IN THE COMPETITION COMMISSION

APPEAL TRIBUNAL

Case No. 1001/1/1/01

New Court
Carey Street
London WC2A 2JT

26 March 2002

Before:

SIR CHRISTOPHER BELLAMY
(President)
MR BARRY COLGATE
PROFESSOR PETER GRINYER

BETWEEN:

NAPP PHARMACEUTICAL HOLDINGS LIMITED AND SUBSIDIARIES

Applicant

and

DIRECTOR GENERAL OF FAIR TRADING

Respondent

Christopher Carr QC and Messrs Herbert Smith represented the Applicant

Mr Peter Roth QC and Mr Jon Turner (instructed by The Director of Legal Services, Office of Fair Trading) represented the Respondent

REASONS FOR REFUSING PERMISSION TO APPEAL

1. For the reasons given below, the request for permission to appeal from the Tribunal's judgment of 15 January 2002 made on 18 February 2002 by Napp Pharmaceutical Holdings Limited and its subsidiaries ("Napp"), is refused.

GENERAL

Background to the Tribunal's judgment of 15 January 2002

2. The Competition Act 1998 ("the Act") came into force on 1 March 2000. By a decision of 30 March 2001 ("the Decision") the Director General of Fair Trading ("the Director") found that Napp had abused a dominant position in the supply of sustained release morphine tablets and capsules in the United Kingdom, contrary to the Chapter II prohibition imposed by section 18(1) of the Act. The Director further imposed a penalty on Napp of £3.21 million under section 36 of the Act. Under section 36(3), the Director must be satisfied that the infringement has been committed "intentionally or negligently" by the undertaking concerned.

3. By a subsequent letter dated 4 May 2001 the Director made directions under section 33 of the Act ("the Directions"). The broad effect of the Directions was to require Napp (a) to reduce its NHS list price for its sustained release morphine tablets, known as "MST", by 15 per cent; (b) and not to sell MST to hospitals at a price less than 85 per cent of the (reduced) NHS price.

4. Sustained release morphine extends the duration of action of a morphine preparation and is used to treat moderate and severe pain, particularly in cancer patients. There are two segments of the market for sustained release morphine, the hospital segment, in which Napp supplies MST to hospitals under contracts at negotiated prices, and the community segment. In the community segment GPs prescribe MST for patients being treated in the community. Those prescriptions are dispensed by pharmacists, and Napp is paid at its NHS list price, less wholesaler's discount. The community segment accounts for some 86 to 90 per cent of the total market, whereas the hospital segment accounts for some 10 to 14 per cent of the total.

5. The hospital segment is, however, of key strategic importance for any new competitor seeking to enter the market for sustained release morphine. In effect, because of various

barriers to entry, it is only by first becoming established in the hospital segment that a new competitor can realistically aspire to penetrate the much larger and more profitable community segment of the market.

6. In the relevant period, which is from 1 March 2000 to 31 March 2001, Napp's overall market share was around 95 per cent in total, 96 per cent in the community segment of the market, and 92 per cent in the hospital segment of the market. It is no longer disputed that Napp has a dominant position in the market for sustained release morphine in the United Kingdom.

7. The Director, in the Decision, identified two closely related abuses by Napp of its dominant position. First, the Director found that Napp was engaging in what is known as predatory pricing in the hospital segment, namely selling its MST tablets to hospitals below, often well below, its direct costs (i.e. the cost of raw materials and direct labour), with the intention of preventing or hindering new competitors from establishing themselves in the hospital segment of the market ("the hospital pricing abuse"). Secondly, the Director found that Napp was charging excessively high prices for MST in the community segment of the market ("the community pricing abuse"). According to the Director, these two abuses were linked, in that it was Napp's exclusionary conduct in the hospital segment which was contributing to its ability to maintain excessive prices in the community segment. In effect, said the Director, by using excessively *low* prices in the hospital segment to block the only viable means of competitive entry, Napp was able to shield its excessively *high* prices in the community segment from competition, thus preserving its de facto monopoly in the market as a whole.

8. Pursuant to sections 46(2) and 48(1) of the Act Napp appealed against the Decision to this Tribunal by a notice of appeal dated 29 May 2001, accompanied by voluminous documentation and witness statements, in accordance with Rule 6 of the Competition Commission Appeal Tribunal Rules 2000 SI 2000 no. 261 ("the Tribunal Rules"). By an order made on 22 May 2001 in anticipation of the appeal, the President suspended the operation of the Directions until the determination of Napp's appeal by the Tribunal: [2001] CompAR 1.

9. By virtue of Schedule 8, paragraph 3 of the Act, an appeal to the Tribunal is a full, substantive appeal. Paragraph 3(1) of Schedule 8 provides:

> "The tribunal must determine the appeal on the merits by reference to the grounds of appeal set out in the notice of appeal."

Pursuant to paragraph 3(2) of Schedule 8:

> "The tribunal may confirm or set aside the decision which is the subject of the appeal, or any part of it, and may–
>
> (a) remit the matter to the Director,
>
> (b) impose or revoke, or vary the amount of, a penalty,
>
> (c) grant or cancel an individual exemption or vary any conditions or obligations imposed in relation to the exemption by the Director,
>
> (d) give such directions, or take such other steps, as the Director could himself have given or taken, or
>
> (e) make any other decision which the Director could himself have made."

10. By virtue of section 60 of the Act, the Tribunal, like the Director, is obliged to apply the Act as consistently as possible with Community law. The Chapter II prohibition is of course substantially modelled on Article 82 (ex Article 86) of the EC Treaty.

11. By a judgment dated 15 January 2002 this Tribunal unanimously confirmed, in its result and on the merits, the Decision, with one minor exception not presently material. As regards the hospital pricing abuse, the law is set out in paragraphs 207 to 216 of that judgment, and the Tribunal's findings are at paragraphs 217 to 352. As regards the community pricing abuse, the law is set out at paragraphs 386 to 388, and the Tribunal's findings, so far as now material, are at paragraphs 390 to 427.

12. The Tribunal further found that the hospital pricing abuse was committed intentionally (paragraphs 459 to 464 of the judgment) and that the community pricing abuse was committed, at the least, negligently (paragraphs 465 to 471), thus entitling the Director to impose a penalty under section 36(3) of the Act. As regards the penalty of £3.21 million, the Tribunal disregarded one aggravating factor relied on by the Director (paragraph 516). In addition, at paragraph 533, the Tribunal held there were mitigating factors in respect of the community abuse.

13. As regards the assessment of the penalty, at paragraph 537 the Tribunal held:

> "We begin by taking the case as a whole. This is a serious case of predatory and selective pricing, lasting for thirteen months up to the date of the Decision, committed by a "superdominant" undertaking in one segment of the market (the hospital segment) and tending to protect high prices and margins in another segment of the market where that undertaking is also a virtual monopolist (the community segment). In addition, Napp's prices in the community segment have been maintained well above the competitive level. If the objectives of the Act are to be achieved such conduct calls, in our judgment, for severe penalties. In those circumstances, absent any significant mitigating factors, we do not think that a penalty of £3 million, as a global figure, is outside the range of penalties that could reasonably be imposed, in a case such as the present, having regard to the permitted maximum of £5.56 million."

(The maximum penalty is calculated in accordance with the Competition Act 1998 (Determinations of Turnover for Penalties) Order 2000 SI 2000 no. 309, see paragraphs 480 and 486 of the Tribunal's judgment.)

14. However, in view primarily of the mitigating factors identified at paragraph 533, the Tribunal reduced the penalty imposed on Napp from £3.21 million to £2.2 million (paragraphs 538 to 541). Pursuant to a subsequent judgment of the Tribunal of 6 February 2002, the reduced penalty bears interest from 30 June 2001 at 1 per cent above Base Rate. In the same judgment, the Tribunal decided that both parties should bear their own costs of the appeal.

15. At paragraphs 544 to 562 of the judgment, the Tribunal upheld the directions imposed under the Directions of 4 May 2001.

The provisions regarding appeals from the Tribunal

16. Section 49 of the Act deals with appeals from the Tribunal:

> "49. - (1) An appeal lies-
> (a) on a point of law arising from a decision of an appeal tribunal, or
> (b) from any decision of an appeal tribunal as to the amount of a penalty.
>
> (2) An appeal under this section may be made only-
> (a) to the appropriate court;
> (b) with leave; and
> (c) at the instance of a party or at the instance of a person who has a sufficient interest in the matter.
>
> (3) Rules under section 48 may make provision for regulating or prescribing any matters incidental to or consequential upon an appeal under this section.
>
> (4) In subsection (2)-
> "the appropriate court" means-

(a) in relation to proceedings before a tribunal in England and Wales, the Court of Appeal;

..."

17. Since this case relates to proceedings before a tribunal in England and Wales, the appropriate court is the Court of Appeal.

18. Pursuant to CPR Rule 52.3(6):

> "(6) Permission to appeal will only be given where –
>
> (a) the court considers that the appeal would have a real prospect of success; or
>
> (b) there is some other compelling reason why the appeal should be heard."

19. Although the appeal for which Napp seeks permission is not a second appeal within the meaning of CPR Rule 52.13, it is or would be Napp's second appeal from the Decision. The Decision itself was reached after a lengthy administrative procedure including two hearings before the Director (paragraphs 23 to 26 of the judgment). That has now been followed by the appeal proceedings on the merits before the Tribunal, which is a statutory tribunal set up to hear appeals under the Act. The detailed course of the proceedings is set out at paragraphs 72 to 90 of the Tribunal's judgment.

20. In this case, Napp's request for permission to appeal, accompanied by a draft skeleton argument of some 56 pages, were lodged with the Registry of the Tribunal on 18 February 2002, under Rule 29(1)(b) and (2) of the Tribunal Rules, which provide for applications for permission to appeal to be dealt with by a written procedure.

21. On the same date, by consent, the Tribunal made an Order suspending the first limb of the Directions, which required Napp to reduce its NHS list price for MST by 15 per cent, pending the determination by the Tribunal of Napp's request for permission to appeal. We understand that Napp has now complied with the second limb of the Directions, which required Napp not to sell MST to hospitals at prices below certain minimum levels.

22. Although Rule 29 of the Tribunal Rules does not further specify the procedure to be followed when a request for permission to appeal is made in writing under Rule 29(1)(b) and (2), the Tribunal invited the Director to submit observations on Napp's request, which

observations were lodged on 26 February 2002. On 28 February 2002 the Tribunal indicated that it did not propose to hold a hearing under Rule 30(2) of the Tribunal Rules, but gave Napp a short period in which to lodge any further observations. A further nine-page submission was received from Napp on 4 March 2002. By letter of 1 March 2002 the Director invited the Tribunal to order Napp to pay his costs of this application if it rejects Napp's request for permission to appeal.

23. By virtue of CPR 52PD, paragraph 21.10(2), if (a) we give permission to appeal, or (b) we refuse permission to appeal and Napp wishes to make an application to the Court of Appeal for permission, then Napp has 14 days, from the date of receipt of our decision, to file an appellant's notice at the Court of Appeal.

24. Rule 30(3) of the Tribunal Rules provides that the decision of the Tribunal on a written request for permission to appeal, together with the reasons for that decision, shall be recorded in writing and notified to the parties by the Registrar. These reasons are recorded pursuant to that Rule.

Appeal on a point of law

25. In determining this request for permission to appeal, we have addressed, at least provisionally, what is meant by "a point of law arising from a decision of an appeal tribunal" under section 49(1)(a) of the Act. This point is not addressed in Napp's application or skeleton argument, albeit it is briefly mentioned in Napp's further observations.

