WHAT IS THE CMA'S APPROACH TO EXCESSIVE PRICING AND WHEN DOES IT BECOME AN ABUSE?

Bruce Kilpatrick, Partner

ADDLESHAW GODDARD

EXCESSIVE PRICING TEST: UNITED BRANDS

United Brands: ECJ held that a price can be unlawfully excessive under Article 102 TFEU where it bears "*no reasonable relation to the economic value of the product supplied*" according to the following test:

1) whether the difference between the costs incurred and the price charged is excessive (limb 1: "excessiveness"); and, if so,

2) whether the price was unfair either (a) in itself or (b) when compared to the price of competing products (limb 2: "unfairness").

Limb 1

Excessiveness: is the difference between the costs incurred and the selling price charged by a dominant company excessive?

- A price is excessive or unfair when it has "*no reasonable relation to the economic value of the product*"
- No clear answer available on what constitutes "*economic value*" of product

United Brands stated that "*other ways may be devised*" for identifying excessive prices, leaving open the possibility for agencies to develop alternative methods

EXCESSIVE PRICING TEST IN PRACTICE

Historically, the CMA and European Commission (EC) have been reluctant to pursue excessive pricing theories of harm, recognising the important role that pricing plays in competitive markets and in stimulating competition (and entry and innovation)

Recent cases have focused on the generic pharmaceutical sector – both in UK but also at EU level (*Aspen*) and national competition authorities

Likely to see an increase in the application of excessive pricing as a theory of harm in the pharmaceutical sector and beyond

Rules on excessive pricing also apply in the context of private enforcement, where parties are seeking to enforce the competition rules independently

EXCESSIVE PRICING TEST: LIMB 1

Cost Plus:

- *United Brands*: measure of *'costs actually incurred*' or *'reasonably attributable*' to supplying product will include costs directly incurred in supplying it plus appropriate apportionment of reasonably attributable indirect costs

- No prescribed methodology for measuring cost
  - In *Albion Water II*, CAT stated it is matter of fact, accounting technique and economic assessment
  - In *United Brands*, ECJ recognised need for flexibility in cost calculation methods
  - Well established that any costs must be reasonably and efficiently incurred (*Ministere Public v Tournier*)

Reasonable rate of return:

- *United Brands* simply refers to costs of production, without further definition

- In *Scandilines*, EC recognised it is legitimate for companies to want to cover their cost of capital

- In *Albion Water II*, CAT recognised relevant components of costs should ordinarily include return on capital thus - when establishing "*costs actually incurred*", it is normally necessary to allocate a reasonable rate of return to cover cost of capital

EXCESSIVE PRICING TEST: LIMB 1 (EXCESSIVENESS - CONT)

- Latvian copyright case: In determining whether a price is excessive:
  - Comparisons with other member states may be appropriate if reference counties are selected "*in accordance with objective, appropriate, and verifiable criteria"*
  - Excessive prices need to be "*significantly"* and *"persistently"* above the competitive level
  - Advocate General Wahl noted that exploitative abuse cases should be rare and exceptional, emphasizing that agencies should be "extremely reluctant" to pursue them

- Albion Water (II)
  - '*Excessive*' can be applied in line with ordinary meaning (having regard to overall purpose of Chapter II)
  - Accepted that a material difference between price and cost must be shown but no need to specify when a particular difference is sufficiently large to be deemed excessive

NAPP PHARMACEUTICALS (OFT 2001)

- First OFT financial penalty for a competition breach. Napp fined £3.2m for abuse of dominance in relation to pricing of MST – sustained release morphine tablets.
- Following expiry of the patent, price of MST tablets to the community remained relatively stable at 12.5% discount from trade price (also stable). But discounts to hospitals increased dramatically over the period to May 2000.
- Napp found to be dominant in market for supply of sustained release morphine tablets and capsules in UK – had abused this position by charging excessively high prices in community market:
  - Prices in community segment on average more than 10 times higher than hospital prices
  - OFT used comparative approach to assess whether the community prices were **excessive**, rather than assessing them in isolation (e.g. using a cost plus approach) - made a range of comparisons that all pointed to Napp's community prices for MST being excessive:
    - Compared Napp's profit margins on community sales with its margins on sales of other products and sales of MST to other markets to assess "*whether the difference between costs actually incurred and the price actually charged is excessive*"
    - Used competitor prices and prices Napp charged elsewhere as proxy for what competitive price of MST was likely to be – looked at whether those prices would enable Napp to earn a reasonable profit.

