IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1016/1/1/03

Victoria House,
Bloomsbury Place,
London WC1A 2EB

13th October, 2004

Before:
SIR CHRISTOPHER BELLAMY
(The President)
PROFESSOR PETER GRINYER
MR. GRAHAM MATHER

Sitting as a Tribunal in England and Wales

BETWEEN:

GENZYME LIMITED

Applicants

and

THE OFFICE OF FAIR TRADING

Respondent

Supported by

HEALTHCARE AT HOME

Intervener

Mr. David Vaughan CBE QC, Mr. Christopher Vajda QC and Mr. Aidan Robertson (instructed by Messrs. Taylor Vinters) appeared for the Applicants

Mr. Rhodri Thompson QC and Mr. Jon Turner (instructed by the Director of Legal Services, Office of Fair Trading) appeared for the Respondents.

Mr. Euan Burrows (of Messrs Ashurst) appeared for the Intervener.

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HEARING

THE PRESIDENT: Good morning, ladies and gentlemen. The Tribunal would like to commence with the following opening comments. In our Judgment on the substance of this matter we invited the parties to reach a negotiated solution to this case if possible, pointing out that it was Genzyme's responsibility to end the margin abuse. We were told that Genzyme hoped to resolve the matter by negotiation.

At present it appears to us that what, in fact, has happened is that little or no negotiation in the true sense of that word has in fact taken place, notably between Genzyme and its customers or the OFT, but an almost entirely adversarial situation has persisted in which, as far as we can judge, Genzyme gives us the impression that it has continued to contest virtually every argument and figure put forward by the OFT instead of engaging constructively with hospitals, clinicians, other homecare suppliers or public authorities in the interests of the patients to find a solution.

We have to say, and we say it so that it can be dealt with in the course of argument if necessary, that we find that approach to the situation in this case to be an inappropriate approach. Related to that, as already pointed out in this Judgment we would underline that in our view it is not the OFT – still less the Tribunal – which bears the primary responsibility of ending the abuse in this case. The primary responsibility rests, in our view, with the dominant company and we deprecate attempts to shift that responsibility on to the public authorities. This matter is not in our view equivalent to commercial litigation, particularly litigation between Genzyme and Healthcare At Home. It is now a matter between Genzyme and the OFT who represent the public interest, including the National Health Service and through them the patients' concern. We hope, therefore, that today's discussion can be pursued in a more constructive spirit than has hitherto prevailed.

We would also emphasise and I think must be fairly clear from the papers, that whatever solution is now found, or imposed, there will clearly be a degree of appreciation and judgment that is necessary, and there can never be total certainty as to future developments. In respect of any prices that might or might not be set or agreed, in those circumstances the prices in our view at present would have to be at a level of "not less than" X, the matter being kept under review to see how matters developed. In other words, it will be necessary in our view, in any event, to have some failsafe mechanism in place so that if the solution arrived at in these proceedings did not, in fact, enable competitive forces to work, or inadvertently allow a margin squeeze to continue or to reappear, there was a mechanism for ensuring that any order made could be reviewed as necessary by the Tribunal and/or by the OFT.

That I think also raises a procedural point on which, at an appropriate moment, we would like the parties' views, which is what should now be done assuming that no agreed solution can

be arrived at. If an agreed solution can be arrived at so much the better. If an agreed solution cannot be arrived at – and this is the question really – should the Tribunal now remit the matter to the OFT for the OFT to make an order, no doubt on the basis of the information that it already has, or should the Tribunal itself cut the Gordian Knot and make an order or direction s it thinks appropriate taking into account all the arguments that we have received. That is a procedural upon which we would like some observations at some point during today.

Those are the main opening points we would like to make. As we see it what we would like to do is to take as our broad agenda the Tribunal's recent letter to the parties explaining how we saw these proceedings unfolding. As far as we are concerned, we would prefer it if this matter continued in open court for as long as possible. There may be occasions when for one reason or another that is not possible, but we prefer this matter to continue in open court. If anyone is addressing the Tribunal – indeed, the Tribunal itself needs to remember – that certain figures re not necessarily known to all parties in the room, and that therefore the mention of figures should always be something that those concerned are careful about. It is quite possible normally to point to a particular figure on a page rather than to mention the particular figure out loud if it happens to be a confidential figure.

Procedurally speaking, we view today as a relatively informal day insofar as one can have any sort of informal days in a setting such as this with serious issues to address. It is probably appropriate, at least in the first instance for the Tribunal to address itself to those who are sitting in the front bench before us, but we hope that at certain points, if appropriate, others in the room will feel free to contribute and speak directly from where they are sitting. We will just see how that unfolds.

Before we commence the discussion, I think we would just like to invite any of the parties to tell us whether there are any particular points they want to make at the outset. We are aware that there was – and perhaps still is – a flurry of activity on an issue regarding disclosure. We have carefully read the papers in that regard. We are not at present persuaded that further disclosure is going to be useful or necessary, but we would not wish to take a final view on that until we have heard the discussion today to see whether indeed it is either useful or necessary to order any further disclosure. So we are not ruling on that issue, but we prefer to park it until we have had a discussion on the merits and we hope that we will now be able to engage on the issues as they present themselves – at least in broad terms.

Does anybody wish to make any observations before we start? Yes, Mr. Vaughan?

MR. VAUGHAN: If I could, it relates to the unbundling issue. In our previous matter we said we were giving due consideration to that. We have come to a conclusion which is that we would propose to unbundled, and that is our intention. Could I hand in a note?

THE PRESIDENT: Yes.

MR. VAUGHAN: Because we have drafted up so that there should be no doubt what it says, and also we can hand it to the other counsel at the same time. [Document handed to the Tribunal and counsel] Basically it is a commitment, an undertaking, for the Tribunal.

THE PRESIDENT: Have you had a chance to let the OFT know in advance?

MR. VAUGHAN: No. Paragraph 1 – we have previously flagged ----

THE PRESIDENT: You are going to take us through it.

MR. VAUGHAN: I was going to take you through it.

THE PRESIDENT: That is probably the easiest way; we are in open court so you had better do that, yes.

MR. VAUGHAN: I think we have ensured that there are not figures in the annex, but there are cross references to their locations. As I said, we have previously said that we considering going down that route and what has happened now is particularly the various evidence of the pharmacists as to the expected prices have greatly assisted that because you will remember that the pharmacists have given an indication of what prices they would expect to have to pay for this type of service – the nursing and the delivery, and obviously that includes profit and overheads of any company.

Genzyme has now decided to commit itself to offer an unbundled price for Cerezyme. That reflects the desires of the Department of Health, the National Health Service, desire to provide pricing transparency in the supply of drugs and for hospitals to be able to invite tenders and enter into contracts. There is a lot of evidence that that is what they want to do. You referred to some of that in the Decision. Mr. Brownlee, Mrs. Stallibrass, Mrs. Patey and I think Mrs. Howe.

THE PRESIDENT: Yes, they all said the same thing.

MR. VAUGHAN: They are all to the same thing. Indeed, it is one of the three remedies suggested by this Tribunal in para. 664.

Our proposal is that we undertake full consultation with the Department of Health and the NHS drugs purchasers about the new unbundled price, the mechanism and the quantity, the volume, what it should be. The new PPRS regime is about to come into force and it will be done in conjunction with that, Mr. Brownlee, you will remember is in charge of the PPRS scheme. Obviously the new price has to ensure that it complies with the PPRS requirements.

It would involve consulting, amongst others, Mr. Brownlee, Mrs. Stallibrass, and the pharmacists at the four referral centres. Mr. Farrell of the Royal Free and Mrs. Patey from Gt. Ormond Street, and Mr. Gibson, Booth Hall, and Mrs. Howe of Addenbrooke's. There are various notes of discussions with them on previous occasions after the judgment at tab4/63-67.

The basic position we start from is that the NHS should not have to pay more for the separate services than it does now for the combined service, that is that it should not have to pay more than £2.975 per unit. That has to be moderated to get a unitary price to take into account the fact that some hospitals are getting it at a lesser price, so we would globalise that by applying the relevant statistical exercises for looking at the number of people who get it at £2.73, so that would become the drug only price.

THE PRESIDENT: You mean you would abandon the present hospital price?

MR. VAUGHAN: We would abandon the special which owes particular reference to the VAT treatment in a particular case, so that would go, but we would ensure that by taking that into account the hospitals were not overall paying more, so the £2.975 per unit would have to be "modulated" – that seems to be the word – to take that into account. Our commitment is that the hospitals overall pay less.

To arrive at the unbundled price we would start from the current market price for homecare services because the purpose of unbundling is to allow competition to develop within that sector, that is what the NHS and the DOHS want.

THE PRESIDENT: Forgive me, this unbundled price, I know it is an internal transaction, but it would be offered as it were to Genzyme Homecare, and Genzyme Homecare would price its services or its offers as if it were a self-standing ----

MR. VAUGHAN: Yes, an arms' length transaction.

THE PRESIDENT: Yes, an arms' length transaction.

MR. VAUGHAN: With no cross-subsidy.

THE PRESIDENT: With no cross-subsidy, and expected to stand on its own feet in commercial terms.

MR. VAUGHAN: If it can, if it cannot then it goes out of business.

THE PRESIDENT: Yes.

MR. VAUGHAN: And it would compete in this market and in other markets for Thalassaemia or whatever markets are available. It would be a full function service, not merely a captive.

THE PRESIDENT: You mean Genzyme Homecare might develop into offering wider homecare services.

MR. VAUGHAN: It could do – I am not saying it would, but it might have to in order to widen its cost base in order to do that. Certainly, in this cold chain world presumably it does not want to enter general nursing, but it might want to enter into cold chain deliveries so that when the man, or the person with the delivery of Cerezyme goes out he can drop off some Thalassaemia or whatever might be appropriate to the neighbour, or whatever might be the position.

Genzyme has had the benefit of the conclusions of Professors Appleyard and Yarrow. They have based their reports upon a cost analysis which is effectively a reverse engineering in this, working out what the price should be from cost. The second thing is that there is now available a considerable body of undisputed and non-confidential information which supports their figures, and I will take you through it in a moment – Mr. Farrell in his note of the meeting of 15th July 2004, which I am not sure you have, because that is in some documents disclosed to us on Monday.

THE PRESIDENT: Yes, we have that.

MR. VAUGHAN: It came with a fax.

THE PRESIDENT: This is Mr. Farrell's meeting with Mrs. Pope on 15th July.

MR. VAUGHAN: That is right, yes. I will come back to it in a moment, but the figures and the identity in 3 are confidential, the figures in 4 are not confidential.

THE PRESIDENT: Yes.

MR. VAUGHAN: He says there that he:

> "thought purely for the delivery element of the homecare services a price of £80 - £100 was about right."

But it would need to be:

> "adjusted to take account of factors that were relevant to Cerezyme but not other treatments such as the value of the drug."

We dispute "the value of the drug part", and then he has added in by amendment:

> "The price would be dependent upon particular patient requirement and ultimately for the market to determine what the price should be."

We obviously entirely accept that. The price would be driven down irrespective of the drug in that way, by competition. So we have that sort of evidence from him. It is a document we only received on Monday, but obviously it is relevant to show you what price he thought delivery only would be, and is consistent with the Professors' view of what it should be.

We have Mrs. Patey's evidence which is broadly to the same effect in volume 1/6, and Mr. Potter's evidence at volume 1/5. We entirely accept the point that some allowance has to be made to take into account different requirements. They may take it up or may take it down, because some of them are more complicated than Cerezyme in delivery terms, and more intrusive in nursing terms. There is also a great deal of confidential information about the figures for various treatments, and I will take you through that in a moment. None of that evidence was used by the OFT in preparing its Report. It made the point that it wished it had market prices but said that it did not have them because it was too difficult for Healthcare At Home to produce this evidence. So they have had to do a reverse engineering exercise. But we

feel pretty confident that if the OFT had seen and taken into account these sort of figures, it would not have come to the view that it did about the cost and the price of delivery and nursing that it came to in its report. That is our belief, but they may say differently, anyhow we will hear about these things.

