent with normal and sufficiently effective competition. So then I am comparing an allegedly abusive price with a price which is equally not -- you know, it is inflated because a company is taking advantage of those barriers, that could be the situation, and that comparison then enables -- it justifies, if you like, a firm being able to exploit the existence of barriers to competition.

THE PRESIDENT: I have been biting my tongue because I do not want to interrupt too much, but I will because where there is something where I am not completely happy with the way you have framed something and I think it matters, I think it is appropriate to articulate it.

You said a couple of minutes ago: it is perfect competition at one end, monopoly supply at the other and normal competition is somewhere in between, so you see it as a spectrum.

A. Yes.

THE PRESIDENT: I am not sure that is right because the one thing that perfect competition lacks is product differentiation, and that is what the real world has which perfect competition lacks, and so you are defining barriers to competition as more or less entirely illegitimate and I think that you need to classify the barriers to competition as, going back to Hydrocortisone case 2 and case 3, because providing proper product differentiation is -- it is an odd use of language, but it is a barrier to competition because by providing something that people want, you are able to eliminate the competition, but in a good way, and that is case 2.

Now, I say that entirely neutral to how high you can price, we have been through that.

A. Yes.

THE PRESIDENT: Case 3 is your illegitimate barrier where there is no product differentiation, and so no justification beyond the illegitimate, to charge more, and so I am not for that reason completely happy with your one bucket for barriers to competition. I think

there are two buckets and that the label "barrier" is not apposite to capture the proper product differentiation that entitles to you charge something more than purely cost plus a reasonable rate of return.

A. Thank you for the question, actually, because it enables me to clarify.

When I am talking about barriers in this example I am talking about barriers to entry and barriers to switching, but not barriers to switching that are created by genuine differentiation on the value proposition, actually. I am thinking about things that get in the way of customers exercising their choice.

THE PRESIDENT: So you are locating your discussion within case 3 here?

A. Possibly.

THE PRESIDENT: I certainly will not hold you to it.

A. So that is the first point that I want to make.

If we could go to the next slide, please {XE7/4/15}. Given that definition of normal and sufficiently effective competition, there is then a sort of related question: well, how do we identify whether a market is characterised by effective competition or not, and this slide talks through two pieces of information which will be relevant to that.

My starting point is that we should look at the

characteristics of the market, we should look at how it operates. Are there barriers or are there not? If there are barriers, what is the nature of those barriers? What is the extent to which we expect them to have a bearing on how competition can take place? So it feels sort of natural that one would look at that.

Then, as Dr Majumdar described earlier, one can look at price evolution, and in my view that is informative of where the competition is taking place. The point that I would make is that in relation to looking at prices, I find them not to be determinative on their own of whether we have got to a position of normal and sufficiently effective competition, and perhaps if we turn to the next slide, I can illustrate that with two diagrams {XE7/4/16}.

So in the first case, left-hand side, we can think about an example of falling prices, and we observe falling prices at the beginning of period 3 if you remember from Dr Majumdar's charts.

The point that I make here is that when you have a product which is an essential product, low elasticity of demand, the price can be very high if it is unconstrained, and then you take a high price and then you see a price drop. Well, that price can drop by quite a long way and still remain above the price that

we might consider to be consistent with normal and sufficiently effective competition.

So in this instance it is the price drop that is indicated by the yellow arrow, brings prices down to a level which still sits above a grey box, which I am saying is above -- which I am saying would be a range of prices consistent with sufficiently effective competition.

It is perhaps worth calling out the difference between Dr Majumdar's chart here and mine. I have sort of located the perfectly competitive price at the marginal cost of production. My grey box, as per the discussion we had earlier, would probably be measured by cost plus, so it would allow for fixed costs of production, it would allow for investment costs, it would allow for the reasonable rate of return and that would be baked in. That is my point on falling prices: we just do not know whether they have fallen to an appropriate level.

If I then look at the right-hand side, and I think this is picking up on Dr De Coninck's comment earlier, he said we see a plateau in the tablet prices, we see them fall and then they reach a plateau, but one can sort of, I suppose, quite easily conceive of a situation where the plateau -- yes, there is a plateau,

competition is not going to develop any further and push prices down any further, but that plateau is above a level consistent with normal and sufficiently effective competition because there are barriers that prevents competition from developing further.

Thank you, so next slide {XE7/4/17}.