ATTHERACES LTD V BRITISH HORSERACING BOARD (2007)

- Case contrasts with Napp- CoA overturned a High Court excessive pricing finding on grounds that it was insufficient to consider only the costs of supplying a product and the supplier's reasonable margins (a 'cost plus' test);
- ATR alleged an unreasonable refusal to supply the data to ATR; excessive and unfair pricing of that data; and discriminatory pricing of that data.
- High Court found price sought by BHB for the pre-race data was far in excess of its economic value – this was to be measured by a reasonable allocation to ATR of the BHB's costs of collating and distributing the data, together with a reasonable return on those costs.
- Court of Appeal rejected High Court's cost plus approach
- BHB's central contention was that the economic value of the product should have regard to its value to the purchaser rather than cost plus – CoA effectively agreed:
  - Must look beyond ATR's immediate interests to the market which it served. BHB sought a 50% share of profits (while ATR carried all the risks and most of the costs). May seem unfair but not in itself abuse of dominance. Little, if any, evidence that competition in market was being distorted by the demands made by BHB upon ATR.
  - High Court had rejected BHB's argument that the benefit of the system to overseas bookmakers was a relevant externality but it was clear that, in a competitive market, overseas bookmakers making commercial use of the services supplied to them by ATR were paying ATR prices for those services - little, if any, evidence that competition in that market was being distorted by the price demands made of ATR by the BHB.

PHENYTOIN (1) – CMA DECISION

- December 2016: CMA imposed £84.2m fine on Pfizer and £5.2m fine on its distributor Flynn after finding both companies had abused their dominant positions by charging excessive prices for phenytoin sodium capsules (anti-epilepsy drug)
  - Case involved Flynn Pharma, a small pharmaceutical supplier specializing in 'end-of-life' medicines, and Pfizer
  - Pfizer had sold the rights to distribute the drug to Flynn, who subsequently made the drug an unbranded generic, meaning that it was no longer subject to the PPRS price regulation scheme
  - Price charged to NHS for packs of the drug increased materially - overall NHS expenditure increased from around £2 million in 2012 to around £50 million in 2013
  - The CMA found that Flynn Pharma and Pfizer had breached competition law by charging an excessive price for the capsule form of epilepsy drug Epanutin, resulting in an increase between 780% and 1,600% in a year
  - To show that these prices were excessive, the CMA relied upon a comparison between the cost of the drug and its price (a "Cost Plus" analysis): it identified a return on sales (ROS) of 6% as a reasonable return bearing in mind Pfizer and Flynn's costs and the fact that they would have obtained that rate of return under the PPRS (i.e. prices were excessive and unfair "in themselves" because they had no reasonable relation to the economic value of the capsules).
  - CMA did not assess the fairness of the price by reference to appropriate comparators – in particular the tablet form of the drug, sold by Teva, that was similarly priced
  - CMA imposed fines totalling £90 million

PHENYTOIN (2) – CAT JUDGMENT

- June 2018: CAT judgment
  - Finding that Pfizer and Flynn were both dominant was upheld
  - CAT found that the two tests under the “unfair limb” are not strict alternatives and that, although the CMA was free to use either of the tests to establish the infringement, it should not have ignored a prima facie valid argument raised by the defendants that the prices were fair under the “competing products” test because it had satisfied itself that the prices were unfair solely based on the “in itself” test
  - CMA should have applied following steps:
    - Identify a “hypothetical” benchmark price or range of prices for phenytoin sodium capsules which would have applied in conditions of "*normal and sufficiently effective competition*”
    - In determining that benchmark price, give proper consideration to whether, amongst other things, phenytoin sodium tablets served as a meaningful price comparator
    - Take into account benefits to patients of phenytoin capsules in determining economic value
- Case remitted back to CMA