26. It is trite to say that a point of law is to be distinguished from a point of fact. As is well known, it may be difficult to say, in any given case, where the border lies between the two. In the present case, the issue is whether Napp has committed an "abuse" within the meaning of the Chapter II prohibition. At one end of the spectrum, the Court of Justice and the Court of First Instance have laid down certain legal principles which apply when determining whether the Chapter II prohibition has been infringed. Whether we had, for example, ignored a relevant decision of the Court of Justice, would, we would have thought, be a point of law. At the other end of the spectrum, there will plainly be points of primary fact. For example, whether in this case Napp's prices to hospitals were or were not below the cost of raw materials is a point of fact. However, between these opposite

ends of the spectrum there will, so it seems to us, often be questions arising under the Act which are essentially questions of appreciation or economic assessment of a more or less complex kind, depending on the circumstances, in which the Tribunal will be called upon to assess a range of factors, bringing to bear such expertise as it has, in order to determine such matters as the boundaries of the "relevant market", the existence of "barriers to entry", whether "dominance" is established, whether a response by the dominant undertaking is "proportionate" and so on.

27. In the present application, for example, a substantial part of Napp's argument on the hospital pricing abuse is that its pricing policy constituted "normal competition" (grounds 1 (i), (ii), (iii) and (vi) of the request), this being, apparently, a reference to a dictum by the Court of Justice in Case 85/76 *Hoffman La Roche v Commission* [1979] ECR 461, paragraph 91, which refers to a dominant undertaking committing an abuse "through recourse to methods different from those which condition normal competition" (see paragraph 207 of the Tribunal's judgment). The issues surrounding this argument, from the many different angles it has been presented, are dealt with at paragraphs 231 to 352 of the Tribunal's judgment, Napp's contentions being rejected on every point. Whether, on the facts of this case what Napp did can be defended on the ground that it constituted "normal competition" does not seem to us to be a "point of law" as such, but rather a question of appreciation of the various interrelated facts and considerations discussed in paragraphs 231 to 352 of the judgment.

28. In the well known case of *Edwards v Bairstow* [1956] AC 14, Lord Radcliffe said at p. 36:

> "When the case comes before the court it is its duty to examine the determination having regard to its knowledge of the relevant law. If the case contains anything *ex facie* which is bad law and which bears upon the determination, it is, obviously, erroneous in point of law. But, without any misconception appearing *ex facie*, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances too, the court must intervene. It has no option but to assume that there has been some misconception of the law and that this has been responsible for the determination."

29. Following *Edwards v Bairstow* in *Pioneer Shipping Ltd v BTP Tioxide ("the Nema")* [1982] AC 724, Lord Roskill said at pp 752-53:

> "My Lords, when it is shown on the face of a reasoned award that the appointed tribunal has applied the right legal test, the court should in my view only interfere if on the facts found as applied to that right legal test, no reasonable person could have reached that conclusion. It ought not to interfere merely because the court thinks that upon those facts and applying that test, it would not or might not itself have reached the same conclusion, for to do that would be for the court to usurp what is the sole function of the tribunal of fact."

30. In *South Yorkshire Transport v Monopolies and Mergers Commission* [1993] 1 All ER 291, the issue was whether South Yorkshire could be "a substantial part of the United Kingdom" for the purposes of section 64(3) of the Fair Trading Act 1973. Giving the judgment of the House of Lords, Lord Mustill dealt with the role of the court where a statutory criterion "is so imprecise that different decision-makers, each acting rationally, might reach differing conclusions when applying it to the facts of a given case." (p. 298 d). He continued (at p. 298 d-f):

> "In such a case the court is entitled to substitute its own opinion for that of the person to whom the decision has been entrusted only if the decision is so aberrant that it cannot be classed as rational: *Edwards (Inspector of Taxes) v Bairstow* [1955] 3 All ER 48, [1956] AC 14. The present is such a case. Even after eliminating inappropriate senses of 'substantial' one is still left with a meaning broad enough to call for the exercise of judgment rather than an exact quantitative measurement. Approaching the matter in this light I am quite satisfied that there is no ground for interference by the court, since the conclusion at which the commission arrived was well within the permissible field of judgment. Indeed I would go further, and say that in my opinion it was right."

31. Applying that test, which is again based on *Edwards v Bairstow*, we would have respectfully thought that an issue such as what is "normal competition" in the particular factual circumstances of this case would be, in Lord Mustill's phrase, "to be an issue broad enough to call for the exercise of judgment rather than an exact quantitative measurement." If that is correct, the point of law under section 49(1)(a) of the Act would be whether the Tribunal's approach to the issue of "normal competition" was "within the permissible field of judgment".

32. Napp has drawn our attention to decisions of the Court of Appeal on the meaning of a "question of law" in the context of appeals from an employment tribunal to the Employment Appeal Tribunal. Those decisions seem to us to adopt a similar approach.

We note that in *O'Kelly v Trusthouse Forte plc* [1984] QB 90, Lord Donaldson MR said, at p. 122H – 123C, again applying *Edwards v Bairstow*:

> "Whilst it may be convenient for some purposes to refer to questions of "pure" law as contrasted with "mixed questions of fact and law, the fact is that the appeal tribunal has no jurisdiction to consider any question of mixed fact and law until it has purified or distilled the mixture and extracted a question of pure law. ... Unpalatable though it may be on occasion, it must loyally accept the conclusions of fact with which it is presented and, accepting those conclusions, it must be satisfied that there must have been a misdirection on a question of law before it can intervene. Unless the direction on law has been expressed it can only be so satisfied if, in its opinion, no reasonable tribunal, properly directing itself on the relevant questions of law, could have reached the conclusion under appeal. This is a heavy burden on an appellant. I would have thought that all this was trite law, but if it is not, it is set out with the greatest possible clarity in *Edwards v Bairstow* [1956] AC 14."

33. Thus a question of law will arise if the Tribunal's decision is perverse, in the sense that it is a conclusion to which no reasonable tribunal could have come: see *Neale v Hereford & Worcester County Council* [1986] ICR 471, at p. 483 per Lord Justice May. Similarly such a question will arise if there is no evidence to support a relevant finding of fact: see *British Telecommunications PLC v Sheridan* [1990] IRLR 27, at paragraph 35.

34. Finally we note that in *Nipa Begum v Tower Hamlets London Borough Council* [2000] 1 WLR 306, the Court of Appeal (Stuart-Smith, Auld and Sedley LJJ) held that an appeal "on any point of law" under section 204(1) of the Housing Act 1996 extended to a consideration of issues which could be raised in proceedings for judicial review, such as procedural error, vires, irrationality or inadequacy of reasons: (see notably Auld LJ at pp 312 H – 313 F).

35. These cases, notably *Bairstow v Edwards* read with *South Yorkshire Transport*, cited above, seem to point to the conclusion that there is a "point of law" under section 49(1)(a) where the issue is whether (i) there is a misdirection on a point of law; (ii) there is no evidence to support a relevant finding of fact; or (iii) the tribunal's appreciation of the facts and issues before it is one that no reasonable tribunal could reach, that is to say the appreciation in question is outside "the permissible field of judgment". In the light of *Nipa Begum*, it may well be that the principles to be applied are not signficantly different from those applicable in judicial review proceedings. We bear these cases in mind in deciding

whether Napp's arguments do involve "a point of law" under section 49(1)(a), and if so whether any such point of law has a real prospect of success.

The amount of a penalty

36. Section 49(1)(b) provides, in the alternative, that an appeal lies "from any decisions of an appeal tribunal as to the amount of a penalty". This provision evidently enables an appellant to appeal to the Court of Appeal simply on the grounds that the penalty is excessive, without otherwise impugning the decision appealed against. Nonetheless, permission is still required. The matters raised in connection with a point of law raised under section 49(1)(a) may also be relevant to the question of the amount of the penalty under section 49(1)(b). But if there is no separate point to be made, it seems to us permission to appeal the amount of a penalty, standing alone, could properly be refused, by analogy with the practice of the Court of Appeal (Criminal Division), if there were no grounds for supposing that the penalty was manifestly excessive or wrong in principle.

Difficulties in dealing with Napp's request

37. We have encountered difficulties in dealing with Napp's request for permission to appeal, at least in any acceptable length, because of the way that request has been presented. It does not seem to us that paragraphs 5.10 to 5.11 (content of skeleton arguments) in the Practice Direction on Appeals (CPR 52 PD-017) have been followed in this case.

38. First, we have found it difficult to link the grounds of appeal with Napp's skeleton argument, or to link either of those documents with the passages in the judgment which Napp seeks to impugn, or indeed to identify those passages. The grounds of appeal, although asserting that the Tribunal "concluded" (i.e. reached conclusions) on various matters (ground 1 (i), (ii), (iii) and (iv)) does not give any cross references to, or cite, the passages in the judgment where such conclusions were said to be reached, and we for our part do not accept the terms in which Napp characterises the conclusions which we reached in our judgment. Nor do any other grounds of appeal (ground 1 (v) and (vi) and ground 2 (i), (ii) and (iii)) refer to any specific passages in the judgment which Napp seeks to attack. Nor is any reference made, in the grounds of appeal, to where exactly Napp advanced a particular argument with which, it is alleged, the Tribunal has failed to deal. Although there are brief references to certain passages in the Tribunal's judgment in the skeleton argument, notably at pages 27 to 30, and again at pages 31 and 32, we have in general had

considerable difficulty "in distilling the mixture and extracting a question of pure law", to use Lord Donaldson's phrase in *O'Kelly v Trusthouse Forte*, cited above. Where cases are cited by Napp, there is no reference to the specific passages relied on: see *Practice Direction (Citation of Authorities)* [2001] 1WLR 1001.

39. Secondly, in our view the presentation of the facts of this case alleged in the skeleton argument is profoundly unsatisfactory. Napp does not, as we would have thought appropriate, refer in the body of the skeleton argument to the facts as found by the Tribunal, with cross references to the judgment, but chooses to present its own version of the facts, almost as if there had been no judgment of the Tribunal at all. Unfortunately, in a case such as the present, it is all too easy to make broad assertions which are, in fact, misleading because of the lack of precision in language, or lack of attention to detail.

40. Thus, for example, the "Summary of Key Facts" at Part II of Napp's skeleton argument refers to the Pharmaceutical Price Regulation Scheme ("PPRS") and then goes on in several places to refer to "the PPRS price" (paragraphs 8, 15 and 20). The expression "the PPRS price" has not previously been used in argument in these proceedings, and as far as we are aware there is no such thing. Despite what is said in paragraph 8, the informed reader could assume from the skeleton argument that the prices of individual pharmaceutical products were in some way fixed by the PPRS. Indeed, paragraph 32 of the skeleton argument contains an express statement to that effect. That is misleading. In fact, as set out at paragraphs 161 to 164 of the Tribunal's judgment, which are based on the uncontested evidence from the Department of Health filed on behalf of the Director, the whole thrust of the PPRS is that, with some exceptions, it imposes an "across the board limit" on the overall rate of return capital which a company may earn on its sales of branded prescription medicines to the NHS, rather than controlling the prices of individual products. At paragraph 164 of the judgment we held that "the PPRS does not have a direct effect on Napp's freedom to conduct itself as it wishes in the market for oral sustained release morphine" and that the effects of the PPRS "are at most remote and indirect": see also the discussion at paragraphs 406 to 426 of the judgment.

41. As regards paragraphs 9 to 21 of the skeleton argument, we do not accept as complete either Napp's description of the respective approaches of GPs and hospital purchasers of MST, nor Napp's account of the conditions of competition in this market. It is difficult in

our view properly to set the scene in this case without reference to the undisputed findings in the judgment on market shares (paragraphs 28 and 218); the history of Napp's hospital discounts and the relationship between Napp's hospital prices and its costs (paragraphs 35 to 39 and 220 to 225); and the level of prices charged by Napp in the community segment (paragraphs 59 to 67, and 393).