If we then turn to what I see as a second area of disagreement with the other experts, the question is was competition in the supply of tablets at any point sufficient to lead to tablet ASPs consistent with normal and sufficiently effective competition, and on this slide I have presented the market facts which I understand to be undisputed.

On the left-hand side, these are the volumes in the tablet market. The chart shows volumes from the start of 2012, which is the back end of period 2, through to the middle of 2015, so all the way through period 3 and a little bit further, and this confirms what Dr Majumdar said earlier that Teva continued to supply the majority of volumes into the market. Wockhardt is in yellow, took a certain share of supply. When Milpharm -- grey bar -- came in, Milpharm took share predominantly from Wockhardt.

The right-hand chart shows the evolution of the tablet ASPs. I have included a small amount of period 1

which is before Wockhardt entered the line. You can see Teva's price there is probably around £26 based on the discussion earlier.

Then Wockhardt comes in. The price is sort of fairly stable, between Wockhardt and Teva, drops off a small amount towards the end, and then it is really in period 3 that prices start to fall, and I think that is the reason for the focus on period 3, is there something different going on in period 3?

Can we turn to next slide, please {XE7/4/18}.

So, yes, the question is were prices consistent with normal and sufficiently effective competition during period 3? So I say, well, let us start by looking at the barriers to competition that existed during that period.

There are three specific barriers that the CMA identifies in the remittal Decision. The first of these is that there were supply issues that affected both Wockhardt and Milpharm. The issue with Wockhardt was to do with the stability and reliability and quality of its product which the CMA notes led to Wockhardt not seeking to increase production for fear of running into quality issues, and that meant there would be certain sales that could not be contested.

Milpharm had a different supply chain. It relied on

its parent company to supply Milpharm product that it could then sell to customers in the UK. My understanding from the evidence is that it could not guarantee that it would always have volumes because it was reliant on the parent company and what it would supply, and this led it to describe its supply chain as hit and miss. It supplied customers on a transactional basis rather than a contractual basis, so it would not necessarily be able to guarantee supply, and again, with the implication that there would be some customers or some points in time when it would not be contesting sales. So that is the first issue.

The second is that the CMA points to strategies employed by Teva and by Wockhardt which sought to limit the price competition between them. So there are documents, and I believe call notes, which refer to giving some share to the entrants in order that they seek not to compete as aggressively on price. So it is all in the context of managing the price decline.

That is the second, and the third barrier to competition is in relation to continuity of supply guidance which we have discussed which, as you mentioned, was in place throughout period 3 and with the MHRA issuing its firmer guidance from November 2013.

My view is that the combination of those barriers,

particularly with only three players in the market, two of which have issues with their supply and significant barriers to switching, for me I take that as something which is not consistent with normal competition, and it would inhibit customers' choice in the market, so competition is not working effectively.

If we may turn to the next slide please {XE7/4/19}.

So then the question is what can we say from the fall in prices, because it is clear that prices did fall, and the evidence would suggest that competition was happening to a degree when Milpharm came into the market. Milpharm challenged Wockhardt and Teva for contracts, Milpharm was successful in picking up some of those contracts, and Milpharm's entry led to prices falling. So there is a competitive dynamic, but then we come back to the views which I expressed a couple of slides ago which is: did they push prices down to a level consistent with normal and sufficiently effective competition, and my view is that that is unlikely, given the existence of the barriers and given that there was not much time when there were those three suppliers in the market for competition to evolve and for prices to evolve to -- to fall to a level consistent with normal and sufficiently effective competition, which I ground with reference to the Oxera study.

It is perhaps worth saying at this point as well, because it becomes relevant, there is a real question about how to treat those prices that are falling at the start of period 3.

My view is that when those prices are falling -- so they start in period 2 at a level, £26 roughly, and that is not a competitive price, and the CMA evidence shows there is not much competitive interaction between Wockhardt and Teva at that point in time.

Milpharm comes in and competition starts to develop, but it is starting from a position of being uncompetitive, so those prices that you first of all see in the market during period 3, in my view are contaminated, they are not competitive prices in themselves, they are prices in transition that are contaminated by the previously elevated price level that existed during period 2.

So sort of irrespective of whether you think prices at some point in period 3 ended up at a level that was consistent with normal and sufficiently effective competition, I would not say that the early prices were ones that were consistent with normal and sufficiently effective competition.