PHENYTOIN (3) – COURT OF APPEAL

- Key issues in appeal:
  - Should the CMA have to establish benchmark rates (beyond a Cost Plus approach) to determine whether prices are excessive?
  - Should the CMA have to consider both alternatives on the second limb (i.e. is it sufficient to demonstrate that the price is unfair in itself or does the price also need to be unfair when compared to competing products)?
  - Should the CMA have to consider any comparators raised by the alleged infringer?
- CoA noted at the outset that it was important to keep in mind that:
  - "*literally overnight, Pfizer and Flynn increased their prices for phenytoin sodium capsules by factors of between approximately 7 and 27*" and
  - the CMA "…*has to be able to do its job depending on the economic circumstances of the case*"
- CoA held that CAT had fallen into error when requiring the CMA to go beyond the Cost Plus approach to establish a benchmark price or range of prices:
  - The CMA can establish a breach of competition law if the regulator shows that a price is unfair in itself **or** when compared to competing products; it does not have to show both
  - In this respect, the CMA was successful in its appeal

PHENYTOIN (4) – COURT OF APPEAL

- However, the CMA was wrong to interpret the two tests under limb 2 of United Brands (unfairness) as strict alternatives:
  - Whilst limb 2 cannot be construed as conferring an obligation on competition authorities to use multiple tests, if evidence is presented by a party under one of the alternative tests under limb 2, that evidence must be considered
  - If they raise prima facie valid comparators as evidence as to why the prices they charge are in fact fair, the CMA is obliged to give these comparators due attention and consider these with “an open mind, carefully and impartially”
  - The CMA then has a margin of discretion in deciding whether competing evidence on one aspect (for example the ‘when compared to competing products’ aspect) would outweigh conclusions reached in the alternative (i.e. the ‘unfair in itself’ test)
- Benchmark price: whilst "*a*" benchmark is required, a competition authority can choose a benchmark based upon costs - it is not necessary to establish a hypothetical benchmark price
- Economic value of phenytoin: CoA dismissed the CMA's challenge to the CAT's findings on 'economic value' - CMA's approach erred in law and adopted an artificially limited approach to the evidence
- Relevance of comparator products: CAT's finding that CMA failed to carry out a sufficient deep or intense investigation (i.e. a failure adequately to consider comparator products) is finding of fact which CAT is entitled to make

PHENYTOIN (5) – KEY TAKEAWAYS

- Key takeways:
  - If a Cost-Plus test is applied, then the CMA should determine whether the margin is "excessive". The authority should then compare the price charged against any other factors which might otherwise serve to justify the price charged as fair and not abusive
  - Competition authorities need to establish a benchmark but they are not required to implement a specific hypothetical benchmark price (or range of prices) in determining whether pricing is excessive
  - The "in itself" and "competing products" tests of the "unfair limb" of the *United Brands* test are not strict alternatives – the CMA has a "margin of manoeuvre" in deciding which test it will use
  - While the CMA has the benefit of a margin for manoeuvre in demonstrating excessive pricing, it must be flexible within that margin and must fairly evaluate all plausible evidence adduced to show that a price is fair, even if those arguments are based on other methods or types of evidence to that relied upon by the CMA
  - It must do so, not only as a matter of properly applied legal test, but also as a matter of good administration and respect for the presumption of innocence. A failure to do so will render decisions vulnerable to challenge.

HYDROCORTISONE (1)

- July 2021: the CMA issued infringement decision in the Hydrocortisone case finding that:
  - Auden Mckenzie and Actavis charged excessive and unfair prices for 10mg and 20mg hydrocortisone tablets during the periods 1 October 2008 to 31 July 2018 (10mg) and 1 October 2008 to 8 January 2017 (20mg)
  - In supplying a de-branded version of the hydrocortisone tablets, the parties were able to exploit the fact that it was only the original, branded version of a drug which was subject to price regulation
  - The parties increased the price of the tablets by more than 10,000% compared to the price that had been charged for the original branded version of the tablets: in April 2008, the price of a single pack of 10mg tablets was 70p and a pack of 20mg tablets was £1.07; by March 2016, the prices had risen to £88 and £102.74, respectively
- Actavis took over Auden Mckenzie's hydrocortisone tablet business in 2015 and is liable for its conduct before that date

