IN THE COMPETITION APPEAL TRIBUNAL

Case No: 1403/7/7/21

Salisbury Square House
8 Salisbury Square London
EC4Y 8AP

Wednesday 4 May 2022

Before:
Ben Tidswell
Dr William Bishop
Tim Frazer
(Sitting as a Tribunal in England and Wales)

BETWEEN:

Dr. Rachael Kent

Proposed Class Representative

v

Apple Inc. and Apple Distribution International Ltd

Proposed Defendants

A P P E A R AN C E S

Ronit Kreisberger QC, Michael Armitage Kennedy and George McDonald (On behalf of Dr. Rachael Kent)

Brian Kennelly QC and Daniel Piccinin (On behalf of Apple Inc. and Apple Distribution International Ltd)

Digital Transcription by Epiq Europe Ltd
Lower Ground 20 Furnival Street London EC4A 1JS
Tel No: 020 7404 1400 Fax No: 020 7404 1424
Email: ukclient@epiqglobal.co.uk

Wednesday, 4 May 2022

(10.30 am)

THE CHAIRMAN: Yes, good morning everybody. We are being live streamed, so I should say the customary announcement about that.

Our proceedings are in open court, an official recording is being made and an authorised transcript will be produced, but it is strictly prohibited for anyone else to make an unauthorised recording with audio or visual of the proceedings in breach of this provision punishable as a contempt of court.

Housekeeping

THE CHAIRMAN: Ms Kreisberger. Good morning.

I think, is it still convenient for us to start with certification?

MS KREISBERGER: It is, Sir. I am grateful for that.

In terms of appearances, I appear with Mr Armitage and Mr McDonald for the proposed class representative, Dr Kent.

Mr Kennelly and Mr Piccinin appear for the proposed defendant, Apple.

Sir, in answer to your question, in terms of timetable, I am grateful for the Tribunal's indication that it has some questions on funding and we are very happy to begin with those this morning.

Mr McDonald will respond to the Tribunal's questions on that and I hope the panel received his note overnight?

THE CHAIRMAN: Yes, we did, thank you. So we had a very helpful note, thank you, and also a very helpful letter in relation to confidentiality and it seemed to us that we could proceed quite straightforwardly on that basis. We are very happy to do that if that is the position.

MS KREISBERGER: I am grateful. That is the hope.

THE CHAIRMAN: Good.

MS KREISBERGER: Then, just finishing on timetable, Mr Kennelly will hopefully this morning address you on his application to strike out the excessive pricing claim or for reverse summary judgment and I will then make my responsive submissions. We anticipate that that will be tomorrow morning. Mr Kennelly then has a reply. The hope is that we can get through that in the two days. If not, we do have Friday morning in reserve. Just in terms of housekeeping, there is a core bundle and, Sir, members of the panel, if you are working in hard copy, it has four volumes: an authorities bundle, which has three volumes; and a correspondence bundle with two volumes. I will be giving the hard copy references with tabs.

With that, unless I can assist the Tribunal further, I will allow Mr McDonald to address you on any questions on funding.

THE CHAIRMAN: Yes, thank you.

Submissions by MR McDONALD

MR McDONALD: Good morning.

THE CHAIRMAN: Yes, good morning, Mr McDonald. Thank you very much for your note, which we found very helpful. What we might ask you to do, given that it came in reasonably late, and I am grateful for whoever was working hard -- perhaps you - working hard on it last night. We might ask you to step through it with us and we can pick up any other questions as we go, if that is all right.

MR McDONALD: Yes.

THE CHAIRMAN: I think we can move fairly swiftly. It does, certainly from my preliminary look at it, seem to me to cover the points we had put very comprehensively so we needn't get into too much detail as we go, I would have thought.

MR McDONALD: I am grateful. Sir, it may be easiest to start with the amended litigation funding agreement, which was also provided last night, but it should have been added to your bundles in place of the existing funding agreement. So it should be in core bundle 2 <C/14/555>.

THE CHAIRMAN: Yes.

MR McDONALD: It starts with the amendment and restatement deed and then proceeds to the funding agreement itself.

The termination provisions are at clause 24, that is at page 583.

The first clause there, subclause 24.1, is not really a termination of the LFA provision itself, it just says when the cost limit, i.e. the extent of the funding provided, is exhausted, the funder won't fund anymore and, similarly, if the action is concluded, then the funder won't fund anymore, which seemed pretty sensible, given that there would be nothing required to fund at that stage.

THE CHAIRMAN: Yes.

MR McDONALD: I also referred back to clause 15 which had similar provisions if the action is discontinued or withdrawn. That is clause 15.4.

So that provides where, with the support of the advice of solicitors and counsel, the class representative withdraws from the action, abandons the action or the action is discontinued. Remember, that would be subject to the Tribunal's approval anyway under the rules. An application would be needed to be made first and the Tribunal would then consider that course of action.

THE CHAIRMAN: Yes.

MR McDONALD: Then the agreement will terminate for the obvious reason that there is nothing further to fund in those circumstances.

So turning back to clause 24.2, the termination provisions are maybe the sort of provisions which are relatively familiar to Tribunals in these sorts of applications because in 24.2.1 and .2, they deal with material breaches by the class representative. 24.2.3 is an inability to pay debts as they fall due, and then -- and accompanying that is the subject of a bankruptcy petition or order, so it is a classic insolvency-type provision. 24.2.4 is where the class representative becomes incapable of managing their own affairs by reason of illness or incapacity or that they pass away. Then 24.2.5 is the solicitors similarly being subject to, effectively, insolvency proceedings or being

unable to pay their debts, or SRA proceedings against the firm, and in circumstances where they don't have adequate professional indemnity insurance, or they are no longer instructed.

I set out in the note that the consequences of termination are at clause 26.1, and it is prospective only is the critical aspect of that, in that the cost to date of termination will be met by the funder but it is only the prospective costs that won't.

So if termination did arise, the course of action would be alternative funding would try to be secured but the Tribunal would be notified in short order and, if alternative funding couldn't be secured, then we would appear before you and no doubt directions could be given for future resolution for proceedings from then onwards. We say that is an unlikely event, but if that did arise, that is what would happen.

That is the termination provisions in the funding agreement.

In the Tribunal's letter, the question also concerned the Project Greve funding arrangements.

THE CHAIRMAN: I am sorry, my apologies, did you deal with 24.3 there, just at the amendment?

MR McDONALD: I apologise, of course. So 24.3 is the merits, the merits provision. Whereby, if the funder ceases to be satisfied about the merits or the commercial viability of the claim, they have a right to terminate. As I set out in my note, a very similar, if not identical, provision was considered in the *Merricks* case where the Tribunal understandably raised concerns that that seemed to be based on the funders' own view but not subject to any expert input either legal or of an expert economist nature.

The wording proposed in *Merricks* that satisfied the Tribunal was "such a view to be reached based on independent legal and expert advice that has been provided to the funder."

The only difference we have here is the wording "where appropriate" has been added before "expert advice". The reason for that is it won't always be the case that expert input is required if it is a legal issue, if it is purely a legal issue, and so it is now common practice not merely to lift the wording from *Merricks* but to add in the "where

appropriate" before the "expert advice" just to make it clear you don't always have to run off to an expert if there is nothing for them to opine on.

THE CHAIRMAN: Yes, thank you.

Just before you move off this agreement, would you mind dealing with the other amendment, which, I must confess, I have not really had a chance to follow through. So it's clause 9, isn't it?

MR McDONALD: It may be easiest to look at this in the footnote to my skeleton. That is at -- sorry, in the note I produced overnight. It is on page 2. The only reason I say that is because it shows the changes.

So clause -- sorry, because it is only an extract, if you open up page 575 of the bundle as well, we can see the introductory wording, so we can see it there. We can then look at the changes. It reads:

"In the event of success, the class representative, assisted by her solicitors, shall ..."

And then various obligations on the class representative. It initially read at 9.1.3 simply:

"... hold the stakeholder proceeds as trust property on trust absolutely for the benefit of class members ..."

The problem with that definition is stakeholder proceeds are recovered costs and payments out of undistributed damages that have been authorised by the Tribunal. So, by their very nature, they wouldn't be monies going to the class because they would be monies either in respect of costs or that the Tribunal has said can be paid out to the funder and others. So it was a bit of a misnomer to say they should be held on trust for the class members, it just didn't make that much sense.

So what we have done is the key change is really to delete the wording "stakeholder" so that the obligation is to hold the proceeds. That is because the proceeds include all damages, so including distributed damages, which would go to the class members.

THE CHAIRMAN: So the definition of "stakeholder" --

MR McDONALD: The definitions are -- the "stakeholder proceeds" is defined on page 568.

THE CHAIRMAN: Yes, I see. Yes, so "stakeholder proceeds" is really defined to mean amounts which are payable other than to class members?

MR McDONALD: Exactly.

THE CHAIRMAN: So the way this works in 9.1 is there is an entitlement to apply funds to those payments under 9.1.2 and to hold them on trust, and then a separate trust under 9.1.3 for the benefit of the class. So you are effectively separating the two out at this stage.

MR McDONALD: Yes. It was intended that 9.1.3 would cover the class members' entitlements as well, it just accidentally referred to "stakeholder proceeds", which, in the context, didn't make a lot of sense, given particularly 9.1.2, which already dealt with that, and the fact that it should apply to the wider definition of "proceeds" which includes the amounts to be distributed to the class.

THE CHAIRMAN: Yes. That is helpful, thank you. That is clear, thank you.

MR McDONALD: Sir, I will now move on to the facility agreement. That can be found in <C/21/737>.

THE CHAIRMAN: Yes.

MR McDONALD: I should say at the outset, my client, the PCR, is not a party to this agreement.

THE CHAIRMAN: Understood.

MR McDONALD: So I can comment on it as best I can, but if any detailed explanation is required, it may be we need to go back to the funder for a further explanation. But I will obviously try to assist as far as I can.

THE CHAIRMAN: Yes, thank you, that is understood.

MR McDONALD: As I expect the Tribunal may have found, the termination provisions weren't clearly headed "Termination" in this agreement, so hopefully it is now clearer that they are in clause 25 which can be found at page 861.

THE CHAIRMAN: Yes.

MR McDONALD: This sets out -- the way this is structured, it sets out events of default in clauses 25.2 through to 25.16. I won't take you individually through these events of default, they concern matters which are not, on their face, unusual, and relate to breaches, agreement misrepresentations, insolvency and the like. If there are any specific queries you have about any of these provisions, I am happy to try to address them.

They conclude at 25.17 with an acceleration clause, which begins:

"On or any time after the occurrence of an event of default which is continuing ..."

You may note, as you are looking through the events of default, that many of them have a remediation clause in them:

"The agent may, and shall, if so directed by the majority lenders, by notice to the parent ..."

And then the critical aspect for these provisions is:

"... cancel the total commitments, at which time they shall immediately be cancelled".

So effectively, there is no need to provide the facility any more, in those circumstances.

THE CHAIRMAN: Yes. One can see why this arrangement is a sensible commercial arrangement. I think it is presumably all about efficient use of capital within the group. So it seems to make sense. I think it is probably the first time in one of these certification cases we have got this far behind the screen, if one can put it that way. So that really was the main reason for wanting to have some discussion about and some understanding of it. I noticed there are one or two other provisions. I think they are probably not captured by the terms of the letter that was sent last night, so maybe I won't talk about the names of clauses, but I notice there are some provisions in clause 8.5 and 6, and then in clause 9, where there are other circumstances in which the funding arrangements might come to an end. Actually, I don't think, materially, that makes much difference to the point that there are circumstances which might arise in which case the funding ceases to flow, and then, presumably, Project Greve is unable to continue to fund. So really it is to be clear that that is a situation that exists in addition to the termination arrangements we talked about under the LFA. One might well feel

that it is cumulative because, actually, one might say, if you have termination provisions in the LFA, then you have to accept as a matter of course that, either through events of default or, actually, through a review of merits by the funder, the funding can come to an end and that is just the reality of these arrangements. So one can look at it that way.

I suppose our interest was to understand, if you like, the extent of those powers and to get some sense of the extent of the risk. Also, just a question that flows from that, which is, I think there is a consultative group that the PCR has set up. I was interested to know whether they had seen these arrangements and what view they had formed about that? I don't know whether that is something you can answer right now, maybe you need to take instructions on that and come back, but we would be quite interested in knowing what the view of the consultative group is of these arrangements and their, if you like, view of the security of funding for the PCR.

MR McDONALD: There are a couple of general points that I would make which may be of use. So, firstly, you would have seen the nature of the entities involved. So it is the Vannin Group, which is explained by Mr Fegan in his witness statement as being a very well established and reputable funder. I won't go into the details, I am not exactly sure what has been redacted and what hasn't, but you have that in his statement. They are now part of the Fortress Group, which you may have been aware of already before Mr Fegan explained that position in his witness statement, but I think it goes without saying they are a very internationally well-known investment management company.

From a simple basis, we say there can be no real doubt that there are funds available to fund these proceedings. Indeed, Apple rightly don't say, and that is no doubt why they don't say, there is any issue with the actual amount being available within the group.

In any funding structure, there will be agreements not exactly like this necessarily, but of this nature, whereby funds are provided by other group entities or outside lenders, or whoever it may be, to the funding entity. What has happened in this case is that rather than just rely on our ALF membership, which was found to be sufficient in *Trucks*, partly

because the Tribunal ordered us to provide further information about how our funding -- how the Vannin entities obtained their funding - the facility agreement has been produced. Now, what that does is confirm the extent of the commitment that had been given by other entities within the group, and I am not obviously going to say the number because that is something we are persisting with confidentiality over. It also shows that this is a serious arrangement. There is no doubt from this agreement that it is a serious arrangement. It is also an arrangement reached between members of the same group that has been ongoing from 2016, which is when Vannin became part of the Fortress Group. You will have seen from the restatement deeds that the amount of funding has been increased. There is no suggestion that it has been problematic so far. Mr Fegan confirms in his witness statement that they have always met their capital adequacy requirements in the ALF code of conduct and they have a commitment to do so. So we say it would take something pretty -- for something to go pretty badly wrong overall for termination even to be contemplated between two members of these groups. It is also worth bearing in mind that these termination provisions don't relate to this specific case. So the LFA is dealing with the merits of the case. This doesn't concern, well, if something goes wrong, one of the PCRs doesn't comply with the terms of an LFA, these are higher-level termination rights which concern the overall relationship between the Vannin Capital entity and the Fortress funding entity.

It is also worth bearing in mind what would happen if termination did arise under the facility agreement. So you mentioned a minute ago it would just mean that Project Greve couldn't then fund the claim. That doesn't necessarily follow because the Vannin Group may have access to other sources of funds by which it could fund the proceedings. So it may have fallen out with this particular entity in the funding group, which is its parent, as I understand it, but it may have access to other funds so they may be able to substitute the facility.

Even if they didn't, what would then happen is that, like a termination under the LFA, it would become very apparent that the funder was not paying monies that it was due to pay, because every month or whenever the accounting period is, the solicitors submit an invoice to the funder. So it will very quickly become apparent that the funding was not available. In those circumstances, again, we could look for alternative funding and, if not, we can come back before the Tribunal to address it. But this would all be in circumstances where there is nothing wrong with this particular case, so the merits of this particular case would remain the same. In fact, it would become a more attractive prospect because we would have had certification. So we would say going out to the market to find funding would not be particularly difficult in those circumstances.

That also factors into the termination of the facility agreement because the lender wouldn't want to forgo all of its potential recoveries in all these potential claims, because the way it is repaid is via the funder. The funder makes money from successful claims.

So if the Fortress entity pulled the plug, it would be waving goodbye or potentially waving goodbye to a substantial amount of repayments that would otherwise be made by the funder to it. So it would be a very serious decision with very serious commercial consequences for all of the Vannin and Fortress entities. We say that is inherently unlikely and, even if it did arise, there are other routes that could be pursued.

THE CHAIRMAN: Okay, thank you.

I think that probably deals with the facility agreement and we can move on and talk about the funding and particularly the question of options for increasing funding and ATE.

MR McDONALD: I will just take instructions on the consultative group point.

THE CHAIRMAN: Whenever is convenient, you can come back to us later, whatever works best.

MR McDONALD: We haven't discussed the facilities agreement with the consultative group.

THE CHAIRMAN: Yes, okay. It is interesting, actually, to have asked that question and to have received that answer. I wondered perhaps if it is something that you should be doing.

MR McDONALD: We will take that on board and no doubt we can have further discussions.

THE CHAIRMAN: Certainly I think we would find it helpful to know -- obviously, the PCR has considered this and is comfortable with the arrangement and that is helpful, but I think it would be also helpful to know that the consultative group had considered these aspects, which we have just discussed, and had a view on them and we would be interested in that view.

MR McDONALD: Yes.

THE CHAIRMAN: Okay.

Good, shall we move on to the next question?

MR McDONALD: Yes. These are the options for the PCR to increase the funding.

THE CHAIRMAN: I should perhaps -- I think you can take this reasonably quickly because we are familiar and the note actually is a good guide to us. If you want to take us through it quickly, that would --

MR McDONALD: I don't think I need to go through the documents.

THE CHAIRMAN: I don't think you need to take us to the documents.

MR McDONALD: Essentially, there are two main sources: either this funder -- and you will see what the Tribunal in *Trucks* said about the likelihood of that happening - and it comes back to the investment point, that it is very likely they would increase their funding, if, without that funding, the claim would fail and they would lose their investment. So we say it is most likely that the funding would be increased by this funder, but there is provision in the LFA for funding to be obtained from third party sources. So we could go to another funder and, as long as they agreed to being pari passu in the priorities order with the current funder, then that is another route for funding.

There is also a particular arrangement between this case and the *Coll* case, which I referred to in the letter - I can give you the reference we don't need to take it up, but the reference is in the correspondence bundle. It is page 332.1. Essentially, that means that the other protected cell, who funds the *Coll* proceedings, can also underspend to

fund this one. But it is in that funder's discretion. So it is not any -- I am not saying this is a be all and end all, it still requires that funder to agree to do it. It is just an amount of money that has been - allocated is the wrong word - but identified as could be used to fund these proceedings.

THE CHAIRMAN: Yes.

MR McDONALD: So those are the options for increasing the own costs funding.

Increasing adverse costs protection, there are similar options, in that you can enter into an endorsement which increases the limit of indemnity under the existing policy, but there is no specific increase mechanism within the agreement, but the way it ordinarily would be done is just an endorsement to increase the level of indemnity.

Alternatively, you could seek excess insurance, and then the third option, which is quite commonly deployed, and you may have seen this under some of the CPO funding judgments, is where the funder gives a direct indemnity either to the class representative or to the defendant.

One of the advantages of that, as I put in my note, is that that wouldn't require any upfront funding because it is -- the funder would be paying itself effectively, if that were the position.

You may be able to achieve the same through ATE insurance, but it may well be the case that the ATE insurer would ask for a deposit premium, so an upfront premium, to increase the limit. That would need to be met by the funder. That is catered for in the LFA in the sense that the funding can be increased and there is also clause 8.2 which deals specifically with increasing the adverse costs protection.

You would have seen I drew your attention to the approach generally taken by the Tribunal on CPO applications where the question about additional funding and additional insurance is being considered.

So that is that issue.

Sir, do you have any questions on that aspect?

THE CHAIRMAN: No, thank you.

MR McDONALD: I am grateful.

The last issue hopefully is a short one, which is we confirm your understanding about the effect of the ATE. I noted in passing the same wording was deployed in the *Trucks* case, in fact, so -- and that was considered satisfactory. Hopefully, that is clear that it does allow the defendant to directly claim under the policy.

THE CHAIRMAN: Yes. I certainly thought it said that, but I thought it was wise to make sure that my reading of it was correct. That is very helpful. Good. Okay, thank you.

Thank you, I think that does deal with the points as far as we are concerned.

Questions from the Tribunal re certification

THE CHAIRMAN: I did have just a couple of other questions relating to certification. I don't know whether it's for you or Ms Kreisberger. One of them is just an update on the question of proceedings. One of the things we need to tick off is whether there are any proceedings involving class members. It is a long time since the claim form was filed and I thought we should check that you are still not aware of any proceedings involving class members.

MS KREISBERGER: I am confident that is the case, but I will just take instructions.

THE CHAIRMAN: Thank you.

MS KREISBERGER: That is right.

THE CHAIRMAN: Good. Thank you.

I also wonder if we could just take a quick look at the draft order, there were a couple of points I think you might need to remind me where that is.

MS KREISBERGER: It is in the first core bundle, tab 4. <C/4>.

Sorry, that is tab 3.

THE CHAIRMAN: Just a few mopping-up things, one of them was the domiciled date. Now, I think the practice has been to set the domiciled date after certification, if certification was granted. I don't know whether it is sensible to try and deal with that now. One

assumes the domiciled date would be the date on which the certification, I think, is granted. I think that is the normal --

MS KREISBERGER: That is the approach taken in other cases such as *Le Patourel*, it was the date of the judgment.

THE CHAIRMAN: Do you think we should proceed on that basis? I don't know whether Mr Kennelly has anything to say about that? Maybe I can come back to you on a minute.

MR KENNELLY: I was going to double check what happened in the most recent one.

THE CHAIRMAN: Yes, thank you. We needn't deal with it again, but if you want to think about it and come back to us --

MS KREISBERGER: We are content with the ordinary approach.

THE CHAIRMAN: Yes, good. Okay, thank you.

The other thing I noted was I think you have updated your class definition in the amended pleading but not in this order. Presumably, somebody will catch that, I think it was particularly the point about the Tribunal interests. If you recall, the claim form was amended. I don't think, unless I have missed it, that this yet captures that amendment. It's on page 54 of the bundle.

MS KREISBERGER: I am sorry, Sir, can I just check with those behind me because that was certainly agreed in the claim form.

(Pause).

I am grateful to you, Sir, for spotting that. It needs to be tracked through to the draft order.

THE CHAIRMAN: Yes. Before it is published of course. Yes, good.

The only other point I had, and forgive me for raising a costs point, but I was curious as to why costs were -- suggested they should be reserved, wouldn't they normally be in the case?

MS KREISBERGER: I think that is right, Sir.

MR McDONALD: Just -- I think the intention would be that costs would be resolved once you have made your decision, because we made the submissions in respect of the CPO

application itself and in respect of the applications made by the respondent. So it may be a case of it is just included in the order, but there can be submissions made about it in due course, because, for example, in *BT* the costs were awarded in favour of the applicant subject to a deduction to take into account the costs that would have been incurred in any event. I don't know whether it has been put in there as an indicative amount and whether it is something intended to be argued at a later date but in this phase of the proceedings.