THE PRESIDENT: To what extent do you think the Tribunal ought to adopt the approach taken in relation to

contamination in, again, *Hydrocortisone* where we had what we called, as Mr Holmes will recollect, the Matterhorn, and there was a question of the extent to which the downward slope of the Matterhorn was in and of itself not an abuse of dominance because it was downward sloping, and what the Tribunal did in that case was -- did not look at the anterior situation and expressed matters in terms of contamination, but vertically sliced the mountain into different phases which could be treated for analytical purposes in the same way, and then disregarding anterior and subsequent phases applied the dominance and abuse tests to that particular phase, so it was neutral as to whether there was contamination, one simply said: well, let us look at day one and the last day of the phase and I think we took an average as well, can one say that there is dominance and an abuse on that basis?

Is that something which you would resist as a form of analysis of historic movements and phased differences, or do you regard it as essentially consistent but a different way of analysing the way you are doing it?

A. If I have understood the slicing of the Matterhorn, as you call it, correctly, that was pricing in relation to the hydrocortisone product and the price that was

alleged --

THE PRESIDENT: That is right.

A. -- and here we are in a situation where I am looking to find a relevant comparator.

THE PRESIDENT: Yes.

A. So in some ways that makes it a bit different, and what I would say is, in my view, we want to be finding a comparator where you can say, okay, here is a comparator sufficiently similar and I am clear that prices reflect normal and sufficiently effective competition.

In my mind, that means it would be justifiable to slice the time period and remove any time period from the construction of the comparator price benchmark, just remove anything that is clearly problematic, and focus on what you think is the best period to take for that construction of a benchmark.

Now, I qualify that because where I end up is that I actually -- in my view, none of the prices of tablets during period 3 make a good benchmark. I do not have confidence that any of those are consistent with normal and sufficiently effective competition.

As you will see when I do make a comparison, because the CMA has and the other experts have, so I have, I do the slicing approach that you describe to try and avoid

this inclusion of prices that are perhaps clearly contaminated.

So perhaps if we could go to the next slide {XE7/4/20}. So now I am coming to the comparison, and, as I mentioned at the start of this teach-in, my starting point is to say: let us be agnostic as to the supply chain for capsules, let us look at the end price that was charged to pharmacists and wholesalers and that is the Flynn price which is shown by the purple line on the charts, and then let us compare that to the prices during period 3 of the tablet suppliers, and the dotted line there is the weighted average price of the tablet suppliers. It is quite close to the Teva line because Teva had the majority of the volumes.

The difference between the purple, the purple averaged across the whole of the relevant period and the benchmark, which in this case is the dotted line is -- I am looking for the figure -- 51%, so quite substantially above what I would say is a sort of best case comparator for tablet ASPs.

In this instance I have not sought to constrain, to slice, period 3 and take only prices from a certain part. I have just used the whole period, and I have used all suppliers, and I suppose I am taking this comparison on the basis that this is what Dr Majumdar

and Dr De Coninck would say is the right measure, I think, I hope I am not putting words in their mouth. I am not fiddling around with tablet ASPs at all, I am just doing a straightforward weighted average, all of period 3, even though I think this is not a price consistent with normal and sufficiently effective competition. And even when I do that, the end price to wholesalers and pharmacies for Flynn is 51% above that tablet ASP benchmark.

So that tells me that the tablet ASP cannot be used to undermine the CMA's view that capsule prices were unfair, because that is not shown by the comparison of those two prices.

If we could go to the next slide, please {XE7/4/21}.

So then following what I said earlier, I then looked at the individual prices for Pfizer and for Flynn and compared those against the tablet prices. Pfizer and Flynn take a different approach in how they set this out. Pfizer's approach is shown by the red line on this diagram which -- this plots Pfizer's adjusted price, so Pfizer's actual ASP adjusted in the way Dr Majumdar said to add a distribution margin, and Pfizer says that had Flynn added a distribution margin in the order of magnitude that Pfizer suggests following the CMA, then Pfizer's price would not have been unfair, it will in

the region of the tablet prices, and I will show this on the next slide.

So in effect we found on the previous slide that tablet prices as a whole cannot be said to be fair with reference to tablet prices. Pfizer's approach says: well, it is not Pfizer, it is Flynn. Flynn said: well, had Pfizer's price been lower, and that red line shifted down on the chart, my purple line would not have been so high because I would have added my standard return and it would have been fine, and clearly they cannot both be correct, so that is something which the Tribunal will need to grapple with. I have set out my view on both of their prices in the following slide, so we can go to that now. {XE7/4/22}.