HYDROCORTISONE (2)

- Record fine of £221.1m in total
- Total fine imposed for the charging of excessive and unfair prices was £155 million
- Chapter I breaches also identified:
  - After Auden Mckenzie bought the licences for hydrocortisone and launched its own generic versions in 2008, CMA found that it paid Waymade £1.8 million in total and AMCo (now Advanz Pharma) £21 million not to enter the market with their own generic versions of hydrocortisone tablets
- Appeal has been launched

LIOTHYRONINE

- 29 July 2021: CMA announced it had fined Advanz Pharma (three of its subsidiaries and two former parents companies) £101m
- CMA concluded Advanz abused dominant position between 2009 and 2017 by charging excessive and unfair prices for supplying 20mcg liothyronine tablets (used to treat thyroid hormone deficiency)
  - In 2007, Advanz developed a "price optimisation" strategy – identified genericised drugs with limited or no competition and high barriers to entry which could sustain repeated price increases
  - By "de-branding" these drugs, Advanz could remove them from the price regulation regime which only applied to branded drugs, enabling it to set whatever prices it chose
  - Strategy resulted in an overall price increase for liothyronine tablets of more than 6,000% - price of a pack of tablets increased from £20 in 2009 to £248 in 2017.
- Found price increases not driven by any meaningful innovation or investment, volumes remained broadly stable, and cost of producing the tablets did not increase significantly
- Price rises caused drug to be placed on NHS's "drop list" in 2015 – left patients facing prospect of having treatment stopped or having to purchase liothyronine tablets at their own expense
- Appeal launched in October 2021

JUSTIN LE PATOUREL V BT GROUP PLC

- At an early stage - an unsuccessful strike-out/summary judgment application where excessive/unfair pricing issues were raised
- Stand alone opt-out CPO application by Justin Le Patourel as Class Representative in respect of approximately 2.3m affected BT customers
- Claiming that, contrary to Chapter II, BT abused its dominant position by charging unfair prices for standalone fixed voice services to certain customers – voice only customers and split purchase customers, i.e. who don't have a bundle of telephone and broadband services from the same provider
- In September 2021, CAT granted a CPO and dismissed a cross-application for strike-out/summary judgment.
  - Extended discussion before the CAT of the "test" for abusive pricing in United Brands and its analysis by the CA in Flynn
  - CAT did not rehearse much of it in its judgment as (Proposed) Class Representative accepted, at least for purposes of the application, that at trial it will need to satisfy both "limbs" of para 252 United Brands, i.e. that the pricing at issue is both excessive and unfair
- Example of new stand-alone Chapter II CA98 claim based on excessive pricing
- See also boundary fares (CPO application)

EXCESSIVE PRICING AND COVID

- Between 10 March and 28 June 2020, the CMA received over 80,000 complaints about coronavirus-related issues, many of which were in response to companies charging excessive prices for essential products such as face masks and hand sanitiser
- CMA launched an investigation on 18 June 2020 under Chapter II of the CA into four pharmacies and convenience stores suspected of charging excessive and unfair prices for hand sanitiser
  - Letter specifically raised concerns over the pricing of hand sanitiser, face masks and paracetamol, which saw a sharp spike in the early months of the pandemic.
  - For the price of hand sanitiser alone, the CMA reported a median rise of almost 400%
  - Cases were later closed
- **PCR Tests**
  - August 2021 – Sajid Javid asked CMA to look into possible excessive pricing or exploitative conduct
  - CMA issued letter reminding suppliers of duties under consumer protection laws and flagged concerns including “bait advertising”, drip pricing, failing to disclose important caveats and refusing refunds where tests not provided within specified timescales

CONSUMER PROTECTION POWERS

- Consultation launched in July 2021 details proposals for significant consumer protection reforms:
  - Granting CMA powers to determine when a business has infringed competition law and to impose fines of up to 10% of global turnover
  - Making undertakings directly enforceable by the CMA and subject to fines for non-compliance
  - New forms of direct redress for consumers, e.g. the development and improvement of alternative dispute resolution (ADR) processes