42. As regards, in particular, the hospital pricing abuse, the Tribunal's appreciation of the relevant market circumstances is fully set out in the judgment at paragraphs 267 to 339, including the effect of Napp's pricing policy on competition (paragraphs 267 to 288), Napp's advantages over its competitors (paragraphs 289 to 300), the market since 1 March 2000 (paragraphs 301 to 306) and Napp's intention to eliminate competition (paragraphs 307 to 333). It is that factual matrix, taken as a whole, together with the conceptual and other matters discussed at paragraphs 231 to 266, which led the Tribunal to reject Napp's so-called "net revenue defence" (paragraphs 334 to 339) and its other arguments (paragraphs 340 to 349), and to conclude that Napp had abused its dominant position (paragraph 352). Relatively few of the Tribunal's specific findings are dealt with, or even referred to, in the request for permission to appeal or in the supporting skeleton argument.

43. The matters referred to in Part III of the skeleton argument are described as "acknowledged" in the Tribunal's judgment but no references are given. A significant number of the matters there referred to, under the headings R&D, brand reputation, "externalities", "first mover advantages" or "potential for inefficiency", consist of assertions, which are not based on specific findings we have made, and which we would not necessarily accept, certainly in the terms presented.

44. In particular the statements at paragraph 29 of the skeleton argument as to the extent to which firms engaged in supplying sustained release morphine to hospitals are likely to take into account "the benefits of the externalities" and how far that would be "normal and rational behaviour" do not accord with our factual findings as to what Napp's real intentions were (paragraphs 327 to 334 of the judgment) or the availability of the alleged "externality" to Napp's competitors (paragraphs 289 to 300). We have already mentioned the misleading statement as to fixing of prices for individual products under the PPRS in paragraph 32. As to Appendix I to the skeleton argument, that document, though no doubt intended to be helpful, did not figure in the proceedings before us. Although parts are

innocuous, much of Appendix I does not appear to us to be relevant to the issues in this case. A number of contentious statements made, such as the object of competition law, (A1.1, A1.22), whether a perfectly competitive market is always desirable (A1.15), the "rough and ready" nature of the patent system (A1.17), what "economists consider" (A1.18), what "competition law accepts" (A1.20) and whether there is a "trade off" between static and dynamic competition (A1.21), are not statements we would necessarily accept. We have not heard any argument, let alone adjudicated, on these matters.

45. More seriously, much of the skeleton argument, particularly as regards the hospital abuse, seems to us to be based on assertions about the facts, rather than on the facts as found in the Tribunal's judgment. For example, the assertions in the skeleton argument as what Napp took into account in setting its hospital prices (paragraph 63(iv)), what Napp and other firms could "reasonably expect" or find profitable to do (paragraphs 63(v), 66), what Napp foresaw (paragraph 65), on what basis Napp took a decision (paragraph 68) and on what that decision was predicated (paragraph 69) do not seem to us to relate to any specific findings by the Tribunal. Assertions such as that in paragraph 68 of the skeleton argument to the effect that the Tribunal made a finding about Napp's ability to raise its prices are simply incorrect.

46. We have had difficulty in discerning whether Napp is, in fact, alleging that our conclusions on the facts are reached on the basis of no evidence, or are factual findings which no reasonable tribunal could have made. No such allegation appears to be made in the grounds on which Napp applies for permission to appeal. In the skeleton argument, the submission as regards the hospital pricing abuse is predicated on the matters set out in paragraph 63, which seem to us to be largely assertions, are followed by further factual assertions, notably at paragraphs 65 to 69, unsupported by the facts as we found them.

47. Rather than deal with the Tribunal's findings of fact in the grounds of appeal or the body of the skeleton argument, paragraph 64 of the latter refers to "Appendix 2". Similarly, paragraph 91 of the skeleton argument contends that "the Tribunal's inferences from its findings of fact are without foundation. See Appendix 2." We do not find it satisfactory that, in a request for permission to appeal on a point of law, the Tribunal (and presumably, the Court of Appeal) should be expected to hunt through discursive material in an appendix to the skeleton argument in order to discover whether or how far the Tribunal's findings of

fact are impugned in the appeal. In our view, any such allegation should be specifically pleaded in the grounds of appeal.

48. As regards to Appendix 2 itself, we do not think that paragraphs A2.3 to A2.7 accurately represent our findings or the Director's position (see paragraphs 70 et seq below). As regards the other matters referred to in Appendix 2, various allegations are simply inaccurate: for example the Tribunal dealt with why Napp's competitors found difficulty in competing at paragraphs 289 to 300 of the judgment, contrary to the assertion at paragraph A2.25 of the skeleton argument. In any event, we have not identified a point of law arising from Appendix 2, even assuming that it is open to Napp, on the basis of its grounds of appeal, to raise the factual matters referred to in Appendix 2, which we very much doubt.

49. We remind ourselves in parenthesis at this point that we had occasion, in our judgment, to find, at paragraphs 329 to 332, that the evidence given to us by Napp's witnesses as regards the reasons why Napp pursued its hospital pricing policy was materially misleading. Moreover, in response to the Tribunal's specific request, Napp was unable to produce any document at Board or senior management level which discussed or referred to the objectives, strategies or policy considerations taken into account by Napp in setting its hospital prices in the whole four years preceding the Decision (paragraph 252 of the judgment).

50. In all those circumstances, for the purposes of deciding this application for permission to appeal, we have disregarded all assertions contained in the skeleton argument about the alleged facts of this case, including notably all assertions as to what Napp or its competitors foresaw, took into account, considered or decided, unless such assertions are supported by specific findings of fact made in the Tribunal's judgment.

51. We deal below only with the main points made by Napp. The fact that a point is not dealt with specifically does not mean that we accept it.

THE HOSPITAL PRICING ABUSE

The Tribunal's findings

52. The essence of the hospital pricing abuse, as found by the Tribunal in its judgment, is as follows.

53. Napp is a virtual monopolist in the supply of oral sustained release morphine, having an overall market share of 95 per cent, 96 per cent in the community segment, and 92 per cent in the hospital segment. It is not disputed that Napp has been selling MST to hospitals well below direct cost, and doing so selectively on those tablet strengths where it has faced competition. Such a pricing policy is, at first sight, an abuse of a dominant position, on the basis of well known principles established in *AKZO* (Case 62/86 *AKZO Chemie v Commission* [1991] ECR I-3359) and *TetraPak II* (Case T-83-91 *Tetra Pak v Commission* [1994] ECR II-755, on appeal Case 333/94P *Tetra Pak v Commission* [1996] ECR I-5951) (paragraphs 225 to 228 of the Tribunal's judgment). Such an abuse is commonly referred to as an "exclusionary abuse", i.e. it has the effect of discouraging or preventing new competitors from entering the market, or eventually driving out those that attempt to do so, by forcing them to incur additional losses. That, in turn, maintains the monopoly of the incumbent supplier.

54. Oversimplifying for the sake of brevity, before the Tribunal Napp advanced two principal, and closely related, defences, a "net revenue" defence and a "normal competition" defence. According to Napp's "net revenue" defence before the Tribunal, loss-making sales to hospitals led on to profitable sales in the community, as a result of a so-called "follow-on effect". In consequence, so the argument ran, Napp's hospital sales were not, in fact, loss-making when the 'net revenue' from the follow-on community sales was taken into account. Napp's "normal competition" defence was that it was "normal" to sell at discounts to hospitals, in the expectation of achieving further sales in the community as a result of being established in the hospital. Such an approach was a normal way of competing in this market, both for Napp and its competitors, and so could not be an abuse.

55. The Tribunal found, on the facts of this case, that hospitals are the key, and indeed the only, viable point of entry from which a new competitor may aspire to penetrate the community segment of the market (paragraphs 273, 281 to 283 of the judgment).

56. The Tribunal rejected Napp's principal defence, the so-called 'net revenue' defence, both conceptually (paragraphs 258 to 266) and factually (paragraphs 267 to 333 of the judgment). The Tribunal's conclusion on the facts is at paragraph 334:

> "On the basis of the foregoing, we find on the facts that, during the period of infringement, (a) Napp's policy of selling to hospitals at prices below direct costs, and on a selective basis, had a significant effect in hindering competition in the hospital and community segments of the market for oral sustained release morphine; (b) existing and potential competitors of Napp seeking to enter, or gain market share in, the hospital segment and, ultimately, in the community segment of the market, were placed at a significant competitive disadvantage by Napp's hospital discounting policy; (c) Napp's intention was, so far as possible, to eliminate competition by preventing or hindering market entry into both the hospital and the community segments; (d) Napp's primary motivation was not to make "extra sales", nor to make "an incremental profit" in recognition of the "follow-on benefits" accruing from hospital contracts, but to deny to its competitors a key means of entering the market for oral sustained release morphine in the United Kingdom through the gateway of the hospital segment."

57. It followed, in the Tribunal's view, that an abuse of dominant position was established, not only on the basis of *AKZO* and *TetraPak II*, cited above (paragraphs 335 to 337 of the judgment), but also on the basis of Cases C-395 and 396/9 *Compagnie Maritime Belge v Commission* [2000] ECR I-1365 ("*Compagnie Maritime Belge*") and Case T-228/97 *Irish Sugar v Commission* [1999] ECR II-2969 ("*Irish Sugar*") (paragraphs 337 to 339 of the judgment).

58. The Tribunal rejected the "normal competition" defence and certain other arguments advanced by Napp, both for the reasons given in paragraphs 267 to 339 of the judgment, and for the further reasons given at paragraphs 340 to 350 of the judgment. Furthermore, the Tribunal found that the consequence of the hospital abuse was to shield from competition Napp's high prices and market share in the much larger and more profitable community segment (paragraphs 422 and 423 of the judgment).

The grounds of appeal as regards the hospital pricing abuse

59. In alleging that the Tribunal erred in law in finding that Napp had committed the hospital abuse, it seems to us that Napp seeks to re-argue, in various different ways, a "net revenue defence" and a "normal competition defence". However, each of the six sub-grounds of appeal relied on seem to us to be matters of fact, or assessment of the facts. We have not

been able to find, even arguably, that there is a point of law within the meaning of section 49(1)(a) of the Act.

Ground 1(i): The Tribunal concluded that, in deciding whether Napp had sold MST to hospitals at prices which fell below cost, it should have no regard to the wider benefits which Napp could expect to secure by selling MST to hospitals (namely, the increased prospect of selling MST to the community segment of the market, resulting in consequential community sales). The Tribunal should have taken account of these wider benefits in deciding whether or not Napp's hospital prices for MST fell below cost, and should have concluded that the hospital sales were profitable, in the light of the wider benefits arising from such sales.

60. To deal with this first sub-ground, we recapitulate briefly the way in which Napp has argued its case hitherto.

61. When the Director first asked Napp about its hospital pricing policy, following the receipt of a complaint, Napp's initial stance was to deny that there was any relationship between sales to hospitals and subsequent sales in the community: see Mr Brogden's letter of 24 September 1999 "Our experience over the last decade has shown that there is little correlation between discounting in hospitals and sales of MST in the community", cited at paragraph 249 of the judgment.

62. In response to the formal notices subsequently served on Napp by the Director prior to the adoption of the Decision (see Rule 14 of the "Director's Rules" made under the Competition Act 1998 (Director's rules) Order 2000, SI 2000 no. 293), Napp, in consultation with its economic advisers, moved some distance away from the position taken in the letter of 24 September 1999 and developed an argument on the basis of what became known as "the narrow follow-on effect". According to this argument, a patient initiated on MST in hospital would continue to be prescribed MST on his return to the community. If one took such community sales into account, the "overall transaction" (i.e. the sale of MST to the hospital at the hospital price plus the sale of "follow on" units to the community segment at the community price) was profitable on a "net revenue" basis. Hence, so the argument ran, Napp's sales did not "generate a loss" within the meaning of the *AKZO* case. This argument was rejected by the Director in the Decision.

