

Flynn and Pfizer v Competition and Markets Authority [2018] CAT 11: the test for excessive pricing

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The Competition Appeal Tribunal ('the Tribunal') handed down its judgment in *Flynn and Pfizer v CMA* [2018] CAT 11 on 7 June 2018. The Tribunal has set aside parts of the Competition and Markets Authority's ('CMA') decision imposing combined fines on the pharmaceutical companies, Pfizer and Flynn, of approximately £90 million for charging (allegedly) unfairly high prices for the anti-epileptic drug (phenytoin sodium capsules) in breach of Article 102 TFEU / the Chapter II prohibition. In doing so, the Tribunal conducted a significant review of the relevant law relating to the test for identifying unfair pricing. The full judgment is available [here](#).

CMA Decision ([67]-[68])

The CMA had found in December 2016 that Pfizer (the manufacturer) and Flynn (the distributor) had each abused their dominant market positions by charging unfair prices for phenytoin sodium capsules.

In 2012, Pfizer sold the distribution rights of the drug, previously sold under a brand, to Flynn, which then de-branded (genericised) the drug. The change allowed the companies to raise prices significantly as branded drugs are subject to price controls whereas generics are not. Pfizer's prices to Flynn were between 780% - 1,600% higher than previous prices, and Flynn's prices were between 2,300% - 2,600% higher than previous prices (the variation dependent upon the capsule strength). Annual NHS spending on the drug jumped from £2m in 2012 to £50m in 2013.

The CMA ruled that both companies held a dominant position in their respective markets for the manufacture and supply of phenytoin sodium capsules. The CMA found that Pfizer's supply prices to Flynn and, in turn, Flynn's selling prices for the drug were unfair and excessive. Accordingly, Pfizer and Flynn were found to have infringed Chapter II of the Competition Act 1998 and Article 102 of the TFEU. The CMA imposed fines of £84.2m on Pfizer and £5.2m on Flynn (which was 10% of Flynn's worldwide turnover, the statutory maximum the CMA could have imposed), as well as directing both to reduce their prices.

Both Pfizer and Flynn separately appealed in February 2017. Both appeals were heard together after the Tribunal granted permission for each of Pfizer and Flynn to intervene in the appeal of the other. See [here](#) for discussion of the

Tribunal's earlier determination dismissing Flynn's application for interim relief suspending the CMA's directions to reduce prices.

Market definition and Dominance ([93]-[253])

The Tribunal upheld the CMA's findings that Pfizer and Flynn had each occupied a dominant position during the relevant period (between 2012 and 2016) in the relevant markets, namely the manufacture and distribution of the phenytoin sodium capsules as manufactured/sold in the UK.

As regards market definition, the Tribunal rejected the appellants' claim that the CMA had erred in not including 100mg strength capsules produced by NRIM Ltd since 2013 in its market definition. NRIM capsules did not, in the Tribunal's findings, sufficiently compete with Pfizer-Flynn capsules such that there was competitive constraint on Pfizer/Flynn: the existence of some degree of substitutability or competition is not sufficient alone to mean that the products form part of the same relevant market ([195]). As such, there was no basis for dividing the relevant period for the purposes of market definition ([196]). The CMA's primary market definition was upheld ([197]-[198]).

As regards dominance, the Tribunal held that both Pfizer and Flynn were able to behave to an appreciable extent without competitive constraint from their competitors or customers ([251]-[252]). Both companies were able to price independently from competition ([246]-[249]), and the Department for Health did not exercise buyer-power that was able to weaken that on the facts of this particular case ([200]-[235]). Further, the Tribunal accepted the CMA's other grounds for dominance: high market shares ([237]), high profit levels ([245]), and high barriers to entry ([250]).

Whilst the legal principles pertaining to market definition and dominance are well-known (see the Tribunal's summary at [110]-[118]) and were not in dispute ([119]), the Tribunal did make one interesting observation concerning the so-called "zero:one" or "binary" fallacy (whereby the competition analysis is conducted solely within the context of the defined market). The Tribunal noted (at [119]):

"It is fallacious to regard as relevant to the competition analysis only those products defined as falling within the relevant market and to disregard entirely any competitive pressure from those products defined as falling outside it. In our view, competition analysis is always a matter of degree and in each case the degree of competitive pressure, whether from inside or outside the relevant market as defined, must be carefully assessed."