So what I have done here, this is where I do the slicing. So my view is if we are going to do this comparison exercise we should be as careful as we can to avoid including prices that are clearly not consistent with normal and sufficiently effective competition in that price benchmark for tablets. So I have taken the period September 2013 to December 2013 as being the slice of period 3 which I think is most relevant to look at. The reason I have done that is because this is the point at which prices start to stabilise in the market, and you can see that through the grey line is

Wockhardt -- sorry, the yellow line is Wockhardt, the grey line is Milpharm. Prices have continued to fall all the way up to until the point of at least September 2013, and then there is a period where they are sort of largely flat.

Wockhardt then largely withdrew from the market at the end of December 2013, which is why I have stopped the price series then. The CMA reports that at that point, Wockhardt was concerned with the stability of its product and it withdrew, I think it is all but two batches -- sorry, or is it one batch? It withdrew all but one batch from supply and that one batch equated to I think two months' worth of supply which it then sold out into the market. So Wockhardt's sort of competitive constraints really ran up until December 2013.

The other thing which I have done is I have excluded Teva from my benchmark calculation, and the reason that I do that is, if one plots -- and it is on one of the previous charts -- the Teva price trajectory, it follows Wockhardt and Milpharm relatively closely for a period, and then it starts to diverge. The Teva price stops falling and then at some point actually towards the end of that period it starts increasing somewhat, and the differential in the period which is shaded grey here is in the region of 70% between Teva's price and Wockhardt

and Milpharm's price.

I am of the view that the likely cause of that differential is, at least in part, down to the effect of the continuity of supply guidance. What I have understood from the factual evidence that the CMA has put in the remittal decision is that there were certain customers -- this is what the companies have told the CMA -- certain customers who were willing to switch, and then there were certain customers who were not, and so I think that sort of explains why there is this downward -- sort of relatively steep downward pressure on prices at the beginning of the period when that is being revealed and knowledge is coming out: so these are the customers that will switch, these are the ones that will not, we need to compete where we want to, and then at some point we are left with a set of customers who will not switch, and because Teva has the largest market share, it will have more of those customers who will not switch, and in my view that is going to be a contributory factor to the substantial price differential that opens up between Teva and Wockhardt and Milpharm and would, in effect, give Teva some market power. So I have excluded Teva's price from this benchmark calculation.

Then where that leaves me is there is a big

differential between the red line and the dotted line, the tablet benchmark, and that is 87%, again, where the red line is measured over the entirety of the relevant period, and then the gap between the purple line, Flynn's price, and the benchmark price is 150%, again, measured in the same way. So my view of the relevance of the tablet ASP comparison is that it does not undermine the CMA's finding that each of the parties' prices were unfair.

Please may we go to the next slide {XE7/4/23}. Thank you.

Dr De Coninck, in response to the analysis that I have set out, has indicated that he does not think it relevant to compare Flynn's price with tablet ASPs and that instead we should be looking at margins, Flynn's margins compared to tablet ASP margins, and I think I would make two points on this. The first is if we were to do that we should again be asking ourselves the question: will margins in the tablet market be reflective of normal and sufficiently effective competition.

My view is that margins follow prices, and so where prices are not -- where I have no confidence that the prices reflect normal and sufficiently effective competition, the same applies to margins. So my view is

that the margin analysis is equally unreliable and uninformative.

If one did want to do a comparison of margins, I would make the same points that I have made on the previous slide: let us be selective, let us rule out any prices which are clearly inconsistent with normal and sufficiently effective competition, and I have not got a chart which does this because I have cobbled together numbers from Dr De Coninck's report and the CMA analysis, but I have calculated the extent to which Flynn's margins measured over a period which is from the start of the relevant period to April 2015, it was not possible to get Flynn's margins across the remainder of the relevant period so I have taken that first period, looking at Flynn's margin over as much of the relevant period as I can; comparing it to Wockhardt's margins in September to December 2013, the differential is 52%.

If we could turn to the next slide, please {XE7/4/24}.

That is the summary of my views on where the experts disagree in terms of tablet ASPs. On the drug tariff price of tablets, I think I have probably made my comments clear earlier. The only thing to note is the chart on this slide shows you the difference between the drug tariff price and the tablet ASPs, so you can see

the extent to which there was a difference between the two which gives me more comfort in being -- makes me more confident that the drug tariff price was not consistent with normal and sufficiently effective competition.