63. On appeal to this Tribunal, Napp advanced the same argument based on the narrow follow-on effect, backed by various expert reports and witness statements (paragraphs 174 to 178

of the Tribunal's judgment). According to Napp, this narrow follow-on effect was equally available to its competitors, so there was no question of an abuse (paragraphs 181 to 186 of the Tribunal's judgment). Napp also, in its submissions to us, downplayed the importance to its competitors of the hospital segment as a means of making sales in the community segment, contending that there were other means of doing so, such as direct promotion to GPs. Hence Napp's hospital pricing did not, so it was argued, "foreclose" the community segment (paragraph 192 of the Tribunal's judgment).

64. Although Napp frequently referred in a somewhat vague way to "linkages" between the hospital and community segments (see paragraph 232 of the judgment) the main thrust of Napp's case before the Tribunal was the narrow "follow-on effect" based on Napp's expert evidence.

65. In its judgment the Tribunal rejected the narrow follow-on effect relied on by Napp for two reasons, namely that the expert report on which it was based did not support the argument relied on (paragraphs 241 to 245), and that there was no evidence that Napp ever took into account any follow-on effect when setting or carrying out its pricing policy (paragraphs 248 to 254). We have not identified any credible challenge to the Tribunal's findings on these points. The Tribunal further found that the real motivation for Napp's hospital discount policy was not the narrow "follow-on" effect, but simply to block new competitors from entering the hospital segment. This was done primarily in order to prevent any new competitor acquiring "hospital influence" which the new competitor could then use as a springboard for entering the community segment (paragraphs 255, 326 to 328, and 334 of the judgment).

66. In this context, "hospital influence" includes "all the ways in which hospitals influence GPs' prescribing habits, including those cases where a patient is initiated in hospital and then returns to the community (the narrow follow-on effect), or the hospital specialist writes a referral letter, or use in hospitals enhances the reputation of the brand, or the hospital serves as a focus for disseminating information about the brand among GPs, pharmacists or nurses in the community" (paragraph 238 of the judgment). As already stated, the Tribunal found that it is only on the basis of acquiring hospital influence that a new competitor can hope to penetrate the community segment (paragraphs 273, 281 to 283 of the judgment). The essential reason for this is that GPs are conservative and not price

sensitive, whereas hospitals are both price sensitive and more ready to try new products: see paragraphs 267 to 273 of the judgment.

67. Napp no longer contests, in this appeal, the Tribunal's finding that it is only by selling to hospitals, and thereby acquiring hospital influence, that any new competitor can enter the market. Indeed, paragraph 28 of the skeleton argument appears to acknowledge, in striking contrast to what Napp has consistently argued hitherto, that hospital influence is "so important that, unless a firm can persuade hospitals to buy its brand, it is unlikely to be able successfully to launch the brand in the community segment at all". It follows that in the case of oral sustained release morphine in the United Kingdom, an undertaking which succeeds in monopolising "hospital influence" will be able to monopolise not only the hospital segment, but also the community segment as well. In essence, the Tribunal found that Napp's hospital pricing policy had precisely that effect, and intentionally so.

68. In ground 1(i) of the request for permission to appeal, however, Napp now contends that what the Tribunal regarded as one of the principal vices of its pricing policy is, in fact, a virtue. According to Napp, the Tribunal ought to have taken into account in Napp's favour "the wider benefits" which Napp could expect to secure by selling MST to hospitals, namely "the increased prospect of selling MST to the community segment of the market, resulting in consequential community sales". The argument appears to be that Napp's sales to hospitals were not really loss-making because the "hospital influence" resulting from those sales would in one way or another generate other, profitable sales in the community (see paragraph 63 of the skeleton argument).

69. This in our view represents a major shift of emphasis from the arguments presented to us prior to our judgment, which were primarily based on the narrow follow-on effect and detailed 'net revenue' calculations. In our view Napp's argument now comes close to arguing that its attempt to monopolise the hospital segment is justified by the profit that it makes from its monopoly in the community segment – to which the hospital segment is the only gateway.

70. It is rather hard to find where in the skeleton argument ground 1(i) is developed. At paragraphs 76 and 77 of the skeleton argument, Napp contests the Tribunal's finding (at paragraphs 258 to 266 of the judgment) that Napp's net revenue defence was conceptually

flawed. At paragraph 91 it is suggested that "the Tribunal erred in assuming that Napp's case relied only on the narrow follow-on effect. Napp relies on the wider hospital influence too". At paragraph 92 the reader is referred back to "paragraphs 76ff above". At paragraphs A2.3 to A2.8 of Appendix 2 it is suggested that the Tribunal failed to understand that Napp was relying on the wider "hospital influence" as well as the narrow follow-on effect, and did not deal with the case on that basis.

71. We agree with the Director's observation that Napp's suggestion, in the skeleton argument, that the Tribunal failed to deal with the "wider benefits" flowing from hospital influence, is a distortion of the judgment.

72. Although it was admittedly difficult to sort out exactly what Napp's case really was, the Tribunal's judgment distinguishes between "the narrow follow-on effect" and "hospital influence" at paragraphs 233 to 238. After rejecting the narrow follow-on effect at paragraphs 239 to 257, the Tribunal found, at paragraphs 255 and 256, that what really motivated Napp's hospital pricing policy was the strategic importance to Napp of retaining "hospital influence" for itself, notably as a means of protecting its market share in the community segment. At paragraph 258 we specifically went on to consider Napp's net revenue argument:

> "whether based on the "narrow follow-on effects" alleged by Napp, or on the "linkages" resulting from hospital influence"

73. At paragraphs 260 and 261 the Tribunal rejected Napp's net revenue argument,

> "even on the assumption that there is some sense in which [Napp's] loss making sales can be considered to be profitable for Napp if one takes into account the revenue from sales in the community segment which follow from hospital influence".

74. The remainder of the considerations which then follow at paragraphs 263 to 350 are all based on the hypothesis that the Tribunal is dealing not just with the narrow follow-on effect but also with the question of the alleged "linkages" flowing from "hospital influence": see e.g. paragraphs 265, 269 to 274, 290, 300, 326 and 327, 334, 336 and 337 to 339 and 349.

75. We therefore entirely reject the suggestion that this was an issue with which the Tribunal failed to deal.

76. As to whether Napp was entitled to rely on the argument that its sales of MST to hospitals were profitable when the "wider benefits" of hospital influence, (i.e. increased sales in the community), were taken into account, the Tribunal did not hold that all cases of "loss leading" by a dominant firm were necessarily abusive. There may be many circumstances, in competitive markets, where it could be legitimate, in pricing one product, to take account of the effect of revenues that may be generated by extra sales of other products (paragraph 288 of the judgment). On the facts of this particular case, however, Napp's hospital pricing policy is not directed to making 'extra' sales in the community segment, since Napp already has 96 per cent of the market, but to preserving its monopoly in both the hospital and community segments.

77. The Tribunal rejected Napp's "net revenue defence", whether based on a narrow follow-on effect or the wider hospital influence, on conceptual grounds, (paragraphs 256 to 266), and because of the detailed factual circumstances applicable in the present case (paragraphs 267 to 339), taking account notably of the effect of Napp's hospital pricing on competition (paragraphs 267 to 288), Napp's advantages over its competitors (paragraphs 289 to 300), the market since 1 March 2000 (paragraphs 301 to 306), and Napp's intentions (paragraphs 307 to 333). Further reasons are set out at paragraphs 340 to 350 of the judgment.

78. Those passages in the judgment are underpinned by the Tribunal's factual findings that:

> "Napp realised the importance of "hospital influence" and saw its policy of discounts to hospitals as part of a strategy to prevent competitors from entering the community segment." (paragraph 326)
>
> "In our judgment there is no credible evidence that Napp ever saw any justification for its hospital discount policy other than the need to exclude competitors from the hospital segment, and thus prevent them from gaining hospital influence which would, in turn, threaten Napp's market share in the community segment." (paragraph 327)
>
> "... In our view, the fact that at some point, in 1996 or, possibly, 1998, Napp's prices went below direct costs, was due entirely to Napp's policy of matching competitors' discounts, whatever the cost, so as to exclude competitors from the vital hospital influence." (paragraph 328)
>
> "Napp's intention was, so far as possible, to eliminate competition by preventing or hindering market entry into both the hospital and the community segments;" (paragraph 334(c)).

> "Napp's primary motivation was not to make "extra sales", nor to make "an incremental profit" in recognition of the "follow-on benefits" accruing from hospital contracts, but to deny to its competitors a key means of entering the market for oral sustained release morphine in the United Kingdom through the gateway of the hospital segment." (paragraph 334(d))
>
> "[The commercial rationale behind Napp's hospital pricing policy] was to protect and preserve its monopoly revenues from the community segment, of over £10 million a year, for as long as possible." (paragraph 510)

79. In all these circumstances, nothing in the skeleton argument persuades us that a point of law arises on the basis of ground 1(i). In our view (1) the factual basis on which the Tribunal proceeded in its judgment was significantly different from the assertions as to the facts made in the skeleton argument; and (2) in any event, the issue raised under ground 1(i) is essentially a question of economic appreciation on the facts of this case, rather than a point of law.

Ground 1(ii): The Tribunal concluded that Napp's conduct in setting its hospital prices for MST was not normal. The Tribunal erred in its reasoning as to what would be a normal method of competition in a market exhibiting the characteristics of the market for the supply of oral sustained release morphine. The Tribunal should have concluded that it represented a normal and legitimate means of competition for Napp (and for other suppliers) to set their prices for the sale of their respective brands or oral sustained release morphine to hospitals at levels which took account of the wider benefits of such hospital sales.

80. Under ground 1(ii) Napp argues, essentially that, in setting their hospital prices, it is "normal" for both Napp and its competitors "to factor in" the expected profits to be made from the community segment. Since, argues Napp, Napp's competitors are just as able to do this as Napp, the facts of the present case merely show "normal competition", or "competition on the merits", and thus no abuse of a dominant position. Once again, this ground appears to be mainly predicated on the factual assertions made in paragraphs 63 to 69 of the skeleton argument.

81. As already stated, we do not accept, as formulated, the factual assertions made at paragraphs 65 to 69 of the skeleton argument upon which ground 1(ii) appears to be based, notably as to what Napp "foresaw", or on what hypothesis Napp's pricing decisions were or were not predicated. Our findings on that issue are summarised at paragraph 78 above.

82. In our view ground 1(ii) re-argues, from yet another angle, ground 1(i). The argument based on "normal competition" formed a principal part of Napp's case before the Tribunal. We rejected this argument for all the reasons set out at paragraphs 258 to 350. The matter of "normal competition" is further dealt with notably at paragraphs 340 and 341. At paragraph 340 the Tribunal found:

> "340. ... We accept that in the pharmaceutical sector discounts granted to hospitals by pharmaceutical companies may be substantial. However, nothing in the evidence before us leads us to doubt (i) that discounts of up to 96 per cent are not normal in hospital tenders; (ii) that such discounts have been granted selectively only where Napp has been faced by a competitor; and (iii) that the resulting difference between what the hospital pays and the normal NHS list price is exceptional – in some cases over 2000 per cent – as the Director finds at paragraphs 198 to 200 of the Decision (see Section VIII below). Perhaps more significantly, we do not regard it as "normal" for prices to hospitals to remain below direct costs for many years. For the reasons already given, we find that the below-cost pricing in question was not a 'normal' commercial response but the response of a superdominant undertaking aiming to eliminate competition. Nothing in the structure of the NHS compelled Napp to act as it did."

(See also paragraphs 286, 287, 341, and 461 to 462 of the judgment.)

83. The question of what is "normal" competition or a "normal method of competition" in a particular market seems to us to be a matter of factual and economic assessment. We have not been able to identify anything in the skeleton argument to suggest a point of law arising out of the Tribunal's appreciation of what was, or was not, "normal competition" in this particular market at the material time, nor the findings of fact on which that appreciation is based.