THE CHAIRMAN: That is helpful. What I didn't want to do is find it just got lost and we were being asked to deal with it in a year's time or two years' time or whatever it may be and having to remember what happened.

Again, perhaps that is something we can come back to, if need be.

MS KREISBERGER: Sorry, you are dealing with a double act which is probably not highly satisfying.

THE CHAIRMAN: No, it is very helpful. Twice the value.

MS KREISBERGER: Yes, if we could come back to you Sir on that.

THE CHAIRMAN: There is no need to deal with it now. I just didn't want it to disappear and not get dealt with. So we can move on and make the order --

MS KREISBERGER: Yes, I understand. I am grateful.

THE CHAIRMAN: -- without further correspondence and so on. That is helpful.

Okay. I think, unless there is anything else -- Mr Kennelly, do you want to say anything about any of that? I am conscious, obviously, you haven't opposed anything but there may be some things there you want to make observations about.

MR KENNELLY: Sir I have no observations to make about those points. On the very last point about costs, it may be sensible to come back to that at the end of my application, and then we can resolve that so that, as you say, we don't leave it hanging for the future. We can come back to that, which I think is what the PCR's representative is suggesting also, to come back to that question at the end of the hearing.

THE CHAIRMAN: Okay, thank you. In that case, I think we can move on to your application.

Submissions by MR KENNELLY

MR KENNELLY: This is indeed Apple's application to strike out or summarily determine the PCR's case that Apple's commission is an excessive price under section 18 of the Competition Act and Article 102 of the Treaty.

With the Tribunal's permission, I propose to introduce our application very briefly, take you to the PCR's pleadings, then open the authorities and then go to the evidence.

Under Article 102 and section 18, before the price for a product can be found to be unfair, the Tribunal must first ascertain what the product is worth. To ascertain what the product is worth, you need to ask what it is worth to the seller and to the purchaser. That is not just the law, it is common sense, because what the product is worth is not necessarily what it costs the seller to make. Its value to the purchaser may be far higher than what it costs the seller to produce. That is especially true for intangible and innovative products. A clever idea may cost its creator very little, but it may generate billions in revenue for those who use it down through the supply chain. Like a blockbuster film or a song or a piece of word processing software, where it is a hit, that will not normally affect the costs incurred by the producer but it will lead to enormous economic value as the film or the song or the software is watched or used or enjoyed by millions of people, or billions of people, even, across the world.

That is why we say the producer of an intangible product that turns out to be a hit can earn revenues far higher than the costs which it incurred in producing the good.

The law on unfair pricing is clear. It is always necessary to ascertain the economic value of the product in question and to take into account any demand side factors.

We are bringing this strike out application because the PCR has not put forward any case or methodology that addresses the value of the App Store to developers and users at all.

Now, the PCR has explained how she puts her case on excessive pricing. Although it is expressed as a preliminary methodology, the PCR is very clear on what she will and will not seek to prove at trial. They will rely primarily on the profits that Apple makes

from the App Store and then they claim to have some useful evidence from the prices charged by comparators.

As to profitability, profits are just the difference between the revenues and the costs for Apple. No matter how high those profits are, they only concern the sellers' perspective, Apple's perspective, the supply side. The PCR's profitability or cost plus methodology does not propose to ask what the product is worth to the developers and the end users, the demand side.

The PCR says it is enough to show that Apple's revenues have been, and remain, significantly above its costs. We say that the legal test requires that the demand side value is ascertained and that, for a product like this, Apple's costs do not measure this demand-side value. That is the key dispute before the Tribunal.

It is the key dispute because the comparator analysis, which I will come back to, doesn't come close to making out a sustainable case for trial if the PCR is wrong about her primary case.

We say it is not surprising that the PCR declines to ascertain what the product or the App Store is worth to developers and end users because, in fact, what Apple provides to them is worth billions, billions of dollars, to them. It would have been hopeless for the PCR to argue that Apple's commission bears no relation to the economic value of the App Store to developers and end users. That is, no doubt, why they don't even make that allegation.

Now, that is my introduction. Members of the Tribunal, I propose now to show you how the PCR puts its case. What I hope to show you is that the PCR's case on unfair pricing depends only on an analysis of Apple's profitability and those comparators that I mentioned. In going through them, I will try to prefigure our answer, which is that their approach refuses to ascertain the economic value of the App Store to developers and end users.

If you go, please, to the claim form. That is the first core bundle behind tab 5 <C/5/58> begins at page 58.

The relevant part on excessive pricing begins on page 92, from paragraph 114. <C/5/92>.

THE CHAIRMAN: Yes.

MR KENNELLY: You will see the starting point, and we will see this many times. The case law is *United Brands*. If you can skip ahead, please, to paragraph 117 over the page. You will see that, at paragraph 117, the PCR breaks down the *United Brands* test, the familiar test the Tribunal has seen. The first limb asks -- this is 117(a) -- is the price excessive? “The claimant may compare the cost of production with the selling price in order to disclose the profit margin; determine whether that is 'excessive' ..."

If I then skip down to (b) because these are cumulative limbs, then, is the price unfair by itself or by comparison?

Then at paragraph 118, this is important, the PCR acknowledges:

"Within this analysis, demand side factors are taken into account, particularly in relation to the concept of economic value. In broad terms, economic value encompasses 'what it is that users and customers value and will reasonably pay' ..."

Echoing case law:

"... but it has long been recognised that this is not sufficient by itself 'since otherwise true value would be defined as anything that an exploitative and abusive dominant undertaking could get away with',” Over the page.

We agree. At the bottom of that paragraph, having examined the Advocate-General's opinion in *Tournier* quoting from Lord Justice Green in *Flynn*, she deals with the point about dependency. She says that "the dependency of the buyer will therefore be a relevant factor in determining the true economic value".

It doesn't mean you don't ask the question what is the economic value, but it is a factor in ascertaining what it truly is.

Then, at paragraph 121, we see the PCR's case, we see how high it is put. I am focusing only on the second bit that begins:

"For the avoidance of doubt, at this preliminary stage, and pending sight of Apple's costs ..."

That is what is missing from PCR's perspective:

"... it is alleged by the PCR that all Commission charged by Apple on Relevant Purchases is excessive and unfair, including [even] those charges of 15% more recently imposed."

Then we see how the PCR pleads that the commission is unfair. Over the page, please, this is page 95. The excessive limb, the first limb of *United Brands*, that is paragraph 122, they say, first of all:

"The evidence currently available indicates that the Commission satisfies the excessive limb ... [because] Apple enjoys an extraordinary profit margin [they say] in respect of the App Store."

They work that out from the following subparagraphs. A focus in particular on what Mr Holt says summarised in (b). They say:

"The exceptional nature of that profit margin is also confirmed by preliminary analyses undertaken by Mr Holt ... Mr Holt has undertaken profitability analyses based on publicly available information to estimate Apple's Return on Capital Employed ... compared to relevant adjusted Weighted Average Cost of Capital ..."

And he says (i):

"... the estimated ROCE is very significantly in excess of [what he estimates to be] Apple's calculated WACC in the Relevant Period."

So we are focusing there only on Apple's profitability.

Then, please, go to paragraph 123. This is the second limb, the unfair limb, over the page, now page 96. These are the reasons why the PCR says that the unfair limb is satisfied. So we see first at (a):

"Persistent rate. The Commission was set in 2009, and has remained stable for over a decade ... The persistence of high prices, given the ... growth of Apple ... indicates that, as a result of its dominant position, [it] has reaped trading benefits which it would not have reaped if there had been normal and ... effective competition."

There we have a reference to, again, Apple's persistent and high profitability, they allege, with no reference to economic value from the perspective of users or developers. And (b):

"Nature of the differential ... the profit margin disclosed ... is not only ... large, it is increasing."

(c):

"Drop in commission to 15 per cent."

Paraphrasing here, the PCR relies on the fact that Apple could reduce its commission. They say that shows market power. Again, there is no mention here of the economic value to developers and end users.

Then (d):

"Other sources of App Store revenue. Apple also charges a $99 per annum Program fee ..."

And they reference the revenues that Apple gets from ads and other sources of revenue to Apple.

The suggestion, I think, is that Apple doesn't need to charge these levels of commission to be profitable. Again, that is nothing to do with ascertaining the value of the App Store to developers and end users.

Then at (e), over the page, page 98, there is a reference to the response by the App developers themselves. Again, just to summarise, some developers have sought to avoid paying the commission and others have complained that it is too high. You will see, and I will come to it, how the CMA in its interim report and the market study records other developers acknowledging the significant value that Apple provides to them, but, ultimately, we say the fact that some developers would like to pay less and increase their own profits has nothing to do with ascertaining the economic value the App Store provides to them and to end users.

Then paragraph 124:

"In the premises [they say], the Commission does not reflect the economic value of the App Store. To the contrary, it is a fee paid under duress by ... developers who are rendered wholly dependent [that is important; we will come back to that phrase, you will see it in the case law] on Apple for distribution of their ... apps. The ... app developers have stridently objected to it: it is not a commission that reflects that which ... users value and will reasonably pay."

They say it doesn't reflect what they value, but nowhere does the PCR, or Mr Holt, propose any methodology, any attempt, to ascertain what value the developers or users derive from or on the App Store.

You will see that their positive case is that there is no need to do so. They say that high and persistent profits will prove that the economic value has been exceeded without needing to ascertain that economic value.

That is the PCR's case on the unfair in itself part of the test.

Then we come to the second part of how the PCR seeks to prove this: comparators. The comparators analysis begins from paragraph 125 on page 99.

You see in paragraph 126 how low the PCR puts the case on comparators. She says in the very last sentence, "Mr Holt" -- first of all, at 126, first sentence:

"... has not identified strong price comparators in the form of other app stores charging competitive levels of commission."

Principally because of his view that Google isn't a proper comparator because of competition problems with Google. But then, at the bottom of paragraph 126:

"However, Mr Holt has identified comparators in the form of certain PC [personal computer] games distribution platforms and the Microsoft app store which have informed [only informed] his price benchmarking analysis."

You will see, when I come to these comparators, that, in fact, most of them have charged, or do charge, a 30 per cent commission, just like Apple. It is hopeless to say that because a couple of them now charge or offer lower rates for their services, that the 30 per cent and 15 per cent that Apple charges for the App Store is unfair. I will make that good when we come to the evidence itself.

Then, at paragraph 128, he reaches for another comparator. He considers that payment processing service providers serve as relevant price comparators for the purposes of assessing whether the commission is unfair. Payment processors like PayPal or Stripe are doing something totally different, they are just processing payments. We say it is hopeless to draw a parallel between that and what Apple provides. We say there is

no real prospect of the comparators demonstrating that the commissions bear no reasonable relation to the economic value that Apple provides to developers and end users.

Then we go to the Reply, because obviously, in our Response, we pointed some of this out to the PCR, so they address it in their Reply. You have that behind tab 7. Same bundle. Page 153 <C/7/153>.

In this document, members of the Tribunal, I will look only at the profitability bit. I won't look at the comparators analysis. We will see that in Mr Holt's evidence. Let's see what the PCR says about profitability and the points I have been making to you.

Go, please, to page 162, paragraph 31.

The PCR says here:

"... a cost-plus analysis is capable of evaluating economic value in particular through the 'plus' element using benchmarks such as ROS [return on sales] or ROCE [which you have already seen in the claim form]; and Mr Holt's profitability analysis takes proper account of economic value, as explained below."

Pausing there, you have already seen that internal sales and ROCE are a measure of Apple's profitability. Apple's costs and Apple's revenues, by themselves, can't tell you anything about what the App Store is worth to developers and end users, because developers might be getting far more value out of the App Store than they are paying Apple by way of commission. That is a question that has to be addressed.

Then, at paragraph 32, "Mr Holt explains, as regards his overall approach, that economic value needs to be assessed in the round following the limbs in *United Brands*. Mr Holt's method of assessing Apple's ROCE against its WACC is a common tool for analysing whether market outcomes are competitive, [the phrase] used by the CMA in analysing Apple's commission rates in the Interim Report." True it is, it is a common tool for assessing if markets are competitive, but it doesn't show you if the prices are unfair under the legal test for Article 102 and section 18. We will see that when we come to the case law.

Now, the Tribunal can assume, because this is a strike out, that the commission, Apple's commission, would be lower if rival app stores were allowed on the Apple devices. But that does not tell you that the commission is unfair within the meaning of Article 102 or section 18.

For that, for the legal test, the PCR needs to show you that the commission bears no reasonable relation to the value that developers and end users get from the App Store. It is not enough simply to say that the price would be lower if there were more competition.

Then, at paragraph 34, the nub of the PCR's case, over the page on 163:

"... Mr Holt's preliminary conclusion for the purposes of certification, and prior to disclosure, is that Apple has, over the Relevant Period, enjoyed excess profits, given in particular the size of the App Store's price/cost margin and its persistence over time."

So the PCR's case is it is enough to show that a dominant undertaking enjoys high profits over a lengthy period. Then this follows:

"He considers those provisional findings ... warrant 'further investigation'."

And he also emphasises the importance of the fact that Apple has structured its ecosystem so that it is the single gatekeeper to users and is shielded from competition.

Then, at paragraph 36, finally they address the point that I have been putting to the Tribunal:

"Third, to the extent that Apple's position is that some higher value needs to be incorporated in the 'plus' element of a cost-plus test to reflect the so-called unique value of the App Store and/or the entire Apple ecosystem -- which, for the avoidance of doubt, the PCR denies ..."

Pausing there, I am not speaking about unique value, I am speaking about any economic value from the perspective of developers and end users to value the product they are getting from their perspective. That is what we are talking about. They are saying, if that is a relevant thing at all, Apple, they go on to say, has failed to put forward any methodology for taking account of this allegedly unique value of the App Store, the

ecosystem, and they say we confine ourselves to simply saying that Mr Holt's analysis is deficient without advancing any alternative approach.

Two points to make in relation to that. First, of course, it is the PCR that needs to prove that Apple's commission bears no reasonable relation to the economic value of the App Store to developers and end users. The case law we will come to makes it clear that it is for the person alleging the unfair price under Article 102 or section 18 to ascertain the value and to show that the prices bear no reasonable relation to it.

Second, Apple has explained through Mr Hitt's evidence, and in submissions, how the App Store generates economic value for developers and end users.

The Tribunal does not need to quantify that economic value in this hearing. It is not necessary. The only question for you is whether it is necessary to ascertain the economic value from the demand side at all.

Then, at paragraph 37, we see what the PCR says:

"Ultimately, the question whether any analysis which may be undertaken, following disclosure and evidence in due course, will be capable of capturing economic value will depend on detailed factual / evidential matters concerning the assessment of costs and their inter-relationship with price."

So again, that is the PCR saying that all that remains to be done is analysis of Apple's costs and their interrelationship with Apple's price. Apple's costs and Apple's revenues. No need, they say, to ascertain the economic value from the perspective of developers and end users.

To conclude, if I may, on the PCR's pleadings, their case is that, by showing high and persistent profitability in circumstances where Apple has a dominant position, they can prove that economic value has been exceeded without ever having to ask what the economic value actually is.

If it is convenient, I will turn now to the authorities. I have been prefiguring them in my submissions, so it may be useful to hopefully make good what I have been saying to you about them all.

THE CHAIRMAN: Thank you. Would it be a convenient time to take a break for the transcribers?

MR KENNELLY: Yes, of course.

THE CHAIRMAN: Shall we do that and then move on? We will take 15 minutes.

(11.32 am)

(A short break)

(11.48 am)

THE CHAIRMAN: Mr Kennelly?

MR KENNELLY: Thank you, Mr Chairman.

If I may then turn to the law.

MR FRAZER: Before we proceed Mr Kennelly, can I just take to you paragraph 39 of the Response. I don't think we quite got that. I think your submission is that the PCR's case is that, in order to determine whether there is excessive pricing, one only needs to take account of the difference between price and costs and the persistence of that. In paragraph 39, she does go on to acknowledge the existence of the importance, as it were, or the relevance, of economic value, and I just wondered whether you were going to take us through that or not. Does that affect your case?

MR KENNELLY: Sorry, 39 of which document?

MR FRAZER: Of the Reply. Just where we were before.

MR KENNELLY: Yes:

"... Professor Hitt's various claims about the value ..."

MR FRAZER: Yes, exactly.

MR KENNELLY: "... and the various factual and evidential issues thrown up by those claims, will need to be tested at trial and are not suitable for summary resolution ..."

Yes, by that she means that the question of the -- she is saying there, or suggesting, that it can be read to mean that how much value the ecosystem provides, how much value they get from the App Store is a matter for trial. But that is not -- I can see how the Tribunal might read it that way, but that is not at all what they are saying in their Claim

Form and the rest of the Reply. They are very clear about that when they say that all that needs to be done is an analysis of Apple's profitability and an analysis of its competitive power and the persistence and significance of that profitability.

There is no suggestion in the pleadings or Mr Holt's evidence that the extent of the economic value would be relevant there. So I am afraid, Sir, although you could read paragraph 39 the way that we have discussed, that is not how it is supposed to be read in light of the rest of the case.

In fact, there is a cross-reference to Mr Holt's second report. You see that paragraph cross-references Holt 2, paragraph 2.2.15? I will come to that when I come to Mr Holt's second statement, second report, and you will see, when you look at Holt 2, he remains of the view, and the PCR's case remains, that there was no need to look at economic value from the demand side.

MR FRAZER: Thank you.

MR KENNELLY: I will turn now, if I may, to the law. I will deal, if I may, first, with the proper approach to strike out and summary judgment and then to the legal test for unfair pricing.

On the proper approach to strike out and summary judgment, this begins, if I may, in Apple's Response to the CPO application <C/6/128>.

At page 128, at the bottom of the page, this is common ground, so if the Tribunal read it for themselves, that would be quicker. The whole of that passage from the judgment Mr Justice Lewison in *Easyair v Opal*.

THE CHAIRMAN: I think we are familiar with that, Mr Kennelly, so I think you can move straight on.

MR KENNELLY: I will then, Sir. I will move straight on. It is a familiar test, but just to be clear.

THE CHAIRMAN: Understood, absolutely. I am sure we have all looked at that and are all familiar with it.

MR KENNELLY: Before I move on, just for the sake of completeness, and to be fair to the PCR, in addition to that passage in their Reply, they also ask the Tribunal to bear in

mind the fact that Lord Justice Mummery's judgment in *Doncaster* is the effect that where there are issues that may be teased out further at trial that are relevant to the issue, that is another reason potentially for not striking out or giving summary judgment.

THE CHAIRMAN: Just for extra caution. Indeed.

MR KENNELLY: You have my point, though, that all that has to be teased out in the PCR's case is further analysis of Apple's revenue and Apple's costs, not the economic value from the demand side.

For this, I propose to take the Tribunal first to the Commission decision in *Scandlines* and then to *Attherаces* in the Court of Appeal and, finally, the most recent judgment, the judgment of the Court of Appeal in *Flynn*. By doing it in that way, I track the chronological order, but also the Tribunal will see how each authority builds on the other and hopefully then you will see what Lord Justice Green was trying to express in *Flynn*.

With that, I would ask you to turn up please the *Scandlines* decision. It is in the fourth authorities bundle behind tab 26.

THE CHAIRMAN: For some reason, we don't have hard copy bundles. I don't know if that message has got through but we are going to need them on here. I am sure that is some efficiency somewhere, to proceed electronically.

MR KENNELLY: So you don't have tabs?

THE CHAIRMAN: I think we are waiting for the document to appear on the screen.

MR KENNELLY: It is <A/26/1255>.

THE CHAIRMAN: Yes.

MR KENNELLY: <A-1255>. Tab 26.

(Pause).

EPE OPERATOR: Sorry, that is the document that keeps coming up for 1255.

THE CHAIRMAN: We will be able to find it elsewhere. It might just take a little bit of time for us to get into the bundle for the Tribunal. Maybe that might be the most efficient thing.

MR KENNELLY: It may be. I am afraid all I can give is the tab and the page number.

EPE OPERATOR: Sorry, that is all that is coming up for 1255.

MR FRAZER: It may well be that the PDF pages and the actual pages are out of sync if, for example, the index has been paginated.

MR KENNELLY: I am told the PDF page is the same.

(Pause).

Maybe try 1366, I am told that might help you. Page 1366.

THE CHAIRMAN: That is definitely *Scandlines*.

MR PICCININ: Try three pages back.

MR KENNELLY: You need to go back three pages to get to the start. Yes, that is it.

I am not sure where that is coming from Sir, I am told that is right.

THE CHAIRMAN: We may need to think of a contingency plan for this afternoon.

MR KENNELLY: Yes. That is the document.

So this is the Commission decision in *Scandlines* and I will take you first to the parties. If you go forward then, presenter, please, two pages. Forward, please, not backwards. I am looking for <A/1257>.

Yes.

THE CHAIRMAN: I just wonder whether we do have it on our Tribunal system, and I wonder if that might be easier.

MR BISHOP: 1257, is it?

MR KENNELLY: Yes.

THE CHAIRMAN: Why don't you keep going? I think we have it. Don't worry too much about what is on here and we will tell you if we can't keep up with you on the Tribunal system.

MR KENNELLY: At page 1257, you see that the undertaking for these purposes is described at paragraph 4: It is the port of Helsingborg. It's the biggest ferry port in terms of volume, and the second biggest in terms of value after Stockholm in Sweden. One of the biggest ferry ports in the world.

Then, immediately above that, in paragraph 3, you see the market that is in issue was the Helsingborg-Elsinore route, a route between Denmark and Sweden.

If you go forward, please, to page 1259, at paragraph 13 you will see the complainant. The complainant is a ferry operator, Scandlines, and about three or four lines down, Scandlines Sverige AB's sole activity is to be the port agent for the ferry operator, paying the port charges in the port of Helsingborg. The allegation being the port charges were excessive prices.

If you go then, please, to 1273, you see the finding of dominance, page 1273, paragraph 78, but I need only the heading that the port had a dominant position on the relevant market, and then go to <A/1277> where the unfair and excessive pricing analysis begins. I am now on <A/1277>.

THE CHAIRMAN: Yes. Paragraph 98.

MR KENNELLY: Just the heading, so you see where the unfair excessive pricing analysis begins, then go over the page to <A/1278>, paragraph 103. The Commission is following a methodology set out by the Court of Justice in paragraph 252 of the *United Brands* judgment, just to note they are following the *United Brands* test.