If we can then turn to the next slide {XE7/4/25}. I think this is the final slide.

In relation to other AEDs, again, I have summarised my view when I set out the full table. Just perhaps to point to the chart in the bottom right, this just shows you the evidence in relation to pricing of phenytoin capsules which is the yellow line, and then the prices of -- this shows four of the five other AEDs, and you can see the prices start quite high, that is because there was no competition at one point, then competition came, the prices dropped, so these are the generic prices, and the generic prices for all of them. They start off high, end up at a level which is significantly below the pricing of capsules. So again on this basis, putting aside issues of the comparability of the products, even when one looks at pricing I take the view that it does not undermine the CMA's unfairness conclusion.

THE PRESIDENT: Thank you very much. We are much obliged to you. That concludes your presentation. Thank you.

MR HOLMES: Sir, I am conscious of the time. There is one further CMA witness. I do not know whether you want to -- Mr Greg Harman. I do not know whether you want to start him now or you would rather begin tomorrow morning.

THE PRESIDENT: Well, I am conscious that we are already entering hot-tub territory.

MR HOLMES: Yes.

THE PRESIDENT: How are we doing in terms of shorthand writer exhaustion?

I think we should make a start.

MR HOLMES: Of course. Can we please call Mr Greg Harman.

THE PRESIDENT: We have a 10.00 start tomorrow. Could we start earlier?

MR HOLMES: From my perspective, that is fine. I have not canvassed with the rest of counsel.

THE WITNESS: Yes, I can come back.

THE PRESIDENT: Let us see what other people think about a 9.30 start, if we can, then we could start the hot-tub clean at 10 o'clock, that would be quite useful. But let us make a start, in any event, Mr Harman, with you.

MR GREG HARMAN (affirmed)

THE PRESIDENT: Mr Harman, welcome. You can hand the card back. Do sit down, make yourself comfortable. You will have some questions about reports from Mr Holmes and

then your presentation.

Teach-in by MR HARMAN

MR HOLMES: Yes, so, sir, taking the staccato approach, Mr Harman, you were a witness, an expert witness in the first phenytoin trial and you prepared two expert reports and a joint expert statement for the purposes of those proceedings; is that right?

A. That is correct.

Q. For the current appeals, you prepared a single report which is at {XE1/15}. Is that correct?

A. That is correct.

Q. And also a position paper?

A. That is correct.

Q. The opinions in the reports and the position paper represent your true and complete professional opinions of the matters to which they relate; is that correct?

A. That is correct.

MR HOLMES: I am grateful.

A. I am waiting for my slides.

THE PRESIDENT: Do you have a reference for the --

MR HOLMES: Yes, apologies. It is {XE7/3}.

A. Thank you.

If we could just go to the next slide {XE7/3/2}. So I just wanted to start by giving some background to myself.

I am both a chartered accountant and I have a masters in economics. I have about 31 years and counting experience, primarily in the areas of competition, regulation, damage assessment and perhaps, importantly for some of my teach-in, around valuations, especially in terms of what investors expect in terms of returns in the real world.

I have also had extensive experience in excessive pricing. Obviously I was the CMA's expert in *Liothyronine* and the first time in *Phenytoin*, but interestingly in a different jurisdiction, I am doing a number of cases in pharma on-patented drugs which, you know, that may be of interest to the Tribunal as to what the difference between thinking about cost plus and unfairness in terms of patented versus generic.

So if I could go to the next slide {XE7/3/3}. Really what I want to cover is firstly to start because my primary instruction was around the excessive limb. I want to first of all summarise what I think is in dispute between the experts. I want to talk a little bit about cost plus and the extent to which it is informative, especially at the excessive limb stage. I am then going to go on to talk about how does one think about calculating a required return and the factors that one needs to take into account when doing

so.

I will then look at how the CMA estimated what it terms as a reasonable rate of return, and then I will perform an assessment, you know, my economic assessment on what I think about the CMA's findings, before I round out with some conclusions.

If I can go to the next slide {XE7/3/4}, and then the next slide {XE7/3/5}.

I think in general for me there is two broad issues: one is what is cost plus, how do you calculate it, and to what degree is it informative or not, and bearing in mind some of the coffee shop debates, you know, one of the issues that I saw at least in the first iteration from the Tribunal is whether a return is required in the cost plus, and so I will comment a little bit on that. I have a couple of comments on the original coffee shop scenario. I have not yet gone to the extended version, but --

THE PRESIDENT: I would save that for tomorrow.