So we would use these factors, and the Professors' Report, and the non-confidential information (you have seen – or will see – the confidential information) to arrive at an unbundled price. If anyone suggests that those type of prices are wrong - Healthcare At Home or something like that – then it could produce to the OFT or whatever, under some confidential system, evidence to suggest those are wrong prices. That would enable us to find, as it were, what we regard as the strictly necessary exercise to unbundled.

We would then (this is para.6) introduce what we call a "safety net" here to allow the changes in circumstances and attempt to avoid further disputes in this matter. So if the first exercise took one down X key, then there would be X + Y which would be the safety net. Obviously what that safety net should be in size or the dimensions of the safety net were matter for debate, but in broad terms we would want to take the safety net beyond what was strictly legally necessary, according to our submissions, somewhere closer to the OFT's position – how close is a matter we obviously have to think about very carefully.

Effectively, that would mean that the unbundled price became, as it were, the drug only price, which is what you suggested in 664. It would mean that there was a sufficient margin between these two price – the unbundled price and the pre-existing price – to ensure the NHS did not pay more for those services. That would become either a contract price or the drug only price, and we know from the Addenbrooke's paper, and I think from everything else, that everyone now is dropping FP10s, so nobody gets reimbursed any more on the reimbursement price, they get reimbursed on the contract price.

So effectively we go back to what were the contract services in the Fresenius Paper.

THE PRESIDENT: Do you envisage maintaining two prices – (i) the existing price; and (ii) a drug only price?

MR. VAUGHAN: No.

THE PRESIDENT: Just the drug only price?

MR. VAUGHAN: Just the drug only price. It is possible I suppose one could have, if somebody were able to show that they could not get financing for the other thing, we might, and if somebody was using FP10s ----

THE PRESIDENT: Because there would still be some people using FP10s, I think, even if Addenbrooke's went over to a different system.

MR. VAUGHAN: But if there were still some FP10s used, which we think is extremely unlikely, they would all tend to go into contract services, but if there were some then obviously we would have to ----

THE PRESIDENT: I think Addenbrooke's said it would take it some time to adjust its system and so forth.

MR. VAUGHAN: If it was a transitional arrangement we would need a transitional arrangement. The whole intention is that we would have a drug only price but there may be some odd ones which would need special treatment, and obviously we would have to take that into account. Basically, this would become – and this is why we need agreement with the Department of Health – a drug only price, and the services which were provided would become contracted services and be open to tender or contract, as the case may be, which is Mr. Farrell's preferred option, and everyone's preferred option. It may take a time to get that set up. I think in his evidence Mr. Farrell said it should not take very long to set that up.

What we would be asking in this context is basically that we have something like six weeks, as it were, to conduct these negotiations with the Department of Health, with the NHS, to set up the method of organisation under which it is done – they would presumably have to open new budget lines, because it would not be paid for under the drug price, it would be paid for under the treatment price, and we would have to discuss with them what the price would be. We would intend to discuss that price and not just the methodology with the Department of Health.

MR. MATHER: Could I ask if you have had any initial discussions with Mr. Brownlee or Mrs. Stallibrass or anyone in the Department?

MR. VAUGHAN: Not since this Decision, but we have had them earlier. We have had the earlier discussions where they made it very clear to us in the meetings that this is the route they wanted to go down. That was the note, sir, at bundle 4/63 para.2. We had discussions with them, and they made it very clear that that is what they wanted to do. If that is what they wanted to do presumably there is a mechanism they could devise to do what they want to do in that respect.

PROFESSOR GRINYER: In your discussions presumably you would cover transitional arrangements?

MR. VAUGHAN: Clearly yes – I must admit we had not thought about that – or I had not thought about it - but there is going to need to be a transitional provision to cover the position so that people are not out of pocket. Apparently we had some more on 1st April ----

THE PRESIDENT: There was an initial discussion.

MR. VAUGHAN: There was an initial discussion, bundle 4/63 – we might as well look at it now. This is a meeting after we had the Tribunal Decision, and so immediately after the Decision the first thing we did was to go and see the bosses, as it were, before we did anything else, and the bosses in that, whether Mr. Brownlee or Mrs. Stallibrass I do not know, but they made it very clear what they want out of that. At the end of p.3 Mrs. Stallibrass replied:

> "…that she doesn't have specific responsibility but she does know how people think. It was for Genzyme now to go to the providers because they were the ones who would be subcontracting the service. However, she came back to the fact that the persons commissioning the service were agitated at having to pay a percentage, and thus a fee that was not service specific."

So they wanted to get away from percentages, they wanted to get to prices, so they do not want a value base. I am told I ought to read para.6. Mr. Brownlee said:

> "that looking at the future pricing arrangements there was considerable impetus for differentiating out the facilities from the medicine. There was resistance to the NHS paying a bundled price for a particular bottle/application device, and the medicine when it could buy them separately or supply one of the two parts itself."

So broadly this is the message we got at a very early stage, that that is what they want. The problem we have had, the particular problem, is trying to work out what is the price, as it were, and that is obviously a major issue, at what price you do unbundled so that we do not get ourselves back into further litigation on the unbundling price in that sort of case. That is why we want to talk to the Department of Health about these things first.

We propose in our note that we would then give a reasoned decision and justification to the OFT and to Healthcare At Home and to anyone else who wanted it and was entitled to see it, and to do that by the end of November. Then both would have three weeks to respond, and if they objected to give full justification for objecting and give documentation for objecting at that stage. That would allow, certainly the parties here, a chance to gainsay. We have seen today a witness statement from Healthcare At Home who object in principle to the whole thing. They do not object, well not at this stage, to the price, but they object to the whole principle and say that it would be wrong in principle to allow us to unbundled. It is rather strange now to take that position when that was the position in the Tribunal when it took its decision as to what the possible remedy should be. However, whatever they think, it is what the Health Service want.

MR. MATHER: I think the thrust of Dr. Jones's witness statement is that there will be very serious practical difficulties in the operation of the NHS, and I note in the document to which you just referred us, that Mrs. Stallibrass said she was not specifically responsible for the system. Is

Genzyme confident that those practical difficulties will not occur, and that it will prove possible to achieve a smooth and effective operation of such an unbundled price?

MR. VAUGHAN: Yes, this is one of the things, the purpose of having the discussion is to find out how these things are to be done. Mr. Farrell's evidence was that it would not be difficult to do it. Mr. Farrell's evidence on this is at bundle, tab 73/13:

> "JF explained that moving from the current position where a bundled price is charged to a position where the price of the drug and price of the home delivery/homecare services is unbundled would be extremely easy and a very welcome development."

So he saw it as not a problem.

> "It would simply require placing two separate orders with the company instead of one. In other words, the RFH [*Royal Free*] would place an order for its requirements for Cerezyme and a separate order for its requirements for the provision for home delivery and homecare services. This change could be implemented immediately. The price paid by the RFH for the Cerezyme would be the new list price …"

which is the unbundled price –

> "…(subject to any available discounts) agreed between Genzyme and the Department of Health."

He explained that:

> "…in relation to the price paid by the RFH for the home delivery and homecare services during the period of appeal, the RFH would have two choices."

But he certainly thinks it would not be difficult. Obviously, there are things to be done. He certainly said it would not be a difficult operative thing.

THE PRESIDENT: Mr. Vaughan, although any step which represents or might represent progress, however small, is clearly to be warmly welcomed, the note from Mr. Farrell that you have just been reading from is 18 months ago, and it would have saved a great deal of time and trouble if something along these lines had been caught out a bit earlier, and indeed if in the more recent past those concerned with today's hearing had been tipped off a bit earlier than this morning as to what your client's position was.

MR. VAUGHAN: The position was that we were working towards this, as we said in our reply submissions. What has happened now is that recently we have got very much further evidence, and become aware of much further evidence that effectively the market price is what the Professors say it is. Our problem was going to be that if we started to unbundled at that price and the market evidence showed a different price, then we would be in difficulties. Certainly, the evidence is that this is what the market wants, and the contemporary evidence is that this is what the market wants. Our discussions since the Judgment with all the hospitals and referring

centres is that this is what they want. Now we can realistically move ahead to what, in our submission, would be the right sort of price.

THE PRESIDENT: So what is your suggestion in practical terms as far as today is concerned?

MR. VAUGHAN: This is what we intend to do, and we want to go ahead doing this. Obviously you have a lot of experts here and a lot of expertise, the possibility would be to see whether we come up with a solution in the time, as it were, to adjourn the matter and then to deal with it. Obviously, it may be that you would be reluctant to do that because we have so many people here and there are obviously certain things we want to discuss in that respect as to the various prices. But this is a commitment irrespective of what we do today. This is what we are going to do irrespective of what happens to day. There would seem to be two ways open, one is that other people make the observations they want on what I have said, and then to review and see what then we move to. My understanding is that when we discussed it with the OFT they welcomed unbundling provided the price was right. Healthcare At Home oppose unbundling whatever the price is. They say it cannot work, and they do not like it and it would be disastrous were we to unbundled. We have obviously got quite a lot of points to deal with in Mr. Jones's witness statements.

THE PRESIDENT: The middle course on that is at least for a period, but perhaps indefinitely to maintain two prices – to maintain the existing list price and to maintain as an option for a hospital that wanted it, the unbundled price.

MR. VAUGHAN: Yes.

THE PRESIDENT: You would therefore have a failsafe mechanism to deal with any of the practical problems that the impenetrable systems of the NHS seem to surprisingly jump out at one when they are least expected.

MR. VAUGHAN: Absolutely. What we would envisage is going for one price with a transitional protection to cover the interim position. But we cannot tell you today what is the unbundled price. We can tell you what we think the market price is, but what we cannot tell you is the extra safety net allowance. The market price is the price that the pharmacists have told you, and the confidential information you have already received will tell you what it is. We have set out in the annex to this what we rely upon in particular as to what the market price is. Everyone seems to accept, other than Healthcare At Home I think, that delivery and nursing ought to be dealt with separately – or could be dealt with separately. There are some contracts which are delivery only, and some which are delivery and nursing. But it is up to the hospital to decide which option to go down, but they each can be priced separately.

One of the problems, without wanting to be too adversarial is that we have seen no evidence from Healthcare At Home about what it charges for any of these services. What we

have is from third parties. Indeed, in their reply document they produce nothing, and Mr. Jones produces nothing today about actual market prices. Everyone, I think, accepts that the prices have to reflect competition in the market, and that was the point that Mr. Farrell added to the note that we just looked at. It is going to be dictated by competition as to what that price should be – a price where we have Healthcare At Home, ourselves, Clinovia and Central competing in that market and we will all presumably be tendering for any relevant contracts that come up, whether in relation to this product, or other related products. At point 4 in the annex Mrs. Patey talks about free competition on that basis. It is very clear from Mrs. Patey anyhow, and from the Department, they do not want a value based price. Mr. Farrell mentions the value based point but, in reality, that could never survive competition. The only time value becomes relevant might be in insurance.

There is a lot of evidence on what the delivery price should be.

THE PRESIDENT: Do I correctly divine, reading between the lines, that your provisional thinking is that the unbundled price would be at a point lower than the existing list price by approximately the percentage that Professors Yarrow and Appleyard identify in their respective reports?

MR. VAUGHAN: Plus the safety net.

THE PRESIDENT: Plus a safety net, and plus what you regarded as a factor to do with coming somewhere closer to the OFT's position?

MR. VAUGHAN: Yes, and obviously there are two possibilities. One is we can go the whole hog, as it were, and one is that we go towards it. But for the purpose of the safety net, and without decrying the Professors' work, we would not insist upon the strict legality.

THE PRESIDENT: No one can be completely sure how things are gong to unfold, and whatever we do it is going to be a matter of judgment and appreciation, and a degree of commonsense has to be injected into a situation like this.

MR. VAUGHAN: That may be another thing in the safety net, commonsense – and may be amicability.