If you go forward please to <A/1289>, you see their conclusion on limb 1, paragraph 160, that this is on limb 1, the prices were excessive, they were above the costs. The next question was whether the prices were unfair in themselves or by reference to comparators, limb 2. In this case the Commission sought to examine the question of economic value under the heading of unfair in itself. We will see from *Flynn* there isn't a strict requirement to deal with economic value there, but that is where the Commission did it in this case.

So we will skip all the comparators' analysis and go to page 1300. <A/1300>.

It should be -- I'm beginning at paragraph 208. You should have that on the page.

THE CHAIRMAN: Yes.

MR KENNELLY: Just to flag the structure the Commission followed here, they set out their own preliminary views that were communicated to the complainant, and then the

complainant's views were described and the Commission gives its conclusions. So we begin at paragraph 208. The Commission says that in their Article 6 letter, their preliminary conclusion was that the economic value of the services provided by the port to the ferry operators would be higher than the production costs incurred by the port. The port charges weren't unfair in themselves because there was no sufficient evidence that they would exceed the economic value of the services and facilities provided by the port to the ferry operators, even if they exceeded the costs actually incurred by the port to provide those services and facilities.

Paragraph 209, I am focusing on the second indent in particular but I will begin at paragraph 209:

"In assessing the 'economic value of the product supplied' the Commission considered in the Article 6 letter that account must be taken not only of the costs actually incurred by the port in providing those services, but also additional costs and other factors which are not reflected in the audited profits and losses of [the port]."

The second indent down the page:

"The ferry operators benefit from the fact that the location of the port of Helsingborg meets their needs perfectly. The Commission argued in the Article 6 letter that this represents an intangible value in itself, which could be taken into account as part of the economic value of the services provided by [the port], and which is not reflected in the accounts of [the port]."

It is demand-side value.

Then, if we go over the page to <A/1301>, we see the complainant's comment at paragraph 213. The complainant -- Scandlines -- said "that a price which exceeds, above a 'reasonable margin' [the profit], the costs of providing the services in question is both unfair in itself and abusive within the meaning of [what is now Article 102]."

"Scandlines considers that 'non-cost factors' should not be taken into account when assessing the economic value of a service. In any case, [says] Scandlines, 'none of the factors' put forward ... are sufficient to rebut the conclusion that the excessive prices charged

... are unfair and abusive. The 'economic value' of the services provided … should, and can be, measured by the cost (also including a 'reasonable profit') of providing these services."

"Where, as here, an analysis of a dominant undertaking's cost structure shows that the difference between the cost of a product or service and its selling price is so excessive that it bears no reasonable relation to the economic value as measured by the cost of providing the service, such a price is both unfair in itself and abusive."

Then the calculation. In this case, Scandlines calculated that the ROCE of the port was about 94 per cent between 1997 and 1999. So there is a stretch of time, persistently high, of very high ROCE, by using the Commission's approximate calculations and comparing it to the average ROCEs for the Swedish industry as compiled by the Confederation, which was more like 12 to 15 per cent between '94 and '98. And a price resulting in a ROCE of 94 per cent over that period is so excessive compared to costs that it is unfair in itself.

That is very similar to the argument you obviously see from the PCR in this case.

Then we come down to paragraph 214. What do the Commission say:

"... an analysis of excessive or unfair pricing abuse must focus on the price charged, and its relation to the economic value of the product. While a comparison of prices and costs, which reveals the profit margin ... may serve as a first step in such an analysis, this in itself cannot be conclusive as regards the existence of an abuse."

"In line with what the Court says in ... United Brands ... a distinction must be made between the assessment of the difference between the price and ... costs -- the profit margin -- and the assessment of whether the price is unfair."

Then if you skip, please, to paragraph 219 on page <A/1303>:

"In its comments ... the complainant implicitly acknowledges that the fairness/unfairness of the price should be assessed in relation to the economic value of the product/service provided. However, it considers that the economic value of the product or service should be determined by following a 'cost plus approach'. According to such

an approach, the economic value of a product or service should be calculated by adding to the costs incurred in the provision of this product a reasonable profit which would be a percentage of the production costs. Any price exceeding the so determined economic value … should then be found unfair."

Skipping down to paragraph 221:

"The Commission does not exclude that the question of whether a price is unfair may be assessed within a cost-plus framework which encompasses the respective relations between the production costs, the price (or the profit margin) and the economic value of the product or service."

Pausing there, you will see an echo of that in the Court of Appeal in *Flynn*. Cost plus can do the job, provided you can show, through cost plus, economic value from the demand side is being assessed.

"However, in such an assessment the economic value of the product or service cannot simply be determined by adding, to the costs incurred in the provision of this product or service, a profit margin which would be a pre-determined percentage of the production costs."

If you go, please, then to page <A/1304>, paragraph 226:

"Moreover, the 'cost-plus approach' suggested by Scandlines only takes into account the conditions of supply of the product or service. The determination of the economic value of the product or service should also take into account other non-cost related factors, especially as regards the demand-side aspects of the product or service concerned."

"The demand-side is relevant mainly because customers are notably willing to pay more for something specific attached to the product or service that they consider valuable. This specific feature does not necessarily imply higher production costs for the provider. However, it is valuable for the customer, and also therefore for the provider, and thereby increases the economic value of the product or service."

"As a consequence, even if it were to be assumed that there is a positive difference between the price and the production costs exceeding what Scandlines claims as being

a reasonable margin (whatever that might be), the conclusion should not necessarily be drawn that the price is unfair, provided that this price has a reasonable relation to the economic value of the product or service supplied. The assessment of the reasonable relation between the price and economic value of the product or service must also take into account the relative weight of non-cost factors."

Then we see the conclusion on page <A/1305>, paragraph 232:

"In the present case, the economic value of the product or service cannot simply be determined by adding the approximate costs incurred in the provision of the product or service, as assessed by the Commission, a profit margin which would be a pre-determined percentage of the production costs. The economic value must be determined with regards to the particular circumstances of the case and take into account also non-cost related factors such as the demand for the product or service."

"As a consequence, a finding of a positive difference between the price and the approximate costs exceeding what [they claim] as being a reasonable margin, would not necessarily lead to the conclusion that the price is unfair, provided that this price has a reasonable relation to the economic value of the product or service supplied."

Then we see the Commission's analysis of the non-cost related factors that should be taken into account when assessing the economic value of the service. We get that from paragraphs 234 to 235:

"The Commission argued [in its preliminary view] that the ferry-operators benefit from the fact that the location of the port of Helsingborg meets their needs perfectly. The sailing distance between the port, which is the shortest between Sweden and Denmark, allows them to operate a frequent, short distance service, which is more cost efficient and attractive for passenger and vehicle traffic. In the port itself, the passenger and vehicles terminals are directly accessible from downtown Helsingborg. The port has excellent connections with road and rail transport."

"The Commission argued in its preliminary letter that this represents an intangible value in itself, which must be taken into account as part of the assessment of the economic

value of the services provided by the port and which is not reflected in the costs actually incurred by the port."

If you go over to page 1307, having heard Scandlines' objection to that, the Commission produces this assessment. Paragraph 241:

"The Commission has explained above … that the economic value of the product or service should also reflect the demand side features of this product or service (i.e. the valuation by the customers and consumers of the product or service). Scandlines acknowledges that the port of Helsingborg represents a value to Scandlines and its customers because of its unique location close to Elsinore. The Commission takes the view that this should be taken into account in the assessment of the economic value of the service provided … and its price."

"The services provided by [the port] may not be superior [this is important] in terms of quality or performance to ones provided elsewhere by other ports, but the fact that they are provided at this place allows both passengers and ferry-operators to cross the Øresund in an expeditious way, which is in itself valuable, creates and sustains demand both on the downstream and the upstream markets. In this case, the demand by customers for the provision of transport services on the downstream market to cross the Øresund between Helsingborg and Elsinore, sustains the demand by the ferry operators for the provision of port services at Helsingborg."

One can see parallels between that scenario and the scenario in this case.

THE CHAIRMAN: So the Commission doesn't actually determine in this case what the value of that is, does it?

MR KENNELLY: No.

THE CHAIRMAN: As I recall, it decides that it hasn't been taken into account but, if it did, it would be a sufficient justification for -- or might be a sufficient justification for the price.

MR KENNELLY: Might be.

THE CHAIRMAN: And decides, therefore, that it is not going to uphold the complaint. Is that correct?

MR KENNELLY: Indeed, Sir. The decision shows that the economic value from the demand side must be taken into account.

THE CHAIRMAN: Where they talk about the location of the port, it doesn't directly refer to it being a comparator exercise but is there a comparator exercise being undertaken there? So, when we are talking about unfairness, in terms of the second limb of the test, obviously the comparator exercise is one way of looking at that. There is almost an element of that happening here, isn't there, with the reference to other ports and the distinction that this port might have by providing extra value on the demand side. Is this a species of comparator exercise, even if it is not expressed as that?

MR KENNELLY: It is in a way, Sir, yes. In the sense that one can see the value of the port to these users compared to how they would be crossing -- or compared to the alternatives to cross the Øresund. In a way -- sorry, Sir.

(Pause)

To that extent, yes, there is a degree of comparison, in the sense that the value of this crossing is that it is much better than, presumably, other ways of getting from Sweden to Denmark, with a car or a truck. But, of course, there is already the comparator exercise itself. You have seen that they do both. It is a straightforward comparator exercise and then they have this analysis, which is the unfair in itself analysis.

THE CHAIRMAN: It is difficult, isn't it, to understand how you distinguish that from any case where someone is buying something that they want. Obviously, if I am buying electricity or water, or whatever it is, I want it and I am prepared to pay for it and it is wonderful when I have it, especially electricity these days. What is it here that is different about the product that has been bought, that means that the value needs to be attributed in a way that you wouldn't ordinarily in a pricing analysis?

MR KENNELLY: Because of the nature of the allegation. Because the allegation is that the price bears no relation to its economic value, it is necessary to ascertain what that economic value is. That means asking, from the perspective both of the supplier but also of the user, what is it actually worth to them?

In this case, what the Commission was saying was there needed to be an analysis of the value of the port services to the ferry operators themselves and, through them, to their users. So it was necessary to model what that value was and to give it some, presumably, ultimately some financial value, to assess whether the price charged by the port bore reasonable relation to whatever that value was assessed to be.

MR BISHOP: Do they go so far as to say it must be modelled? I didn't see that in there? They say it must be acknowledged.

MR KENNELLY: You are quite right, Professor Bishop. They didn't say it has to be modelled, they say it has to be acknowledged. The degree of analysis that is required isn't addressed in this decision.

That, if I may say so, is an important point. It certainly wasn't suggested in this decision that the port had to produce some -- or had to explain what the value was, or produce a methodology to say our price isn't excessive because here is our methodology that demonstrates what the economic value is to users. It was never suggested that was a requirement for the dominant undertaking to provide. That answers, in my submission, in part, the point made against me, which is, it is all very well talking about economic value but you haven't told us what that value is.

Just like the port of Helsingborg, the burden is not on us to model or explain or calculate what the value is to the developers or end users. It is for the complainant to show that the price charged bears no relation to the value that is ultimately provided to the users and their customers of the port.

THE CHAIRMAN: Do you say that you need to do that in every case, if you are -- you need to consider the supply side and demand side in every case? I suppose that is really my question. I am not sure why, when you are looking at ports, you need to look closely at the demand side and satisfy yourself, and why you wouldn't do that in every case where somebody alleged excessive pricing?

MR KENNELLY: Indeed. That is why I said at the beginning you have to ask whether there are any relevant demand side factors. In some cases there won't be relevant demand

side factors that affect the economic value. *Albion Water* is an example of that, and we can come to that later if it will assist. There are some cases where it is possible to say the value of this good or service is demonstrated, or is ascertainable, by reference to the costs of the dominant undertaking and here there aren't any relevant demand side factors. That works for certain types of industries. In *Albion Water*, a conclusion along those lines was reached; particular reasons why the costs were a proper assessment of the economic value in that case.

In this case, it is absolutely clear -- it is common ground, really -- that there is some value. We will see that in the CMA interim report that I will take you to. There is no doubt there was some economic value being provided to the developers and end users. All we are saying is, Mr Holt and PCR provide no methodology, no acknowledgement even, that that has to be taken into account in assessing the economic value of the App Store.

THE CHAIRMAN: So it is perfectly legitimate, if you can, to start with the cost analysis?

MR KENNELLY: Yes.

THE CHAIRMAN: And do cost plus. And there is some suggestion that you might -- I think we will come to it in *Flynn* -- but there is some suggestion you might use plus -- you mentioned before plus as a proxy for incorporating the demand side benefits. But what you are saying is that you need to recognise that the cost plus, unless -- well, it may not be appropriate to do it in the plus, you still have to find a way of incorporating this aspect of economic benefit and demand side into your assessment, either at the unfairness stage or the excessive stage, as we understand the *Flynn* judgment.

MR KENNELLY: Yes.

THE CHAIRMAN: And your position, I think, is that you are saying that the PCR has avowedly turned their face to anything beyond the cost plus analysis, which is limited to the comparison of ROCE and WACC? That is the point you are making?

MR KENNELLY: Yes, exactly.

Now, my learned friend may point to scraps in their pleadings here and there which suggests that they do intend to take into account demand side value, but one has to look at what

they actually say in the pleading and, more importantly, in Mr Holt's evidence, where he does exactly that which the Chairman has outlined as our case.

I respectfully agree with everything, Sir, you have just said.

THE CHAIRMAN: Thank you.

MR KENNELLY: Paragraph 242. We have the point made about what is valuable in these services. Now I go on to *Attheraces*, which is in the first authorities bundle, tab 9.

THE CHAIRMAN: Give us a minute, again, I am afraid, just to --

MR KENNELLY: The A number that I was going to go to was <A/204>.

THE CHAIRMAN: Are you starting at Court of Appeal?

MR KENNELLY: I am starting at Court of Appeal.

THE CHAIRMAN: So, that is 193.

MR KENNELLY: It is <A/204>, I am going to the first page I want to take you to, not the first page of the decision. Paragraph 47, if that helps.

THE CHAIRMAN: Paragraph 47 did you say?

MR KENNELLY: 47 is the paragraph, yes.

(Pause)

In this case, we see first, at paragraph 47, the product that was in issue. Pre-race data. The BHB obviously was the governing body for British horse racing, it had a commercial arm and sold the pre-race data. We see what that is here. It is the name and time of the race, the course where the race is run, the race distance, the criteria for entry, names of the horses and runners, saddlecloth, stall numbers and so forth.

Then, at paragraph 48, we see what the cost of collating and distributing the product is. Information data supplied by the owners and trainers under the regulatory rules. It is supplied to their agent, which is paid about £5 million a year by the BHB to collate the information, to compile the database, and to distribute it to persons authorised by the BHB.

So, £5 million a year is the cost of the product. The database is regarded as a reliable and essential source of information. It should also be noted that, without the information of

the pre-race data, the BHB will itself be unable to develop the fixture list and race program. It had to get this data anyway, and it was the sole collector and ultimate source of pre-race data for British racing; no substitute, no competitor.

If you go back please to page <A/200>, we see the claimant, paragraph 34, ATR is essentially a broadcaster, paragraph 35, and over the page, next page, <A/201>, the two companies which are affected by the -- or that are alleging excessive pricing. There is SIS FACTS, an audio-visual bookmaker service, produced and distributed by SIS internationally for bookmakers, including overseas bookmakers, and (iv) ATR International an international satellite television bookmaker service for tote pool betting.

Those are the parties. If you skip ahead, please, we see the finding of dominance at page <A/213>, paragraph 107. As is clear from what has been seen already, ATR needed pre-race data to run its business, there was no substitute. ATR was completely dependent on the BHB for this product.

Over the page, 214, we see the beginning of the analysis of excessive unfair pricing and economic value. Page 214. The Court of Appeal, Lord Justice Mummery quotes *United Brands*. The passage is obviously very familiar. Then, paragraph 115, he cautions against a too literal reading. He says:

"It would be wrong to read this paragraph too literally, it must, in our judgment, be read and applied with care."

Lord Justice Green makes a similar point in *Flynn*.

He notes that it poses two questions -- I'm now on paragraph 116 – “the first is whether the difference between the costs actually incurred and the price actually charged is excessive. The second … is whether, if the first question is answered affirmatively, a price has been imposed which is either unfair in itself or when compared to competing products.”

"Secondly, the central concept and abuse of dominant position by excessive and unfair pricing is not identified as the cost of producing the product or the profit made in selling it, but

as the ‘economic value of the product supplied’. The selling price of a product is excessive and an abuse ‘if it has no reasonable relation to its economic value’.”

"Thirdly the court did not say that the economic value of a product is always ascertained by reference to the costs of producing it plus a reasonable profit… or that a higher price than cost + is necessarily an excessive price… The court was indicating that one possible way… of objectively determining whether the price is excessive and an abuse is to determine, if the calculation were possible, the profit margin by reference to the selling price and cost of production.”

"Fourthly, it has to be borne in mind… the law on abuse of dominant position is about distortion of competition and safeguarding the interests of consumers in the relevant market."

I stress this:

"It is not a law against suppliers making ‘excessive profits’ by selling their products to other producers at prices yielding more than a reasonable return on the cost of production, at more than what the judge described as the 'competitive price level'.”

"Still less is it a law under which the courts can regulate prices by fixing a fair price for a product on the application of the purchaser who complains he is being overcharged...."

We see at paragraph 121:

"A long critical section of Mr Justice Etherton's [as he was then] judgment was devoted to the issue of the economic value of the pre-race data and to establishing ‘the competitive price level’ of the data.”

Here we have the judge addressing the question of economic value:

"The section was in the context of market definition of the product… but the judge referred back to it when dealing with abuse of dominant position in the market by excessive and unfair pricing. His overall conclusion was: ‘The economic value of BHB's pre-race data is not more, or significantly more, than the competitive price.’"

“His conclusion on ‘the competitive price’ of the pre-race data is to be found in the earlier section of his judgment where it is expressed as follows."

This is the judge speaking:

"I consider the competitive price is such as would recoup to BHB the cost of producing its Database (about £5 million) together with a reasonable return on that cost, and also, in principle, some small additional element to reflect any specific head of expenditure by BHB that could be identified as benefiting ATR's customers."

Expenditure by BHB, though, that is the focus.

"As I have said, no such separate head of expenditure has, in fact, been identified in the evidence before me.'"

Pausing there, if I may, there are two points to make. The first is that a so-called competitive price is used by the judge to evaluate economic value. The second is that that competitive price was found by the judge to be a combination of the dominant undertaking's costs plus a profit limited to a specified return on capital.

THE CHAIRMAN: One of the curious things is that -- and maybe this is where the judge went wrong, but he seems to have undertaken this exercise, firstly, in the context of the market definition of the SSNIP test. At that stage, he rejects externalities as being relevant to that calculation. I think the externalities, as I understand it, is used not necessarily synonymously but quite similar to the point you are making about demand side.

MR KENNELLY: Yes.

THE CHAIRMAN: Then, when the judge comes back to look at the question of excessive pricing and unfairness, he uses the same price that is set during the SSNIP test, but doesn't, at that stage, accept any externalities either, I think is perhaps the way to put it, or, perhaps, having rejected it once, doesn't address the point again. Is that correct, that is the sequence?

MR KENNELLY: It certainly is the sequence in that he refers back to how he addressed the issue in market definition but he had extensive submissions made to him about this question of economic value and so it is implicit in what we see here that he is rejecting that and saying that (i) one uses a competitive price as the benchmark; and (ii) that

competitive price is calculated by reference to the cost of production and what would be a reasonable profit for this dominant undertaking. That is why -- because that is the legal approach he adopts, that is why he can ignore what the ATR are calling, or BHB were calling, externalities before him.

You can see, if you go to page 159, if we go back to the first instance judgment, so it is page 159 and paragraph 176, we see where the first instance judge was coming from. Here he is explaining why Attheraces had, in fact, conceded that BHB should be allowed more than its marginal costs and he is dealing with what is efficient. His point was whether, with high, fixed costs with low marginal or incremental costs, it is efficient for the dominant undertaking to seek to recover its fixed costs as well as its marginal costs. So the judge was using "competitive price" as a synonym for "efficient price" from an economic perspective.

You see that in the last sentence at paragraph 176.

This is a question of law and as in the proper test for unfair pricing under Article 102, and we see then at paragraph 123 where we went with it.

So before I go on to paragraph 123, obviously the Tribunal has in mind those parts of the claim form which I showed you which was that the PCR's case is that the return on capital allowed to Apple is the competitive price which Mr Holt says is sufficient to evaluate economic value. You will see Mr Holt's evidence; he says you can use the return on capital to evaluate the economic value of the App Store to developers and users. That is enough to show as you have heard me say now many times that the price is lawfully unfair if the price actually charged is persistently and significantly above that benchmark.

Then we see the appeal. Before I go on to the appeal, just to note the point about the extent of the differential here, just to see how egregious BHB's prices might be viewed. Paragraph 124 is on page 215 and goes over on to page 216. Again, quoting from the judgment of the trial judge:

"BHB's charges to ATR, and those proposed prior to commencing the proceedings, have been so far in excess of any justifiable allocation of the cost of production and the reasonable return (in effect, the competitive price) [you have my point about that] that they are, in my judgment, plainly excessive. For ATR to pay £1,800 for each of the 583 fixtures, it would have to pay [just over £1 million]. Further, BHB's data income in 2004… covered its costs nearly 4 times over, (i.e. a profit margin of 300% of the cost of maintaining the Database."

That is what he was dealing with in that case.

Then we see the appeal. It begins on page 217 from paragraph 134:

"According to BHB the judge failed to consider the correct test for determining the key issue of alleged excessive and unfair pricing. He applied the test of the cost to BHB plus a reasonable rate of return (cost +), whereas, in determining the economic value of pre-race data, account should also be taken of its value to ATR and how much ATR could make out of the data as a source of income. The economic value of a product is not the same as what it costs to produce. The product is a revenue-earning opportunity for ATR with profitable billing opportunities for bookmakers."

Then the next point, paragraph 135:

"The judge also took too narrow a view [say BHB] on the relevance of costs to BHB, confining costs in the 'cost +' formula to BHB's cost in maintaining the database".

Pausing there, members of the Tribunal, this is obviously a separate point BHB is making, a separate error they identify in the judgment of the judge below. Their argument here is that he took too narrow a view of which costs should be included in working out what the proper cost plus analysis was.

"The pre-race data was a by-product or secondary product dependent on the primary activity of horseracing, and revenue was needed to maintain the primary activity. BHB's assistance with the cost of the primary activity was relevant to the pricing of the pre-race data."