84. Contrary to the assertions made in the skeleton argument, at paragraphs 289 to 300 of the judgment we also rejected on the facts Napp's contention that it was equally open to its competitors to follow the same pricing policy as Napp: see notably the summary in paragraph 299:

> "Among the reasons why the potential availability of the "links" mentioned by Mr Mountain do not give rise to a level playing field are the following: (i) Napp has an established flow of profits from the community segment which can subsidise the losses on its hospital business, whereas a new entrant has to start from scratch without that advantage; (ii) Napp is in a position to impose its hospital prices on new entrants, thereby forcing them to incur losses on sales to hospitals over and above the normal costs of development and

promotion associated with entering a new market; (iii) Napp as the incumbent supplier benefits from the existence of hospital switching costs which new entrants have to overcome; (iv) the low level of purchases by individual hospitals means that switching costs may prove an insuperable barrier to a new entrant; (v) with its established reputation Napp no longer has to incur additional costs of promotion in order to benefit from hospital influence in the community segment, whereas its rivals have to invest heavily; (vi) Napp has higher prices in the community segment than its rivals and thus can more easily recoup its losses in the hospital segment; (vii) any "linkage" is likely to be more reliable and predictable in the case of MST than other products because of Napp's established reputation; (viii) according to the Internet Survey, 30 per cent of patients with a hospital prescription or referral letter may be switched by their GP to another brand, which is most likely to be MST; (ix) where Napp has procured a sole contract, that will be an additional barrier to a new entrant; and (x) Napp has the benefit of its established position in the community segment in the large proportion of cases where a patient is initiated by a GP without the intervention of a hospital or a referral letter."

85. Napp's suggestion, at paragraphs 67 and 87 of the skeleton argument, that "if Napp alone were prohibited from taking account of externality benefits then that would not create a level playing field" and leave Napp "unable to compete normally" is contrary to the findings of fact the Tribunal made when addressing this specific issue.

86. First, for all the reasons summarised at paragraph 299 of the judgment, cited above, there is no "level playing field" between Napp and its competitors in this case.

87. Secondly, for the reasons given at paragraphs 346 to 349 of the judgment, the Tribunal found on the facts that it was still open to Napp to compete on the merits:

> "346. More specifically, we do not accept that Napp had no commercial alternative but to reduce its prices below direct costs. Even if Napp's hospital prices had remained above average total costs, in our view non-dominant competitors such as BIL or Link would still have faced difficulties in building up a significant market share in view of the high existing barriers to entry already mentioned. It is unlikely, in our view, that Napp would have lost all or even most of its hospital contracts.
>
> 347. Nor do we accept Napp's argument that it is placed in an impossible position if there is, legally speaking, a 'floor price' on its discounts to hospitals at the level of average direct costs or average total costs, because, according to Napp, competitors such as Link would be able to undercut Napp, making up their losses on hospital contracts by means of the profits from the community segment generated by the 'linkages' between the two segments.
>
> 348. First, we see force in the Director's view, expressed in his letter of 4 May 2001, that discounts offered by competitors would be unlikely to remain

> at their present levels if Napp's hospital prices were to rise. Link has already suffered considerable losses, which Link would have an incentive to minimise. Moreover, even with the benefit of the "linkages" which Napp asserts, it seems to us, on the evidence, that Link or any other new entrant, may still face some difficulties in establishing itself in either the hospital or the community segments, even on the basis of selling at low prices to hospitals, because of the substantial switching costs in both segments and Napp's existing dominant position.
>
> 349. It is also open to Napp to compete on the therapeutic qualities of what is no doubt an excellent product, and on the efficiency of its operations. More importantly, if Link or another new entrant began to secure more hospital business, and thereby threaten Napp's business in the community segment, in our judgment the correct response on Napp's part is not to engage in predatory pricing in the hospital segment, but, if necessary, to reduce its high prices in the community segment. That in our view would be "competition on the merits", which has so far been prevented by Napp's abusive conduct in the hospital segment."

88. In any event it is well established law that a dominant undertaking does not enjoy untrammelled freedom to react to competition as if it were a non-dominant undertaking. As the Director points out in his observations, the fact that certain conduct may be rational behaviour for a profit-maximising monopolist, does not mean that such conduct constitutes "normal competition" for the purposes of the Chapter II prohibition.

89. As regards Napp's further observations of 4 March 2002, it does not seem to us that there is any proper basis on which it could be said that the questions there set out are "the correct" or only legal questions, or that no other matters can be taken into account. It is perfectly true that whether the conduct of a dominant undertaking is disproportionate is one among many issues to be considered in a case of an alleged abuse. The Tribunal dealt with that issue at paragraphs 342 to 345 of the judgment, and came to the conclusion "On any view we do not think that Napp's conduct can be described as "reasonable" or "proportionate", as the Director found at paragraph 202 of the Decision". The factual findings underpinning that view are set out in paragraphs 267 to 333, including our examination of Napp's intentions (paragraphs 307 to 333) and the Tribunal's findings on "normal competition" already mentioned.

90. Nor do we accept the assertions in paragraph 14 of Napp's further observations that "the only permissible influence" from the "primary facts" is that new entrants would have "undoubtedly" chosen to insist in exploiting hospital/community linkages, such that

"Napp's discounts did not serve to increase the cost of market entry for competitors". On this issue we refer to the detailed findings on the facts at paragraphs 275 to 280 of the judgment (switching costs) and paragraphs 292 to 299 of the judgment (why exploiting hospital/community linkages is not a viable strategy for new entrants).

91. In these circumstances we are not persuaded that any of the arguments presented by Napp under ground 1(ii) give rise to a point of law, or that the matters invoked by Napp are based on facts in the judgment.

Ground 1(iii): The Tribunal concluded that, in any event, Napp's conduct was abusive because it hindered competitors' efforts to compete in the market for the supply of oral sustained release morphine, and resulted in the maintenance of Napp's market share in circumstances where Napp was dominant, or even superdominant. The Tribunal should have concluded that, provided that Napp had not resorted to abnormal means of competition, then its conduct was not abusive.

92. First, we have found it hard to identify where in the skeleton argument ground 1(iii) is developed.

93. Secondly, we find ourselves in disagreement with the way Napp expresses the Tribunal's conclusion. Conduct by a dominant undertaking does not become abusive if and in so far as it represents a proportionate competitive response by the undertaking in question (paragraph 342 of the judgment). The fact that such a proportionate response may hinder competitor's efforts does of itself not make that response abusive, and we are not aware of having suggested otherwise. In this case it is the combination of circumstances that constitutes the abuse, namely a dominant undertaking charging prices well below average variable costs, and targeting competitors on a selective basis (paragraphs 225 to 229 of the judgment), while having no lawful objective justification for doing so (paragraphs 231 to 306). The fact that the result of Napp's conduct was to foreclose the market as regards both the hospital and community segments (paragraphs 281 to 287 of the judgment) and that Napp had every intention of achieving that result (paragraphs 307 to 333 of the judgment) are further elements, but not the only elements, which support the conclusion of abuse.

94. In any event, the Tribunal has found on the facts that Napp's conduct did not constitute "normal competition": see paragraph 82 above. For these reasons, ground 1(iii) does not seem to us to give rise to a point of law.

Ground 1(iv): The Tribunal concluded that it was relevant to a determination as to whether Napp's conduct was to be regarded as abusive that it had found that Napp intended to eliminate a competitor (in the sense that Napp foresaw that its conduct might result in a competitor's withdrawal). The Tribunal should have concluded that evidence of an intention to eliminate a competitor is relevant to the test of abuse only if it serves to prove that a firm's decision to undertake specific conduct was founded on a desire to eliminate competition, and that the firm would not have undertaken the conduct unless it had envisaged that its conduct would have that result. The Tribunal had no basis for concluding that Napp's conduct met these requirements in the present case.

95. Again, we are not quite sure where in the skeleton argument this ground of appeal is developed, but paragraphs 59 to 61, 68 and 100 may be relevant. This is not a point which, so far as we are aware, was argued before us.

96. The first point to make is that, strictly speaking, it was not necessary for us to make a finding as to Napp's intention for the purposes of the *AKZO* and *Tetra Pak II* test: paragraph 307 of the judgment. Secondly, Napp does not seem to mention the cases in Community law to which we directed ourselves in considering whether Napp had "the intention of eliminating competition" as alleged by the Director: see paragraph below, and paragraphs 308 to 309, 450 and 456 of the judgment (see also paragraph 128 below). The test for an intention to eliminate competition as formulated to Napp does not seem to us to be supported by any of the case law cited in the judgment. Thirdly, it seems to us that there was ample evidence upon which to find that Napp had the requisite intention: see paragraphs 310 to 334 of the judgment.

97. Fourthly, and in any event, at paragraphs 59 and 61 of the skeleton argument Napp accepts that

> "if it was a decisive factor in the firm's decision to offer such prices that the firm expected thereby to eliminate competitors (so that it would not "normally" have taken such a decision) then the conduct is abusive".

and that:

> "the question is not whether the dominant firm realised that its conduct might result in its competitors' withdrawal, the question is whether the expected withdrawal was decisive in the decision to undertake the conduct."

98. We would not accept that those propositions are correct in law. However, the propositions on which Napp relies seem to us to be very close to what we found on the facts in the present case, namely that in the decisive factor in Napp's decision to offer hospital prices well below average variable costs, and to maintain those prices throughout the period of infringement, was to eliminate competition: see again paragraphs 310 to 334 of the judgment, and paragraph 78 above. It would appear, therefore, that the application of the legal principle as formulated by Napp would not materially affect the outcome of this case.

99. In those circumstances we see no reason for granting permission to appeal on the basis of ground 1(iv).

Ground 1(v): The Tribunal failed to conclude that, as a matter of law, Napp was not causally responsible under the Chapter II prohibition for any deficiencies in the state of competition in the market for the supply of oral sustained release morphine.

100. This ground appears to be based notably on paragraphs 78 to 85 of the skeleton argument, but does not seem to us to go to any finding in the judgment.

101. It was not suggested by the Director that Napp was "causally responsible under the Chapter II prohibition" for any deficiencies there may be in the market structure for oral sustained release morphine, and we do not think that our judgment finds or implies that Napp is so responsible. It is true that, at the relevant time, there appears to have been a certain disconnection between NHS purchasing policies in the hospital and community segments respectively. Equally, the hospital segment was the only viable point of entry into the community segment. However, as the Tribunal found, what Napp did was to *exploit* this disconnection (paragraph 263 of the judgment) by pricing below average variable costs without objective justification, and by following policies which did not constitute normal competition, as already set out above. This had the effect of raising barriers to entry and foreclosing the market (paragraphs 276 to 285 of the judgement) which is a serious matter where the barriers to entry protecting an incumbent monopolist are already high (paragraph 286 of the judgment). Moreover, the Tribunal found on the facts that nothing in the structure of the NHS compelled Napp to act as it did (paragraph 340, last sentence, and paragraphs 342 to 349).

102. For these reasons ground 1(v) does not seem to us to be sustainable.

Ground 1(vi): The Tribunal failed to conclude that the fact that Napp offered different discounts to different hospitals, or in respect of different dosage strengths of MST, was consistent with Napp's discounts being a normal method of competition. The Tribunal should have concluded that, as a matter of law, the fact that different discounts were offered in different cases did not itself give rise to an infringement of the Chapter II prohibition and did not render Napp's discounts abusive in any particular instance.