A. Yes.

PROFESSOR WATERSON: There may be another one by then.

A. I do hope so.

So on the left-hand side, I say that normally when I have performed cost plus it is both an addition of direct costs, common costs and the required return, and

I will explain why in a second, but the second dispute around the required return is how do you calculate it, which is something that I address on the right, and principally there is two alternatives in general: one is a return on capital employed approach, one is a return on sales approach. Return on sales is just a metric. It is possible that you could use different metrics, but the parties have alighted on return on sales.

Now, to the extent that you can do both approaches, it would be reasonable to do both approaches. They are both trying to determine what the absolute return is that should be included in the costs stack.

To the extent there is any confusion as to whether the return on capital employed or the return on sales are trying to measure something different from the plus perspective of cost plus, I would say they are not, they are both trying to do exactly the same thing in terms of trying to determine what a reasonable rate of return is.

If I could then go to the next slide {XE7/3/6} and then the next slide {XE7/3/7}.

In essence my starting point is, is cost plus informative? My understanding of the legal position -- and it is not for me to comment on that from *United Brands* -- is that the first step requires a comparison of actual costs and actual prices, and in

effect, that is what the cost plus is trying to do. We will come on to whether the return is a cost or not, and I will explain that it is.

Without going into the theory, Ms Webster went through this in some detail, competition models generally predict some link between price and cost, so the cost plus is informative to an extent. Now, that does not mean that it is the price benchmark for normal and sufficiently effective competition, but it is a potential benchmark, and for that reason I think that it is important in the first step. We recognise that it is a potential benchmark before going on to the second step and determining whether it is unfair, ie whether there could be alternative price benchmarks.

I think my reading again of *Hydrocortisone*, you know, it kind of indicated that, you know, this is a step we would go through, but having done the first step we might recognise that prices could be above cost plus, and there is case 1, case 2 and case 3, whether there is temporal differences, whether there is efficiency differences, whether there is differentiation, and that is certainly -- I think, you know, my position through all my reports is that: yes, prices can be above cost plus if there is a justification for that.

Absent the justification, so if there is no justification, if you are into case 3, I think the cost plus becomes more informative because I would expect prices to be converging towards the cost plus figure in the long term, and the last point that I make on this slide is that obviously it can also act as a filtering mechanism, not always and I will come on to explain that, but if you found that cost plus was above prices on a per se basis you might think that there is unlikely to be an excessive price, but I will come back to that because I think efficiency or inefficiency can just give a slight curve ball to that assessment.

So if I could go to the next slide {XE7/3/8}. So is the plus a cost or a return? Well, I think it is both in fact, but let me explain that. I mean, from an economic perspective, we would normally say that the cost of capital is a cost because it is a cost to the firm for paying its investors, equity investors, or debt investors, for the use of their investment. So it is a cost to the firm: I have to generate sufficient profit to be able to pay back equity shareholders and debt providers.

The OFT noted this, and I have quoted it there, you know, they talk about the return first of all being expected, it is an expected return, and you could earn

less, you can earn more, but that is what you expect. If you had a diversified portfolio, which modern finance theory assumes, on average that is the return that you would receive, and you have to generate a sufficient profit to be able to pay back the return to lenders and shareholders.

So from that perspective, it is both a cost and a return. I need to earn a higher return, profit, so that I can pay the cost to debt holders and to equity holders.

Now, coming back to my valuation experience, investors are primarily interested in two things: the level of money that they have to lend and the risk lending that money. The riskier the investment, the higher return on that capital will be required. If something is less risky, a lower return will be required. I think in our everyday lives that kind of makes sense, right. If somebody comes to a bank and says: can I have a lot of money for something that I do not know whether is going to be particularly successful, maybe you would be into a venture capital type of world, you know, looking for a funder that is willing to take risk, well, the required return from a VC, you know, may be 50%, 60%, very high.

If you are going to a bank to lend money for a house

where there is collateral, you know generally speaking the return that is required for that investment is much lower.

THE PRESIDENT: You would also, I think, have a temporal element, would you not?

A. You would, but I would say that that comes into the risk.

THE PRESIDENT: Well, yes, but let us take your VC investor, a 60% return. Chances are that for ten or so years they will say: we are not expecting a return at all.