Now, you have seen in the PCR's skeleton argument that this last point has been put to you as a reason to distinguish *Attheraces* from this case. But, as you have seen, and as you will see when you go through the analysis of the Court of Appeal, that was not -- this point here was not the basis for the court's conclusion. The decision in *ATR*, in *Attheraces* was based on the economic value analysis and that is directly on point for the PCR's case against Apple.

So go, if we may, to page 218. Here we have ATR's submission, page 218, paragraphs 140. ATR's answer to the point summarised. – "According to ATR the judge considered the economic value of the pre-race data [so he considered it] and, on the facts of the case, correctly measured it by reference to the costs of producing it plus a reasonable return." An echo of the PCR's case here.

"The judge was correct in finding on the facts that the economic value of the pre-race data was no more than 'the competitive price' for it. The facts in each case included consideration of the nature of the product, who produced it and expenditure which increased the demand for the product."

Then we have the conclusions of the Court of Appeal from page 224 under the heading "Economic value". Before we get to the conclusions of the court, I will refer to the BHB submissions because these were adopted by the Court of Appeal, so it is useful to read these before we get to the conclusions of the Court of Appeal.

Paragraph 186:

Mr Roth for the BHB, his "second main criticism of the judgment in excessive pricing was that the judge's conclusion equating economic value with cost + did not involve any separate analysis of economic value. The judge gave no meaning to economic value other than the competitive price defined in terms of the supply side. Economic value looks to the demand side rather than the supply side. It means value to the customer not the cost to the seller."

"*United Brands* … focused on the price charged in relation to 'the economic value of the product supplied.' Although a comparison between price and cost of production may

be a step in the analysis of economic value, it was only a first step. The costs of production were relevant, but they were not, as shown by cases such as *Scandlines* [which you have seen], conclusive on the question of excessive pricing and the existence of an abuse."

Paragraph 189:

"Mr Roth emphasised that the economic value of a product was a different concept from its cost, as it reflects the revenue-earning potential to the person who acquires it."

If you skip down, please, about six lines, he references the case of media rights for facilities and access to film and broadcast sporting events for high sums:

"[T]he sums paid by ATR for the media rights to the races were not related to the cost to the supplier of making the media rights available: they represented, in commercial terms, the economic value of the product in question to ATR, as the acquirer of a revenue-earning asset or opportunity for itself and on a re-sale to such end users of the service as the betting offices. The benefit of the revenue-earning potential for ATR and for the overseas bookmakers who subscribe to [those companies] which include the pre-race data, is what gives the data its economic value. When considering excessive and unfair pricing, the judge failed to have regard to this aspect of the value of the pre-race data."

If you go then, please, to page 226. Again, to give you a flavour of the factual background that informed the court's analysis, we see it from paragraph 200 on page 226. The judge had described as "a striking increase in amounts received by BHB from a sale of pre-race data in the past six years". So again, we have a persistent, fairly lengthy period of a striking increase in prices. That showed, said the complainant, a lack of any constraint on BHB as the dominant undertaking.

Then paragraph 201, BHB explains this in part because it chose to increase prices dramatically as part of a new policy of commercialising its assets. We get that from the second half of 201. The prices before 2002 were inevitably low because the

database was subsidised by BHB's other revenues. The position changed with the advent of the commercialisation proposed in place of the levy.

Then paragraph 202:

"Further, the increases in the amount received by BHB since 2002 are directly attributable not to an increase in prices charged [by BHB], but to increased betting revenues, particularly in Ireland and the Isle of Man, which led to an increase in the payments under the BHB standard form…licence agreement."

BHB was getting more and more money because its customers, the users of the data, were earning more and more money, which was then coming back in part to BHB by way of its commission.

Then we have the conclusions on excessive pricing, beginning at paragraph 203:

"In our judgment, although the judge reached the right conclusions on important issues raised by the claim for abuse of dominant position, he erred in holding that the charges proposed by BHB were excessive and unfair. We are in broad agreement with Mr Roth's submissions criticising the judge's approach [which I have taken you to]."

"The judge correctly stated the law as laid down in *United Brands* but the formulation [I am skipping to the end] begs a fundamental question: what constitutes economic value?"

"On the one hand, the economic value of a product in market terms is what it will fetch. This cannot, however, be what [the law] envisages, because the premise is that the seller has a dominant position enabling it to distort the market in which it operates."

"On the other hand, it does not follow that whatever price the seller in a dominant position exacts or seeks to exact is an abuse of his dominant position."

Paragraph 207:

"How is the critical judgment of the economic value of the pre-race data to be made? That has to be determined before deciding whether BHB is seeking to charge ATR a price which abuses its dominant position by trying to obtain substantially more than the economic value of the pre-race data. There is nothing in the Article or its jurisprudence to suggest that the index of abuse is the extent of departure from a cost + criterion. It

seems to us that, in general, cost + has two other roles: one is as a baseline, below which no price can ordinarily be regarded as abusive; the other is as a default calculation, where market abuse makes the existing price untenable."

"ATR argued that if the indicator of abuse is a presumptive competitive price, cost + is what a competitive price should be. That seems to us to be, at best, a rule of thumb. Competition may drive price down below cost for a time … . Where profit is obtainable, the margin of profit will be as great as the market will yield, reflecting [for example] elasticity of demand. Thus, even a hypothetically competitive market may yield a rate of profit above, as well as below, the reasonable margin represented by cost +."

Skipping down two lines:

"It seems to us the most that a successful challenge under Article [102] can achieve in a case like this is a renegotiation, not a cost + limit on prices, for whatever else Article [102] does, it does not create a European system for determining prices."

Then paragraph 209, if I may skip Mr Hollander's submission and go to the middle of that paragraph:

"... to the extent [this is about four lines down] that he sought [Mr Hollander for ATR] to make charging above cost + the principal criterion of abuse of a dominant position, we do not agree. Exceeding cost + is a necessary, but in no way a sufficient, test of abuse of a dominant position."

If we skip, please, over to page 228 from paragraph 212 -- I'm taking from paragraph 212 down to 214:

"Mr Roth's central contention is that there is no reason why the economic value of a product should not be its value to the purchaser rather than cost + as held by the judge. He instanced the high franchise fees paid by broadcasters for what is no more than permission to operate their equipment from cricket grounds and football stadiums -- in other words a simple licence to enter the property and view a sporting spectacle. If it were, as arguably it should be, for the purchaser to show he cannot make a reasonable

return because of the price exacted by the seller, failure would mean that the product was at economic value to the purchaser at the material price and ATR would fail."

"As already noted, the Commission's decision in *Scandlines* [here we have the Court of Appeal adopting *Scandlines*] supports the view that the exercise under Article [102], while it starts from a comparison of the cost of production with the price charged, is not determined by the comparison. This in itself is sufficient to exclude a cost + test as definitive of abuse. Mr Roth accepts there is no single methodology or litmus test of abuse: the court has a choice of methods, but not an unlimited one. His contention is that the judge has gone outside the admissible limits of method in coming to his conclusion."

Skipping down to paragraph 214:

"As the expert witnesses in the present case agreed, economic theory recognises the relevance of externalities to price. The judge rejected BHB's argument that the benefit of the system to overseas bookmakers was a relevant externality. But it was incontestable that the overseas bookmakers were paying ATR, in a competitive market, amounts which afforded it a handsome profit which it wanted, so far as possible, to keep. The facts found by the judge do not suggest that anybody is going to go out of business as a result of the alleged abuse of dominant position. Despite its elaborate legal and economic arguments and high levels of moral indignation, the case is about who is going to get their hands on ATR's revenues from overseas bookmakers. There is no need to classify the benefit derived by the bookmakers from the deployment of part of BHB's products as a 'positive externality' in order to recognise that it has a bearing [I would say at least a bearing] on whether their pricing is excessive."

Paragraph 215:

"That said, we accept there is moral force in ATR's position. ATR adds value (in the form of pictures of the races) to the pre-race data and has the task of collecting overseas

bookmarkers' payments. It is taking all the risks and, as the judge found, will have to absorb most or all of the costs, while BHB seeks to take half of what they make."

BHB was doing very little for taking half of everything its customers made. It might be thought to be unfair, but it is not an abuse under the law, and if I could draw your attention to the second part of that, quoting the Advocate-General in *Bronner*:

"... the principal object of Article [102] is the protection of consumers, in this case the punters, not of business competitors. In our judgment, this is correct even if it is the competitors, not the consumers, who are alleging the abuse of dominant position. We need to look beyond ATR's immediate interest to the market served by ATR. There is little, if any, evidence that competition in the market is being distorted by the demands made by BHB upon ATR."

Just pausing there, that is an important reference because at times you will see Mr Holt comes to this question, the judge was noting there was no evidence that competition in a market served by ATR was distorted, the market between ATR and its competitors. Obviously, if BHB is charging a high price, there is the risk that those prices will be passed on to the consumers downstream and it was, in fact, found as a matter of fact that ATR might charge higher prices passing on the BHB's charge, but that does not mean that competition in the downstream market is distorted. That follows from what the Court of Appeal is saying here at the end of paragraph 215.

Similarly here, when we look at the markets in which the developers compete, there is no allegation that Apple's commission is making it difficult for the developers to sell digital content or that competition between the developers is distorted. If the allegation is that the developers' customers are paying more because of Apple's commission, that is precisely what was found as a matter of fact in *ATR*. We don't accept that, but that is found as a matter of fact in *ATR*. But, ultimately, it made no difference, as we see at the end of paragraph 215 of the Court of Appeal.

Before I leave this case, again you will see that it was never suggested that it was for the BHB to advance any particular methodology for ascertaining the value of the pre-race data

to ATR. It is for the claimant, it was for ATR to ascertain to develop a model or at least acknowledge, to use the term of Professor Bishop, that there was economic value from the demand side that had to be taken into account before one could conclude that the prices were unlawfully unfair.

I will move on then, if I may, to *Flynn*.

THE CHAIRMAN: Yes. Thank you.

MR KENNELLY: That is in the second authorities bundle behind tab 15.

This begins at <A/472>. Again, this, I am sure, is familiar to the Tribunal, so I won't take you to the factual background in the judgment, I will just summarise it, if I may, briefly myself.

THE CHAIRMAN: Yes, thank you.

MR KENNELLY: This case concerned an old drug, Phenytoin, with declining demand, but there was a small but captive group of patients who would struggle to switch to a different drug. There was also clinical guidance recommending against switching, so, to that extent, this group of patients was dependent on the company supplying Phenytoin.

Now, while the drug was branded by Pfizer, it was price controlled under the regulatory regime. But by debranding it and allowing it to be marketed as a generic drug, it was possible to increase the price dramatically. Pfizer and Flynn entered into an agreement whereby Pfizer, who had produced the branded drug, would still manufacture it, but Flynn would resell it as a generic drug and that would allow them to charge far higher prices.

The Department of Health complained, the CMA investigated and found that the new price was excessive, contrary to Article 102 and section 18. That finding was overturned by the Tribunal and remitted. The Court of Appeal upheld that order, but for different reasons in certain important parts.

In this judgment, Lord Justice Green first surveyed the authorities, including *Scandlines* and *Attheraces*, and he crystallised it into eight propositions which you see on paragraph 97 on page 500.

I'll take these from (i). First, he sets out the basic test for abuse, set out in the Chapter 2 prohibition in Article 102. It's whether the price is unfair:

"In broad terms a price will be unfair when a dominant undertaking has reaped trading benefits which it could not have obtained in conditions of 'normal and sufficiently effective competition', i.e. 'workable' competition."

"(ii) A price which is 'excessive' because it bears no 'reasonable' relation to the economic value of the good or service is an example of such an unfair price."

There Lord Justice Green is setting out the legal test. You need to take them together, in my submission, and in the context of the cases we have looked at, since this is supposed to be crystallising the authorities, including *Attheraces* and *Scandlines*.

The reference to trading benefits that a dominant undertaking could obtain under workable competition is not, if this is what the PCR is suggesting, a licence to ask whether prices would be lower if there was more competition. That is not the test, as we have seen from the authorities so far.

You can't use that reference to "workable competition" to go and calculate an efficient price as Mr Justice Etherton did in *Attheraces*. As we will see, Lord Justice Green's analysis is entirely consistent with *Attheraces* in that economic value, including from the demand side, must be addressed somewhere, although not necessarily in the unfairness itself or the comparator analysis.

Then we have from (iii) down the different ways in which the test may be applied, the different methodologies to establish whether an abuse exists. So he says "There is no single method or way in which abuse may be established and competition authorities have a margin of manoeuvre in deciding which methodology to use and which evidence to rely upon. Depending upon the facts and circumstances of the case, a competition

authority might, therefore, use one or more of the various tests. There's no rule of law requiring them to use more than one test or method in all cases."

Then at (v), he describes what needs to be done if a cost plus methodology is used:

"If a Cost-Plus methodology is applied, the competition authority may compare the cost of production with the selling price in order to disclose the profit margin. Then the authority should determine whether the margin is 'excessive'."

This is the first limb of *United Brands*.

"This can be done by comparing the price charged against a benchmark higher than costs such as a reasonable rate of return on sales… or another appropriate benchmark such as… ROCE."

That is limb 1.

"When that is performed, and *if* the price exceeds a selected benchmark, 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."

Then in (vi), again still on limb 2:

"In analysing whether the end price is unfair, an authority may look at a range of relevant factors, including, but not limited to, evidence of data relating to the defendant itself and/or evidence of comparables drawn from competing products and/or any other relevant comparable..."

There is no fixed list, in answering limb 2 of *United Brands*, whether the price is unfair in itself or unfair by comparators.

The rest of these conclusions are immaterial for our purposes.

So there is no fixed list of methodologies or types of evidence, but in all cases it is necessary to assess the economic value of the product at some point in the methodology, as we will see Lord Justice Green saying, and in all cases the Tribunal must ask if there are relevant demand side factors.

Now, as regards methodologies, Lord Justice Green recognised that, for intangible products, the cost plus analysis may not be suitable. I am not saying it is a definitive ruling on

the point, but it is interesting to note it as we pass through the authority. It is on page 503, paragraph 105. At six lines down, page 503, paragraph 105 the learned Lord Justice says:

"In some cases, a comparison between production costs and prices is used but price/cost analysis is not feasible in all cases due to lack of data or because the disputed price relates to an intangible good such as an IP right."

THE CHAIRMAN: Are you saying, in this case, that it is one of those examples? It is not clear to me whether you are actually saying that this exercise can be done, and indeed it has been done by Mr Holt, but you are not saying, are you -- just a test point, are you saying or not that this is a case in which you could not use a cost price analysis?

MR KENNELLY: I am not saying that. I don't need to go that far. On its face, cost plus looks entirely unsuitable for this, and the cost plus approach that Mr Holt has advanced is critically flawed in this respect because it does not include any attempt to assess economic value from the demand side.

Now, we see from the case law that it is possible to create cost plus models which do address value from the demand side. So, in theory, to that extent, it may be possible to do it, so I don't need to say that it is impossible to do it through a cost plus model, all I need to show the Tribunal is that, under the PCR's case, and on Mr Holt's evidence, they have advanced no methodology, no acknowledgement, that Mr Holt and the PCR needs to assess value from the demand side by looking at the demand side factors.

THE CHAIRMAN: So you have something of a spectrum. You might have a case where it is just not possible and there is a suggestion, perhaps, I think *in Latvian Copyright*, that it is the case but you couldn't -- it is not entirely clear why they say you couldn't sensibly do it. Then you might have a case where you could do it, but you might argue that the results were meaningless because there was just no way in their process to capture the elements you are talking about. Then you might have a case where you had to do it, or you could do it, but you would need to capture some other things either through that or some other way of bringing them into the equation --

MR KENNELLY: Yes.

THE CHAIRMAN: -- informing your overall view of economic value. I perhaps don't want to be pinned down on where you are precisely between 2 and 3, but I don't think you are 1, as I understand it.

MR KENNELLY: I am not saying it is impossible to imagine any scenario where cost plus could be used at all, because the case law tells us that cost plus can be used in principle to assess economic value, including from the demand side, which is why I don't want to say it can never be done, or could never be done, in this case.

What is very clear is that the PCR and Mr Holt are not advancing any attempt to do so and have turned their face against it. We will see that very clearly in Mr Holt's own evidence.

THE CHAIRMAN: So --

MR KENNELLY: Let me make sure I haven't overstepped the mark.

THE CHAIRMAN: So, to what extent, really -- perhaps it is unfair to characterise it as a pleading point, but you are effectively saying this is something which they could do if they had chosen to adopt a different course, at least in theory, and yet, because they have made statements in the expert report satisfying certification requirements, it is no longer open to them to adapt their case to meet the challenges that you are making. Perhaps it is unfair to call it a pleading point, but you are taking advantage, to some extent, aren't you? Ordinarily, at this stage in the proceedings, we wouldn't have a report from Mr Holt and we might well have a pleading which didn't articulate --

MR KENNELLY: It is not -- I don't regard “pleading point” as an unfair charge at all, because, if this were an ordinary High Court action, not certification, we would be bringing the same application in a High Court case. In pleading a case of excessive pricing, they would still need to explain in outline how they proposed to take account of economic value from the demand side and, if they had pleaded in a High Court case as they pleaded here, perhaps in more particularity from whatever the experts were telling them, we would still be saying they just haven't shown you a way in which, at trial, they

will address this legal requirement. Therefore, you should strike it out now. They can go away and amend it, they can come back with a different claim form and a different expert report. I am not saying we would be happy with that either, but that is a route they could have taken. They have not done that. They have been very clear that they do not need to address value from the demand side and we see that in Mr Holt's second statement.

Mr Hitt's evidence is that cost plus couldn't work in assessing economic value from the demand side but I don't need to go that far for the purpose of this application as I have explained to you just now.

THE CHAIRMAN: Okay, thank you. Is that a convenient time?

MR KENNELLY: I can come back to that after lunch. Absolutely, Sir. I see it is 1 o'clock. That is a convenient moment.

THE CHAIRMAN: Thank you.

(1.02 pm)

(The short adjournment)

(2.00 pm)

THE CHAIRMAN: Mr Kennelly?

MR KENNELLY: Thank you Mr Chairman.

Before I go back to *Flynn*, I just reviewed the transcript and spotted what I hope was an error. If I said it, then I need to correct it. The question of pass-on was raised. I was relying on the fact that in *Attheraces* the judge found as a matter of fact there had been pass-on from the BHB's charges through to ATR's customers. That obviously wasn't enough to make it an excessive price and I was saying, if, which we deny, there is pass-on to consumers in this case by reason of our commission, it would still not have the effect of rendering commission an unfair, excessive price contrary to Article 102, section 18. I want to put that on the record, if I had misspoken previously.

Now I am back to *Flynn*, and we are on page 518, behind tab 15. We were getting into the analysis by Lord Justice Green of the question of economic value. Page 518, tab 15. The Tribunal will let me know --

THE CHAIRMAN: I don't know if we are still on the same system, I don't know if you are using --

MR KENNELLY: I am using old fashioned papers.

THE CHAIRMAN: Yes, very good.

MR KENNELLY: Paragraph 154 says Lord Justice Green:

"The concept of economic value is not defined. In broad terms the economic value of a good or a service is what a consumer is willing to pay for it. But this cannot serve as an adequate definition in an abuse case since otherwise true value would be defined as anything that an exploitative and abusive dominant undertaking could get away with."

We respectfully agree. At paragraph 155:

"The simple fact that a consumer will or must pay a price that a dominant undertaking demands is not therefore, an indication it reflects a reasonable relationship with economic value. But a proxy might be what consumers are prepared to pay for the good or service in an effectively competitive market, hence the relationship between the two descriptions of abuse in paragraphs [249] and [250] ... *United Brands*."

Then, at paragraph 156, we see the allegation that the CMA has made:

"The issue is relevant because the CMA advanced an argument to the Tribunal that due to clinical guidance that prevented switching… patients were in effect tied to the manufacturer's brand and the payer… had no option but to pay the price demanded. In such circumstances it was not possible to say that the therapeutic advantages patients derived from the drug amounted to an indication of genuine economic value."

The Tribunal will see right away an echo there of what Dr Kent says in the claim form. You will recall having examined the question of unfair in itself. She said that the users of the App Store, the developers and end users, are captive. Developers pay under

duress, she says, and they are wholly dependent; the same point being made by the CMA here.

Then paragraph 157:

"The particular 'economic value' said to be in issue is 'patient benefit', i.e. the benefit of epilepsy patients derive from their use of the capsule and its ability to keep their condition under control. The specific complaint of the CMA is that the Tribunal erred in finding that the CMA had attributed a nil value to patient benefit ..."

And the CMA explains, at 158, it did take account of economic value generally and patient benefit specifically:

"This can be seen from detailed analysis of those issues in the decision in the context of the 'plus' component of the Cost-Plus test."

What the CMA said there was that the profit element in the cost plus analysis dealt with economic value, that whatever economic value is relevant was covered by the allowance for profit and was done by reference to Flynn's costs. The CMA made no attempt, as you will see, to ascertain the value of the product to patients.

Our focus on that question of patient benefit in the paragraphs that follow. We see at paragraph 158 what the CMA said they did in the profit element. Then paragraph 159, first sentence:

"Having established there was no <u>additional</u> economic value in the Pfizer/Flynn Capsule beyond Cost Plus, the CMA went on to find that their prices were unfair in themselves."

So apart from cost plus a reasonable return, there was no account taken of the particular value to the patients, the particular benefits they got from the drug itself.

Then we have the Tribunal's assessment. Go, please, to paragraph 162 on page 520, just the indented bit, the actual quote from the Tribunal judgment itself:

"The CMA was criticised by the parties for not considering the patient benefit although it did indeed describe. in broad outline… the nature of epilepsy and phenytoin's role in its treatment. The CMA has not, however, contested the evidence of Professor Walker and has, in effect, conceded that phenytoin remains a useful and effective treatment

for a significant number of patients. That being so, we find the outright rejection of any value at all to patients surprising. The CMA seems to have placed some reliance upon the age of the drug, which is irrelevant in therapeutic terms. We think there is clearly some economic value to be derived from the therapeutic benefit to patients of phenytoin capsules."

At paragraph 163:

"The Tribunal then addressed an argument raised by the CMA about dependency."

This is important, members of the Tribunal, because a very similar point is made by the PCR about how the developers on the App Store, they say, are trapped and wholly dependent on Apple:

"The basic idea is that because patients are unable to switch away from the Pfizer drug because of clinical guidance… they (or the state as the payer) are bound to pay whatever price is demanded. The simple fact that patients value the drug highly and must remain wedded to it is not therefore to be treated as a discrete patient benefit, it is a feature of the regulatory regime surrounding the drug, but not the drug itself. [For that,] the CMA relied upon the Opinion of Advocate-General Jacobs in *Tournier*."