THE PRESIDENT: It may not be at the end of the day an exercise that can be done in completely scientific or mathematical terms.

MR. VAUGHAN: No, that is right.

MR. MATHER: In legal terms the price will be the price, or the discount will be the discount, I assume, and the safety net is purely something which internally in Genzyme you are using to calculate the price you offer. Is that correct?

MR. VAUGHAN: The first stage of the exercise would be a purely economic exercise, looking to see what the market price is now for these particular services, provided by people who are competing in the market. The second exercise would be the safety net.

MR. MATHER: My point was that in offering a price to the NHS they would not be troubled with the safety net, they would just be offered a price which you had calculated, taking into account those two steps.

MR. VAUGHAN: Yes, which would particularly include the safety nets, and that would be part of the discussion, because obviously Genzyme wants to get on with its business – it has new products coming on the market and it really wants to get on providing them to the patients.

There is quite a lot of evidence on what the delivery only price is. We have the evidence of Mr. Farrell, Mr. Potter and Mrs. Patey as to what they would expect to have to pay. They all take a slightly different view, but all are in the same ball park, and all in the same ball park as the Professors without the benefit of that analysis. Indeed, Mr. Potter, who now works for us, in fact is the highest of the estimates of what he would expect to pay. There were some rather nasty remarks about Mrs. Patey, that she has not shown what her experience is on these things. I think that has now been clarified in her recent e-mail to the Tribunal. Basically, that is quite considerable, open, non-confidential evidence.

THE PRESIDENT: How do you see things from this point of view, Mr. Vaughan. You are relying here on the work of Professors' Yarrow and Appleyard and what you say are the views of Mr. Farrell, Mrs. Patey and Mr. Potter in particular.

MR. VAUGHAN: Yes.

THE PRESIDENT: On the other hand, in the various OFT studies there is quite a lot of other evidence that is put forward by way of cross check and otherwise, from Clinovia, from Central Homecare, from Healthcare At Home itself, and from the historical evidence that the Tribunal had at an earlier stage. How does all that fit into this approach you have here?

MR. VAUGHAN: Basically our approach is that the jurisdiction of the Tribunal is to deal with the question now, what is the position now? What is the competitive position? If, for example, we were to take a price that was too low, which over reimbursed, it would mean that anyone competing on this market was effectively being paid to provide the service twice. They would go to the Health Service and asked to be paid under the contract, but in fact they would be getting the difference between the reimbursement price and the other one, and the discounted price. One of our intentions of the whole exercise is to get away from list prices, get away from discounts, and start on the basis that everyone was equal. There is a lot of the OFT Report, as we have made clear, that we do not accept, and because when one looks at the

documents one actually finds that they are not supported in that way. I will come on to that in a moment.

Broadly, we would say it draws a fresh line under the whole thing, and seeing what the nub of this is. This price also coincides with certainly two of the prices which Healthcare At Home has given in para.321 – the figures again are confidential, and I think the products are confidential – the first three are consistent with this sort of figure. The others which they have given are wholly aberrant in that way, we just cannot understand them. One of the prices is the delivery for an expensive drug at exactly the same cost as the drug itself, and it is a high price – I think it is Immunoglobulins, where the price of delivery (there is a range) equals the price of the drug itself. That cannot be right, there must be something else – if that is the right price there must be something else and Healthcare At Home refuse to produce those documents and, indeed, refused to bring them to the Tribunal today, they said they would not bring those documents.

THE PRESIDENT: One of the points that, at least provisionally, seemed to me to have some force from the OFT's point of view, was if the final solution (at least initially) tended to over compensate the homecare service providers, there was at least a realistic possibility that competition would tend to compete that away and you would settle down to a competitive price. But if it were the other way around that the homecare service providers were being under compensated, then the risk would be that competitive conditions would not be restored because you would not get people prepared to offer the services at the underestimated price that one had arrived at.

MR. VAUGHAN: Yes, that is part of the purpose of looking at what the current position is now, and then providing the safety net, and we have no problems with the idea that the OFT should have a power of review as it does in other pricing areas from time to time, to review the undertakings – or whatever it might be – to see whether they are being complied with. We would be perfectly satisfied to give this as a way of a binding undertaking, as it were, to the OFT, so that the order was policed by them, and I am sure you do not want to police the order.

THE PRESIDENT: No, that is their job, is it not?

MR. VAUGHAN: And so we would, as a matter of form I suspect, put it into a binding commitment, and that would be a way of undertaking to them which would then building a review process. One of the things that is going to happen is that TKT, for example, is going to bring out its generic product in, we think, early 2006 now, so we are 18 months from that. So that is, as it were, going to completely distort the whole market at that stage. It may well be that one needs a review to take into account at any particular stage. So one would probably

need the very frequent one, because it may be that the price one is talking about, the unbundled price is completely unsustainable, if there is competition from a generic at the same time.

I do not want to take you through this, it will take too long, but it is to set out basically – if you look at treatments generally, all the evidence supports the sort of price that the Professors say. If you look at haemophilia (para.11) we know the haemophilia price, which is confidential. Healthcare At Home complained that their price was distorted now because of the action of the vertically integrated supplier. But if one now looks at the note from Mr. Farrell, which was disclosed on Monday, one sees effectively on para.3 – I have to be careful with this – I cannot mention the name of the companies, and I cannot mention the names of the bids.

THE PRESIDENT: No, but we can see it in front of us.

MR. VAUGHAN: You have read it.

THE PRESIDENT: Yes.

MR. VAUGHAN: And it was not, as it were, done by themselves, there was another bidder at pretty well the same sort of price at that time. It was not just a price where they were driven down and, indeed, if one looks at Mr. Farrell's original evidence, he does not support that view that they were driven down. The supplier, in fact, had to quote separately for the drug and the service in that way. We know that a drug company got the drug and Healthcare At Home got the service.

HIV – the evidence is that HIV, and I think this is fairly undisputed (in Mr. Potter 2) basically that if anything HIV is a more expensive service to provide because effectively the distributor has got to deliver a whole cocktail of drugs at each delivery, and they may vary on each particular person, so the whole delivery process, which is also cold chain is quite a lot more complicated.

Thalassaemia – I do not think we have really paid sufficient attention to this, or I have not, Mr. Farrell in an e-mail, which is in bundle 4/73/1 has given us some Healthcare At Home prices, and I do not think the OFT had picked them up at all. On p.4, one really needs to start in the middle, from Ann Pope to Mr. Farrell:

"Many thanks. I will add in the additional point and put the meeting …"

Sorry, no.

THE PRESIDENT: This is quite an early stage, is it not?

MR. VAUGHAN: This is an early stage, absolutely, this is in February 2002. She asks him for some equivalent prices and HIV were paying that amount per patient, per delivery every three months. Thalassaemia, that amount for delivery and services every two weeks, and Ashurst, in their recent document on discovery point out that Thalassaemia is very close – probably the best comparator – to Cerezyme (and in delivery and nursing). They point out in that letter to

Mr. Farrell's witness statement, where he says that. That is their document on discovery in this matter. That is well in line with the Professors' evidence. They refer and rely upon, and this is their letter of 7th October. They refer to Mr. Farrell, his witness statement of 30th June where, at para.48 he says:

"Nursing support is not a feature of the homecare/delivery service for all conditions, e.g. we do no require it for haemophilia patients. However, for Gaucher disease and for Thalassaemia, nursing services form an integral part of the "package" of care."

Indeed, our evidence and Mr. Potter's third witness statement, deals with that a little more. I am not sure we have put in Mr. Potter's third witness statement. Basically he is making the point which I can do now that if anything Thalassaemia is more demanding than Cerezyme. We are perfectly prepared to accept that it is an apt comparator and, indeed, Ashurst make the point that it is relying on Mr. Farrell that it is an apt comparator in that respect. That is Thalassaemia. We have Professor Appleyard and Yarrow and then we say all the evidence points to that being the appropriate price, which is what the Professors say. There is less evidence about nursing by itself, in conjunction we have Thalassaemia, but nursing by itself there is less evidence.

Mr. Farrell, in the same note we have just been looking at, said he had a less clear idea of how much it was appropriate, especially as nurses could be very expensive. The Royal Free are paying £400 for oncology specialist nurses. It is unclear to what extent that is comparable.

On Cerezyme Mr. Farrell said in his evidence to the Tribunal:

"I would expect most nurses who are practising in hospital to be able to do it"

that is the infusion. Indeed, I think Julie Kelly's evidence points to the Healthcare At Home asking for nurses with cannulation experience.

Mrs. Patey give evidence of what she thinks it is an hour. Mr. Potter give his estimates of what it is an hour, and that is in line with para.25, the University of Kent research for the NHS, cited by Professor Yarrow, and we have seen the Thalassaemia – it is broadly the same sort of figure, although combined with delivery in that way. Broadly, we have considerable contemporary evidence that that is the right sort of price, and none of that really was taken into account by the OFT. One of our main criticisms of the OFT is that they asked (correctly) Healthcare At Home to provide this sort of information. Healthcare At Home said they could not provide it because it was too difficult to do and too time consuming. It is abundantly clear there is that evidence, and what I am not talking about now is the discovery part, because we suspect that all those tenders they succeeded on give prices roughly in this sort of area, and would be supportive of us in this area. Indeed, one could ask oneself why would they refuse to produce it if in fact it was going to help their case in this matter.

Broadly, that is what we say. This is the route we want to go down. In a way the most attractive one is saying "If you say so, go and do it" as it were and then see what happens. We are still paying 3 per cent. discount under the interim order, so nobody is being unduly penalised. If 3 per cent. is too little and we lose the claim eventually, then they have got that in by way of damages in a claim against us in that respect. It is not as though they are unprotected, they have the 3 per cent. in order to work with and, indeed, that is the basis they have been working for the last year and a half I think it probably is. They would no doubt say "that is not enough" as indeed they said at the time, but it is not as though they are totally unprotected in this time. Also, in addition to that they have credit terms available.

THE PRESIDENT: Has the credit issue now been resolved?

MR. VAUGHAN: They get 90 days credit, and the evidence is that that is longer than the period by which they get reimbursed from the Health Service, the average period. So they get that, whether it is a month or whatever, extra credit we give. It is not as though they are being hung out to dry in the meantime and anyhow this is effectively for two months and if we cannot work this out – I suspect we will never please Healthcare At Home because they object to the whole principle. But if we can satisfy the OFT that we are right, at least we are in the right area and that basically is our objective, namely, to satisfy the OFT that our figures stack up, our safety net is adequate and then that is our objective, and I do not think realistically we will ever satisfy Healthcare At Home unless we give everything away, basically, and that is not what the intention is. Our intention is to provide enough to keep a competitive market in which Healthcare At Home and we others can compete, as they do compete in this way. That is what everyone seems to want. I apologise really that it has come so late, but the problem is trying to find out what is the evidence to support the first part of the exercise, obviously the safety net is important. But to what extent could we rely upon the Professors' evidence? All the evidence effectively now shows that as of recently the Professors were right, and therefore the part of the exercise would work on the basis as you say, that they were right, but the second part of the exercise would take into account the possibility that they may not be entirely right, and then move towards the OFT's figure. Obviously the cannot negotiate figures, but they can approve or disapprove figures. It would obviously be inappropriate for them to negotiate in that way, but they can at least tell us whether they are right or wrong. I am sorry, I have taken rather a long time.

THE PRESIDENT: Thank you, Mr. Vaughan. I think at this stage we had better hear from the OFT and the intervener's first reaction.

MR. TURNER: May it please you, sir, Mr. Thompson and I are going to box and cox, but I will begin with preliminary observations in relation to what Mr. Vaughan has said. It is clear that

some officials in the NHS have referred several times to the desirability of achieving transparency as between the price for the service and the price for the drug. But the separate question with which we are faced is what is the appropriate discount to bring the margin squeeze abuse to an end? That is the issue before the Tribunal.