103. This ground of appeal does not appear to be developed in the skeleton argument except for a passing mention at paragraph 86(c). It was not suggested by the Director, and we did not so find, that the offering of different discounts to different hospitals or in respect of different dosage strengths of MST was *of itself* an abuse. What the Tribunal decided was that in the circumstances of this case the offering of discounts selectively targeted against competitors, at levels even below the cost of raw materials, was an abuse, for the reasons already given. If and in so far as this ground of appeal seeks to re-present, in yet another guise, Napp's "normal competition" defence, we do not accept that defence has any factual basis on the facts of this case, again for the reasons already given.

104. In so far as this ground of appeal is directed at the Tribunal's finding, in the alternative, that Napp's discounts to hospitals were in any event abusive within the meaning of the decision of the Court of Justice in *Compagnie Maritime Belge* (see paragraphs 337 to 388, and 344 of the Tribunal's judgment), we agree with the Director that that case does not establish a wholly different set of principles applicable only to "superdominant" undertakings, as suggested at paragraph 101 of Napp's skeleton argument. However, that case does show that in certain circumstances it is not necessary to show that prices have fallen below cost in order to establish an abuse. For the reasons given in paragraphs 337 and 338 of the judgment, we found that the approach indicated in the judgment of the Court in *Compagnie Maritime Belge*, was also applicable in the factual circumstances of the present case.

105. It follows from the foregoing that we, for our part, have been unable to identify any relevant point of law, or any point of law with a reasonable prospect of success, arising out of our findings on the hospital pricing abuse.

THE COMMUNITY PRICING ABUSE

106. The essence of the community pricing abuse, as found by the Tribunal, is that Napp has been charging excessively high prices for MST in the community segment. The basic facts

are summarised in the following terms at paragraph 393 of the non-confidential version judgment:

> "...
>
> — Napp's prices in the community segment are typically around [between 30 to 50] per cent higher than its competitors.
>
> — Apart from certain across-the-board reductions applying to the pharmaceutical industry as a whole under the PPRS, Napp's price in the community segment has remained the same since the launch of MST in 1980, (save, as we understand it, for one increase in 1983) notwithstanding the expiry of its formulation patent in 1992.
>
> — Napp's list price (less wholesale discount) in the community segment of the market is on average over 1400 per cent higher than its price in the hospital segment of the market for 10mg, 30mg, 60mg, and 100 mg tablets, where Napp faces competition.
>
> — At Napp's highest level of discount, the list price in the community segment is on some tablets over 2000 per cent higher than Napp's hospital prices.
>
> — Napp's prices in the community segment are over 500 per cent higher than its prices for export on a contract manufacture basis. As we understand it, MST faces competition in export markets.
>
> — Napp's gross profit margin on sales to the community segment is [in excess of 80] per cent, compared with a margin of around [between 30 and 50] per cent on Napp's other products sold to the NHS.
>
> — Napp's gross profit margin of [in excess of 80] per cent on sales to the community segment compares with a gross profit margin of [less than 70] per cent for Napp's next most profitable competitor. If Napp's manufacturing margin is recalculated on the basis of the costs of its next most profitable competitor, Napp's gross margin becomes [less than 90] per cent compared with that competitor's [less than 70] per cent."

107. The Tribunal's reasons for upholding the abuse of excessive pricing in the community segment are set out at paragraphs 394 to 421 of the judgment.

108. In ground 2 of the request for permission to appeal, Napp alleges three sub-grounds of appeal in support of its contention that the Tribunal erred in law as regards the community pricing abuse. Those grounds are as follows:

> (i) The Tribunal erred in the application of its own preferred test to decide whether Napp's community prices of MST were excessive. On the test adopted by the Tribunal, the Tribunal would have needed to determine what would be a competitive price of MST, but it did not do so correctly or at all. Moreover, the Tribunal assumed that Napp would have been

able to recover R&D costs and investments during MST's period of patent protection. But the Tribunal had no proper basis on which to assume that.

(ii) In any event, the Tribunal erred as to what is the correct test to be applied in deciding whether the community price of MST was unfair, as being excessive. The Tribunal should not have looked only at the costs, prices and margins incurred or earned in respect of comparator products. It should have looked at whether Napp's community prices for MST were reasonable, having regard to the need to ensure that the returns permitted to be earned in pharmaceutical markets from successful products are sufficient to provide appropriate incentives to firms to invest in the invention, development, promotion and supply of new pharmaceutical products.

(iii) If the Tribunal had applied the correct test, it would have been unable, on the evidence available to it, to conclude that Napp's community prices for MST were unfair, within the terms of the Chapter II prohibition, by virtue of their absolute level.

109. Since ground (iii) appears to be a conclusion rather than a separate ground, there are really two sub-grounds of appeal, (i) and (ii).

Ground 2(i)

110. The Tribunal's approach, in the judgment, was to ask itself whether Napp's prices were higher than they would be in a competitive market, as indicated at paragraphs 390 to 391:

> "390. In paragraph 203 of the Decision, the Director states that, as a matter of principle a price is excessive for the purposes of the Chapter II prohibition:
>
> > "if it is above that which would exist in a competitive market and where it is clear that high profits will not stimulate successful new entry within a reasonable period. Therefore, to show that prices are excessive, it must be demonstrated that (i) prices are higher than would be expected in a competitive market, and (ii) there is no effective competitive pressure to bring them down to competitive levels, nor is there likely to be."
>
> 391. While there may well be other ways of approaching the issue of unfair prices under section 18(2)(a) of the Act, the Director's starting point, as stated in paragraph 203 of the Decision, seems to us to be soundly based in the circumstances of the present case."

111. Napp argues that, in applying the Director's test, the Tribunal would have "needed to determine what would have been a competitive price of MST but did not do so correctly or at all". This contention is apparently based on paragraph 110 of the skeleton argument,

where the central allegation appears to be that the Tribunal failed to take into account the fact that Napp could command a brand premium for MST.

112. In our view, the factual basis of this allegation is unsustainable. It was always accepted by the Director that MST could command a premium over other brands and the Director's price comparisons were made on that basis (paragraphs 362 and 366 of the judgment). In accepting, as we did at paragraphs 397 to 405, the Director's price comparisons, we necessarily accepted the assumptions on which those comparisons were based, including the assumption that Napp could command a brand premium. That in our view is made explicit at paragraph 554 of the judgment where the Tribunal said:

> "554. On the substance of the Directions, it seems to us that the requirement to reduce the NHS List Price of MST by 15 per cent is at this stage the minimum necessary to mitigate the abuse of excessive pricing while at the same time allowing the development of competitive conditions... The figure of 15 per cent reduces the previous gap between Napp and its competitors, *while allowing Napp some brand premium* and according sufficient room to manoeuvre to Napp's competitors to allow competition to develop." (emphasis added)

113. As to the exact amount of the brand premium for MST which Napp could reasonably command, a matter raised for the first time in Napp's further observations of 4 March 2002, it was not disputed that Napp's price was [30 to 50] per cent higher than that of its nearest competitor. The Director, in the Directions, required Napp to reduce its NHS List Price by 15 per cent. It seems to us fairly obvious that the difference between these two figures represents what the Director considered to be a reasonable brand premium for MST, and that anything above that was to be considered excessive. We saw no reason in our judgment to disagree with the Director's view, or require him to spell the matter out in more detail in the Decision (paragraph 405). We also upheld the Director's assessment that a reduction of 15 per cent in the NHS List Price for MST was the minimum necessary to mitigate the abuse of excess pricing (see paragraphs 554 and 556 of the judgment).

114. Under ground 2(i) Napp further suggests that the Tribunal assumed, without any proper basis, that Napp would have been able to recover R&D costs and investments during MST's period of patent protection.

115. In so far as this argument relates to the facts of this particular case, the Tribunal found at paragraph 407 that Napp's original investment in MST was made in the early 1980s and could have been expected to have been recouped long ago. That finding was supported by Napp's own experts. Napp never suggested the contrary, nor did it suggest that it was unable to recoup its R&D costs and investments relating to MST prior to the expiry of its formulation patent in 1991. Neither point seems to us to be relevant, on the facts of this case, to the question whether Napp's prices were excessive ten years later, in the period from March 2000 to March 2001.

Ground 2(ii)

116. Under ground 2(ii) Napp argues that, in deciding whether the price of MST was excessive, the Tribunal should have considered whether Napp's community prices for MST were reasonable, having regard to the need for pharmaceutical companies to earn a sufficient return from their successful products to fund R&D in the development of new products: see paragraphs 111 to 120 of the skeleton argument. This argument, based on the idea of "portfolio pricing", is essentially the same as that presented to the Tribunal, and summarised at paragraph 409 of the judgment.

117. In the proceedings before us, the Director made clear that he did not intend in this case to take a position on this "portfolio pricing" argument as it might apply, in the abstract, to the pharmaceutical industry. The Director said he was concerned with the specific facts of this particular case, where the excessive prices in the community segment had been maintained by exclusionary conduct in the hospital segment. The Director told us that he would not wish to maintain the abuse of excessive pricing in the community segment in circumstances where the Tribunal found that there had been no exclusionary conduct in the hospital segment (paragraphs 430 to 432 of the judgment).

118. The Tribunal rejected Napp's 'portfolio pricing' argument for the reasons given at paragraphs 410 to 427 of the judgment. In particular, at paragraphs 421 to 423 of the judgment the Tribunal found that Napp's argument based on 'portfolio pricing' in the context of the PPRS did not apply in circumstances where Napp's prices in the community segment did not represent a competitive market outcome but had, to a material extent, been shielded from competition by Napp's anti-competitive practices in the hospital segment.

119. Napp does not seem to us to address any of the points made at paragraphs 410 to 427 of the judgment. However, at paragraph 121 of the skeleton argument Napp does concede that "[t]he situation might be different" as regards its "portfolio pricing" argument "if Napp had, by wrongfully foreclosing access to the community segment of the market (by the alleged hospital abuse), sustained its community prices at higher levels than it could otherwise have obtained. In that event, Napp's community prices might be abusive, in consequence of the hospital abuse".

120. That, it seems to us, is precisely the position in this case. The Tribunal has found on the facts in this particular case at paragraphs 421 to 423 of the judgment that Napp has indeed maintained its community prices at excessive price levels, whilst shielding itself from effective competition by its own anti-competitive practices in the hospital segment. For that reason, as set out in paragraphs 421 to 424 of the judgment, Napp's arguments in the abstract regarding portfolio pricing in the pharmaceutical industry in general do not apply in the circumstances of this particular case. That point is virtually conceded in the skeleton argument.

121. Since we have not been able to identify a point of law which arguably undermines the Tribunal's findings as regards the hospital pricing abuse, it follows from paragraphs 421 to 423 of the Tribunal's judgment that no arguable point of law about the theory of portfolio pricing arises on the specific facts of the community pricing abuse, even supposing that the theory of portfolio pricing in the pharmaceutical industry is a matter that could give rise to a point of law.

122. It follows from the foregoing that we are unable to find any ground for giving permission to appeal under section 49(1)(a) of the Act as far as concerns the substantive finding of infringement challenged under Grounds 1 and 2. In those circumstances, the question of setting aside the Directions, mentioned in Ground 3, does not arise.

ISSUES RELATING ONLY TO THE PENALTY

Intentionally or negligently

123. Ground 4 of the request for permission to appeal is in these terms:

> "*4. In consequence of 1 and 2 above, and in any event, the Tribunal erred in law in concluding that Napp committed an abuse:*
>
> *(a) intentionally, in the case of the hospital abuse; and*
>
> *(b) intentionally or negligently, in the case of the community abuse.*
>
> *In concluding that Napp had infringed the Chapter II prohibition intentionally (in the case of the hospital abuse) and intentionally or negligently (in the case of the community abuse), the Tribunal made the following particular errors of law:*
>
> *(i) the Tribunal failed to recognise that, in order for a firm to commit an infringement, it must (inter alia) resort to methods of competition which are not normal;*
>
> *(ii) the Tribunal failed to recognise that, in order for a firm to be found to have committed an infringement intentionally or negligently, it must be shown that the firm knew (in the case of an intentional infringement) or ought reasonably to have known (in the case of a negligent infringement) that its conduct was to be regarded as abnormal. The Tribunal could not, if it had recognised this requirement, have found any infringement committed by Napp to have been committed intentionally or negligently.*"

124. In so far as this ground repeats Napp's argument that it engaged in "normal competition" we have already dealt with that point above.