Now, we have seen that the PCR has flagged an intention to rely on the *Tournier* case in submissions before you. So we will look more closely at what the Court of Appeal says about that:

"That Opinion arose in the context of requests for preliminary rulings in a series of cases concerning the conduct of the French copyright management society SACEM towards discothèque owners in relation to charges for music in France. The Court of Justice was requested to consider whether the royalty rates charged were discriminatory and excessive, particularly by reference to the royalties charged [by collecting societies] in other EU member states. The Advocate-General considered the relevance of the importance of music to French discothèques, i.e. the benefit to users. He said… the idea that those who need music more should pay more was 'superficially attractive' but the 'usefulness of such criteria breaks down' when users were 'completely dependent'

on the supply of the music in question and there was no other possible source of supply. The CMA concluded, by parity of reasoning, that because patients stabilised on capsules were dependent [because they were wholly dependent], zero value should be ascribed to patient benefit when determining the economic value of the capsules."

"The Tribunal did not disagree 'generally' with the Advocate-General's assessment… but observed '…the facts here are a little different'. It was true that a competitive market was difficult to apply where there was only one supplier and the buyer was medically dependent upon the supply, but it did '... not follow that the value to be attributed to demand side is zero'."

Go over the page to 521 and skip down to what is indented paragraph 417 of the Tribunal's judgment:

"We therefore do not think this is a binary issue but more one of degree. … There is clearly some economic value to be derived from the significant contribution of phenytoin to treating epilepsy in a significant number of patients. Some allowance must be made for the extent to which the choice of switching from phenytoin may be restricted, which decreases the value as measured in terms of patient benefit."

So generally saying, even if they are wholly dependent, you still have to assess the benefit the patients are getting. You may need to make a discount or an allowance for dependency, the fact they may have no choice, but that doesn't mean, as a matter of principle, you give a zero value to the benefit they are getting from the drug.

Here is the Court of Appeal:

"I do not accept this ground of appeal", which they uphold in the Tribunal, and they go on to explain -- Lord Justice Green goes on to explain what he agrees with in the Tribunal's judgment and where he disagrees. Beginning with what he liked, paragraph 166:

"The CMA objects that the Tribunal found that the CMA attributed a nil value to patient benefit as economic value, whereas, in fact, it was analysed as part of the Cost-Plus test carried out by the CMA. I agree that demand side factors may be capable of generating economic value, but in a fair reading of the Judgment, the Tribunal was not

saying the CMA failed to address its mind to the issue and for that reason ignored economic value. It was saying that having addressed itself to the issue (as part of Cost-Plus) it had failed adequately to take account of evidence that there might be 'some' (albeit unspecified) value to be attributed to patient benefit, and that the reasons given by the CMA for rejecting patient benefit as relevant (namely dependency) was itself an issue of fact and degree (and not principle) and did not mean that the CMA could ignore relevant evidence."

Pausing there, members of the Tribunal, that is an important passage because the CMA had said, as we have seen, based on the Advocate-General in *Tournier* that where the user of a product is wholly completely dependent on the dominant undertaking, as a matter of principle, no economic value should be attributed to his demand, whatever benefits he might in fact be getting, even if, in fact, the drug was beneficial to him.

But the Tribunal said, even if wholly dependent, it was not correct as a matter of principle to say that no economic value is attributable, it was a question of fact and degree.

We still needed to ascertain the value of the drug to the patient. I ask the Tribunal to please bear that in mind when you come to look at Mr Holt's evidence.

Back to paragraph 167, on page 521:

"Insofar as it is argued that the Advocate-General in *Tournier* was laying down an absolute and immutable rule that wherever there is dependency there was no residual scope for any economic value to arise, I agree with the Tribunal that this is not what the Advocate-General was seeking to say and, in any event [over the page at 522], is a proposition that is far too inflexible (or 'binary'…). Economic common sense indicates that dependency and the inferences to be drawn from its existence are indeed matters of fact and degree. Even if there is dependency there might still be *some* economic value but not necessarily reflecting the full price demanded."

So I will skip now the passages on materiality that follow and go down to paragraph 170 and following. These are the passages where the Court of Appeal disagreed with elements of the Tribunal's reasoning:

"There are certain paragraphs in the judgment relating to value that I do have a concern about in respect of which we have received submissions which went beyond anything advanced to the Tribunal."

Since the matter has been remitted, he sets out his views. 171, if I may:

"... the Tribunal observed that this was clearly a legal test. The categorisation of this as a 'legal' concept seemingly led the Tribunal to treat economic value as a discrete component of the test in law to be applied. It is 'legal' in the strictly limited sense that it has been ascribed a meaning in a court judgment, but, at base, it is an economic concept which describes what it is that users and customers value and would reasonably pay for..."

So the need to take account of economic value from a demand perspective is a legal requirement but what it is, is an economic concept.

Paragraph 172:

"Second, the Tribunal did not agree with the submissions of all parties that economic value was simply a matter to be taken into account as part of other components of the test. The Tribunal held that it was not part of the 'in itself' test but was part of 'a more general assessment'. … I agree with the parties on this".

We respectfully agree, as we must:

"It is evident from the judgment in *United Brands* that the reference to 'economic value' is as part of the overall descriptor of the abuse; it is not the test. The test should therefore, when properly applied, be capable of evaluating economic value. So, for instance, as the CMA argues, when evaluating patient benefit, it would be possible to measure its economic value in the Plus element of Cost-Plus or even in the fairness element. Equally, if there is evidence of the prices being charged in relevant, comparator, markets which were effectively competitive then those prices could be capable of acting as proxy evidence of the economic value of the benefit. Insofar as an issue of fact arises which can be categorised as an aspect of 'economic value' it needs to be measured and it can be evaluated in various parts of that test. If it is properly factored

into 'Plus' or 'fairness' or in some other part of the test or is reflected in other evidence which is concerned as a proxy for economic value, then there is no incremental obligation to take it into account again..."

So what we take from that is that it is necessary, as I said in opening, in all cases, to ascertain the economic value of the product. Somewhere in the analysis, and in all cases, account must be taken of any relevant demand-side factors.

You will see, when we come to the evidence, there is no doubt in this case there are very large relevant demand-side factors which the PCR has advanced no methodology to assess.

Now, members of the Tribunal, those are my submissions on the case law. That is all I am going to take you to by way of authorities.

It is significant, we say, that none of *Flynn* or *Attheraces* or *Scandlines* concerned innovative intangibles in the technology industry. The disconnect between the sellers' costs and economic value is even clearer there because, in the technology industry, the scope for a good product to be adopted by millions, or even billions, around the world is so much greater. In this industry, the scope for the disconnect between the producers' costs and the economic value realised downstream is even greater than the authorities that I am taking you to.

One final point, if I may, on the law, before we go to the evidence and to the factual background, is a claim in the PCR's skeleton that the CMA has found it likely that Apple's commission is an abuse of dominance under section 18 or Article 102 of the Treaty. The very thing which they allege in this case. It is a suggestion in the skeleton. I need to show you the skeleton first just to address that now. It is in the core bundle, behind tab 1 <C/1>.

I have left my core bundle in the meeting room, which is a rather important omission. I can probably make this without having it in front of me because we are very familiar with the skeleton.

THE CHAIRMAN: Give us the reference.

MR KENNELLY: It is in core bundle, tab 1, page 3, <C/1/3> I am looking at the very last part of that page, paragraph 7.

They say there:

"That the summary dismissal application is misconceived is underlined by the recent finding by the CMA that Apple is 'likely to be charging above a competitive rate of commission to app developers which will ultimately mean users paying higher prices for subscriptions and in-app purchases such as within games'. Apple is thus inviting the Tribunal to conclude that an allegation which the CMA considers to be 'likely' has no realistic prospect of success and should be dismissed without a trial."

I thank Mr Piccinin.

So, that, we say, is a complete misreading and misunderstanding of what the CMA was actually analysing and concluding in its interim report for its market study.

The CMA was not asking itself the legal or economic questions which we have just considered. To show you that, I need to take you to the CMA's interim report itself. That is in the fifth volume of authorities, behind tab 32.

THE CHAIRMAN: I don't think we have a fifth volume. Maybe it is just the authorities bundle. We will find that. Do you have a page number?

MR KENNELLY: I think it begins at 1677. Page 1680 is where the report begins if that helps. <A/1680>.

Before we go to the particular passages --

(Pause).

THE CHAIRMAN: I think we have it.

MR KENNELLY: Before I go to the passages themselves, just to recall the nature of this document. First, it doesn't contain any conclusive findings. It is not a market investigation final report, this is for a market study, and even then, as I said, it is interim only.

We asked ourselves, what is the purpose of this market study? Is it to examine whether the Apple commission bears no relation to the economic value to the demand side? We

see its purpose at paragraphs 26 and 27, internal number page 13, which is page <A/1689>. The context of this market study.

THE CHAIRMAN: Yes.

MR KENNELLY: If I could just go to the very last line on that page:

"... the government has indicated that it intends to establish a new [over the page] pro-competition regulatory regime to address concerns relating to digital platforms with 'strategic market status' (SMS)."

Skipping down about four lines:

"The government recently consulted on proposals to bring this new regime into force which, would result in firms assigned with SMS by the [CMA's Digital Markets Unit] facing enforceable codes of conduct, and potential pro-competitive interventions to address the sources of their market power."

Paragraph 27:

"The CMA expects that this market study will contribute towards the establishment of this new pro-competition regulatory regime, in particular by helping to inform the assessment of whether Apple should be designated with SMS in relation to any of the activities captured by the scope of this study. The study also provides an opportunity to consider how, were Apple to be so designated, key elements of the regulatory regime - in particular codes of conduct and pro-competitive interventions - might be used to address the potential harms to competition and consumers identified. Our preliminary views on these issues are set out further below."

There's no question of them considering excessive prices within the meaning of section 18 or Article 102 at all.

We go then to the passage relied on by the PCR in her skeleton. That is on page 1732. That is where the heading "Prices" is found. She writes, on paragraph 2.70, second bullet, so it's over the page on page 1733, where Apple is said to be charging above a competitive rate of commission to app developers. That is the preliminary view.

What does the CMA mean there by a "competitive rate"? For that, we need to go to appendix D of the interim report, the same bundle, but it begins at page 1965. Paragraph 2:

"This financial analysis is an important part of our evidence base as it supports our understanding of the two companies' incentives and strategies in relation to particular products and services. This financial analysis should be read alongside our economic analysis of the barriers to entry and expansion ... It supports our understanding of where Apple has been able to generate returns persistently higher than might be expected in a competitive market."

That is what they are looking at. We see that on page 1973. Go further on, 1973, we see what the CMA meant by a "competitive rate".

Paragraphs 28 to 30:

"Why we use ROCE [return on capital employed] as a measure of profit."

"As set out in our Guidelines for market investigations, we normally measure profitability using rates of Return on Capital Employed derived using accounting profits which are then adjusted to arrive at an 'economically meaningful measure of profitability'. In a competitive market we would expect firms to 'earn no more than the 'normal' rate of profit', at least on average over time. ROCE is calculated by dividing earnings before interest in tax by the value of capital employed in the relevant business. For our purposes, we consider the actual investment in capital (i.e. the cash spent on buying assets used to generate revenue)."

"ROCE is a good measure to test where profits for a particular firm or sector are high, because it can be compared against an objective benchmark, the weighted average cost of capital."

We saw that in the claim form.

Then paragraph 30:

"A finding that ROCE is higher than the WACC is not in itself indicative of a competition problem. A firm that innovates and gains a competitive advantage may earn higher ROCE for the period that it is able to sustain that competitive advantage. In a market

characterised by effective competition, any excess of returns above the WACC would then be expected to be eroded over time, as competitors would seek an opportunity to enter and earn higher returns on capital. However, our guidance indicates that a finding that 'profitability of firms which represent a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process'."

Pausing there, we see the CMA was investigating whether Apple's return on capital exceeds a normal return on capital and it was doing this under the market investigations guidelines. There is no requirement under those guidelines, and none are suggested here, to show abusive prices under the Competition Act. That is not required to warrant intervention.

You can see in Appendix D, paragraph 37, more detail of what the CMA actually did. We are now on page 1975. Here the CMA is saying, as a preliminary view:

"Given a scale of the actual ROCE and by how much it exceeds any reasonable benchmark, we have not at this stage undertaken a detailed assessment of Apple's WACC. As a reference point, we would normally expect investors to have an expectation of earning returns of the order of 10 per cent per annum for investing in shares of large firms with significant assets exposure to the wider economy. In the digital advertising market study, we estimated Google and Facebook had a WACC of about 10 per cent. In other words, a ROCE above 10 per cent is indicative of Apple making higher returns on its invested capital than normally required by investors in the shares of comparable companies."

That says, as we have seen, that investors normally expect a return of roughly 10 per cent per annum, so if Apple's returns are greater than that, it is indicative of it earning more than investors usually require. Again, the entire focus of the CMA is on Apple's costs and its revenues, its profitability. They also looked at R&D costs, another point which Mr Holt invokes, and we will see that. You get that on page 1981. The CMA, from

paragraph 58, noted that Apple had been increasing its expenditure on R&D, but then, go down to 60, they said:

"…our initial estimates indicate that, even if [you were including all of the R&D], [it] was all capitalised and amortized over a long period [over the page] Apple's ROCE would continue to be substantially higher than a reasonable benchmark."

So they don't actually include the R&D within the current costs of their analysis.

The key takeaway from this, and the reason why the PCR is wrong in the skeleton to say that the CMA was looking at the same thing as the Tribunal, is that they weren't trying to measure the economic value of what Apple provides to developers or end users at all. There is no attempt to examine demand side factors, and that is not surprising, because the CMA wasn't required to according to the standards that it was applying in this context.

THE CHAIRMAN: So the CMA is -- perhaps it is wrong to characterise it like this -- but it is effectively carrying out part of the first limb of the test. It is looking to see whether, on the face of it, the returns look excessive compared with what you would find in an ordinarily competitive market.

MR KENNELLY: Yes.

THE CHAIRMAN: The question then is, depending on where you decide you want to look at your demand side benefits in the excessive pricing analysis, either in limb 1 or limb 2, you need to bring that in. You say they haven't had any need to do that here because all they wanted to conclude was that there was something that was different from ordinary competition conditions?

MR KENNELLY: According to the test that they were applying. Yes, Sir.

One could see -- this is a preliminary view, Apple disputes it -- but one can see how at least the approach they are taking might be used as part of limb 1, in looking at whether the price is excessive. But there is no attempt here to analyse economic value, still less the economic value from the demand side perspective. And nor would they have to, according to the standards they were themselves applying.

I am going to turn now, if I may, to the factual background. Actually, I will ask you to stay in the CMA interim report. Hopefully uncontroversial because, for these purposes, I will seek to rely on the CMA interim report as much as possible. They did analyse the market and, although, as I say, Apple disputes much of what is in this, since it is relied upon by the PCR I will seek to rely on it myself for the purposes of this strike out.

So I ask you to turn, if you could, please, to page 1681, paragraphs 2 and 3.

First of all, there is a definition of "mobile ecosystem". It is useful because I will be referring to that expression later. You can see, at paragraph 2, the CMA saying:

"A mobile ecosystem can be broadly characterised as comprising the following core set of products:

Mobile devices: … smart phones and tablets that can connect to the internet;

Mobile operating systems: the pre-installed systems software powering the devices; and

Mobile applications (or apps): the computer software providing functionalities to mobile devices."

Then, paragraph 3:

"Mobile devices generally come with at least one app store and one browser pre-installed. These are the two channels through which users and content providers can connect through two main panels of content distribution", native apps and browsers and web apps.

I am going to move quickly through this uncontroversial background.

Paragraphs 4 and 5:

"When consumers today purchase a mobile phone, they effectively enter into one of two mobile 'ecosystems' - one operated by Apple powered by iOS, the other operated by Google…The operating system on a mobile device determines and controls a range of features that are important to users of mobile devices, ranging from the appearance of the user interface, through to the speed, technical performance, and security of the device."

All of those elements, as I shall show the Tribunal, generate value for developers and end users.

With that, we go to page 1684, paragraph 9. Where the CMA says:

"It is important to recognise [and I will refer only to Apple, since only Apple is relevant for these purposes] Apple's control over their ecosystem can give rise to a number of positive outcomes."

I will go through them now. These are all, we say, relevant to the value the developers and end users get from the App Store.

The first bullet:

"Having an operating system, app store and core set of apps (as well as, for Apple, mobile devices) developed by a single provider help guarantee that products work seamlessly together, and are easy and convenient for users. Apple's" ecosystem is "highly valued by consumers". The CMA had received evidence that, overall, "users' satisfaction with iOS is high, with over 9 in 10 satisfied with their device."

Because Apple ensures that the apps work seamlessly within its operating system and devices, because Apple ensures they are easy and convenient for end users, those end users are more willing to transact with developers on the App Store, on Apple devices. That is valuable for developers.

Second bullet:

Apple has "engaged in innovation that has improved the features, functionality and performance of their mobile devices and operating systems, as well as the tools they provide to support app developers. This innovation will have benefited users as it has made devices quicker, more powerful and increased the number of things consumers can do on their mobile devices."

Let's break that down, if I may. First, the features, functionality and performance of the device and the operating system make the apps more valuable because the apps and the operating system allow the app developers to create apps, games in particular, to do things that would not otherwise be possible. For example, as you have seen in the

evidence, the iPhone has a gyroscope, a form of complex motion sensor. That is technology that Apple developed and introduced into its devices that has enabled the creation of augmented reality apps and augmented reality games that have been used by developers, that have earned developers millions and millions of dollars of revenue.

The second feature is just as important, maybe more important; the highly innovative tools which Apple has created, which help developers develop and improve their own products. This is the first way the developer obtains value from Apple. Apple allows them to use Apple's software technology, Apple's own intellectual property, for a nominal fee, and they use this to create their apps in the first place. This is what they actually use to create the apps. Apple has an incentive, as you will see, to allow them to create more and more attractive apps for the benefit of the developers and their end users.

So, both in terms of the things that they can do on the Apple devices, but also the technology Apple provides to them which allows them to create their apps, they get economic value. Pure and simple. They earn more revenue because of these features.

If you look to the next bullet:

"We have heard from some app developers that Apple's … stewardship" of its "ecosystem, in particular through app review processes and strong security features, helps to create consumer confidence and trust, which is vital for small start-ups and unknown brands. We have also heard that having stable, secure, and trusted platforms helps to create the conditions that are needed to encourage investment in future innovation, and that by providing and maintaining app stores with low cost of entry for the majority of developers, Apple enables new businesses to come forward that otherwise may not be viable."

So, one can see immediately there, this is not just a distribution platform or a processing payments service. They are providing the technology with which the apps are made, they are providing the technology upon which the apps are consumed, and they are

providing with Apple an ecosystem which earns the trust of consumers, which trust is extended to the app developers when they appear in the App Store.

In this regard, that last feature is key. This channel is trusted by over a billion customers across 175 countries because of the technology and the effort that Apple has made to protect individuals' privacy and security. That means that when app developers appear on the App Store, they don't need to worry about customers not having heard of them before or whether customers are concerned about whether a legitimate product is being sold; developers know that consumers know that they have been satisfied by the Apple brand that that is all taken care of by Apple.

There is also a single distribution channel, so developers don't have to worry about regulatory issues, tax questions, or whether a local presence is necessary. Again, that is provided by Apple. And all of it generates value.

Similarly, the last bullet:

"We … recognise that revenue earned from Apple's … core services funds the provision of a large number of other valued services for free to users, including the app stores, browsers and their underlying engines."

The key point here is that at no point does the CMA say that profitability is a measure of the value that Apple is providing to app developers on the App Store.

I pause there, because it is relevant to a point raised with me by the Tribunal before lunch about what the PCR needs to do in order to address economic value from the demand side. One sees from this summary, and I will expand on it through the CMA report as we go through it, this demonstrates the enormous nature and scale of the value which is provided by Apple to developers and end users, and that needs to be ascertained. It can't just be treated in a footnote or in a submission from counsel, it is highly significant and extensive. This is what the PCR and Mr Holt ought to have been seeking to capture in their claim form and evidence.

Also, when one looks at the value and the extent of the value provided by Apple to developers and end users, we see why the PCR does not want to engage with value from the

demand side. If the PCR and Mr Holt sought to ascertain the extent of this value, they would realise very quickly, and so would the Tribunal, that the excessive pricing case is unsustainable. Once this value is ascertained, it would be very hard to see how Apple's commission could bear no reasonable relation to it.

THE CHAIRMAN: Is there any guidance in the cases on how you go about ascertaining their value? We have seen *Scandlines*, where we didn't actually see any articulation of a methodology; I don't think we see that in *Flynn*. How do you measure -- it is quite a difficult question, isn't it -- how do you measure what the value of all of this is for comparison with the price that you have identified through the cost exercise? If you were going to then distinguish an element of dependency, how do you measure that? Is there anything that helps us with that sort of analysis, generally, in these cases?

MR KENNELLY: There is no guidance in the papers before you now that tells you how that should be done, to answer the question directly. As I said in opening, it is not for Apple to construct a system for working out what the value is to developers and end users, that is a matter for the PCR.

What we have done, though, is we have shown where the value arises. You can see from the evidence of Mr Holt and Professor Hitt that quantification, in very crude terms, the revenues earned by developers, the starting points are there in the evidence but how one isolates that is a matter for the PCR and their economic advisers.

THE CHAIRMAN: That is an entirely fair point. I suppose -- and in a way it is jumping ahead to if there was a resolution of this, if the matter proceeded and so on, but it is perhaps relevant to your point -- about whether there is a methodology that can be articulated clearly now beyond -- and you may not accept that you can do this at all -- beyond the extent to which you can use supply side factors to indicate the level of investment and innovation, so the R&D point. In a way, the R&D point is capable of being a little bit of a proxy for some of the benefits that you have mentioned, because you would allocate those costs into the calculation and give the maker of the product the benefit of having made that investment and therefore getting a reasonable return on it.

I understand you are saying that you can't just do that here, but I suppose if there is no other methodology that anyone has yet established, then the question is what would you expect the PCR to be saying?

MR KENNELLY: May I take that in stages. I will start with the most recent point you made first.