The OFT's position in relation to the question you canvassed in your opening remarks on this is that we are of the view that there is sufficient material before the Tribunal for the Tribunal to be able to grapple with that issue, without the necessity for remission. We will obviously see how the day progresses. We note also that Mr. Vaughan is not in terms applying for an adjournment, he is content for the day to proceed.

THE PRESIDENT: Yes.

MR. TURNER: There is a fundamental difference of approach that has been teased out of Mr. Vaughan's remarks, which seems to be as follows. Genzyme relies very heavily on figures which relate to certain other disorders, which they say are comparable in many ways, and we have had today increased reliance upon the example of Thalassaemia. Previously we have had reference to haemophilia, and certain other conditions. They also rely upon certain general remarks that have been made about, for example, the cost of a basic delivery service, and what sort of ball park figures one might see for that. Using those elements they seek to draw to a conclusion of what the market rate might be for the provision of a Gaucher homecare service. The OFT's approach is that such factors are relevant, but their starting point is rather different, because the OFT focuses more on certain direct evidence relating to the Gaucher Homecare service, and that includes, notably, we say "historical, but in fact fairly recent example of the re-negotiated price in 2000 for the contract between Genzyme and Healthcare At Home which, if memory serves, at that stage led to a 9½ per cent. discount from the existing NHS list price.

We have also, relating to Gaucher Services and Genzyme Homecare plan, if you look at that you will see that they were thinking forward – we will find a reference over a period of a number of years to the cost of that service equating to something like 6-7 per cent. of the list price – and we have in the OFT's report a discussion of both Clinovia and Central's views in relation to the provision of this particular service, as market operators. We have the information which is digested from Healthcare At Home, which currently provides this service. All of that, in the OFT's view, is the correct most relevant information for the Tribunal to concentrate upon. It may be appropriate also to note that in relation to the Gaucher homecare service, there are certain elements of information, for example about patterns of nurse visits, nurse costs and so on for which Genzyme itself will have relevant information but which has not been brought to the table in this discussion. The OFT's position in summary is

that that is the right way to approach the question that is currently before the Tribunal. That is by way of opening remark.

There is one procedural point which, if I may, I will mention. It relate to a statement in the Tribunal's letter of 11th October, that the Tribunal may have questions for the parties and their experts and, Sir, you have referred to that position in your oral remarks this morning. We say in relation to that that there is a difference between the position of Genzyme certainly and that of the Office of Fair Trading. In the case of the Office, the OFT reports are essentially a collaborative effort of the Civil Servants involved. They have not hired themselves out as expert witnesses in this case in the same way as Professors Yarrow and Appleyard. There are some concerns that if the Tribunal is envisaging direct questioning or cross-examination of these officials in court, at any rate extensively, that that might not be appropriate and our preference would be that, at least so far as possible, the Tribunal should deal with questions about the reports when we arrive at that stage, through Mr. Thompson and myself.

THE PRESIDENT: Yes.

MR. TURNER: Sir, that is all I desire to say in opening.

THE PRESIDENT: What do you say we should do about this, and do you or Mr. Thompson have any first reaction as to whether Genzyme's position on unbundling represents progress or not, the timetable that is suggested and all that sort of thing?

MR. TURNER: So far as that is concerns that we would, first of all, appreciate the opportunity as this was dropped on us just now, for a 15 minute adjournment if that would suit.

THE PRESIDENT: Yes.

MR. TURNER: But our preliminary thoughts are that it is for the Tribunal to make this decision and we believe that it can and should make this decision. Genzyme were originally given in the Judgment in March six weeks in which to arrive at a negotiated solution. We are now six months down the line and we are asked for six weeks essentially for them to arrive at a solution along the lines that you have heard. We feel provisionally that we should press on. The Tribunal is capable and should determine this matter.

THE PRESIDENT: In principle if one were to go down the road of an unbundled price, possibly in combination with a discount from the existing list price, so that you had the option, the homecare services provider either bought at a discount from the list price or at the drug only price, it comes to the same thing. Is it your submission that the level of the unbundled price should be set at the same percentage off the existing list price, that one would have arrived it if one had simply been taking the percentage necessary to deal with the margin squeeze – if you follow my question.

MR. TURNER: I believe I follow. Essentially, yes, our position is that whatever discount is set the aim of the exercise – the essential task – is to find a sufficient margin to allow other homecare providers to compete in the service that is offered. Whatever the inclusive price that Genzyme offers, whatever the combination of its price for the drug and/or the service, whether that is at the existing list price or at a lower level the important thing is that there should be a discount from that combined price which is sufficient to enable other homecare providers to compete. That can be expressed either in cash terms, or pence per unit, or as a percentage of the existing list price, it does not matter, but that is the key exercise which will bring the margin squeeze abuse to an end.

THE PRESIDENT: Presumably, in the case of a straight unbundled price, it would be part of the solution to ensure that the NHS did not in the end finish up paying more than it does at the moment. For example, to take a totally hypothetical example – which is totally hypothetical – if the evidence was that a homecare services provider really could not tender, or would not want to tender at anything less than drug price plus 10 per cent. – to pluck a figure out of the air – and the new drug only price was - plucking a figure out of the air again – only 5 per cent. less than it is now, the net result would be that although you had a drug only price the NHS in the tendering procedure might finish up paying more than it was paying at the moment with the bundled price. Do you follow me?

MR. TURNER: Yes, I do follow that.

THE PRESIDENT: So presumably one of the things that the Tribunal would need to be satisfied about was that the bundle price, plus a market price for homecare services would not together finish up with a total cost that was higher for the NHS than it is at the moment.

MR. TURNER: Yes. For our part I think we would like to think about that. The one thought that immediately occurs is that one would not want essentially to endorse a predatory pricing abuse through the back door, as it were. If it turned out, for example, that the combined price of Genzyme was set at a level that others could not match because essentially the Genzyme Homecare operation was providing the service at a loss.

THE PRESIDENT: There would certainly need to be some sort of policing review, surveillance arrangement to make sure it was a genuine arms' length and, in principle, profitable operation.

MR. TURNER: But if the Tribunal proceeds today on the basis that we are looking at essentially let us call it the discount from the existing list price, which is sufficient to bring the margin squeeze abuse to an end, that would be at the very least an extremely useful exercise in assisting any further discussions that take place outside this court.

THE PRESIDENT: Yes. Yes, Healthcare At Home – good morning, Mr. Burrows.

MR. BURROWS: Thank you, Sir. I think we support generally the comments that Mr. Turner has just made. We do think that there are some issues to be at least discussed in the case. We did not think that the Tribunal wanted us to address you in detail on legal points today.

In summary, our position on the legal approach to any remedy is in line with what the OFT have just said but there are, of course, broader, and we would say ordinary considerations which that any remedy imposed should be an effective remedy, and that we do not have a remedy that would, in any way, facilitate a recurrence of this abuse or, indeed, a related abuse as one might have seen in circumstances such as Michelin 2. As I say, we did not think that the purpose of today was to address you in detail on the legal points, but we are happy to do so if that is thought necessary at a later stage.

Dealing with the issue which is essentially Mr. Vaughan's latest proposal, I have to say our overwhelming thought is one of déjà vu. The original Judgment, of course, trusted Genzyme – as they implore you to do again – and gave them six weeks to go away and negotiate a solution and that process has dragged out into three or four months of expensive litigation for all concerned and, most importantly, further delay to the resolution of the issue.

We would also say that it is unclear why this remedy has been thrown into today's proceedings at such short notice. In the written submissions that were put in on behalf of Genzyme it was said that any delay in coming to a view for you on bundling was due to the need to either resolve detailed accounting issues and/or potential changes to the PPRS regime. We have had no indication today that those have been resolved, or indeed why it has been put I at such short notice. I think the upshot of that point is that we, like the OFT, are going to need a little bit of time to look at this properly and come up with some considered points for you. However, it is possible – I think even on the hoof so to speak – to identify a number of problems that would arise at this stage.

In summary, we would say that this proposed mechanism is essentially another attempt on behalf of Genzyme to enable them to fix a very low homecare price via the backdoor. That arises as a result of the mechanism which has been proposed, which is essentially that Genzyme will take responsibility for a meeting with the Department of Health and the relevant healthcare officials in order to discuss the margin. Now, of course, that ignores the point that I seem to remember making back in May that of course it is Healthcare At Home who has the majority of the patients and will, in fact, be providing the service. So the opportunity that I believe is being envisaged, which is that we would have the opportunity, say, in November to make comments I would say is almost inevitably going to be called upon and we are simply going to have further delay and again, dragging this back into the litigious process that has characterised it so far.

We also would point to the notes of the meetings that have been taken by and on behalf of Genzyme and you were referred to this morning. These are in bundle 4, tab 64 – we have the meeting note with the Royal Free Hospital, and his of course raises the point of the list price which the Tribunal is already aware of obviously, and is discussing. If you read at the bottom of para.2 on the first page:

"There has already been a meeting with the Department of Health. Michael Brownlee notes that the Judgment does not affect the list price…"

THE PRESIDENT: Yes.

MR. BURROWS: So it is unclear to us the extent to which the parties at least in this meeting were envisaging a change to the list price, and then again if one were to refer back to tab 63, where one has the meeting note with the Department of Health – again we start off on the presumption that the list price is not going to change. Now, we understand that it is envisaged at the moment in Genzyme's proposal, that the list price will, in fact, change, if not initially, there were some sort of transitional arrangements which were – if I may say so – proposed very much on the hoof. So if they had not been thought of before it seems to be a rather ill-thought out measure. We say that if the list price is to change, as you have seen in the statement of Mr. Jones, that is going to cause extremely serious problems and repercussions.

The other point which was raised in your questioning of Mr. Vaughan was whether or not it would be possible to prevent any form of cross-subsidy, and I think you have raised the question that the price would be offered to Genzyme Homecare as free standing price and essentially there would be no cross subsidy. Sir, we say that raises another very difficult issue which is thoroughly inappropriate to deal with on the hoof, but I shall try to do so. Even if there is transfer, or ex-manufacturer price that is to apply to all – not just to Genzyme Homecare but also to us, one has the additional point of whether or not there is potential to have cross subsidy between he two businesses in other ways, and I am not sure that the issue has even been thought about here about the need potentially for complete accounting separation, the need to split assets, the need to split management, all of these type of things that are generally looked at in that form of remedy. Again, these are difficult and complicated issues that need to be dealt with carefully.

The final point I would wish to make on the hoof, so to speak, is can the Tribunal have any reasonable expectation that if it does trust Genzyme again to go away and negotiate this that it is likely to succeed, to come up with a remedy that is capable of working, let alone remedying the margin squeeze. We will say that the answer to that is plainly "no", and that is apparent on the face of the latest document itself, which is still clearly trying to put forward the old arguments of a margin, faced either with reference to the expert evidence that Professors

Appleyard and Yarrow face upon the very narrow bases of direct avoidable cost, or, even taking account of the safety net is still, plainly on the face of that document, envisaged to fall below the level at which the OFT have proposed. There is no hope that that is something that is not going to incite comment – certainly from us – in November, and I leave it for my learned friend from the OFT, but I very much suspect they may well have issues.

In summary, Sir, we would say that this is a matter which should be retained within the Tribunal, and we need a very clear direction with regard to the maximum available evidence, in particular historical evidence that is before you as to the appropriate margin for Homecare.

THE PRESIDENT: Thank you.

MR. MATHER: I wonder if I could ask two questions, one about the list price issue and then one about procedures. In Doctor Jones's witness statement there is a great preoccupation with the risk that an unbundled price could, in the practical operation of the Health Service, reduce funding available to patients and thereby the operation of homecare services. Recognising you are commenting on the hoof, are you therefore supporting the idea I think I heard the President mention that in an ideal world there would be both an unbundled price and a continuation of the existing NHS list price, and would that avoid that risk, or do you have any proposals to put to us which would avoid that risk?