125. According to Napp's skeleton argument, an infringement cannot be committed "intentionally" for the purposes of section 36(3) of the Act unless it is shown that "the firm knew (or was wilfully blind to the fact that) its conduct was not to be regarded as a normal (and hence lawful) form of competition". Similarly, according to Napp, an infringement cannot be committed "negligently" under section 36(3) unless it is shown that "the firm ought reasonably to have known that its conduct was not regarded as a normal form of competition". Napp relies by analogy on *R v Ghosh* [1982] 2 QB 1053. According to Napp, these criteria are not satisfied in this case, as regards either the hospital pricing abuse or the community pricing abuse (paragraphs 124 to 130 of the skeleton argument).

126. In Napp's further observations of 4 March 2002, however, at paragraph 21, Napp appears to concede that in its judgment "the Tribunal may use language which, read out of context, may suggest that it looked at the right questions" on the issue of "intentionally or negligently". Napp's argues, however, that because the Tribunal failed to ask itself the right questions as regards the constituent elements of the abuse, in particular whether

Napp's conduct was "normal" or not, the Tribunal was not able to approach the issue of "intentionally or negligently" from the correct legal starting point.

127. We have already rejected above Napp's arguments concerning the constituent elements of the substantive infringements as regards both the hospital pricing abuse and the community pricing abuse. If the Tribunal's approach to the substantive infringements was not incorrect in law, it would appear from the observations of 4 March 2002 that Napp only faintly contests the Tribunal's approach to the question of "intentionally or negligently".

128. We set out our interpretation of the concepts of "intentionally or negligently" in conformity with Community law at paragraphs 456 and 457 of the judgment in the following terms:

> "456. As to the meaning of "intentionally" in section 36(3), in our judgment an infringement is committed intentionally for the purposes of the Act if the undertaking must have been aware that its conduct was of such a nature as to encourage a restriction or distortion of competition: see *Musique Diffusion Français*, and *Parker Pen*, cited above. It is sufficient that the undertaking could not have been unaware that its conduct had the object or would have the effect of restricting competition, without it being necessary to show that the undertaking also knew that it was infringing the Chapter I or Chapter II prohibition: see *BPB Industries and British Gypsum*, cited above, at paragraph 165 of the judgment, and Case T-29/92 *SPO and Others v Commission* [1995] ECR II-289, at paragraph 356. While in some cases the undertaking's intention will be confirmed by internal documents, in our judgment, and in the absence of any evidence to the contrary, the fact that certain consequences are plainly foreseeable is an element from which the requisite intention may be inferred. If, therefore, a dominant undertaking pursues a certain policy which in fact has, or would foreseeably have, an anti-competitive effect, it may be legitimate to infer that it is acting "intentionally" for the purposes of section 36(3).
>
> 457. As to "negligently", there appears to be little discussion of this concept in the case law of the European Community. In our judgment an infringement is committed negligently for the purposes of section 36(3) if the undertaking ought to have known that its conduct would result in a restriction or distortion of competition: see *United Brands v Commission*, cited above, at paragraphs 298 to 301 of the judgment. For the purposes of the present case, however, we do not need to decide precisely where the concept of "negligently" shades into the concept of "intentionally" for the purposes of section 36(3), nor attempt an exhaustive judicial interpretation of either term.

129. At paragraph 466 we said:

> "There is little guidance in Community law as to the meaning of "intentionally or negligently" in the context of the exploitative abuse of maintaining unfairly high prices. In our judgment, it must be shown that the dominant undertaking either knew (in the sense that it could not have been unaware), or ought to have known, that it was, without objective justification, maintaining prices above the levels that would prevail in conditions of normal competition."

130. It does not seem to us that Napp has shown a reasonable prospect of establishing an error of law in the above paragraphs.

131. As regards our factual findings on the issue of intention on the hospital pricing abuse, we have already cited, at paragraph 78 above, our main conclusions on that issue. The matter is further discussed at paragraphs 459 to 464 of the judgment. For the reasons there given, we concluded that:

> "... the overwhelming inference, to be drawn from the evidence as a whole, [is] that Napp's hospital discounting policy was pursued with the deliberate intention of eliminating, or at least severely hindering, competition."

132. As regards the community pricing abuse, our factual findings on the issue of "intentionally or negligently" are at paragraphs 465 to 472 of the judgment. We concluded, notably, that:

> "467. On those facts, in our judgment, Napp at least ought to have known, that (i) it was a dominant undertaking; (ii) it was maintaining prices in the community segment well above competitive levels, and (iii) that those prices were not subject to significant competitive pressure.
>
> 468. ... In our judgment, the natural inference is that Napp intended to do everything it could to maintain its community prices at levels above those which would prevail in competitive conditions. That inference is drawn by the Director himself in several places in the Decision, as the citations in paragraph 422 above show.
>
> 470. In our view Napp ought to have realised, on reasonable reflection, that its arguments of objective justification based on the PPRS were unfounded, for the reasons we have given at paragraphs 390 to 427 above. Moreover the fact that the Director's case has developed in the course of the proceedings does not alter the fact that, objectively speaking, Napp maintained prices in the community segment that it at least ought to have known were well above competitive levels and protected from competition. We do not accept that the question of "intentionally or negligently" under section 36(3) of the Act depends on whether or not the undertaking was told by the Director how to conduct its business. In the present case reference to *United Brands*, at paragraphs 248 to 253 of the judgment, cited above, would or should have put Napp on notice of the possibility that it was reaping trading

benefits in the community segment "which it could not have reaped if there had been normal and sufficient competition".

471. On those facts, it seems to us, the abuse of excessive pricing was committed by Napp, at the least, negligently, within the meaning of section 36(3) the Act."

133. In the light of the foregoing, it does not seem to us that Napp has shown an arguable error of law arising out of our findings on the issues of "intentionally or negligently". For these reasons we are not persuaded to grant permission to appeal on the basis of Ground 4.

The imposition and amount of the penalty

134. Under grounds 5 and 6, Napp challenges the imposition of any penalty, alternatively the amount of any such penalty, on the following grounds:

"5. *In consequence of 1, 2 and 4 above, and in any event, the Tribunal erred in law in deciding that any penalty should be imposed on Napp in respect of:*

(a) the hospital abuse; and/or

(b) the community abuse.

In concluding that it should impose a penalty on Napp, the Tribunal erred in law in that it failed to recognise that, for the reasons elaborated in 1 to 4 above, the circumstances in which Napp committed any infringement of the Chapter II prohibition were novel and unusual, and it would be inappropriate, in all the circumstances of the case, to impose any penalty on Napp.

6. In the alternative to 5, the Tribunal erred in concluding that it was appropriate, in all the circumstances of the case, to impose a penalty on Napp of £2.2 million. In all the circumstances of the case, the Tribunal should have imposed a lesser penalty.

The Tribunal erred, in assessing the amount of the penalty to be imposed on Napp, in that it failed to recognise that, even if the arguments referred to in 1 to 4 above are incorrect in law, nonetheless they demonstrate that the imposition of a penalty of £2.2 million is excessive."

135. Napp argues that it is not appropriate for any penalty to be imposed where a firm's abuse is novel, or where the application of existing principles in a new market sector gives rise to such conditions. Napp also argues that even if its submissions are wrong in law, the arguments underlying these submissions suggest that the penalty is excessive (paragraphs 132 and 133 of the skeleton argument).

136. Under section 49(1)(b) of the Act an appeal lies, irrespective of any point of law, but with permission, as to the amount of a penalty. We deal with these grounds of appeal as being under section 49(1)(b) rather than as involving a point of law under section 49(1)(a). Our assessment of the amount of the penalty in this case is set out at paragraphs 517 to 543 of the judgment.

137. As regards the hospital pricing abuse, we held at paragraphs 463 and 521 of the judgment that there was no novelty in the abuse having regard to *AKZO*, *Tetra Pak II*, *Compagnie Maritime Belge* and *Irish Sugar*. The fact that this case is the first decision under the Chapter II prohibition concerning a case of predatory pricing in the pharmaceutical industry does not seem to us to make the hospital pricing abuse a "novel abuse".

138. As regards the gravity of the hospital pricing abuse, we took a serious view of the matter. The factors we took into account are set out at paragraphs 518 to 528 as follows:

> "518. We agree with the Director that predatory pricing, even of short duration, falls into the category of a serious abuse. Although it may, at first sight, seem anomalous that the application of competition law should result in higher, rather than lower prices, the present case vividly illustrates that the reason for predatory pricing is typically to exclude or neutralise competitors with a view to maintaining market share and/or high prices in sectors that would otherwise be threatened by competition. The "benefit" that some consumers (in this case hospital purchasing authorities) receive from below-cost predatory prices is wholly outweighed by the "disbenefit", in terms of high costs and lack of choice, which flows from the monopoly (in this case in the community segment) that the predatory pricing is designed to protect or strengthen. Unless predatory pricing, and especially pricing below average variable cost, by dominant undertakings is rigorously penalised by competition law, new competitive entry may be thwarted, with the result that consumers never receive the benefit of competitive conditions, and the lower long-run price levels, wider choice and better quality which, in general, competition brings.
>
> 519. We therefore agree with the Director's view, at paragraph 2.4 of his *Guidance* that predatory pricing by a dominant undertaking is one of the most serious infringements of the Act.
>
> 520. As far as the present case is concerned, we regard Napp's conduct in the hospital segment as a serious abuse. We accept the Director's submission that Napp "consciously and very deliberately" priced below its direct costs in order to exclude competitors from the hospital segment and thus prevent them from gaining any form of toehold from which they might enter the community segment. Price reductions were not made across the board but were targeted selectively against

competitors. Napp's pricing policy was in support of the monopoly already enjoyed by a "superdominant" undertaking. To borrow Mr Mountain's phrase, Napp had the key to the only viable point of entry into the whole of the relevant market, but chose to keep that gate locked.

521. As regards the various points made by Napp in mitigation, in the Decision the Director found that Napp had intentionally eliminated competition (paragraph 236(a), last sentence), and plainly proceeded on that basis when fixing the penalty. The infringement, in our view, was not novel as *AKZO* and *Tetra Pak II* show. In any event, the present case falls squarely within the principles of *Compagnie Maritime Belge* and *Irish Sugar*.

522. Although paragraphs 4.15 to 4.17 of OFT 414 are not entirely happily worded, we do not think in the circumstances of this particular case that Napp can credibly claim to have been misled by those paragraphs into believing that its hospital pricing policy in this case was not abusive (see paragraph 288 above).

523. Although it is true that the Director's case has not been wholly consistent as to what narrow "follow-on effect" he did or did not accept, we regard that as a side issue which does not affect the fundamental point that Napp's pricing policy was intended to, and in our judgment did, substantially hinder competition in the relevant market. As to the extent of foreclosure, we have already indicated our view that the whole of the relevant market was indirectly, or potentially, affected by Napp's conduct: paragraphs 281 to 283 above. Nonetheless, we are prepared to make some slight allowance, by way of mitigation, to take account of the fact that OFT 414 is not drafted quite as clearly as it could have been, and the fact that the Director's case on follow-on effect and foreclosure has not been expressed entirely consistently.

524. We do not think that the Director's investigation in this case was unreasonably delayed, or that Napp can seriously claim that it did not know what to do to avoid infringing the Chapter II prohibition by its hospital pricing policy.