There is no way that the R&D costs can sound as a proxy for the value to developers and end users. That, in my respectful submission, if that point is made, it is unarguable. The R&D costs tell you nothing about the extent of the value that the developers and end users have ultimately earned from the App Store. That is the point I made at the very beginning, about how one can have a bright idea which can depend on R&D costs to a certain extent but, if it catches on, the value that is created isn't linked in any way to the R&D costs that were spent. It is a function of many other factors and will usually, in innovative intangibles, bear no relation to the R&D costs spent. One can take them into account in a cost plus analysis but the word I balk at is the word "proxy". It certainly couldn't stand as a proxy for the value to developers and end users.

THE CHAIRMAN: I think we have been given warnings about bright lines and rules in this space, so perhaps "proxy" is the wrong word. But you are not saying that there isn't at least an effective -- it may be a place in some cases for R&D to stand as a proxy, if I can use the word again, I will think of a better one, but there may be some cases where it is an appropriate thing to do, where in fact actually the research and development, and therefore the innovation that comes, that is as good a way as measuring what the benefit is to consumers as anything else. Is that not right? You may be saying in this case that is not the right way to do it but are you saying that you could never do it?

MR KENNELLY: I am not saying you could never do it because there may be some cases where it would work. In this case, I have to satisfy you that a case that says that Apple's R&D costs stands as a proxy, or could at trial operate as a proxy, for the value to developers and end users has no reasonable prospect of success. It just doesn't

work. R&D costs is just another type of cost that goes into the cost plus analysis, and the law -- this is why it is a question of law -- the law tells you that simply looking at the costs of the dominant undertaking and its revenues is not sufficient of itself to capture the economic value to end users. That is exactly what Mr Justice Etherton tried to do in *Attheraces*, and the Court of Appeal said that was the wrong way to do it. It does not capture economic value. For that, you need to look at the demand side.

That brings me to the second of the two points I wanted to make, which is how do you do it? What would I expect to see? Was it so hard that one can't expect anything from Mr Holt and the PCR at this stage?

The answer to that is they, at the very least, needed to set out some methodology in outline -- the standard is not that high -- which would demonstrate a credible, plausible basis for capturing the demand side value to developers and end users. If, as part of that, they wanted to isolate value by reference to dependency again, that is something they would have to explain by way of methodology. It is Mr Holt's methodology that is under scrutiny.

The PCR accepts that they need to show you that his methodology survives the strike out standard, not what Apple needs to produce but what he needs to be showing you at this stage. That is what we don't see. That is really why we are here. There is no attempt by him or the PCR to explain how they can capture economic value from the demand side.

The reason is, we think, that once they go down that road, there is no way they can show that the 30 per cent is excessively high by reference to the legal standard, because of the enormous amount of value the developers get from the App Store.

THE CHAIRMAN: Maybe methodology, again, is a slightly unhelpful phrase. We are not in the sense of certification testing the methodology, are we, we are back to strike out or summary judgment. Without, again, wanting to be too rigid about the way we approach it, the summary judgment would, of course, take some reference to what the experts -- we have the benefit of the expert evidence. The strike out aspect of it, if one

were approaching it through that lens, would be largely on the basis of the pleadings. I am not saying it has to be constrained like that, but there is no obligation on the PCR to put forward a methodology at this stage, as you might have seen in some of the certification cases for particular reasons. That is not what is happening here, is it? It is a strike out or a summary judgment, stand alone.

MR KENNELLY: Which is why I said if this were a High Court case and there was no expert evidence, they would still have to show in their pleading how they were going to capture the economic value to developers and end users. And on summary judgment it has to do so too. I take no point distinguishing between strike out and summary judgment. For our purposes, the test is the same.

THE CHAIRMAN: I think we can treat them the same. Certainly, the *EasyAir* judgment is an agreed reference point for the test, isn't it.

MR KENNELLY: That is the problem here. We are not quibbling with elements of Mr Holt's reasoning. I will come to that in a moment. They have taken a very clear stance as to how they will satisfy the legal test. Apple's profitability, which they say is the means by which they evaluate economic value, and comparators. We say the first is not open to them as a matter of law, and the comparators are hopeless.

MR FRAZER: Just on that, can we go back to the Court of Appeal in *Flynn Pharma*, the paragraph 97 you took us to. In subparagraph 5 of paragraph 97, it talks about an approach based on cost plus. So the court there says if the cost plus test is applied, you compare the cost of production with the same price, disclose the profit margin, and then determine whether it is excessive or not by reference to retail sales or ROCE. Then look to see whether it is unfair by looking at a range of factors in subparagraph 6.

In the discussion in the authorities, it seems to be the case that you could take account of economic value on the demand side either by looking, I suppose, at the cost, i.e. are you including all the costs of innovation in there, the R&D and more? Or, in the plus

bit, i.e. are you, in determining excessiveness, or later fairness, are you taking account of a proper calculation of demand side value?

That is the approach which the Court of Appeal has mandated in *Flynn Pharma*.

So far as methodology is concerned, then, are you saying that, in adopting an approach which looks at cost plus, nevertheless the PCR has failed to provide any methodology relating to economic demand value? In other words, that it can't be fitted even within what they have already done, improved, as it were, or supplemented I should say, by reference to evidence that comes in later in the process?

I am sorry that question is a long one.

MR KENNELLY: I think the answer, if I may say so, is yes, in the sense that we do say that the cost plus model methodology they have put before you is incapable of capturing the economic value from the demand side. They say in terms -- Mr Holt says in terms that the profitability of Apple is the means by which they will evaluate the economic value, the relevant economic value for the legal test. Apple's profitability doesn't tell you anything about the value of the App Store to developers and end users. That is the fundamental flaw in their approach.

What the Court of Appeal in *Flynn Pharma* is not saying was that by doing that kind of exercise, by simply using cost plus, one could somehow avoid assessing economic value from the demand side. On the contrary, the Lord Justice says that it can be included within it but it must be included somewhere. However you fiddle with the language, you can't avoid doing the work of assessing the value from the demand side.

The question then is can you assess the value from the demand side, simply by looking at Apple's profitability? That is what Mr Justice Etherton tried to do in *Attherace*s, and it was rejected as a point of law by the Court of Appeal. They said that doesn't address value from the demand side.

Mr Piccinin makes the point that *Flynn* is not saying that you can use cost plus in all cases. I think that is clear. They are saying it can be used in some cases, and where it can

be used will be case specific. I hope that helps. What certainly isn't the case is that you can avoid looking at value from the demand side.

I was on the CMA report and I will take you through, if I may, this question of value. It hopefully will go to show why, for example, R&D costs couldn't possibly be a proxy for the value the developers and end users get, even on the basis the CMA found on a preliminary basis in the interim report.

Let me just get my reference. We are on page 1730. Paragraph 2.61. The CMA says:

"…the important role that mobile devices play in the lives of the majority of UK citizens [skipping down four or five lines] ... This is in part due to a substantial investment by Apple over the years in bringing forward regular new features and updates to their products and services. This, in turn has been complemented by the wide range of innovative and complementary products [that is a symbiosis between Apple and developers] and services from third parties within Apple's mobile ecosystem."

Go, please, to page 1753. We see what the CMA says about those improvements in device features and capabilities. The CMA uses the comparison of the original iPhone to the iPhone 13 Pro. One sees, in figure 3.5, the innovation and the development between the old iPhone and what is in the iPhone 13 Pro: screen size -- and I asked the Tribunal to bear in mind how these changes would be a value to app developers. How these changes might be incorporated into, for example, games, which the developers then monetise:

Bigger screen size, up to 6.7-inches; the resolution, as we can all say from personal experience, has improved incredibly; the processor is more powerful; the storage is significantly greater; you see what it says about the greater networks; the camera is of huge utility to app developers and there has been colossal advance in the technology and innovation in the iPhone over the years, on an ongoing basis.

You will see references to LiDAR, night portrait, portrait mode, live photo, cinema mode -- we will come back to those -- battery life, and then the additional features which are described at the bottom of the figure.

Below that, in paragraph 3.6 in blue, you see the various iOS releases from 2007 to 2020, showing the very regular efforts that Apple has undertaken through innovation to improve its products and make them more attractive to users, and thereby draw more of them to the App Store and improve functionality and performance of the devices.

One sees over the page, at paragraph 3.45, page 1754, the CMA says:

"Suppliers of mobile devices… may have an incentive to improve the features, functionality and performance of their devices for a number of reasons."

Go down to the third bullet:

"In order to increase the opportunities for generating revenue within the mobile ecosystem... This means they have an incentive to innovate in ways that increase the usage of mobile devices by users (eg in terms of engagement or time spent) or increase the offerings available through apps (if innovations allow app developers to offer additional services or features that are charged for). This is because such features are likely to generate additional revenue for suppliers of mobile devices and operating systems, and this may be of increasing importance given the more limited opportunities for further revenue growth in hardware."

It is obviously implicit in that that that revenue growth will also mean significant revenue growth for the app developers.

Then, paragraph 3.46:

"It is clear that over time Apple has improved the features, functionality and performance of its devices and iOS operating system."

Then the bullets below:

"Apple provide a list of examples of the many enhancements and innovations it has introduced over just the last 5 years, that included: hardware and software innovations which improve the processing speed, functionality and quality of its mobile devices and connected devices, such as innovations in chips, haptics and material such as Ceramic Shield Glass; hardware and software innovations in relation to privacy features, such as Apple's face ID; and software innovations at the operating system level that are

provided to developers to assist in building new and improved apps, such as CoreML and ARKit."

Things that allow the developers to make more money. It is economic value, pure and simple.

Paragraph 3.47:

"This will have benefited users over time as the quality of mobile devices has increased."

If you go then, please, to page 1797. There is an acknowledgement by the CMA -- and the Tribunal would have picked this up, I think, from the evidence already seen -- that app stores are a gateway between -- paragraph 4.2:

"app stores are a gateway between mobile device users and app developers. They are a way for: (i) the app developers to distribute their products and services to users, and (ii) users to find and install the apps and engage with the products and services of app developers. As app stores serve to connect two different customer groups, users and app developers, they are a two sided platform."

That tells you why you need to look at demand both from the developers but also from the end users. Apple needs to encourage both the users and the developers to participate if it is to work.

Page 1801, paragraphs 4.18 and following, referring only here to Apple if I may:

"Apple … provide[s] a variety of tools and services designed to attract app developers and users to their app store. Apple … provide[s] app developers with tools for app development, testing and quality control, APIs [and I will come back to those] (eg that help enhance an app's functionality), guides and documentation with instructions on how to use the development tools, as well as advice and support. In addition, they make available services and tools to help developers promote and distribute their apps to users, giving developers access to a platform on which to make their products available, the tools to manage the release of their apps and updates and access to analytics about app performance. They also include app discovery tools and features, services related to compliance, tax for example, as well as marketing tools and services."

Pausing there, when we come to comparators, I ask the Tribunal to bear in mind these features when asking whether payment processing services, such as PayPal, are properly comparable, or even PC games platforms.

Paragraph 4.20:

"Apple also provides various services to users, designed to enhance their experience of app stores. This includes services relating to the discovery of apps [page 1802], such as search features, suggesting apps to users, displaying ratings and reviews given by other users; account management (such as management of subscriptions); customer support and handling of queries related to refunds; parental controls; security protections, and protecting users from harmful apps (including through the app review process and the monitoring of apps already published). Other features include Apple's Family Sharing (which allows sharing across family members)." All of which generates value for developers and end users.

Further detail is given in Professor Hitt's report. I appreciate in a strike out I can't rely in detail on his report but there are some elements that I will take you to now, if I may. That is in the core bundle. <C/10/370>. I will try and take you to the non-controversial bits, and it will mean not taking too much of what Professor Hitt is saying.

If you go, please, first to page 378. We have here a very simple figure. These are the downloads over a period of 2008 to 2021. This tells you the growth of use of the App Store. This is the increasing use of the App Store. The actual figures are confidential but they are set out in paragraph 20, immediately above the figure. One sees the growth from zero, when it was launched in 2008, the number of transactions by millions in that figure. The figures themselves, which are very very large indeed, are in paragraph 20.

More interesting, perhaps, from the perspective of developer value and the value developers get, one sees over the page, page 379, the developer revenue from initial downloads and in app purchases. This is just the UK storefront, so we are looking only here at revenue in the United Kingdom between 2008 and 2021, beginning from zero when it

was launched, and one sees the figure at the very end on the right-hand side. The particular numbers themselves are at the very top of page 379. Very very large figures indeed. This is developer revenue.

Again, there can be no clearer picture of value, value the developers are earning, and end users through their enjoyment and use of the apps, than we see here.

At paragraph 22, Professor Hitt says:

"It should be noted that transactions through the App Store constitute only a small share of the total value of the app-based commerce associated with the App Store."

Because there are lots of other ways in which the developers can choose to make money from their apps. They are not required to make it this way. Developers can choose to make the money through in-app advertising, by organising for the delivery of physical goods and services, and digital goods and services used within but transacted outside the App Store. You buy something through your PC and then use it on the App Store.

These “represent a large volume of App Store related commerce, none of which is actually subject to Apple's commissions."

If I could just take another look at this figure, figure 2, the key insight for this, when you think about how this fits in with Mr Holt's analysis, is that on his approach, if the App Store flopped, if the user numbers collapsed significantly and the transaction volumes fell and developers earn far less revenue than we see here as a result, on Mr Holt's approach the value of the App Store would remain the same. In working out the value, all he takes into account are Apple's costs and a measure of profit equivalent to Apple's WACC. So he would say the value remains the same, even if this figure was turned upside down.

Now, Professor Hitt goes into great detail on the innovations that Apple has provided through its ecosystem. I am not going to take you to all of those, I am only going to go to the ones cited by the CMA, and even then, over a sample of them because so many are listed by the CMA.

Tracking the innovations and the things in the App Store and the Apple ecosystem that bring value to the developers and end users cited by the CMA, I will ask to you go to page 396 first. It is paragraph 57.

That is a reference to Apple's ARKit, you saw that in the CMA report. It is:

"[An] innovation that enhances the quality (and therefore the value) of app transactions between developers and consumers by offering a ready to use software solution that allows developers to incorporate augmented reality features into their apps. Specifically, ARKit allows developers to create apps that place a virtual object into the real surroundings observed through a camera. ARKit simplified the prior process for creating augmented reality content by providing predesigned packages able to handle these and other components of generating an augmented reality app."

If you go then, please, to page 399, paragraph 63, these are the privacy and security features that the CMA mentioned. I will ask the Tribunal just to read those to yourselves and I will move on when you have got to the end.

(Pause)

THE CHAIRMAN: Thank you.

MR KENNELLY: Now, page 465, please. Professor Hitt has a very long appendix of the innovations which Apple has created. Again, I am sticking only to the ones mentioned by the CMA.

Page 465. This is an Apple innovation for the benefit of the App Store hardware/software integration. The Tribunal sees, at 465, a reference to the retina display. This is the pixel resolution and the huge strides that Apple has made there. I am not asking the Tribunal to read all of that, go just to the short passage about the release in 2010 and the description of the innovation. That should do it.

(Pause)

Then, please, go to page 468. Under paragraph 20, you see LiDAR. That is obviously in the CMA report also, you saw that, and you can read what that innovation involves.

469, please, over the page. This is from paragraph 4.19 of the CMA interim report. Software development kits. These are the developer tools that Apple provides to developers. We can skip the long passage in the description, but just the description of innovation: "The SDK provided developers access to the new iPhone's hardware and software innovations, such as the Multi-Touch user interface, the three axis accelerometer and the geographical location and technology."

Then this:

"Today, Apple provides 150,000 APIs for developers using iOS14."

An API is Application Programming Interface. That is the building block that developers use to develop apps. Apple is providing 150,000 of them to developers, to allow them to create and develop more and more attractive products, their products.

Then, please, page 473. ARKit is here referenced. You saw that in the CMA report and, if you read simply the description of the innovation, that will suffice.

Finally, 475, this is the last one, we have the app monetisation models that Apple has created. These are the ways in which developers can make money and the ways in which consumers can purchase digital content through the App Store. So we have in app purchases, the ability to allow for say a free download, with consumers then to make purchases within the app itself; subscriptions and Family Sharing. These are also innovations created by Apple generating substantial economic value for developers.

Now, that is all I am going to take you to in terms of the value Apple provides for developers and end users. As I said in opening, I don't need to ask the Tribunal to quantify that, I simply need to show it to you to show the enormous amount of value that the App Store and the Apple ecosystem provide to developers and end users.

I can even accept, for the purposes of this application, that adjustments may need to be made for dependency, for the fact that, because we are to assume, against myself, that Apple is dominant and the market is as defined by the PCR. Even assuming all of that, we know from the case law that there was still legitimate economic value on the demand side that must be ascertained.

The PCR's case is that they don't need to ascertain it. You can simply assess Apple's profitability and you can assume that those profits are so high that whatever economic value is there is vastly exceeded. That is like the CMA in *Flynn*. The CMA in *Flynn* made the same point; it is sufficient simply to include a reasonable rate of return and a cost plus figure will cover off whatever economic value Apple provides to developers in the App Store.

To be clear -- and this comes to a point raised with me by the Tribunal -- that is just another cost. However, one looks at it, profitability, comparing ROCE to WACC, it is just a version of looking at Apple's costs. It doesn't tell you the value that developers or end users derive. It is a cost Apple incurs in providing that value.

Now we turn to Mr Holt's evidence, if I may. Before I go to this, I would like to respond at this point to a point taken up by the Chairman before we broke for lunch, the question of pleading. Am I really just taking pleading points here with the PCR? Is this not something they can simply improve if they were certified?

For that, in terms of the legal framework of how one approaches pleadings and evidence in this context, can I ask you to take up the *O'Higgins* judgment of this Tribunal very briefly.

We will come back to Mr Holt in a moment.

It is in the third volume of authorities behind tab 22. Tab 22, page 966.

Just to deal with the suggestion which might be made that, well, we can fix all this when we get disclosure and, if there are inadequacies, that can all be addressed at some later stage. My short point is that it can't wait for disclosure, it needs to be done much much earlier than that if they are to change their case or amend.

Page 966, and you will see that, first of all, at paragraph 208 on the previous page, the Tribunal summarised the test for strike out in *EasyAir*. In paragraphs 209 and 210:

"We have no hesitation in saying that, in those causes of action where actionable damage is a necessary element… a failure properly to assert a causal link between breach and damage will result in a claim being defective and, if it is not cured, liable to be struck

out. … It is not enough for a claimant to commence proceedings, unable properly to make the necessary factual averments sufficient to constitute a cause of action."

I rely on that passage.

"In particular, a claimant may not commence proceedings in the hope that material will turn up later to enable him or her later to make the necessary factual averments in the pleadings."

That is why the Tribunal in *O'Higgins* sent the parties a reference to *Nomura*, because in *Nomura* it was held that it was an abuse of process to advance a claim where it is not possible, at the time the claim is made, to plead out all of the necessary elements of the cause of action.

Over the page, paragraph 212:

"The basis upon which claims can be struck out has expanded with the advent of the Civil Procedure Rule, which the Tribunal Rules emulate. Under these rules, a claim may be struck out where the statement of case discloses no reasonable grounds for bringing or defending the claim."

I will skip down, if I may, to the very last sentence in paragraph 212:

"Although a party will generally be given an opportunity to amend to make good a deficiency in the pleadings, *Nomura* makes clear [and so did the Tribunal here] that that opportunity must be taken <u>before</u> and not <u>after</u> disclosure."

So, if the Tribunal finds that there is a deficiency here, as I am saying there certainly is, it cannot wait, as the PCR may suggest, until after disclosure to be fixed.

With that, if I may, we will turn to Mr Holt's evidence.

THE CHAIRMAN: Yes. Thank you.

MR KENNELLY: His first report is in the first core bundle, tab 8.

I will skip, if I may, the introductory bits and get straight into the substance, which begins on paragraph 3.3.2.

THE CHAIRMAN: Would it be convenient to have a break for the transcribers or would you like to get going on this? In your hands, but we probably ought to break quite soon.

MR KENNELLY: I think we are at the mercy of the transcribers. I am happy to stop now.

THE CHAIRMAN: We will come back in ten minutes.

(3.15 pm)

(A short break)

(3.25 pm)

MR KENNELLY: Thank you, Sir.

THE CHAIRMAN: Yes, Mr Holt.

MR KENNELLY: Mr Holt. Core volume 1, tab 8, page 204. <C/8/204>. Paragraph 3.3.2.

THE CHAIRMAN: Yes.

MR KENNELLY: Just the very last sentence in that paragraph:

"Mr Holt acknowledges that the availability of apps makes a device more attractive to users."

Paragraph 3.3.3:

"The App Store acts [he says] as the unavoidable intermediary between two sides of the app market.... The developers can use the App Store to publish and monetise their apps, whilst users can search for and install apps on their devices. The App Store is an example of a 'two-sided market' where demand from one side (users) depends on demand for the other side (developers). The more users there are, the more attractive the App Store is for developers; and the more developers there are, the more attractive the App Store is for users. That is indirect network effects."

Then we move on to the structure of the commission, we have not seen this so far. This is 3.4.1 over the page, page 206.

Mr Holt summarises the types of ways in which Apple levies its commission on relevant app purchases, in app purchases and subscription purchases.

Over the page to <C/207> he describes how the commission was reduced. He describes at (b) how Apple's commission was reduced for small app developers, earning below $1 million, in the previous calendar year, effective from 2021. That is, in my submission, what the CMA was talking about when it said that low entry costs for small

developers helps competition in the development market. So the commission is reduced for developers earning below $1 million in the previous calendar year.

Mr Holt says it is unlikely to be significant, for this reason. He says:

"An estimated 98 percent of app developers will be eligible for the 15 percent cut, but those developers generate just 5 percent of the App Store's total revenue last year."

That is interesting because it tells you, on Mr Holt's analysis, that the largest 2 per cent of developers earn about 95 per cent of the revenues on the App Store. The developers who actually pay the 30 per cent are very large indeed and are earning the kinds of revenues that you saw on that table in Mr Hitt's report.

Then we have, at (d), a reference to the reader app exception that you have seen in the pleadings. And, at (e), the multi-platform service where Apple allows people to use content which is being paid for elsewhere. The reader app exception, by the way, can involve a scenario where the content can't even be purchased on the App Store, but Apple still allows it to be used on its devices, even if it is purchased elsewhere and cannot be purchased on the App Store.

Then we have the excessive pricing analysis, beginning on page 236. That is 236 of the bundle. We will skip over the first bit of this quickly. There is a reference to *United Brands* on page 236, and then we go over the page to 237 and paragraph 7.1.6. We see how Mr Holt deals with the two limbs of *United Brands*.