MR. BURROWS: Sir, thank you. The short answer is that to some extent we have been feeling in the dark because we simply do not know what is proposed, and the Tribunal has repeatedly said it is for Genzyme to propose a remedy. In so far as I can deal with the points in principle that you raise, the list price, and any change to the list price is perhaps, if I may call it, the first objection and that would create, as far as we see it, a unique situation and is certainly not something that the Tribunal should contemplate and that is because, as we understand it and if, indeed, this is what is contemplated it would be the creation of a drug only list price, i.e. devoid of any delivery.

Mr. Jones is not aware of another situation where one has an NHS list price that does not include in any form a margin for delivery, whether or not that is the usual 12as we understand it and if, indeed, this is what is contemplated it would be the creation of a drug only list price, i.e. devoid of any delivery. Mr. Jones is not aware of another situation where one has an NHS list price that does not include in any form a margin for delivery, whether or not that is the usual 12½ per cent. wholesale margin or otherwise.

There then arises I think a slightly more complicated and distinct point which it is necessary to approach by distinguishing the various drugs that are provided, the homecare services provided for out of the margin in the pharmaceutical contract, and that will include drugs for MS, arthritis and the growth hormones and, indeed, the present situation. Then, there

is the separate category of drugs such as haemophilia, HIV, where a separate form of homecare tendering has been agreed. Now, if what is suggested is taking Cerezyme from essentially the first category to the second category, which is where we establish a drug only price, a number of potential dangers and complications will arise. The Tribunal has seen a multitude of evidence about two peculiar circumstances that apply to haemophilia, and I am not going to go through those again. However, the essential point is that these type of treatments such as HIV, haemophilia, parental nutrition, will generally involve a reasonably large volume of patients and in circumstances such as haemophilia, the drug company is prepared to give a large discount, and it is out of that discount that the NHS is then prepared to go on and agree the additional funding. But, and this is the crucial point, that does not happen in every case. You may have patients who are registered with The Royal Free for haemophilia treatment, or indeed Birmingham for HIV treatment, who are given an additional, if you like, homecare service which is funded by the Trust. But, as I say, that does not happen in every case.

I do not want to give evidence on my feet in terms of how many patients that will include, and Mr. Jones is here and would be happy to give you his views, but the point in principle that applies to Cerezyme is that it is a specialist condition, it is extremely rare, it is a national condition, and in so far as it is appropriate for Healthcare At Home to make comments about what is best in the patient's interest, we say that there is a real risk that if you put this drug from the first into the second category you expose those patients to the risks of so-called postcode prescribing and that, I think, is another point.

MR. MATHER: Thank you very much for that. My second question briefly is about your last point. You said that the Tribunal should not trust Genzyme to come to a speedy conclusion. Do you have any proposals, therefore, about the procedure which the Tribunal should adopt to avoid further extensive delays?

MR. BURROWS: Sir, I think the broad point is that we would very much welcome an approach from the Tribunal very much in line with the President's opening remarks – seize the initiative today, and essentially deal with the issues on the basis of the historical evidence before you.

In terms of a detailed remedy, "no", I am afraid is the simple answer. Option B, both in the agenda and I think it was set out as the second option in the Judgment seemed to us would be the sensible way to proceed. This is perhaps an important point – insofar as there is any negotiation required then that should be facilitated or could be led by the OFT, subject to very clear directions from the Tribunal as to mechanism and obviously the issue we will return to later, margin. If that process is to be – "abrogated" is too strong a word – handed to Genzyme then extremely strong and clear directions will be needed in order to prevent a recurrence of

the litigious atmosphere that has pervaded the case thus far, and continues to pervade it as is evidenced in the latest document that still puts forward these very low figures.

THE PRESIDENT: Thank you, Mr. Burrows. The Tribunal will rise for a few minutes.

(Short break)

THE PRESIDENT: The Tribunal's view as at present advised is as follows. We note Genzyme's commitment on unbundling that has been given to the Tribunal today, and we have taken account of the various remarks Mr. Vaughan has made. This comes somewhat late in the day and it seems to us at this stage that we should not alter the timetable that we had otherwise envisaged for determining the present case. Insofar as negotiations might now take place to resolve this matter any realistic and constructive opportunity to negotiate is to be welcomed. At this stage, however, it seems to us that what Genzyme needs to do is to satisfy in the first instance the OFT of the soundness and realism of any proposals that it puts forward. The various individuals concerned from the Department of Health and in relation to purchases from the NHS are not necessarily at this stage as fully familiar with the issues and arguments in this case as the OFT is. We would therefore think it desirable that negotiations now at this late stage (if they are to take place at all) should take place under the auspices of the OFT and the OFT should be associated and desirably present at any particular meetings that take place to discuss these matters so as to avoid these misunderstandings occurring as matters progress.

Insofar as the Tribunal itself is concerned, what we propose to do in the time still available to us today is to proceed as if, as it were, nothing had happened, and to raise certain points that we have on the evidence as it stands at the moment, so as to give the parties at least some chance to comment on those points, and to indicate in broad terms, at least, the present state of the Tribunal's thinking. We hope that that, as an exercise, will not only clarify the Tribunal's mind, as far as its judgment is concerned, but also may assist the parties in focusing on the kinds of issues that need to be focused on in any negotiations that in fact take place.

We only have now, unfortunately, half a day instead of the day originally set aside, but we will make what use we can of the time available. Thereafter, our present view is that we now have realistically speaking a wealth of material from a large number of quarters that would enable us to decide what the solution to this case should be. As at present advised it seems to us that the question of what the discount off the list price of Cerezyme should be, and the question at what level any unbundled price of Cerezyme should be set is effectively the same question, although posed in different terms, and we will therefore proceed to decide the matter in those terms.

Our present view is that any remedy that is to be devised would need to contain as many failsafe provisions and safety net provisions as possible and may well include preserving the

NHS list price for practical reasons for the discount of that price as well as providing for the option, presumably at a hospital request for an unbundled price. On that basis obviously there would have to be a logic between the level set for the new unbundled price and the discount off the existing list price. We were also somewhat concerned to be told that under consideration was some kind of abolition – or as I think was said "modulation", of the existing hospital price, because the hospital price, which we have not so far discussed, is the third of the Tribunal's three options, that is to say there should be a hospital price as there is with very many NHS medicines, and it is then up to the hospital to decide from whom it wishes to acquire homecare services. So we are far from clear that it would be at all appropriate in this particular case to suppress the existing hospital price, but that is for discussion hereafter.

Unless there are particular observations from the parties, which of course we are delighted to hear, what we would propose to do now is to rise at this point, resume again at 2 o'clock and then discuss a number of the issues that are in particular set out towards the bottom of the second page of our letter of 11th October. We would do our best to lead the discussion and, although we are not going to be able to complete the discussion in the course of the afternoon that will, at least, I hope give the opportunity of signalling issues to which the parties need to address their minds in more detail than has hitherto been possible. So unless there are any particular observations, we will rise now and resume at 2 o'clock.

MR. VAUGHAN: Can I just say, to avoid time, we have another discovery application. I do not propose to make it now but I would like it to be noted that we are making that application, for formalities' sake and in the terms of our note, but I do not want to do more than that because otherwise you will have even less time.

THE PRESIDENT: I have not for one minute imagined that you had abandoned that application! [Laughter]

MR. VAUGHAN: Well no, I think also we were providing the opportunity for you, as it were, the opportunity for you to discuss with Professor Yarrow, Professor Appleyard and whoever else you wish, and Mr. Prothero, and Miss Kelly are also present here if you want more technical health matters.

THE PRESIDENT: Yes, well let us see how we get on. Yes, Mr. Thompson?

MR. THOMPSON: Can I just reiterate on behalf of the OFT that the way we see the best way for the form of remedy to focus everyone's minds, as we see it the core issue is the relationship between the inclusive or end price offered by Genzyme, or Genzyme Homecare, and the price at which homecare service providers can obtain Cerezyme for the purposes of providing a competing service. It seems to us that whether one sees it in terms of unbundling or a discount off the list price, or a discount off some variant of the list price which Genzyme may see fit to

offer in the future as the price at which it will provide homecare services, the key differential is between whatever the end price to the NHS is from Genzyme and Genzyme Homecare, and the price at which its competitors can receive Cerezyme, and it seems to us that any remedy must focus on that particular issue, whatever form the remedy takes. It seems to us that in a way the proposal that has been made this morning is something of a diversion from that core question which has to be grappled with by the Tribunal with respect, and which we think is essentially a different issue from anything that Mr. Brownlee might have to grapple with in relation to the complexities of the PPRS, it seems to us that that issue is squarely before the Tribunal, and it is that issue which we would urge the Tribunal to seek to resolve in whatever time is available today or whatever further hearing may be arranged in the future.

THE PRESIDENT: Mr. Thompson, at least as far as I am concerned at the moment, and provisionally, so that Mr. Vaughan understands the position, that is broadly how I at least see the situation. Whether one talks in terms of an unbundled price or a discount off an existing list price, the core issue is still what discount off the list price or reduction from the list price to give an unbundled price is appropriate, and it is the same issue.

MR. THOMPSON: It is only the question of whether it is the list price. In our submission the core question is what is Genzyme offering the NHS as an inclusive price, and what is the difference between that price and the price at which it is offering the drug alone to the competitors of Genzyme Homecare, so that any change in the list price – or any change in the price at which Genzyme Homecare is prepared to provide an inclusive service, the key question must be the differential between that price and the price at which its competitors can receive the drug, and so that must act as a constraint on any unbundling that Genzyme may wish to undertake in the future. That is our core concern, but I think perhaps in slightly different words I am merely concurring with what the Tribunal said.

THE PRESIDENT: Mr. Vaughan may want to come back to this in due course.

MR. VAUGHAN: Well I am not sure if we take any different position. We are going to unbundle. We have to decide what the unbundled price is going to be. Whatever happens we are going to unbundled. The question is what is the unbundled price which allows people to compete in the market in an open competitive position, not in any protective historic position, but in the "now" situation, and the now situation which is going to continue for the immediate future anyhow, and that is the price that we need to look at. That is why we have to look at the "now" market prices rather than the historic prices.

THE PRESIDENT: To put it somewhat compendiously, let me see if I can get it right – I may not get it right – what is the unbundled price that would allow a reasonably efficient competitor to

offer homecare services to the National Health Service in competitive conditions on the basis that the overall cost to the Health Service is not increased from where it is at the moment.

MR. VAUGHAN: Exactly, so I do not think there is a difference. I think the critical difference between us and the OFT and Healthcare At Home is that we say these are "now" figures, market related figures, and they say they are the "then" figures, anyhow, Professor Yarrow will deal with that no doubt.

THE PRESIDENT: Yes, to put it in crude but direct terms you come up with quite a small percentage by which you say an efficient homecare provider could manage to be perfectly effective and the OFT comes up with a somewhat higher percentage and Healthcare At Home comes up with a still higher percentage.

MR. VAUGHAN: Yes, but not based on the market basis but on ---

THE PRESIDENT: Well whatever the basis is they have a different percentage.

MR. VAUGHAN: Yes, and there is a million miles between the top and the bottom.

THE PRESIDENT: And somebody – and unfortunately it seems at the moment to be us, unless it can be sorted out – has to decide on that range where to pitch it on the basis of the evidence that we have.

MR. VAUGHAN: That is right.

THE PRESIDENT: That is basically the job.

MR. VAUGHAN: Yes. Plus, we would say, the evidence that you should have had, which we will get if we see the application, but I do not want to go into that, it is probably lunchtime.

THE PRESIDENT: Well let us have lunch, and we will restart at 2 o'clock, if that I s convenient.

MR. VAUGHAN: Thank you very much.

(Adjourned for a short time)

MR. VAUGHAN: May I mention one matter, Sir?

THE PRESIDENT: Of course, Mr. Vaughan.

MR. VAUGHAN: In your remarks before the short adjournment you mentioned the possibility of a meeting with the OFT. My instructing solicitor has had discussions with Ann Pope of the OFT about such a meeting and while the cannot formally commit themselves they are positive about such a meeting. We obviously would want that as soon as possible but for understandable reasons they felt they could not do it before the beginning of November – it would be necessary to assemble the cast and Mr. Brownlee is a pretty busy man, so it is probably realistic to think we would be looking at November.