In short, products falling outside the market definition for that stage of the analysis, may still be relevant to an assessment of dominance or abuse.

Abuse ([254]-[444])

The Tribunal found that the CMA's findings on abuse of dominance were legally flawed and accordingly had to be set aside.

The United Brands test

The Tribunal held that CMA did not correctly apply the legal test for finding that prices were unfair as laid down in C-27/76 *United Brands v Commission* and subsequently developed and interpreted by both the CJEU (particularly the Advocate General's Opinion and Judgment in C-177/16 *Latvian Copyright*) and the Tribunal. The ECJ in *United Brands* set out a two-limb test ([288], emphasis added):

"(1) the price must be "excessive" (in United Brands, it was said that this could be calculated as the difference between the cost of production of the product and the selling price ("Excessive Limb"); and

(2) the price must be "unfair" either in itself ("Alternative 1") or when compared to competing products ("Alternative 2") ("Unfair Limb")"

This test is not, however, the only way to determine whether a price is unfair as there may be "other ways": [253] of *United Brands* (and see [294] of *Flynn and Pfizer*). In the application of the test (and, indeed, any other methodology), there is also always the need for an over-arching assessment: [248]-[250] of *United Brands*.

As regards the two alternatives in the Unfair Limb, the Tribunal held (at [366]-[367]) that:

"...the two are alternatives, in the sense that an authority can, as a matter of law, establish a breach of Article 102 under either Alternative 1 or 2 and does not need to succeed under both. However, that is not the same as saying that the authority has an unfettered choice between the two. Nor does it mean that a breach of Article 102 can be established by selecting only one Alternative instead of the other so that an approach can be taken that gives rise to a finding under one Alternative that the pricing is unfair, when a prima facie argument has been raised that under the other Alternative, the pricing is fair..."

... it cannot be right that an authority can simply ignore a prima facie valid argument that a price is fair under one Alternative and proceed to find an infringement of Article 102 solely on the basis of the other Alternative establishing that prices are unfair. That is not to say that the authority cannot find that there is an infringement where one Alternative demonstrates unfairness and the other does not since it does not need to succeed on both heads. However, the authority must consider whether a

prima facie case of fairness under one Alternative undermines the basis for the finding of unfairness under the other Alternative and produce a reasoned basis for determining that the Unfair Limb is satisfied.”

At [443] the Tribunal set out a list of eight exercises which the CMA should undertake when applying the United Brands test in an excessive pricing case:

- (1) consider a range of possible analyses to establish a benchmark price that reflects the price that would pertain under conditions of normal and sufficiently effective competition;
- (2) compare that benchmark price with the price charged in practice;
- (3) for the purpose of the Excessive Limb, determine whether that differential is sufficiently significant and persistent;
- (4) proceed to consider whether the price is unfair under the Unfair Limb;
- (5) consider whether to use either Alternative 1 or Alternative 2 in the Unfair Limb, and consider any *prima facie* convincing argument that the pricing is actually fair under either Alternative;
- (6) assess the economic value of the product and whether the price charged in practice bears a reasonable relation to it;
- (7) consider any objective justification advanced by the dominant undertaking; and
- (8) make a finding if all the conditions above are fulfilled and the dominant undertaking is reaping benefits that it would not under conditions of normal and sufficiently effective competition.

The Excessive Limb

In relation to the Excessive Limb, the Tribunal struck down the CMA's findings of abuse ([310]) on the basis that the CMA:

- (a) was wrong in law to confine its methodology for testing whether the drug prices were excessive to a purely “Cost Plus” approach i.e. the CMA's finding that Pfizer's and Flynn's respective prices were excessive because they materially exceeded their respective costs plus a reasonable return rate ([256]). The Tribunal held that the correct approach, which the CMA should have but failed to adopt, was to identify a benchmark price or price range which would have applied in conditions of “normal and sufficiently effective competition” ([310]). As the Tribunal stated, there “must be a benchmark for the normal competitive price to

estimate the excess under the Excessive Limb" ([313]).

(b) was wrong in law to adopt the Cost Plus methodology that produced a result that would have pertained in circumstances of perfect/idealised competition rather than in the real world.

(c) made an error of assessment by relying on the Cost Plus approach.