A. Yes.

THE PRESIDENT: And that is something which you factor in how in your return when you are looking at --

A. Yes, so I mean, in that sense, I would say there is a delay in the period that you would be paid back. There is no such thing as something for free, right, so if the project was one year and the VC came to you and said: okay, you will realise your project, there will be a return, you will pay me back, if the interest rate was 30%, at the end of the year they would say: we would like 30% on that outcome.

If the answer was: we do not know how long it is, that 30% would roll over cumulatively, it would be a bit like going to the person down the back alley to get a pay day advancement rent and if you do not pay back

the next day, the amount that you have to pay back increases and it would increase exponentially.

Now, of course, in the VC world it is slightly different because they may put somebody on the board, they may be able to assess the risk, there may be stages of when additional investments are made, and so on and so forth, but in general, that cost of capital, you know, looks forward and says: if something is paid back in the future, then we are going to discount that payment more significantly, which means that you would have to pay us back more. If at the end of 10 years you have got your return, well then the 30% return that you would have had to pay would be cumulative across that period.

THE PRESIDENT: Yes, I completely understand that. My question really is this: when one is assessing the difference between the price charged for a product and its cost, if the cost is deferred in the manner you have suggested, obviously there is no such thing as a free lunch and you will have to pay at some point --

A. Yes.

THE PRESIDENT: -- but if that point is in the future, do you include that future cost in your present assessment of the gap between price charged today and cost assessed today, even though the cost is in fact paid at a higher

future rate because you are engaged in a developing business that needs to keep its costs to a minimum?

A. Yes, I fully understand that. I think that when there is temporal components, the standard way of thinking about things is to come up with -- I will say two things: one approach would be to say that there is a charge, an average charge, over time, so one could reflect that cost into your cash flows or into your cost plus as an average over time, that is one, but in the real world there may be all sorts of different profiles: you could pay at the end, you could pay at the beginning, and so I think if you are in a situation where, when you have to pay the return, or when you have to pay, the cost occurs, then you have to model that through a sensitivity analysis to say there are different ways of factoring in that cost into your cost plus, and there is probably no exact or right way of doing that.

So as an example of that, which is a little bit like -- it is a bit different -- if I bought an asset and I could choose to depreciate it -- I will depreciate it from an accounting perspective, but from an economic perspective its value is going to change over time. So normally when you do a cost plus there are two components to the return: one is the return of capital

over time, because it has to be paid back, and the second is a return on that capital.

So you could choose a depreciation profile that says straight line over 10 years, right, and that gives you a certain profile, but there are different ways to depreciate. You could depreciate it all in the first year or over the first two years or over the first three years and for certain products it may be sensible to do so.

So by reference to the example that you gave in terms of mobile phone operator investing in a set of assets, demand unknown, the point at which competition enters the market unknown, it may be reasonable for a telecoms operator to have a higher allowance of depreciation in those first years to ensure they recover it over time.

So definitely when I have done this analysis before I have taken in those temporal cost issues by thinking about different allocations of costs over time to make sure the results are robust to that.

THE PRESIDENT: I see the time. Is that a convenient moment to break?

A. Yes.

THE PRESIDENT: I appreciate there is never a convenient moment when you are presenting.

A. No, no, that is fine, I can pick up tomorrow.

Housekeeping

THE PRESIDENT: I am very grateful, Mr Harman, to you.

Ms Stratford, you are on your feet.

MS STRATFORD: I anticipate you will not be happy to see me rising, but I assure you it is just to correct something I said at the very beginning of today which may seem a long time ago, but I handed up a single sheet.

THE PRESIDENT: You did.

MS STRATFORD: I am conscious that the Tribunal is --

THE PRESIDENT: And you gave a reference.

MS STRATFORD: Yes -- very largely or wholly working electronically, and the Opus reference that I gave you has been superseded, so I just want to correct that.

THE PRESIDENT: It was {XO/11}.

MS STRATFORD: It is {XO/13}. Someone else got in ahead of us, and I think 11 and 12 are now Dr Majumdar's slides, so it is {XO/13}.

THE PRESIDENT: I am very grateful.

MS STRATFORD: I am grateful.

THE PRESIDENT: In terms of tomorrow we will start at 9.30, I will do some re-arranging to make that possible for me, if nobody else has a problem with that.