We, Genzyme, would anticipate the meetings would try and achieve consensus, if not total agreement on the main aspects, matters such as what are the prices they are paying for these sort of services – the value based payment idea – the variations for different drugs and

how they deal with the different drugs, and the retention of the FP10, which if that is going to go in this way that will remove one of the problems, and also if there are any practical funding issues which are outstanding for the NHS. We hope that if consensus is achieved in all those things we would be on the high road to reaching agreement, at least as between us and the OFT, as to what the appropriate price is, whether it is below the margin of the OFT's present guideline, or within it and if so at what stage, we would hope to reach agreement as to what to do then. We would then be able to bring a figure back to the Tribunal as to what we would propose in the light of that, and if the OFT agreed that would be a factor – or we do not oppose it being a factor – for the Tribunal to decide finally. We accept that it is the Tribunal's jurisdiction to agree – or whatever the expression would be – what the final figure, the revenue would be. Basically we anticipate that if the next hearing was, say, in the middle of November, we would be able to come forward with a figure, or at any rate a report of that meeting which resolves a lot of the problems, if not an actual figure – we hope there will be an actual figure.

THE PRESIDENT: (After a pause) We, for our part, had not actually envisaged another hearing. We are just going to go on and write a Judgment now on the basis of what we have and subject, of course, to your outstanding application for discovery, which I have not forgotten about - despite appearances to the contrary I have not forgotten that.

MR. VAUGHAN: This is what we plan to do and if we come forward with a figure we would then be in a position to let you know what the figure was.

THE PRESIDENT: That is obviously helpful.

MR. VAUGHAN: Because that is the way we are going to do.

THE PRESIDENT: We would assume on that kind of scenario, the OFT would also take it upon itself to keep other interested parties, by which I mean particularly Healthcare At Home at least informed in broad terms of what is going on so that no avoidable misunderstandings arise.

MR. VAUGHAN: Very well, thank you very much, Sir.

MR. BURROWS: Sir, could I make one very, very quick point on that?

THE PRESIDENT: Yes, of course, Mr. Burrows.

MR. BURROWS: Just to avoid the potential for any misunderstanding as to what this negotiating process should be. We had understood you to state quite clearly that it should be undertaken under the auspices of the OFT.

THE PRESIDENT: Yes.

MR. BURROWS: Now we understand that to mean that if the OFT consider that there are issues that need exploring directly with the relevant, I should not use the word "stakeholders" but I will use it ----

THE PRESIDENT: Yes.

MR. BURROWS: -- then indeed that should occur. We have noted the comments of the OFT this morning that we are as keen as we are that essentially this should be gripped by the scruff of the neck and further delay avoided. We are very keen to avoid any potential that it should turn into another round of negotiations by default essentially driven by Genzyme, and I am just wondering whether that door is being opened slightly.

THE PRESIDENT: Well we see the situation in the terms that I expressed them before lunch, that it is now up to the OFT to negotiate with Genzyme and Genzyme with the OFT involving at least the relevant representatives of the NHS and the purchasers, and at the same time keeping you properly informed and consulted about what is going on basically. The risk, if I may put it in blunt terms, that there may be some kind of carve up that excludes any one of the stakeholders that I have just mentioned is one that should be avoided, and we would take a very dim view if there was some kind of fait accompli that resulted in some unfairness to any party present here, including Genzyme obviously. You, as the complainant, have certain procedural rights anyway and the last thing we want is a further round of proceedings in which you are the "plaintiff" against the OFT for having, as it were, arrived at a settlement without appropriate procedural steps having been taken vis à vis your interests.

MR. BURROWS: I am very grateful, Sir.

THE PRESIDENT: It is difficult for everybody, but I am sure that commonsense and good administration will help the matter along – at least I hope so.

MR. BURROWS: Did you have any timetable in mind at all?

THE PRESIDENT: I think the timetable is entirely up to the parties. We are going to write our Judgment and if the Judgment comes out before the settlement (if there is one) well, it comes out.

MR. THOMPSON: I do not want to delay things.

THE PRESIDENT: But you are going to anyway!

MR. THOMPSON: I am going to be very brief. It is simply that in relation to the way it was put about Mrs. Pope and what she was or was not prepared to do. We are obviously positive about performing our role as, as it were, supervisors of any negotiations that take place. We do not see our role to be to negotiate because we are not strictly a party to any of these negotiations, and ----

THE PRESIDENT: Well you have the statutory responsibility to make a direction, so it is your responsibility, I think, to form a view as to what is the appropriate remedy to remove this abuse. We, as the Tribunal, are only performing what your statutory role is. You cannot abdicate that to us entirely because the primary responsibility is yours.

MR. THOMPSON: We obviously await with interest the Judgment to see ----

THE PRESIDENT: Well is that not right? You cannot just sit back, wring your hands and say "We don't know what to do", you have to make a direction at some point – or there has to be a direction. If we sent it back to you, you would have to make one, would you not?

MR. THOMPSON: Indeed, if that arose then clearly we would, but until that arises it seems to us that our position is essentially as suggested by the Tribunal this morning as someone who is, as it were, holding the ring to ensure that no form of carve up or inappropriate solution is reached that avoids ----

THE PRESIDENT: Your overall duty, I would have thought, is to preserve the competitiveness of the homecare services' market for these patients.

MR. THOMPSON: Indeed, and all I am seeking to say is that we would see our role in any negotiation, which we are happy to participate to that extent, we are positive, to be along the lines that I suggested just before lunch, to ensure that the margin squeeze which has been identified in the Judgment is not perpetuated as a result of any negotiations, and that is essentially our role, as we see it. That is all I wanted to add.

THE PRESIDENT: Yes. It seems to us that the starting point of the exercise is to determine what ex-manufacturer price for Cerezyme would enable a reasonably efficient homecare provider to supply its services to Gaucher patients in competition with Genzyme Homecare and, in doing so, earn a "normal" profit. That is how we see the exercise and if in the course of the afternoon anybody disagrees with that fundamental premise and starting point, we would be glad to have that signalled to us.

I would like to make some comments in very broad terms about how we have seen the evidence so far, and then to come to four or five particular issues that we would like a bit of help on.

In very broad terms, it seems to us that there are four different approaches in the various papers that we have seen. The first approach is what I think has been described as a sort of reverse engineering approach, namely, to build up a picture of costs, to add a profit margin and come to a figure. That approach involves, among other things, various questions of cost allocation, and taking a view on what is the right way to look at the calculation of profit margin in this particular business. That is one way of doing it. These various ways are not necessarily contradictory and to some extent they overlap.

A second way of doing it is to examine hypothetical tenders for Gaucher homecare services provided by other providers, and that in particular means looking at the evidence from Clinovia and Central Homecare as to what they would do if tendering for this business. That

approach has the feature that it relates to the Gaucher business, but the further feature that it is by definition a hypothetical exercise.

The third way of doing it is to look around for comparators, for actual market prices for similar kinds of services – the kind of exercise that in several fields of law courts are accustomed to doing. It seems to us that that approach raises at a first level what a comparator is or might be. We have had in this case obviously a great deal of explanation of the care of Gaucher patients, as to whether Gaucher is comparable to Thalassaemia, haemophilia, HIV, and other diseases, and the possible differences between all those various diseases and how they are coped with and the different numbers of patients involved and so forth and so on, bearing in mind, for example, in the case of haemophilia there are many more unfortunate sufferers of haemophilia than there are Gaucher disease, etc. etc. It seems to us to be an exercise that has in itself a certain degree of complexity, in addition to which having established possible comparators one then has to go into a number of issues such as assuming perhaps a certain figure for delivery, how many deliveries we are talking about, how many nursing visits we are talking about, what level of quality of nurse we are talking about and whether we should allow for travel time, whether there should be some complexity quotient, and so on and so forth. All of those are complications in that particular approach which, as I gathered this morning, was the approach that Genzyme is perhaps tending to at the moment.

The fourth way of looking at things is to look at what we already have in our files by way of historical information and typical costs and margins, which relate essentially to the original contract between Genzyme and Healthcare At Home, the figures provided to the Department of Health in 1999, the Genzyme Business Plan from 2000, the Dixon Wilson Report, and the evidence of Mr. Williams in the main proceeding. There is actually quite a lot that we have already. If we are invited to reject that historical picture, we do need to understand very clearly on what basis we are being invited to do that, especially since quite a number of those things have already been given in evidence before the Tribunal.

There may be other ways of looking at it, and I may not have captured all of them. If there are other ways again we would be glad of somebody signalling to us that we have left off something extremely important. What we would be glad of at some point – not necessarily on the hoof – is any further observations that anyone has to make as to which of these various ways is superior to any of the others, but certainly at the moment we are not necessarily persuaded that we should exclude any of these ways of looking at it. It may be one of those situations, as in the *Napp* case, where a number of different approaches should be looked at taking account of various possibilities of margins for error and at the end of the day a broad view formed. I think I would emphasise in that respect that in a case such as this our view is

that at the end of the day one has to form a broad view. It is not going to be possible without really disproportionate investment of time and effort to do more than form a broad appreciation of what is needed and since as we see it any business man wishing to remain in or enter this market would himself form a broad view of what sort of profit he was looking for, we should adopt that sort of approach without necessarily trying to dot every "i" or cross every "t" as to whether one half of a particular person is allocated to this particular job or that particular job.

Within those broad possibilities I think there are four matters that we would particularly like to touch on. The first two relate to the first way of doing it which is the build up of costs and add a profit margin. At least at one stage that seemed to present a conflict between the OFT and Genzyme as to whether the correct approach to costs was on the basis of avoidable costs or fully distributed costs. What we would like to understand is whether that is still in dispute and what are the pros and cons of the two approaches in this particular situation.

The second point that arises out of this first approach, which relates to the profit margin and is how one should approach the calculation of a profit margin in a business such as this, which is essentially a service business in which there is very little fixed capital by definition. Should one proceed down the route of looking at some rate of return on capital and, if so, what? Or should one be looking, however imperfectly, on some return on sales or similar way of looking at it. The third point is what weight should we give to the evidence we have about Clinovia and Central Homecare? Is that valid and useful evidence or not? The fourth point is the historical picture – should we disregard all the historical evidence that we have allowing, admittedly, for the fact that some of it is indeed historical – not that historical because quite a lot of it is fairly recent – and should we just disregard that? Those are the first points we need to bear in mind.

As to other matters and matters of detail they may well crop up as we go along, and I think we would just like to have a look at mattes, so far as we can in broad sweep at this stage. So shall we take our courage in both hands and see if we can have a go at some of these points? If we take first the issue of fully distributed costs and avoidable costs. We started off in the OFT's first report [tab 53] at 3.3 with a statement to the effect that the OFT did not consider it appropriate to consider only the avoidable costs of providing the Gaucher homecare service, and that theme is continued at 2.4 of the OFT's supplementary report where there is a dispute as to whether various overheads are indeed fully allocated or not. Is it possible for us to have a bit of further elucidation on this aspect as to whether there is, in fact, a difference of principle between the parties or whether it is simply a question of the application of agreed principles.

MR. VAUGHAN: Can we start on the basis that you are asking Professor Yarrow and then Professor Appleyard will come in – they both deal with this in their reports. They know the question, as it were.

THE PRESIDENT: Yes. Have I, roughly speaking, Professor Yarrow, explained what it is I want to know?

PROFESSOR YARROW: Yes, I think I understand your question. The issue for me is that it is an important conceptual issue and I tried to impress this on the OFT, because fully distributed costs at the end of the day depend upon arbitrary accounting conventions and they are not linked to economic decisions and, therefore, if this is the general approach in competition policy you would not be able to get the kind of reasoning that you get in AXO, for example, which links the cost concept to the business behaviour to determine the abuse. So at a conceptual level I would say it is very important. At a practical level in terms of numbers it makes very little difference because going back to what you said was the problem, we would say that it is right then to take a long run approach to costs because you are looking to see whether an efficient competitor can survive over a longer term and therefore in the longer term most costs do tend to fall into the avoidable category.