525. We reject Napp's argument that the effect of its hospital pricing policy on consumers was not great. On the contrary, we regard it as a serious feature of the present case that the product concerned is a pharmaceutical product for the treatment of patients in severe pain. Napp's conduct has, in practice, tended to limit the choice of prescribing doctors and in some cases to deny their seriously ill patients alternative oral sustained release morphine products (e.g. capsules). Napp has also made it more difficult for its competitors to bring new products to market. In so far as Napp's hospital pricing policy has tended to protect Napp's market share in the community segment and prevent market entry of cheaper products, it is the taxpayer who has suffered – in some cases paying on average a price over 1400 per cent higher depending on whether the product is dispensed by a retail pharmacist or in a hospital (see paragraph 420 above).

526. We agree with Napp that the exit of BIL should not be taken into account as such in fixing any penalty, but that matter is not mentioned by the Director as one of the factors that he has specifically taken into account. We do not take it specifically into account either, but do note that Napp's market shares in fact increased during the period of the infringement. The fact that price cutting was originally initiated by Farmitalia/BIL, and that hospital buyers allegedly 'encouraged' Napp (as to which we make no finding) are not in our view relevant to the abuse as committed during the period of infringement, especially in view of the case law cited at paragraphs 207 et seq above. The fact that we have not upheld paragraph 236(a)(i) of the Decision in our view merits only a nominal reduction in the penalty, since that point has hardly figured in the proceedings.

527. We add that we do not see Napp's alleged "co-operation" with the Director as going in any way beyond the normal, and thus not a mitigating factor. Napp has made no attempt to modify its conduct. We note that it is apparent from the documents disclosed to the Tribunal that there was material known to Napp which threw light on Napp's original motives in pursuing its hospital pricing policy about which Napp chose, whether rightly or wrongly, to remain silent in the course of the administrative procedure and the early stages of this appeal. We see no mitigation there.

528. In the result, we have identified only slight mitigating factors in respect of Napp's serious abuse in the hospital segment."

139. As regards the gravity of the community pricing abuse, as already indicated we concluded that Napp at least ought to have known that its prices in the community segment were being maintained well above the competitive level and were protected from competition. Napp should have been on notice that it was reaping trading benefits that would not be available to it in normal competitive conditions (paragraphs 465 to 471 of the judgment).

140. At paragraph 531 of the judgment we held

"531. We take the view that the abuse of excessive pricing in the circumstances of this case is a serious matter. The size of Napp's margins, coupled with the extent of the differentials when the same product is sold in different segments of the same market, seem to us to be exceptional. For the reasons we have given, we do not think that Napp had any "legitimate expectation" that it would not be penalised if it remained within the limits on ROC under the PPRS, nor do we accept Napp's suggestion that Department of Health officials do not agree with the Director's case: see, on both points, Mr Brownlee's evidence."

141. However, at paragraph 533 of the judgment we held:

> "533. On the other hand, we see some mitigation in Napp's favour. First, it was not until the adoption of the Directions that Napp finally knew the Director's position as to the amount of reduction required to mitigate the "excess". Secondly, the existence of the PPRS, while not in our view sufficient to prevent Napp's infringement from being at least negligent, is in our view some mitigation. Although in our view Napp should have realised that the PPRS afforded no defence, it may not have been easy for Napp to come to terms with the fact that, as from 1 March 2000, the Chapter II prohibition imposes restraints on unfairly high prices charged by dominant undertakings, in addition to the constraints under the PPRS which, of course, applies to dominant and non-dominant firms alike. It is also true that the way the Director has characterised the abuse of excessive pricing before the Tribunal, linking it more explicitly to the abuse on hospital discounting, has to some extent "muddied the waters" as to the circumstances in which he (the Director) might consider the PPRS to be a defence to a charge of abuse of excessive pricing on pharmaceutical products. In addition there has been no decided case at Community level upholding an abuse of excessive pricing in circumstances comparable to the present case, and the principles upon which a price is to be judged "unfairly high" for the purposes of the Chapter II prohibition have not been considered in any previous decision of the Director or the Tribunal."

142. Substantially on the basis of the matters set out in paragraph 533, we reduced the overall penalty on Napp by £1 million, from £3.21 million to £2.2 million (paragraph 538 of the judgment).

143. As can be seen from paragraph 533, we made a substantial allowance for the fact that there had been no previous case on excessive pricing in circumstances comparable to the present case, and for the existence of the PPRS. Thus Napp has already received a very substantial discount off the original penalty. The grounds of appeal disclose no new mitigating factors.

144. In those circumstances we do not think it would be appropriate for us to grant permission to appeal as regards the amount of the penalty.

145. It follows in our view from all the foregoing that none of the grounds of appeal advanced form a sufficient basis for the Tribunal to grant permission to appeal in this case.

SOME OTHER COMPELLING REASON

146. We have considered whether, despite our inability to identify any point of law with a real prospect of success within CPR Rule 52.3(6)(a), there may be "some other compelling

reason" to give permission to appeal within the meaning of CPR Rule 52.3(6)(b). We have some difficulty in identifying some other compelling reason in circumstances where, in our view, the matters put forward by Napp do not raise arguable points of law.

147. It is true that this is the first application for permission to appeal under the Act, the first time that the Director has found an infringement of the Chapter II prohibition, and the first time that a penalty has been imposed, but these matters in themselves do not seem to us to be sufficiently "compelling" for granting permission if there is no real point to be made. The suggestion in Napp's further observations of 4 March 2002 that this case is of interest to the pharmaceutical industry is no doubt true in general terms, but we doubt whether it has much general significance on such questions as "portfolio pricing", because of the particular factual circumstances of this case already mentioned.

148. We are also concerned in this case that a large part of the arguments with which the Court of Appeal is being asked to grapple are based on factual assertions which do not in our respectful view accord with the findings we have made. That does not seem to us to be an appropriate basis on which we should decide to allow this case to go forward to the Court of Appeal.

149. It follows from all the foregoing that in our view we should refuse permission to appeal.

SUSPENSION OF THE DIRECTION REGARDING THE REDUCTION IN THE COMMUNITY PRICE

150. The Directions were originally suspended in their entirety, pending the determination of Napp's appeal to the Tribunal, by order of the President, made by consent, on 22 May 2001 under Rule 32(3)(a) of the Tribunal Rules. The Director consented to that order because Napp was prepared to give an undertaking to the Department of Health, which is dated 23 May 2001, to compensate the NHS for losses incurred as a result of not reducing the NHS price for MST between the date of the interim order and any final order of the Tribunal, and to pay interest on any compensation due.

151. Following the determination of the appeal by the Tribunal's judgment of 15 January 2002, Napp has complied with the Directions as regards the raising of its hospital prices, so there is no further issue as regards that.

152. By the order which the Tribunal made on 15 January 2002 when giving judgment, Napp was required to reduce its NHS List Price for MST by 15 per cent within 15 working days of 5 February 2002.

153. By letter of 5 February 2002, however, Napp intimated to the Tribunal its intention to apply for permission to appeal by the date allowed by Rule 29 of the Tribunal Rules (18 February 2002), and requested the Tribunal to order the further suspension of its obligation under the Directions to reduce the NHS List Price by 15 per cent, until such time as the Tribunal and the Court of Appeal had rejected Napp's request for permission to appeal, or the Court of Appeal had rejected Napp's appeal. Napp proposed to continue its undertaking of 23 May 2001 to the Department of Health during that period, on the same terms.

154. By letter of 11 February 2002 the Department of Health opposed Napp's request for a further suspension of its obligation to reduce the NHS List Price for MST, intimating that the Department would have been unlikely to accept Napp's original undertaking of 23 May 2001 had the Department known that that undertaking would apply until the determination of any appeal to the Court of Appeal. In the Department of Health's view, the two aspects of the Directions (raising hospital prices and reducing community prices) should be implemented simultaneously. The additional cost to the Department of MST tablets pending the determination of the appeal would be incurred at the expense of delays in other patient care, which was unacceptable.

155. By letter of 11 February 2002 the Director did not oppose a further suspension of Napp's obligation under the Directions to reduce its NHS List Price, but only up to the date of the determination, by the Tribunal or the Court of Appeal, of Napp's application for permission to appeal.

156. By order of 18 February 2002 the Tribunal suspended Napp's obligation under the Directions to reduce its NHS List Price by 15 per cent until determination by the Tribunal of Napp's application for permission to appeal.

157. In its application for permission to appeal dated 18 February 2002 Napp has renewed its request for a suspension of its obligation to reduce its NHS List Price for MST until either

the final determination of any appeal by Napp to the Court of Appeal, or the final determination by the Court of Appeal of an application by Napp for permission to appeal. Napp's undertaking would be continued in the meantime.

158. The Director in his observations of 25 February 2002 does not object to a further suspension of that obligation for 7 days after the Tribunal's determination of Napp's request for permission to appeal and, on condition that Napp has filed an application for permission to appeal at the Court of Appeal within 7 days, thereafter until determination by the Court of Appeal of that application.

159. Napp in its further observations of 4 March 2002 argues that it should have the full 14 days to apply to the Court of Appeal. According to Napp, the Directions should be suspended at least until the determination by the Court of Appeal of the application for permission to appeal and, it appears, for a short time thereafter to enable Napp to make a separate application for suspension during such further period.

160. We remind ourselves that the only ground of appeal on which a further suspension of the Directions could be based is Ground 2. We see no point of law under Ground 2. However, whatever the intrinsic merits of Ground 2, it does appear that Ground 2 is unlikely to "get off the ground", so to speak, unless Napp also succeeds on Ground 1 (paragraphs 116 to 122 above). Since we, for our part, can see no good reason for granting permission to appeal under either Ground 1 or Ground 2, we do not see any substantive basis for continuing to suspend Napp's obligation under the Directions to reduce the list price of MST by 15 per cent.

161. Although the Department of Health is protected by Napp's undertaking, it is a point of concern that the full implementation of the Directions has already been delayed by more than a year by the appeals process. It is also of concern that the obligations which Napp will, on the view we take, have eventually to meet, are increasing daily with, as yet, no definite date on which those obligations will crystallise. We note also the concern of the Department of Health expressed in its letter of 11 February 2002.

162. On the other hand, we can see that it would complicate matters procedurally, from the point of view of the Court of Appeal, if we were to refuse any further suspension as from today's date. In those circumstances we have decided, but only for that procedural reason,

to suspend the operation of Directions regarding the reduction of the NHS List Price for MST for a further 7 days, or until the determination by the Court of Appeal of an application by Napp for permission to appeal made within that period. If Napp were to seek any further suspension thereafter, that would be a matter for the Court of Appeal. We abridge the time from 14 days to 7 days under CPR Rule 52.4(2)(a) for the reasons given in paragraph 161 above.

163. We take it that, in the event of Napp making an application for permission to appeal to the Court of Appeal, Napp will place before the Court of Appeal not only this judgment but the Director's observations dated 26 February 2002 and the Department of Health's letter of 11 February 2002.

164. By letter of 1 March 2002 the Director applied for the costs of this application. In the circumstances we think the Director is entitled to those costs in the exercise of our discretion under Rule 26(2) of the Tribunal Rules, such costs to be assessed by the Tribunal if not agreed.

165. On those grounds the Tribunal unanimously orders

1. Napp's application for permission to appeal dated 18 February 2002 is refused.

2. The Tribunal's order dated 18 February 2002 suspending the Directions as regards the reduction of Napp's NHS List Price for MST tablets is continued on the same terms for 7 days from the notification of this judgment, or until the determination by the Court of Appeal of any application by Napp for permission to appeal made within that period, whichever is the later.

3. Napp will pay the Director the costs of the application for permission to appeal, to be assessed by the Tribunal if not agreed. The Director shall apply to the Tribunal to assess the costs if agreement is not reached.

Christopher Bellamy Barry Colgate Peter Grinyer

Charles Dhanowa
Registrar 26 March 2002