MS STRATFORD: I do not see anyone -- I am just checking, because obviously we need all of the experts to be --

for that to be possible for all of them.

THE PRESIDENT: Indeed. I think if we possibly can a changing of the shift for shorthand writers would be very useful because it is a long day even with breaks, but I leave that to the parties to work out.

MR HOLMES: We will coordinate and see what can be done, sir.

THE PRESIDENT: That would be very helpful.

Two points, not quite housekeeping, but what we are hoping to achieve with the hot-tub coffee shop example, it has been drafted in the spirit of Mr Justice Chitty's will, Mr Justice Chitty being an eminent Chancery lawyer wrote his will with a view to creating as many problems for the Chancery Bar as possible, and he incorporated every dubious question of law in his will so that it would have to be resolved.

The coffee shop example has been crafted with that in mind, so that in a hypothetical scenario where there is no question of factual controversy, the economic controversies can be aired, and if there is a dispute of fact I can simply rule to say: this is what the hypothetical example is intended to say, and we can move straight to the economists' analysis, so that is why it has been crafted in that way, and I just want everyone to understand that.

One point which I think all of the economists need to think about -- and I know Mr Harman will be starting with that tomorrow -- is I think we do need to ask ourselves why we are carrying out an assessment of a costs stack, because why one is looking at costs is likely to be time-sensitive or context-sensitive in the sense that what is my cost or what something is worth for purposes of a business sale is going to be rather different to what I have to do in order to compile my accounts for tax purposes, to what I am doing to work out whether a price is excessive over cost, and I do think that the answer is likely to be different according to context, and it does seem to me that is something which we will certainly be going into in terms of the hot-tub assessment.

I may bite my tongue with Mr Harman during the course of his teach-in, but I do think that is something that everyone needs to bear in mind because I think we may be taking our eye off the ball in terms of what we include in a costs stack for purposes of excessive prices as opposed to the costs stack that will be relevant for purposes that are simply not relevant for these proceedings, so I put that down by way of a marker, and with that I will -- I am ever so sorry.

PROFESSOR WATERSON: I also handed round a diagram and just

to reassure everyone on two points to avoid unnecessary work, etc, one point is that this is not meant -- this is similarly not meant to be -- to fit the situation we are talking about exactly by any means, it is just meant to start us off on a particular issue.

The second point is that I will, in using this example, which is not the only thing that I am going to be asking about, but in using this example, I will take the economists through some of the stages of it so it is not as if they have to guess what is going on there, although they may or may not know.

MS STRATFORD: I am sure that is very much appreciated and will assist everyone's good rest tonight.

PROFESSOR WATERSON: I will be testing the barristers on it later.

MS STRATFORD: 10.00 pm court, I am sure our President would be fully up for that.

More seriously, but prosaically, I was just thinking since I am on my feet, we are going into the hot-tub. Obviously we had hoped to be in the hot-tub already. Under the protocol for the hot-tub, the agreed proposal is that the five experts taking part in the hot-tub should be on the front row, so I am just wondering on my feet -- and this may not be a good idea -- but so that we do not lose further time, whether we should begin

tomorrow morning with -- move back.

MR HOLMES: Sir, from our perspective that seems highly sensible.

THE PRESIDENT: You should all move a row back?

MR HOLMES: That we arrange the courtroom ready for the hot-tub so that we do not lose time in ordering the furniture.

MS STRATFORD: I just think we cannot afford to --

THE PRESIDENT: I think that would be sensible.

MR BREALEY: Which means five mics, I think, and a few mics back. I am looking at Opus. I imagine counsel will be asked some questions or will need a couple of mics at least there --

THE PRESIDENT: Yes, I think that is probably right.

MR BREALEY: -- and there will need to be probably five, or they will share them, I guess.

THE PRESIDENT: I appreciate it is now well past 5.00 and we are making an early start tomorrow. I think it is sensible, Ms Stratford, if you do move back a row, and we will do what we can to ensure that your interventions are appropriately recorded. Clearly that does involve microphones. If we do not have them, then we will ensure that your contributions get on the record in some way. However, we take your point, we do not want to lose any more time.

MS STRATFORD: I am grateful.

THE PRESIDENT: Thank you.

Well, in that case, Mr Harman, good evening, we will see you tomorrow 9.30, and we will see everyone else 9.30 as well, thank you very much.

(5.08 pm)

(The hearing adjourned until 9.30 am on Thursday, 16 November 2023)