THE PRESIDENT: In the long run everything is avoidable!

PROFESSOR YARROW: Indeed, exactly.

THE PRESIDENT: Including these proceedings I hasten to add!

PROFESSOR YARROW: There was a difference of issues about directors' costs, but it boils down to very small numbers and it would not stand in the way of any progress at all in terms of getting a resolution of this issue. We have allocated all costs, including central overheads.

THE PRESIDENT: So in principle, a method of allocating all costs, including central overheads, albeit imperfect, or open to a degree of arbitrariness is not wrong as a way of approaching this particular problem?

PROFESSOR YARROW: No, I think I would say start with the right concept and then use the accounting information to achieve the best approximation you can for the particular problem. In this particular case nothing at the end of the day has been left out

PROFESSOR GRINYER: Fair comment..

THE PRESIDENT: Right. Do you want to add to that, Professor Appleyard?

PROFESSOR APPLEYARD: Just to concur. We should always start with principle, and then apply the accounting information, which is the only information which we really have, as an estimate of these economic costs.

THE PRESIDENT: But as I have understood it the possible difference between two different principles in fact, as it were, fades away when you get down into the numbers.

PROFESSOR APPLEYARD: In practicality it does.

THE PRESIDENT: In this case, in this particular case?

PROFESSOR APPLEYARD: Yes.

PROFESSOR YARROW: For the particular purposes of this case, yes.

THE PRESIDENT: From the OFT's point of view how far is this part of the exercise now agreed, in particular the statement just made that all costs have been allocated? I think there may be an outstanding dispute about the allocations but that something has been done to all allocable costs, is that broadly agreed?

MR. THOMPSON: Consistently with the approach that Mr. Turner suggested this morning, you unfortunately get me rather than an expert, but my understanding is that there was an initial difficulty which is reflected in para.3.3 in the OFT's response to Professor Appleyard's first report, where our understanding clearly was that he had taken a more restrictive conception of avoidable costs and that we thought a broader approach was needed. Since Professor Yarrow has come on to the scene, it seems to us a slightly different approach has been adopted and that in principle Professor Yarrow has accepted a full allocation of costs although there is a difference between the OFT and Professor Yarrow about, for example, whether directors' costs should be included in such an allocation.

THE PRESIDENT: Can I just understand a bit better then 2.4 of the OFT's supplementary report. Professor Yarrow helpfully has just told us that all central costs have been allocated, and you are apparently in 2.4 disagreeing with that and saying that the majority of HH central overheads have not in fact been allocated.

MR. THOMPSON: I think that is consistent with what I just told the Tribunal in that was essentially an historical question about Professor Appleyard's first report, whereas I think we would accept that in Professor Yarrow's report there is an allocation albeit one that we think is "insufficiently generous" – if I can put it that way.

PROFESSOR GRINYER: The major difference lies in the basis for distribution – whether delivery numbers or some other basis?

MR. THOMPSON: There are some items that are left out altogether, such as initially directors' costs, for example, were left out completely by Professor Yarrow, although he has modified that to some extent, and there is still an issue about the quantum. On other issues, there is a dispute about quantum, which is essentially about whether or not it is treated as an average based on delivery numbers or whether one needs to put some form of waiting to reflect the complexities involved in Cerezyme, but in principle I do not think there is now a major difference as to whether or not costs are allocated – probably for the reasons that Professor Yarrow has explained.

PROFESSOR YARROW: Can I just add, Sir, that on behalf of Professor Appleyard, who will speak for himself in a moment, the first statement is simply a misreading of Professor Appleyard's report. The OFT have been corrected on this, there is absolutely no doubt that Professor Appleyard, from the very beginning, allocated all central overheads.

THE PRESIDENT: Yes, thank you. You will have to forgive us, Professor Appleyard, we have to struggle to keep up with you.

MR. VAUGHAN: In annex 2 of our submissions for this hearing, at paras 2.21 and 2.23 Professor Appleyard deals with this. He says that he explained this point to the OFT at the discussion and he is very surprised to see that they still make the point.

PROFESSOR APPLEYARD: I think that is enough said.

THE PRESIDENT: It is water under the bridge as far as we can see.

PROFESSOR APPLEYARD: I think so, yes.

THE PRESIDENT: Very good. Perhaps while we are on this point, it does naturally take us on to para.3.2 of the OFT's supplementary report, which tries to at least explain the difference between the parties on this rather dry question of allocation, but no doubt an important one, in the absence of anything better. I would like to ask perhaps Professor Yarrow and Professor Appleyard, have you had a chance to think about the issue of complexity and whether this is a case where some kind of adjustment ought to be made for complexity of some kind, especially given the earlier evidence about the nature of the service, or what?

PROFESSOR YARROW: Yes, obviously I have thought about it. I think the issue boils down to what the services are that are being provided, so you do have to think about that. Looking through the various drugs it seems to me, at least, that Cerezyme delivery and nursing is simpler than some and more complex than others. What I have done – and I think it is the same for Professor Appleyard – is to say these are quite detailed issues, this is a tiny business, there are swings and roundabouts as you go through all the various categories, and I can say to the Tribunal that I can see no reason why a proportion of allocation on the basis of activity would give you a misleading answer to any great degree – of course, it will not be exact because there are differences and variations in cost. But I think there is no evidence that they are terrifically significant.

If I can just deal with the general point on the market evidence, because I think this is quite important. If we look at the market, and you look at the charges that are made for homecare services when it is a contract between the homecare services provider and a manufacturer, you will see tremendous variation in the charges ----

THE PRESIDENT: You mean a contract between the homecare services provider and the manufacturer ----

PROFESSOR YARROW: Yes.
THE PRESIDENT: -- and not between the homecare services provider and the hospital?
PROFESSOR YARROW: No, between the homecare services provider and the manufacturer. I would refer you on that to, I think, it is table 3.21 in the OFT's supplementary report, where you will see – I think this figure will be non-confidential – the variation of a factor of about 28 between the numbers. Paragraph 3.21.
THE PRESIDENT: Yes, I am there, but it was not quite clear to me who is being charged here. It is presumably the NHS that is being charged, is it?
PROFESSOR YARROW: Well ultimately, in all of these cases, it is the taxpayer, that is what it comes to.
MR. VAUGHAN: I am sorry, I do not think that is right. I think the reason they are not producing this evidence on discovery is because they say it will reveal confidential information between them and the manufacturer. So on the last three anyhow these are the points – it is between them and the manufacturer. The point I am making is that the evidence before the Tribunal shows that it is, it is not just supposition.
THE PRESIDENT: Well we might see if we can clarify that. Were you rising, Mr. Burrows?
MR. BURROWS: Only if it is convenient to clarify it now or later?
THE PRESIDENT: I think if you can just tell us whether you can clarify it?
MR. BURROWS: Yes, I can.
THE PRESIDENT: What is the clarification?
MR. BURROWS: The first is a contract with the pharmaceutical company, as is the second. The next three are contracts with the NHS, and then the last one is a pharma.
THE PRESIDENT: Sorry, the first two are the product manufacturer?
MR. BURROWS: Yes.
THE PRESIDENT: The third one with the NHS.
MR. BURROWS: The fourth one with the NHS, the fifth one with the NHS, and then the last one is a contract with a manufacturer.
PROFESSOR YARROW: I do not know whether it is legitimate, Sir, for me to ask a question on that which I think is very important, and that is on the fourth contract, where you will see the very large number which is being paid for a single delivery, could we know whether that was a bundle contract? Was it a price for the drug? Or was it a price for the homecare services?
THE PRESIDENT: I think we might, just for the moment, leave that sort of question hanging in the air.
PROFESSOR YARROW: It is terribly, terribly important.
THE PRESIDENT: It may well be important, Professor Yarrow, I am not saying ----

PROFESSOR YARROW: It is a lot of taxpayers' money.

THE PRESIDENT: It is indeed a lot of taxpayers' money.

PROFESSOR YARROW: The point I wanted to raise is that these prices are all over the place, and the fourth one, which is the very expensive one, as far as I know is not a cold chain delivery, whereas the first one, which is a cheap one, is cold chain delivery. So there does not appear to be any relationship at all between these charges, and the sorts of factors that you would expect to affect costs. When you move to a tender system, when you get unbundling, what you will see from the market evidence is all the prices tend to converge, so I am dealing here with your point about the difficulties with comparators. I think your points are good in general but cannot be sustained until you have actually looked at the numbers, because when you look at the numbers, when you look at the market evidence and you will find a great deal of convergence. Now, again they are not identical the prices that come out, you would not expect them to be in tenders, each tender has slightly different conditions, but there is a tremendous amount of convergence. Where I am getting back to is that convergence suggests that in competitive conditions the complexity factors are not substantial – they almost certainly exist, there will be differences, but quantitatively once you look a the market evidence you can get a bound on complexity, and I think you will see that once you get competition to unbundled services you get considerable convergence to a fairly well defined band of prices, and that is the market working, of course.

THE PRESIDENT: One could imagine that, looking at a table like 3.21, that to understand that table one would perhaps need to know quite a lot about the background of these different drugs and whether they were being supplied in competitive conditions and what the competitive forces were and whether there were elements of historical inertia or what.

PROFESSOR YARROW: I think to understand them completely that is true. I think the thing you can conclude almost immediately from that tale is that there is very massive price discrimination in the market. I think that is fairly obvious from the number. I think if you saw those in another context ----

THE PRESIDENT: And you would intuitively attribute that to what?

PROFESSOR YARROW: That indicates lack of competition because competition, as I have just said, will bring about the convergence of those prices. Now you get to the complexity, because the problem with the market is that you have a market where there is a big tax distortion from the way the value added tax system works, and that is a major influence on what has happened in the market over the past 10 years.

THE PRESIDENT: Are we talking now about Cerezyme or are we talking about drugs in general?

PROFESSOR YARROW: No, general.

THE PRESIDENT: Pharmaceuticals in general.

PROFESSOR YARROW: Secondly you have a Byzantine regulatory system, with all sorts of quirks and oddities, and thirdly, of course, you have all the complexities of the NHS, which is one of the largest public service organisations in the world. So you see this is a market which throws up all sorts of odd prices and, as you say, to unravel this and understand each one would be a difficult exercise.

THE PRESIDENT: I think it is part of our hesitation about going too deeply down the comparator route. The relevant comparators are those where there have been tenders, where the services have been specifically identified and where we know the market is giving considerable price convergence, because they are the competitive conditions, and since the question is whether an efficient firm could survive long term in competitive conditions, these are the best indicators of costs where you have the tenders and, as has already been said, quite a bit of information is already available showing considerable convergence, there are other bits of information which could be readily gathered if there is any doubt about this, but these numbers give you, in fact, the best sight of what the competitive market will throw up in terms of charges for homecare services. Tenders have been run for several years now.

MR. MATHER: But presumably they have been around patchily. I am struggling to find what your sort of general conclusion is. This is a slightly alarming picture, the big tax distortions, the Byzantine regulatory system, the complexities of the NHS, these all exist, these are the circumstances in which Genzyme has been selling its products.

PROFESSOR YARROW: What has been happening, as you may know for a number of years health policy has been trying to detach pricing from pricing of drugs. It did that very successfully in the 1980s and 1990s for general pharmacy. The Department of Health have been desperately struggling to get greater transparency in the market with only limited success. You say "patchily" but there are quite a lot of cases where the unbundling has taken place, where competitive conditions have been established, where the evidence is available. So if that evidence had showed wide variation in the numbers that it was coming out with then I would say that we are back to square one, this is just the complexity again. But the really interesting thing about the market competitive evidence is that you get convergence, and of course that is exactly what we expect with competition. So this is what market prices look like, and what costs are really like, as exposed by the competitive process.