First, (b):

"To consider the first limb, I carry out a preliminary profitability analysis in relation to the services in question. [It] is a common tool for understanding whether market outcomes are competitive ... [used in] market investigations. Under reasonably competitive market conditions, over time you would expect competitive pressure to lead to returns approaching the risk-adjusted cost of capital for investing in the sector. This does not mean any increment above cost of capital [is] … excessive … [for the first limb.] Pricing can be legitimately high in situations where the firm innovates and, by virtue of that innovation, maintains an advantage over rivals. Higher prices can also efficiently

signal opportunities for entry. However, profitability that is significantly and persistently above the cost of capital, particularly where entry is limited or prevented, can provide a strong indication that prices are excessive."

If Mr Holt, there, is dealing only with the first limb of *United Brands* and is not trying to ascertain economic value, I wouldn't try and strike that out. As he describes it there, it is not the test for unfair, abusive prices.

Then:

"To consider the second limb, I consider price benchmarks to the relevant services. While I have not identified any perfect comparators, I refer to various examples which indicate what would likely be the competitive level were competition allowed to develop on the iOS app distribution and iOS payment processing markets."

Those are the comparators.

"I have also considered whether the evidence in the round indicates if the commission is 'unfair' in itself, taking into account persistent high levels of profitability and the fact that (with ...exceptions) , [it hasn't] reduced over time..."

THE CHAIRMAN: When he is talking in the second paragraph at (b) about a firm innovating, isn't he recognising there that there is a value ascribable to innovation which is not captured by the profitability analysis?

MR KENNELLY: He may. I mean, that may be an unwitting acknowledgement of the point I have been making to you. What he is certainly not acknowledging there is that he needs to take account of the value to end users through the innovation that Apple undertakes.

He is, first of all, dealing with excessive pricing, the first limb only. What he doesn't do, here or in the second report, is explain how he could capture value from the demand side.

THE CHAIRMAN: Because, we know, as we have discussed, we know that this point about the value of the demand side can be put, apparently, into the first limb or the second limb, it doesn't matter where you put it as long as you do it.

MR KENNELLY: Indeed. In theory, it could be, but we ask rhetorically where does he do it? The answer is nowhere.

THE CHAIRMAN: Yes. You mean when he actually explains what he is doing?

MR KENNELLY: Yes.

THE CHAIRMAN: So if you were doing it -- just as a matter of principle, if you were doing it, you could see for example he might -- I am not saying he necessarily is, but he might be saying, when you look at the first limb there is this question of realising that the profitability analysis won't capture all the value of innovation, which presumably is a demand side feature as well, otherwise he wouldn't be raising that beyond the profitability.

If you were going to capture it in the second limb, presumably you would be asking yourself that question principally in relation to whether it was unfair in itself. Because, I suppose, if you were looking at -- if you did have good comparators, he says there aren't, but if you had perfect comparators presumably that would be quite a good way of determining whether the demand side actually delivered any value in this particular case compared with other comparable situations?

MR KENNELLY: Yes.

THE CHAIRMAN: In the absence of comparators, I suppose you are driven back to the question of unfairness and whether the high profitability you have identified can be explained for some other reason. A bit like an objective justification, which sometimes seems to be referred to in some of the cases.

MR KENNELLY: Indeed. Obviously, on that last point, it is clear that they need to show that the price bears no reasonable relation to economic value as part of their own case.

THE CHAIRMAN: Yes, quite. No, I understand.

MR KENNELLY: On your point, Sir, could it be said that here, when he talks about prices being legitimately high if a firm innovates, is he there even indirectly envisaging the value that Apple equates for developers and end users? The answer, I think, is no.

Here, all he is doing is acknowledging that, in his approach, he accepts that prices can be high for a short time but then they will be driven down by competition. There may be lots of reasons why prices can be legitimately high, one of them is innovation. But he is at no point here, even indirectly, seeking to take account of the value that Apple provides to developers and end users, which, in theory, could mean the price is fair, even if well above costs plus a reasonable return.

THE CHAIRMAN: Yes. He might actually be asking himself the right question here, but you say he hasn't then gone on and answered it.

MR KENNELLY: He is not even asking the right question. If you look at the last sentence of that paragraph, however one tries to read that word "innovates", then he says:

"Profitability that is significantly and persistently above the cost of capital, particularly where entry is limited …, can provide a strong indication that prices are excessive."

As you will see, that is his approach. He is saying: whatever your innovation is, if your profitability is significantly and persistently above the cost of capital, where entry is limited, full stop.

I said that might be okay if he was just looking at the first limb, but you will see that is his -- that is where he captures, or seeks to capture, economic value. The last sentence, he says that is enough.

THE CHAIRMAN: Maybe putting aside the facts of this case, which you may say is different, there is nothing on the face of it controversial about that at all, is there? You would normally expect the benefits of innovation to be competed away. So you would expect that to be correct, I think?

MR KENNELLY: If you were asking only about the competitive level within the meaning of the CMA's approach on market investigations, this idea that if more entry was in the market, prices would fall and that would be the competitive level and we might need to intervene to secure that outcome, if that is the question, then yes. If the question is are the prices unfair, contrary to section 18 or Article 102, it is a very different test. The question then isn't, are the prices at a competitive level that you would expect to see if

new entry or entry drove it down? That is not the test. The price can be above the competitive level and still escape the prohibition under Article 102.

THE CHAIRMAN: I suppose it depends -- you are right, it depends what question you are asking. But if what you are trying to identify here is whether, having observed that there is excessive profitability on the face of it, there might be some reasons why that isn't egregious and actually reflects a reasonable relationship with economic value, then you would be asking exactly that question, wouldn't you, which is, are there reasons why innovation might be a reason why it was higher, but then, ordinarily -- and it may be not this case you are going to say -- but, ordinarily, you would expect that innovation, the benefit of that, to the producer to be eroded away at the time.

MR KENNELLY: You might say you don't even get off first base on limb 1 because, even if there is a big gap between costs and revenue, that is still not sufficient for the purposes of the first limb of the *United Brands* test. That might not involve analysing economic value on the demand side, you might just recognise that --

THE CHAIRMAN: Well, you might choose to do it later, but if you did choose to do it on limb 1, then that might be your thought process, mightn't it, that you recognise innovation delivering benefits you hadn't captured in the cost plus and then you also made an assessment of whether it was reasonable to continue to retain the benefits of that innovation in the long run. That's what I'm putting to you.

MR KENNELLY: I see.

THE CHAIRMAN: I hope it's not -- it wasn't intended to be a particularly controversial --

MR KENNELLY: I see. Again, I think the point has been put to me, it is the same scenario envisaged in some of the cases that, in theory, cost plus can do the job, but that still has to involve an analysis of -- to ascertain the economic value from the demand side.

THE CHAIRMAN: I think what I am putting to you is that he is saying that he recognises that cost plus might not entirely do the job. That is what I am putting to you.

MR KENNELLY: Sir, I am afraid, if you read that last sentence in (b) when he says -- I think we will carry on, because it really boils down to what is Mr Holt actually saying is the

proper approach. Before we start giving him the benefit of that gloss, I think we'll just keep going, because here you will see the sentence reappearing. He is not saying, 'I am going to try and capture innovation some other ways', he is saying 'profitability, profitability'. It was persistent and significantly above the cost of capital where entry is limited, end of story. That is going to cover off any value that is being offered to anyone.

The suggestion -- if that last sentence is the test, well, it is inconsistent with *Attheraces* and *Scandlines* for the reasons I have given. It is not enough to say that your profits are significantly and persistently above your costs, even if there is no entry. If that were the test for an abuse, for an unfair pricing abuse, *Attheraces* would have been decided the other way.

THE CHAIRMAN: Again, I am not entirely sure that is what he is saying, but, in a way, I think you are right. Let's move on and see how you develop.

MR KENNELLY: The second limb, he has his benchmarks. I have covered that.

I move on to paragraph 7.1.7:

"To conduct my preliminary assessment of whether Apple is ... charging excessive unfair Commission ..."

He has used public domain information to estimate the profitability of the App Store:

"My approach necessarily relies on assumptions which I would expect to refine if I had access to further data from Apple."

Not looking at anything from the developers or end users:

"My assessment of the profitability of the App Store, and of whether the Commission is excessive, may need to be updated considering that evidence."

You will see what he means by that further evidence. That is costs and revenues on the Apple side, on the supply side.

Then page 240, please. His preliminary review of evidence on the App Store commission. Paragraph 7.3.1, he says:

"I first assess evidence as to whether the … Commission may be excessive by carrying out a benchmarking analysis that includes [linked] profitability analysis and price comparisons against appropriate comparators (where available)."

So we have, again, a clear statement it is profitability and comparators and nothing else. So profitability at 241, page 241, paragraph 7.3.2. His profitability analysis compares the return on capital employed, which he prefers to the return on sales. And paragraph 7.3.3:

"The ROCE is calculated as earnings before interest and tax ... divided by long-term debt plus equity."

Then it's:

"... (WACC) is a measure of the cost of a business' investment. It is the average rate a business expects to pay to finance its assets."

Again, you have seen this summarised in the claim form and, indeed, in the CMA interim report.

All this is just profitability. Telling -- we say it is telling that the CMA market investigation guidance is referenced; this has nothing to do with abuse or dominance.

Paragraph 7.3.4:

"It should also be noted that the CMA has subsequently clarified that a finding that ROCE is higher than WACC does not imply a competition problem on its own. For example, a firm that innovates and gains a competitive advantage may earn higher ROCE for the period it is able to sustain the competitive advantage. However, the CMA also makes clear that in a market characterised by effective competition any excess returns above the WACC would be expected to be eroded over time."

That is not an attempt to take account of economic value. That is saying, you might have a higher price for a short time, but the test is whether the price is higher than the price that you would see if there were effective competition in which excess returns above WACC would be eroded over time.

You have seen from the case law that the Commission in *Scandlines*, the Court of Appeal in *Attheraces*, and the Court of Appeal in *Flynn* turned their faces directly against that. That is not the correct legal approach, simply to say, is the price above the level that you would see with effective competition, which is excess returns over WACC being eroded over time.

Then, paragraph 7.3.30, that is on page 248 now we have the "unfair in itself". We are off profitability. He goes on to say:

"The persistence of Apple's excess profitability" -- and by "excess" he means over the costs and a reasonable return of the App Store -- "over the period I have reviewed was a factor indicating unfairness in itself."

He says it hasn't reduced over time, despite the large growth of the Relevant Purchases.

Then we go on to his comparisons. That begins at page 251. Before we go on to comparisons, you have seen what Mr Holt has said. My learned friend can go back in her submissions to the passages I haven't taken you to, but he is very clear it is just profitability. He is saying if Apple's profits are significantly and persistently above the cost of capital, then in a situation where there is no effective competition, that is enough to show that economic value is captured and you have an unfair abuse contrary to our Article 102.

Then move on to comparisons. Paragraph 7.3.44. He has considered two types of app distributors, the Android apps on Google and the PC games distribution platforms. Look at table 7.6.

First of all, we have -- obviously, the iOS App Store is the first relevant operating system. Then we have Android. We see that for Google Android -- the Google Play Store the commission -- the headline commission is the same. It is acknowledged to be very closely comparable but the market is not accepted to be competitive and so we move on.

Then this:

"PC game distribution platform."

We will focus just on Steam for now. Mr Holt notes -- if you see in that vertical column which covers Steam, he notes that it is a market leader. He gives details about that later. He accepts, though, that the market in which Steam operates is competitive. In answer to "Is the market competitive?", Mr Holt gives it a tick. He says that Steam is highly comparable, that is his pie three quarters full, highly comparable, with a comparable pricing structure. You have that from the bottom of the vertical column. And then look at the commission that it charges on Mr Holt's own evidence. At the same or higher than Apple's headline commission. It is impossible, just pausing there, to see how that supports even an arguable case that Apple's commission is so excessive as to be an abuse of dominance with Steam as a comparator. I will come back to the Epic Store and the Microsoft Store.

Move to page 255 and the PC game distribution platforms. Paragraph 7.3.58. At (a), Mr Holt explains why, in his view, it is comparable:

"The business models of PC games distribution platforms resemble the business model of the App Store in certain important respects. The PC games distribution platforms, (… known as 'game stores'), are platforms in which game developers can reach computer game users and sell them their games. Game stores usually offer users access to a large catalogue of computer games, which can be directly purchased online. After the purchase, the user needs to download the game from the store. They install it on a computer and then start playing immediately. The business model is essentially the same as that of app stores on mobile devices, including the App Store."

It's important to pause there on the question of how comparable these distribution platforms really are. He says that these are essentially just platforms on which game developers can reach game users. Just like a store. They download the games on their own PC and they play it on whatever PC they own. Hopefully, the Tribunal has seen, from what I have shown you in the CMA report and Professor Hitt, that this is a fraction of the economic value that Apple provides. We have seen, and it is in the CMA report, Apple provides enormous amounts of technology to developers that developers use to create

their apps and it's in a totally different level of economic value altogether. You saw that Apple provides about 150,000 tools to developers that they use to create and generate revenue and value from their apps. It is just not comparable at all to say it is the same business model as the PC game distribution platform. So even if these PC platforms offer lower rates, that can't tell you if Apple's commission is unfair.

Over the page, 256, just for the Tribunal's note, the economic significance of games as a category, the games category is the single biggest iOS app category within the App Store in terms of revenue, according to the source. Games accounted for 68 and 71 per cent of the worldwide mobile iOS app revenues in 2019 and 2018 respectively. The games are very, very important as a revenue source on Mr Holt's evidence.

Then we have paragraph 7.3.60. He says:

"Overall, this market exhibits characteristics which make it more competitive relative to the the iOS App Distribution market ..."

"First, there are multiple game distribution platforms available on PC, the two largest ones being Steam and Epic .... In addition, other large competitors, such as Microsoft, are also competing in the market. Some of the largest game publishers have also launched their own digital distribution platforms. For example, EA Games have launched their *Origin* platform…"

And he refers to others.

"(b) Second, developers and users can (and often do) multi-home."

That is where they use the same game across various different devices and their computers and consoles:

"It is common for developers to release their games via multiple game stores."

Then this important last sentence in (b):

"Overall, the switching costs between game stores appear to be very low and users can easily use multiple stores on the same computer."

He says:

"In the following benchmark analysis, I consider the level of commission charged by the largest store, Steam ..."

He goes on to describe Steam at paragraph 7.3.62. And over the page:

"It is ... by far the largest game distribution platform."

It has over 120 million monthly active users and the number -- and, importantly, at the end of paragraph 7.3.62,

"the number of games purchased [on Steam] increased by 21.4 per cent over 2019".

So it is a growing games platform.

“In 2018, there were more than 9,000 computer games newly released on Steam, representing 38% of all games released that year…up to the end of 2019, Steam had over 30,000 games in its library. It was the world's largest distributor of PC games, taking up 75% of the global market share. 50-70%of the world's PC downloads took place on Steam.”

Paragraphs 7.3.65 and 7.3.66:

"Until recently, Steam consistently charged all developers a 30 per cent commission for distributing their games. This was deducted from developers' sales revenues."

Their market power, says Mr Holt, has been eroded in the last few years.

“Large game publishers started to launch their own digital distribution platforms…to avoid paying Steam's 30% commission. In December 2018, Epic launched the Epic Game Store, a game distribution platform open to third parties…Epic charges a 12% distribution fee.”

Paragraph 7.3.67:

"In November 2018, Steam lowered its commission by up to 10 per cent ..."

So you see straight away they lowered their commission before Epic launched the Epic Game Store, but they lowered it by up to 10 per cent for the largest developers, using a sliding scale system. They still charged 30 per cent commission on all revenue under $10 million. Commission drops to 25 per cent revenue between 10 and 50 and 20 per cent for revenue over $50 million. So the headline rate remains at 30 per cent.

Mr Holt then introduces some, in my submission, very weak, anecdotal evidence to suggest that Steam is losing appeal which might put downward pressure on its 30 per cent commission. You see that in 7.3.70, page 258. He says:

"Despite decreasing its commission, Steam appears to be losing its appeal to large game developers, who are increasingly favouring the Epic Game Store or their own platforms ..."

You have just seen that Steam was very successful and growing. You have just seen that in the previous passages.

Look at the last sentence in paragraph 7.3.70. He says:

"There are other games developers that launched their own platforms to circumvent the commission charged by Steam, including EA Origin."

You've seen a reference to EA Origin before. Footnote 209. Let's look at footnote 209:

"EA launched Origin in 2011 to rival Steam. Subsequently, it took its games off Steam up until mid-2020, when it decided to bring back EA Games to the [Steam] platform."

Now, they have various reasons, player oriented, to say why they have done that, but one can see, from a competitive point of view, what happened. They set up a rival platform, they took their games off Steam but, by mid-2020, they were back on Steam. But this is, Mr Holt said, still a competitive market, subject to a point that he goes on to make.

At paragraph 7.3.72 he says:

"…Steam was able to sustain charging developers 30 per cent commission only whilst it enjoyed significant market power. Steam's recent commission decrease and further evidence suggests that, as competition ... intensifies, so does the pressure on Steam to decrease its commission."

So the basic facts are these. As Mr Holt says, until recently, Steam charged all of the developers 30 per cent commission, the very rate he says is abusively unfair. Then he relies on the fact Steam started to offer lower rates to developers of higher revenues. So what he is saying is you should ignore the fact Steam charged 30 per cent for everyone for many years on the basis that they were probably dominant

when they did that. That is the suggestion he is making: 30 per cent must be a function of their market power. But you still ignore the fact that it continues to charge 30 per cent to small developers but you can rely on their 20 per cent commission to find that the Apple 30 per cent is abusively unfair. It was not at the races there, in terms of an abusive case under Article 102 or section 18. That is a hopeless attempt to say that the Apple commission is even arguably unfair. It is also alarming that Mr Holt is basing his analysis on an implication that Steam was somehow abusing its dominant position. That is how he suggests they got away with the 30 per cent commission when they did. That is the inevitable consequence of his analysis. But the PCR will not be able to show that either. He will never be able to show that Steam's 30 per cent commission was also unfair on the legal test for the same reason that we have been discussing all day.

More importantly, given the profound differences that I went into between the App Store and Steam, even if he could show that the maximum fair price for Steam was 20 per cent, it is just not comparable because of the difference in value that Apple is providing to developers.

Then we go to Epic. Paragraph 7.3.76:

"To distribute its Fortnite game [this is on page 259] and to avoid paying Steam's 30% commission, Epic launched its own game distribution platform (Epic Game Store). Like the Steam platform, Epic imposes commissions which are deducted from developers' gross revenues. Epic charges a 12% commission to developers while also allowing developers to use their chosen payment processing service ..."

Paragraph 7.3.77:

"Based on Epic's experience of running the largest online game, Fortnite, they estimate that by charging a 30 per cent commission ... Steam is marking up its costs by [a very, very large percentage]. Epic claims that its store can be profitable even when charging only 12% commission ..."

Now, Mr Holt will accept, and you will see this in his second report, that the Epic Game Store is not profitable. It is currently not profitable, charging a commission of 12 per cent. If you go ahead to paragraph 7.3.82, over the page, 260, you will see that Epic is a lot less successful than Steam notwithstanding the fact that for the last few years -- it launched in 2018, it is charging much lower commission. After two years' development and expansion, it has become much more popular, though it is considerably smaller than Steam. In January 2021, Epic announced that its store grew from 190 games to 471. In comparison, Steam has 30,000 games in its library.

So again, it is barely comparable to Steam, never mind the App Store. It is hopeless to take this example of an unprofitable store charging 12 -- an unprofitable game store, not even the same as the App Store, charging 12 per cent to developers and conclude from that that Apple's 30 per cent commission is abusively unfair and contrary to Article 102. There is no precedent, no such comparison has ever succeeded. They are not connected logically at all.

Then we see the Microsoft Store. Paragraph 7.3.83. This is an app store run by Microsoft for its mobile and desktop devices. In 2015, so a long time ago, Microsoft announced it would merge several of its separate app stores. Then, paragraph 7.3.84, at the end of 2020, the Microsoft store hosted approximately only 670,000 apps, less than 25 per cent of the number of apps available on Google Play, less than 30 per cent of the number apps available on the App Store. It is a much, much smaller business, and it is not prospering.

Paragraph 7.3.85:

"Since its launch the ... store charged a 15% commission for non-game apps, leaving developers with 85%..."

This is half of the commission of Apple. Fine. But then for game apps, which are by far the most important category from the perspective of revenue, Microsoft store charged also a 30 per cent commission. Again, the chosen comparator is not comparable really.

Even it was charging a 30 per cent commission, until very recently, for game apps. We see how that changed. Paragraph 7.3.87:

"On 29 April 2021 [only last year], Microsoft announced it had changed its store terms with PC game developers - starting on 1 August, ... [it] reduced its commission for PC games from 30% to 12%, in line with Epic's commission."

But we have seen how this business has struggled since 2015 and has a much, much smaller scope than any of the -- well, certainly than Apple and far smaller than Steam.

Where Microsoft has been successful, it is keeping its 30 per cent commission. We see that in paragraph 7.3.90:

"For completeness, I note that Microsoft also uses the Microsoft Store to distribute its Xbox games. These sales are subject to a 30% commission. However, [its] ability to charge a 30% commission is due to the high level of market power it enjoys in the market for distributing Xbox games and the different business model of game consoles."

Again in order to justify the fact that his chosen comparator is charging a 30 per cent commission he has to suggest in this scenario also they are only getting away with that because they enjoy market power. The implication being, again, this is an abusively high price in a market where Microsoft has some kind of dominant position, otherwise they could never charge a 30 per cent commission.

How can you prove that? It is not even applying the right legal test. But his whole structure is based on trying to prove that Steam and Microsoft separately enjoy market power and charging prices which are, by definition, on his approach, abusive.

THE CHAIRMAN: Can you help us: how does this fit into your application in the sense that, if you are right about the point about economic value, is this necessary to consider for us -- if we were to find in your favour on that point, do we need to get into all this or are you doing this because, even if you are right on economic value, you need to show that it is not possible to sit on any of this? If that is right, are you doing that on the basis that you are saying that -- it seems to be you are saying on the basis that it is

just lacking in any evidential value and, therefore, it is a summary judgment type point --

MR KENNELLY: Exactly.

THE CHAIRMAN: -- and you're not wanting to characterise it too much because you are saying we can dispose of it on the basis it doesn't meet a threshold of any credibility for the purposes of the test? Is that where this is going?