Unfair Limb

In relation to the Unfair Limb, the Tribunal held that the CMA did not correctly assess whether the prices it found to be excessive under the Excessive Limb were also unfair. The CMA wrongly relied only on Alternative 1 and did not properly assess the possible impact of meaningful comparators (in particular phenytoin tablets) for the purpose of assessing whether the prices charged were unfair ([362]). In particular, the CMA should have given proper consideration to whether phenytoin sodium *tablets* – the prices of which were higher than the allegedly excessive prices for *capsules* – served as a meaningful price comparator. The CMA had, in the Tribunal's findings, failed to take sufficient account of such comparable products ([374]-[398]).

Economic value

Whilst the parties were reluctant to specify precisely where economic value should be dealt with in the analysis ([405]) and the CMA had in the Decision dealt with it under the Unfair Limb, the Tribunal noted ([405]):

"... we think it has, consistent with the structure in United Brands, a clear place in the scheme of analysis and is best understood if discussed after the assessment of unfairness in the Unfair Limb. As we have set out above, one of the over-arching questions for a finding of abuse is whether the price complained of "bears no reasonable relation to the economic value of the product supplied"."

One of the over-arching questions for a finding of abuse is whether the price complained of bears no reasonable relation to the economic value of the product supplied ([405]). The CMA had found that there were no non-cost related factors which would increase the economic value of the capsule beyond the Cost Plus test. In response, the Tribunal found that the CMA erred in law in failing to have any regard to the benefit to patients of phenytoin capsules in determining their economic value ([403]-[423]). Whilst calculating monetary value of patient benefit is not straightforward, the Tribunal stated that it *"would be possible and should have been attempted by the CMA rather than simply assessing this value a nil"* ([419]). Economic value can include the cost of production but also other elements of value to the purchaser even where the purchaser is materially dependent on the supplier.

Pfizer as a supplier ([445]-[458])

Pfizer has argued that, because of its vertical relationship with Flynn and distance from Flynn's pricing (in Flynn's downstream market), it could not be in breach of Article 102 TFEU in any event ([446]). The Tribunal rejected this in theory and in practice.

As a matter of theory, the Tribunal considered ([450] and [454]), in short, that Pfizer's submission would effectively mean that, in order to evade the application of Article 102 TFEU, a dominant party would only need to contract with a third party on terms which were extremely attractive to the dominant party, but which still theoretically allowed the third party to determine its own pricing in the downstream marketing. That would mean that if it the dominant party were to set its prices at considerably higher than the retail price (and at a level which bore no relationship to economic value), that party could never commit an abuse where the third party set at a level which was not itself abusive in light of the high input price. That would be inconsistent with the rationale of Article 102 TFEU to protect consumers ([455]).

As a matter of practice, the Tribunal found that Pfizer's supply price did constitute a price floor, and that this was a floor which Flynn would not price below. Further, the pricing strategy was developed by both Pfizer and Flynn together with regard to the mutual benefits which would follow. This was regardless of the fact that, contractually, Flynn could have determined the price it actually set ([457]).

Penalties and Next Steps ([459]-[470])

In light of its findings, the Tribunal did not determine matters in relation to the level of the financial penalties imposed by the CMA as that would involve detailed consideration of further information which may need to be obtained and tested before assessment ([7] and [467]-[468]). (The Tribunal did note at [461], however, that if it had upheld the CMA's findings on abuse, it would likely have regarded the substantial deterrence uplift applied to Pfizer as difficult to justify.) Instead, the Tribunal set aside the part of the CMA's Decision on abuse (plus consequential parts), and indicated that its provisional view is to remit the matter back to the CMA for further consideration. The Tribunal has, though, invited written submissions from the parties (on whether to remit the matter to the CMA) before coming to a final decision on remedy.

The CMA has since released a [statement](#) in which it states that it is "*disappointed*" with the ruling and is considering an appeal. Whilst emphasising that the Tribunal's judgment "*makes it clear that a finding of abuse remains possible given the size of the price increase that occurred*" (see, for example, [441]), it added that "*[i]t is regrettable that the Tribunal chose not to make its own finding as to whether Pfizer and/or Flynn Pharma had committed an abuse*".

The ruling is also a potential setback for the CMA as it has several active investigations into the pharmaceutical sector, which, according to the CMA, could now be “*severely delayed, potentially meaning that the NHS is paying more than it should for some drugs*”.

[Mark Brealey QC](#) acted for Pfizer and [Ronit Kreisberger](#) acted for Flynn.

The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.