MR KENNELLY: If I break it down, it is open to the PCR to show that economic value from the demand side is being taken into account, both by way of limb 1 or limb 2 of the *United Brands* test. In this case, the PCR is squarely saying we are doing it by a profitability analysis and we will see that in Mr Holt's evidence. That really should be the end of it. We know from the case law it is also possible, if they have good comparators, genuinely comparable markets, they could say that that is another way of analysing economic value from the demand side. We can get that from the comparators also. So I do need also to show you that the comparators are bad at the summary judgment standard, which is what I am trying to do now.

THE CHAIRMAN: You accept you have to win on both points to get to where you want to get to?

MR KENNELLY: Exactly.

The point I made before about the PCR and Mr Holt really putting all their eggs in the profitability basket is clear from his reports. Mr Holt really uses these comparators as a makeweight. He is very frank about that in his own report and I will show you where he says that.

In reality, if you are against them on the profitability, there is nothing left, but, for the sake of completeness, I am going through these comparators also. One can see, or I have to persuade you, that these are not even proper comparators for the purposes of a summary judgment application. They are not comparing like with like, and even when they do, even when Mr Holt does use them as comparators, we see the rates

they are charging, which are, in many cases, either currently, or very recently, the very same commission which he says is abusively unfair.

It is worrying that, in order to get away from that harsh reality, he has to suggest that both Steam and Microsoft were in their own ways also charging anti-competitive prices.

The fact that Microsoft charged a 30 per cent commission until last year on its games in its competitive market is, in fact, positive evidence in support of Apple's case.

Despite all of these examples of platforms in competitive markets charging, until very recently, 30 per cent, or currently 20 or 30 per cent, he goes on to say, in paragraph 7.3.92, that his preliminary view, based on those comparators, is that the competitive level of commission in the iOS app distribution market would be in the rate of 10 to 20 per cent with a midpoint of 15 per cent. I am afraid that conclusion just doesn't follow, even on its own face, from what Mr Holt has set out in the earlier sections.

His next comparators are payment processors like PayPal or Stripe. He goes on to describe those from paragraph 7.4.1. I shan't ask you to read these, I am just going to make my submission, which is one I prefigured earlier. These charge, obviously, much lower levels of commission than Apple and that is hardly surprising because all they do is process payments. PayPal, Stripe, they don't provide a device like a smartphone on which end users spend three hours a day, as the CMA found, and which the end user already uses as his or her main way, or one of their main ways, to interact with the wider world, and which the end user trusts with a huge amount of personal information, which trust is extended, as I said, to the App Store curated by Apple. PayPal -- I mean no criticism of PayPal -- doesn't supply huge amounts of valuable IP to customers, teaching them how to invent more attractive and successful businesses, which then make the products in which those innovations are an integral part of the ecosystem and then sells them through the device. The payment processing is the least of the things that Apple does in its ecosystem and that is highly relevant when you are asking, what is the demand side prospective of economic value?

An argument that the payment processors are comparable to the App Store, to the value provided by Apple, that, in my respectful submission, has no prospect of success.

So, overall, even on Mr Holt's own evidence, the PCR's case that the Apple commission bears no reasonable relationship to the economic value provided, that we say cannot succeed. But when you review Professor Hitt's report and Mr Holt's response to it, that, we say, is then put beyond doubt. I will ask you then to go to Professor Hitt. He is in the core bundle also at volume 2, behind tab 10. Page 391, please. Paragraph 44, page 391. I will ask the Tribunal, if I may, to read paragraph 44 to yourselves. It goes over the page to page 392. Each of those three bullets in paragraph 44.

(Pause).

Thank you. Then, if you go to paragraph 74, which is on page 403, we come to how Professor Hitt deals with comparables. What I showed you there was all I wanted to show you on Professor Hitt's response on profitability and it being a gauge of value.

Now we look at comparables because, as Professor Hitt says at paragraph 74, the App Store is not the only two-sided platform for digital transactions, he refers to many others, and because Mr Holt gave an incomplete list of comparable platforms, or arguably comparable platforms, because we don't accept they are properly comparable at all, but adopting Mr Holt's approach, what other comparable platforms are there and what commissions do they charge, we go over the page, 405, we see not just the App Store but the Amazon app store. I am referring here to headline commission rates. I accept the effective rate for some of these may be different and they may have discounted rates, but in the context where it is alleged that 30 per cent commission is so high as to be an unfair, abusive price, it is sufficient, in my submission, to look at the headline rates which are the same or very similar, or were until recently. The Amazon app store's headline commission rate is 30 per cent, Samsung Galaxy store 30 per cent, and the GOG game store also charges 30 per cent. You have my submission on Microsoft store on Windows on page 406 and, over the page, page 407, looking at the

console app transaction platforms, you have my point about the Xbox, but the Nintendo eShop and the PlayStation Store, also transaction platforms, each of them charge 30 per cent.

If we carry on on the same question of comparability and look at page 408, footnote 134, you have the factual reference that tells you why the Epic store isn't profitable. This is actually a quote from the Epic and Apple judgment in the United States, "By charging a 12 per cent commission Epic's Game Store will not be profitable for at least several years". Upon that basis, Mr Holt also accepts that the Epic Game Store isn't profitable.

If you carry on, please, over the page to paragraph 79 on page 409, you see what Professor Hitt says in response to Mr Holt. Could you read, please, paragraph 79 to paragraph 86. That will be all I aim to show you in Professor Hitt.

(Pause).

Thank you. You can put Professor Hitt away, unless Mr Frazer has a question about it? I hesitate to pre-empt the Tribunal.

I was going to take you now to Mr Holt's second report. I see the time.

THE CHAIRMAN: How much longer do you think you are going to be.

MR KENNELLY: I may be 20 minutes more. I am afraid I will go beyond 4.30. I am happy to start again in the morning. I won't take longer than that so as to not eat into Ms Kreisberger's time.

I am in the Tribunal's hands I am happy to keep going if I haven't put you to sleep.

THE CHAIRMAN: If you are happy to keep going, we will see if you can keep it to 20 minutes or thereabouts.

MR KENNELLY: I thank the transcribers also. Again, if I am speaking too quickly, I hope they will tell me.

We are going on now to Holt 2. Core bundle, tab 9. <C/9/345>. My point about Mr Holt's second report is that he still maintains that it is sufficient to rely for the purposes of showing an abusively unfair price on a profitability exercise and his comparators.

We get that from page <C/351>. Paragraph 2.2.2. He says:

"... [his] principal methodology involved conducting a standard profitability analysis which compares estimated operating profit against capital employed, in order to estimate profitability by reference to a normal rate of return informed by the cost of capital."

He says in principal because, of course, he has his comparators' approach also, but here he is looking at profitability only, there is no suggestion of examining demand side value at all. The value to developers and end users.

He says, carrying on at 2.2.2, he has not taken the cost as the limit of its economic value, he doesn't consider any profit generated higher than the WACC is automatically excessive, but his finding is that "the App Store is excessively profitable…based on the magnitude and persistence of the price cost margin (or the excess return over the WACC). It is on that basis." Nothing about value or innovation. "It is on that basis, and taking account of Apple's unique gatekeeper status, [that's the dependency point] which, in my view, warrants further investigation, including by reference to Apple's own cost data; rather than relying solely on public domain information as I have so far had to do."

So the further analysis of Apple's own costs data, not the value to developers or end users.

Then we go to Paragraph 2.2.6 on page 352. Paragraph 2.2.6 just read the first sentence very, very carefully because it is surprising but informative. He says:

"I agree with Professor Hitt that aspects of the Apple ecosystem such as device features may increase the demand for iOS apps which use those features and vice versa; but he has not explained why that is relevant to the assessment of whether Apple's App Store's profits are excessive."

Pausing there, PCR's case is just that. They can't deny that the Apple ecosystem makes the developers' products more valuable. Developers can charge end users more. There is more value for the developers, more value for the end users because of the features created by Apple. It is hard to imagine a clearer demonstration of economic value from demand side. But Mr Holt suggests that this is irrelevant. Now, you have seen that the authorities show it is actually part of the legal test. Mr Holt goes on to say, "I don't

understand Professor Hitt to be suggesting that Apple's business model requires that it sell devices at a loss then recoups the losses from the App Store revenues". He says that would be implausible. He seems to be saying it might be different if the iPhone was sold at a loss and the App Store made up revenues needed to cover Apple's costs, but that is just another cost plus analysis. He is refusing to engage with the question, what is the value of what the developers and end users are getting from Apple? He says that it is a matter for Professor Hitt to explain why that is even relevant to the assessment of whether the App Store's profits are excessive. He is not accepting it is relevant at all.

Then on profitability, on page 353, we see what he says about R&D. He says, at 2.2.9:

"Professor Hitt states my profitability analysis [does not take into account the] value of the innovations and investments made by Apple in intellectual property... ."

He says, well, it does:

"…my profitability analysis does specifically account [how does it do it] for an allocation of Apple's investment costs such as R&D, as well as other indirect costs in Apple's accounts, based on an estimate of the proportion of the App Store revenue as a share of Apple's overall revenue."

He says:

"I do take account for innovations and investments."

The Tribunal has my point that the R&D costs are not a proxy for the value that developers and end users get from the App Store. They may well be relevant in a cost plus analysis but they cannot, by themselves, tell you anything about the value that developers and end users get. R&D could be well spent, R&D could be spent extensively and the product could flop. Someone could spend very little R&D, but the product could be a huge success. You develop a product that sells one unit, that is good. But a product generated by a clever idea, but perhaps hardly any R&D, could be used a billion times. The huge value that creates is untethered from the R&D costs.

Because you can't tell from the R&D cost how much value is ultimately generated, it cannot stand as a proxy for the very thing the law tells us we have to ascertain.

Then we go on to the cost of the – paragraph 2.2.13. This is the dependency point that was rejected. In my submission, this is the very point that was rejected by the Court of Appeal in *Flynn*. He says:

"Secondly, while intangible value can, in principle, arise when firms are able to earn above normal returns due to factors such as a sustained competitive advantage, in my view, that is not the case here because Apple's high profitability arises out of the App Store's unique position as the only gateway to iOS device users by virtue of Apple's complete exclusion of any competition. It is important, in considering intangibles, to avoid capturing Apple's ability (by raising insurmountable barriers to entry) to charge supra-competitive prices as an intangible asset. Such an approach would clearly be circular and enable any price to be justified no matter how dissociated it is from what would be expected in a competitive market."

If that is his justification for doing what he is saying which is not accepting the relevance of economic value from demand side, if that is the justification, that is wrong in law. We know from the Court of Appeal in *Flynn* that, dismissing the CMA's appeal on this point, even if there is complete dependency, you still have to assess economic value from the demand side. It is not a point of principle that allows you to exclude it.

He goes on at paragraph 2.2.14:

"For this reason, I fundamentally disagree with Professor Hitt's position that 'profitability is not a measure of value for an innovative, differentiated product like the App Store'."

He says that Professor Hitt's view was contrary to the CMA in its interim report and the US court in *Epic v Apple*.

I have covered the CMA interim report. I make a similar point about the US court in *Epic v Apple*. In the time available, I won't go to that now. I will go straight to the really important point, which is 2.2.15, because this was the paragraph that was

cross-referenced in paragraph 59 of the Reply to which Mr Frazer took me this morning. Paragraph 39. Forgive me.

I will ask the Tribunal to take up -- actually, it is in the same volume -- the Reply and remind ourselves what it said. The Kent Reply, paragraph 39 and page 165.

Professor Hitt's various claims about the value of the ecosystem and the various factual and evidential issues will need to be tested at trial and are not suitable for summary resolution -- see Holt 2, paragraph 2.2.15 -- the suggestion being that perhaps here Mr Holt is in some way acknowledging a need to take into account, or even a potential need to take into account, the extent of the value provided to end users and developers.

At paragraph 40, since we're in the Reply, the second sentence:

"To make good the Application, Apple needed to show that Mr Holt's proposed methodology has no realistic prospect of establishing that Apple's prices were excessive ... or unfair within the meaning of that concept..."

So they accept that the question for the Tribunal is whether Mr Holt's methodology has no realistic prospect. That is why it is so important to look at what he is saying.

So we go back to what he says in his paragraph 2.2.15. First of all, he is not acknowledging here that he needs to ascertain economic value from the demand side. He says:

"Professor Hitt's position that the App Store's high levels of profitability which I have identified are nonetheless justified by Apple's 'investment and innovations' raises the following questions which he would need to analyse: (a) what are the precise costs/investments of the innovations and how much should be allocated to the App Store? [That is a costs point again.] (b) [and similarly (g)] to what extent do claimed innovations go beyond what might be expected as a baseline, given broader developments in technological progress? … (g) is there evidence that innovations would not have occurred absent the exclusionary conduct?"

Even if he is right it doesn't mean -- I mean, even if there were exclusionary conduct, even if the innovations are no better than what would be happening anyway, it doesn't mean

that what the developers and end users got had no value. We saw that from BHB, in fact, from the Commission in *Scandlines*. The Commission said there was nothing special about the port of Helsingborg, but, still, the value it was providing had to be ascertained. Apple's case is a million miles from that because of the huge value that Apple provides.

Then (c) how closely are the claimed innovations related to the App Store and were they of benefit? This is potentially what Mr Holt is telling us that Professor Hitt needs to look at. First of all, how closely are the claimed innovations related to the App Store. Well, that is obvious. We know from the CMA's own interim report that the innovations have a relationship to the App Store, it is unarguable to suggest otherwise. Were they of benefit? He is saying something that Professor Hitt would have to ask. He is not suggesting it is something that he needs to even address in order to win an excessive pricing case. Most importantly, I suppose, to make that point good, he offers no methodology to ascertain the extent of the benefit that end users and developers get from the App Store. If this is the hook that the PCR seeks to use to say that economic value from the prospective of developers and end users is incorporated in his methodology that, in my submission, is hopeless. It just doesn't come close to satisfying that requirement.

Then at (f) does the approach risk capitalising Apple's market power arising from the fact the App Store operates as a unique gateway for app developers to distribute their apps? That, again, is the dependency point and we say again, for the purpose of a strike out, if there is dependency, you have to factor that in, you can take account of it, but, as a matter of principle, it doesn't mean you exclude the exercise of asking what is the economic value to end users and developers.

The fundamental flaw in this methodology can be seen by applying it to the approach of the Court of Appeal in the *Attherraces* case. How would Mr Holt deal with the BHB's database? That database cost £5 million to produce, and wasn't protected by any IP. It had to be produced by the BHB in any event under its statutory functions, but despite

all of that, the Court of Appeal permitted them to charge one customer £1 million per annum for access to the database. We saw from the factual analysis that the BHB had been earning high and increasing returns for several years after it had begun selling access. It did it because it looked at the question of the value that the users were getting from the database.

The PCR here, and Mr Holt, can't explain that outcome in *Attherace*s in a way that can be reconciled with their case against Apple.

Then Mr Holt moves on to comparators. He accepts in fairness to him that this is weak stuff, page 365, paragraph 2.3.23. I am skipping over his response to Professor Hitt but I rely on this at 2.3.23:

"In any event, the clear implication of Professor Hitt's observations is that it is very difficult to compare the prices and the value of services provided by different platforms where there are important differences such as those highlighted by Professor Hitt, including differences of charging structures. I agree. That is why I place less weight on the comparator evidence for the assessment of excessive and unfair pricing."

It is a makeweight. He is placing far more weight on his point, which we say is wrong in law, that profitability alone is sufficient to tell you if Apple's commission is unlawfully unfair.

That is my submission on Mr Holt.

MR FRAZER: You skipped over the paragraph beginning 2.2.16 where Mr Holt does come to economic value. I don't know if there is anything you want to submit in relation to that?

MR KENNELLY: 2.2.16, Professor Hitt describes his approach as flawed because it doesn't encounter the value. At 2.2.17, Mr Holt says "I disagree". He says:

"My approach does consider value of the App Store to ... developers and ... users and does this by considering what they would pay in an effectively competitive market."

But his effectively competitive market, Sir, is the market where competition drives -- you would expect competition to drive the price down to a level where the ROCE was not significantly above the WACC, that the competitive price, the competitive level is sufficient to show, once you have that, that a price significantly above it is unfair and

abusive under Article 102. That was the very approach that Mr Justice Etherton upheld in *Attheraces* and that was overturned by the Court of Appeal. That is why this approach is wrong in law. If this is how he thinks value is being ascertained, well, that doesn't do the job.

If you recall, Sir, in *Attheraces* Mr Justice Etherton also held that value was being ascertained by way of constructing competitive price and finding that that was the costs plus a reasonable return and that approach was overturned.

MR FRAZER: Is this not him simply saying he is putting economic value into limb 1?

MR KENNELLY: He is certainly doing that. He is dealing with it in limb 1, yes. But he is -- he is putting it in limb 1 but the key point, though, is, how is he considering value? We see that in 2.2.17 which is profitability and profitability only. That is consistent with what he has been saying throughout his two reports.

THE CHAIRMAN: When you talk about profitability, if you have gone through the exercise of working out comparing the ROCE with the WACC and you have ended up with a big gap so you have prima facie got excessive pricing, put aside Mr Holt for a minute and the way he approaches it, if you are then going to factor in the demand side and you have got some way of measuring that, maybe not quantifying it, but at least measuring it, as we are told to do by Lord Justice Green in *Flynn*, is there any reason why you shouldn't do that by reference to the gap that you have identified in that exercise? In other words, I am just wondering whether -- when you criticise the PCR's reliance on profitability, I am wondering whether you mean that that is not something which can be employed and taken into account, the demand side, whether, actually, it is a perfectly reasonable place to start? If you are going to go and do that, you would look at that gap and then you might say, actually, absent the demand side factors, it is a very large gap and would suggest excessive and perhaps unfair pricing, once you take those factors into account, even if you can't completely quantify them, it looks like a much more reasonable price, and so, therefore, I am not concerned about them.

MR KENNELLY: I respectfully agree, because that is what the Court of Appeal meant when they said cost plus analysis is a very important first step. One can use that to see whether they get off that first stage. It is a necessary, but not sufficient condition in the analysis. As you say, when you do the cost plus analysis that tells you when you compare it, the ROCE to WACC, it might tell you the range that you are looking at to examine by way of economic value, so it is a starting point, a legitimate starting point, but it cannot be a shortcut to the very complex question which has to be answered, which is, what is the extent of the economic value to developers and end users? The profitability analysis tells you nothing about that. It might tell you the extent of the job that the claimant has to do, but it doesn't help you with what the value ultimately is.

THE CHAIRMAN: Yes, but you could still -- am I right in thinking you would agree with me you could still use the outcome of that profitability analysis as your reference point for taking into account the benefits that you quantified? I appreciate it might not be precise, but if you have a return -- if your comparison of return on capital and WACC is 300 per cent and you looked at the demand side benefits and thought they were very, very substantial, you might then say, well, 300 per cent is actually not such a big number taking account of -- you don't just ignore it at that stage, do you, you use it as a benchmark to then apply the other factors. Is that a reasonable way to look at it?

MR KENNELLY: Indeed. Forgive me if I misunderstand. What I think you are saying is that, by doing that, what I call the first step, one sees the gap between the price and the costs and then one asks, okay, well, let's look at the economic value and see whether the economic value explains that gap -- well, not explains it, but helps to identify whether the prohibition in Article 102 and section 18 is breached. It doesn't explain the gap, that is the important point, because that gap, that profitability analysis, still doesn't tell you anything about the value that, for example, intangibles produce. Apple's profits don't tell you, and will never tell you, the value that millions of users are getting from the App Store. Even very high profits don't tell you that. We have that from the case law. So if the Tribunal is saying to me to do the profitability analysis as

the first step, as a starting point which then might assist the resolution of the legal question once the economic value work is done, I think I would agree. But it doesn't help you do the economic value analysis. That is a separate discrete task which can't be short circuited.

THE CHAIRMAN: Yes I think that was the point I was putting to you. Once you have done step one, the identification of the gap -- and, as you say, price is effectively a way of working out the difference between the price and the cost -- then you are coming back and asking yourself the question as to whether there are other reasons which might justify that gap to draw you away from the conclusion that there was no reasonable relationship between economic value and price.

MR KENNELLY: As part of the Tribunal's ultimate task.

THE CHAIRMAN: As part of the ultimate task, yes.

MR KENNELLY: Very finally, then, if I may, I am just going to take you very quickly to the skeleton argument of the PCR where various points are made about our arguments and I can skip through this really in five minutes. I promise I will be finished by quarter to 5, and I thank the shorthand writers for their patience.

This is, as I said, the skeleton of the PCR, volume 1, tab 1, page 20.

This is the PCR saying that our application should be dismissed and various reasons why our construction of the test is wrong as a matter of law and economic principle. So I will just go to the headings. Page 20, heading (i), they say there is no prohibition on cost-based methodologies for intangibles, and you have my point that cost-based methodologies may be used provided economic value was ascertained within them somewhere, including from the demand side. You have my point about that.

The second heading is on page 22, heading (b), they say that we are arguing for a separate evaluation of economic value. Again, we are not saying it is a separate part of the legal test, but we are saying that it has to be done just as Lord Justice Green said it had to be done in *Flynn*.

Then heading (c) putting counterparties out of business is not part of the test for an excessive price. That is the point that you have seen in *Attheraces*, the throttling point that Lord Justice Mummery noted when he said that this may be intuitively unfair and the user of the good supplied by the undertaking may come close to being throttled. That doesn't mean the price is unlawfully unfair. We are not saying that throttling is part of the legal test. That example was given by Lord Justice Mummery as an explanation of how the test, using it, coming from the demand side, might go. The purchaser might end up paying far more than he would like to pay and far more than the seller spent on making the thing, but it doesn't mean the price is abusively unlawful. That is not the role of Article 102 to prevent such an outcome.

Ultimately, here, I make my final remarks, and you can put the skeleton away. Even at this certification stage, the law requires the claimant to show some methodology, some approach, some acknowledgement, even, to quote Professor Bishop, although an acknowledgement providing a structure as to how they would do the job, which can show that, at trial, the PCR will ascertain the economic value of the App Store from the perspective of developers and end users. This has to be done in order to establish if, in fact, Apple's commission bears no reasonable relation to that economic value. The PCR's case and Mr Holt's very frank evidence is based exclusively on Apple's profitability with some weak comparators in support. The case, the PCR's case, is that it does not need to ascertain the economic value of the App Store to developers and users at all. It does not accept -- Mr Holt doesn't accept it is relevant to do that. An analysis of Apple's costs will suffice. That, in our submission, is hopeless and it's why that part of the case should be struck out now.

Unless I can assist you further, those are my submissions.

THE CHAIRMAN: Thank you very much, Mr Kennelly. We will start at 10.30 am tomorrow morning.

(4.45 pm)

(The hearing adjourned until 10.30 am the following day)