So my interpretation of what Professor Appleyard and I have done, which is on costs is that that exercise (which is the exercise a Regulator would go through in these circumstances) should be seen alongside this other evidence, but in a way you do not need to worry too much

about the complexities of the cost analysis, if you accept the market evidence, and I think the market evidence is very clear.

THE PRESIDENT: You do not need to build up on some hypothetical basis if you have a market price to which you can gear it?

PROFESSOR YARROW: The other thing you can do is to look and see what the accounting says and, if it looks consistent, which it does, then you get mutual confirmation of the two approaches.

THE PRESIDENT: In broad terms – you will never get a perfect fit – but a sensible accountancy based exercise in allocation and a proper profit and all the rest of it should, over time, produce market price should it not.

PROFESSOR YARROW: Similar, and they do. That is the point that I would hope if you go with no other point from what I say – as I say, I felt it was not justified to do a very complex accounting exercise, I did a relatively simple accounting exercise and so did Professor Appleyard. We think it is the right approach to take, but the real cross check is that it stacks up bang on the market evidence.

MR. MATHER: On the market evidence I took you a moment ago to be referring to a range of drugs in this patchwork. Have you – I should know this – drawn to our attention the evidence on which you are drawing in making these statements other well-known studies in the literature.

PROFESSOR YARROW: It is not well known studies. This has been part of the discovery process. Because the way the market operates it is very non-transparent – I think it is the most non-transparent set of markets, the health markets that I have ever -----

THE PRESIDENT: We are talking about health in general now?

PROFESSOR YARROW: Health in general now, yes. So it is very difficult to get this information. I know bits from other contexts, web searches and so on. But Mr. Vaughan and the lawyers have collected together what they could and, of course, part of the argument is that if you are in any doubt about this these tenders are there, and it should be straightforward to get the tender prices. I am saying to you that if you get those tender prices I expect, with a high degree of confidence, that they will line up with what the accounting numbers suggest and with the tender prices that we already have. Unfortunately I cannot order people to disclose prices of tenders, so I am at a slight disadvantage.

MR. MATHER: Leaving this interesting issue of disclosure, which keeps popping up again, for a second, just going back to the literature and to published work, are you saying there is none?

PROFESSOR YARROW: There are no empirical studies because all these things are kept tightly under the belt. I am not quite sure why sometimes, because sometimes it is the NHS itself – I think the OFT have had difficulties getting information from the NHS which is rather

surprising. More generally there is a great tendency to keep things secret. I know this, I worked on community pharmacy and tried to broker an arrangement where by community pharmacists would finally disclose how much they were paying for the drugs they were buying in return for the Department of Health not immediately snatching it all away from them, and Tony Appleyard worked on this too. It is very, very difficult to get people to reveal information.

PROFESSOR GRINYER: It seemed to me, in fact, talking about market prices it brings us on to Clinovia Central Homecare simulation in a way, and here they have hypothetical cases, but they are seeking to replicate a market situation as far as they can. Would you see that as valid, or do you see major problems with that?

PROFESSOR YARROW: I think hypothetical exercises are always inferior to actually looking at the market data clearly. I mean market data is the thing which tells you how people actually behave rather than the way they say they would behave in certain circumstances. I have some difficulties with the exercise because it was totally unclear what questions had been asked by the Office of Fair Trading and I think they themselves would recognise that it was a fairly informal exercise with very little standardisation.

That said, my take on what one of those two companies said was that it was, in fact, quite close to the accounting numbers, and to the market evidence. There is a bit of disagreement on this I think with the OFT, but I think it is partly because there is a lack of standardisation of assumptions about working capital. I do not think in fact there is a very big disagreement, or at least one that could be resolved. I would say to you that my interpretation of one of the hypothetical bids is it is fairly close to the accounting evidence and to the market evidence.

The other hypothetical bid was well above the number, it was significantly higher. What is interesting though is that those two companies were the same two companies who have actually bid in a real market tender for haemophilia. If you look at what is said about the outcome of the haemophilia tender the company that hypothetically gave numbers, which I think are quite close to where we are, actually bid quite close to the market price, and the other company, which gave in the hypothetical tender a much higher number actually bid much higher in the real situation. So until I saw the latest documents I thought that you could discount one of the hypothetical bids as being made up or unrealistic. But it does actually seem to correspond with the actual market behaviour in another context. The main issue is really how to interpret those two things. As I say, in my view one of them is very close to where we are, the other is far away, but that may actually be where the costs lie of the two companies.

THE PRESIDENT: Perhaps we could just move the discussion across at this point towards the OFT's side of the room. Basically what Professor Yarrow is saying, and this brings us back to

where we started which is how you allocate costs, that any complexity factor will tend to get competed away and that your best guide as to how to assess these various things is by reference to what has actually been happening in the market in comparable tenders. Is there a general position or reaction to that?

MR. TURNER: Yes, there is. Professor Yarrow began by saying that the Cerezyme delivery and nursing is simpler than some and less simple than others. It boils down essentially therefore to a factual issue of appraisal on that analysis. Just for ease of reference we have calculated that if you were to do the analysis of costings without taking into account the complexity analysis of Healthcare At Home compared to if you do, the difference amounts to about 1 per cent. of the existing NHS list price in terms of the significance of the number. So it is a significant point.

So far as the idea is concerned that under competitive conditions you see convergence in the rates that are charged for homecare in these different market areas. The OFT does dispute that, first, because we do no see a wealth of evidence, following Mr. Mather's questions in relation to that. We have traces of evidence with which we are all familiar, some relating to haemophilia, some remarks by in particular Mrs Patey of Great Ormond Street, which seemed to be pitched in general terms. The OFT's essential point is that the specification of the particular service is critical and may make a critical difference in what you perceive between, for example, haemophilia and what should be charged, and the Cerezyme service on the other hand. If I may give an example which comes out, for which I apologise, only perhaps too indistinctly from some of the materials that you have before you. One of the features that we apprehend distinguishes the Cerezyme service from haemophilia – and I am going now to an e-mail of 16th July this year from Lindsay McDonald from the Royal Free – is that the haemophilia patients are trained in the hospital and are sent home for the homecare service only when they are very stable. The homecare operation is thereafter much more straightforward, whereas our understanding is that in the case of the Cerezyme service after a number of infusions at the hospital and while the patient is, as it were, somewhat raw and untrained, they are then passed over to the homecare operation. This means that not just in the case of the nursing that is involved, but also in the of elements of the delivery service, which includes large amounts of customer care, liaison, and elements of that kind, the service is more demanding, and these factors are a real difference. It is difficult for this Tribunal to go into these sorts of difference, but they are there. Healthcare At Home has put forward its evidence as a provider of these different services, that there are important differences. We, for our part, accept that that is so, although we also accept that it is not practical to go into that in great detail in proceedings of this kind. What we can say on the other hand is that to equate the price that you see in a haemophilia delivery contract of a certain level, with that in another service,

Thalassaemia, and say that what you are seeing here is that competition viewed in general terms boils it all down to a similar number is profoundly misconceived. You do not see that.

On the final point of the Clinovia and the Central Homecare tenders, and the significance to be attributed to those, we say that some weight does have to be given to these because they are, after all, people who are addressing their minds to the particular demands of the service with which the service is now concerned. The extent to which they have successfully done that and taken into account all the relevant matters is difficult to ascertain without quite detailed questioning of them. Healthcare At Home is in the best position to really know the differences because it engages in these different services From the OFT's point of view it is true that we have not ourselves been able to probe very deeply, we have not had formal powers to compel information and so forth, and the Tribunal is aware that this has been a compressed exercise, but we are satisfied that in the time available, and taken together with the other material, which has been labelled the historical information, there is enough. That is our essential response to Professor Yarrow's argument.

THE PRESIDENT: Do you want to come in, Mr. Burrows?

MR. BURROWS: Sir, I am not sure we really do need to make any points of any great length at all. Just to correct one point on haemophilia for the Royal Free, there are no nursing services involved for the Royal Free in that context, it is not just a question of less.

In respect of the Caremark Clinovia issue, of course we have not seen any confidential information from them. However, in our submissions we do point out at p.17 various quotes where the OFT's reports themselves highlight potential problems with the evidence that has been given and the way it has been compiled. I think the principle point arises in connection with the assessment of profit which again concerns sensitive numbers.

THE PRESIDENT: Yes, we will come to that in a moment.

MR. BURROWS: Which we are going to come to in a moment, I think, yes.

THE PRESIDENT: Professor Yarrow, what troubles me a little, and I am not sure I know quite how to express it, is that apart from the possible physical differences in the kinds of service that are actually being provided which I suppose, if one had the time and resource, one could eventually try to pinpoint, this particular market that we are talking about, homecare services for Gaucher patients, does seem somewhat atypical in relation to its relatively small size, and the particular geographical spread of these patients, and the apparently specialised way in which it operates and one might, in a very broad brush intuitive way, suspect that if you really wanted to get at least some competition going in a market of that kind, potential providers might be looking for a margin that was a bit above what they were customarily expecting, or

might earn in other more mass produced markets. I have put that rather crudely but do you see what I am driving at?

PROFESSOR YARROW: Yes. I do not have the numbers but many of these markets are quite small and, of course, with a company like Healthcare At Home its competitive strategy is to serve several.

THE PRESIDENT: None are quite as small as this, as far as we know – it may be there are one or two. Haemophilia is about 10,000 I think, something of that order.

PROFESSOR YARROW: I did see a statement in the file from Mr. Farrell who was asked I think by the OFT whether there was any significant relationship between charges and volumes of activity, and I believe I am right in recollecting that he said not. I cannot see any reason why you should expect anything very significant. All of these things have an effect, but the issue is always the quantification of the effect. It is true, I think, that if Genzyme Homecare remained a specialist homecare provider specialising only on the small area it will of course be at a cost disadvantage because of the failure to get the economist density, if I can use a technical term. There are issues of business strategy there, but for the general homecare provider it is another patient, the drop can be made on a routing which has other deliveries, it would be the same refrigerator, going through the same pharmacy, it is a very stable market. One of the differences with haemophilia is that the haemophilia demand is much more volatile because somebody may have a sudden bleed, so again there are differences, but one has to be careful about cherry-picking the differences.

I cannot see any reason why there should be – again it is a question of magnitude – a substantial profit difference in serving this particular group of patients than any other group of patients.

I do not know whether Professor Appleyard has any comments?

PROFESSOR APPLEYARD: Could I come back to the issue we addressed at the start, which was complexity and therefore cost allocation. Clearly, the principle is cost causation. We are trying to allocate these costs to this segment of this business and so there are various ways obviously of doing this and as accountants we would look for what we would call cost drivers, and they may well be input drivers, output drivers, or even turnover drivers. But you cannot do it in the abstract, you have to go and look at the business, and that is what you do. You go and see what the business is, and then you re-look at the information and so in terms of an input driver I looked at staffing at Healthcare and made the allocation on that basis. I looked at output in terms of patient numbers and it is roughly the same so that gave me some credibility in what I was doing. I then looked at the whole process about the predictability about the way this drug is delivered to patients, to the lack of uncertainty in the treatment of these patients, and that all

then fits together. So in terms of what Professor Yarrow talks about, swings and roundabouts I was quite happy to treat this in terms of an accounting exercise as not complex and I would therefore remain to be convinced by other information that was forthcoming in order to change my view. The consequence of that in seeing other information steadily coming to is that it has led me not to change. So even things just recently like "How much stock do you need to have? The latest thing we had from the July meeting "Probably a week's supply", so there is no great uncertainty in this system, it functions perfectly easily. Then you look at the other evidence about how long nurses are with patients and so on, and there is no complexity really that you could say "I will factor in big chunks of overheads for this", and so I remained very happy with my initial position.

PROFESSOR YARROW: If I could just go back to the similarity point – I do not want to get into a debate with lawyers, but I think it was implied that I was implying a greater degree of similarity than I was in terms of pricing. What I was saying was these narrow to a band, and if you look at that band that would be very helpful to the Tribunal in scooping the issue. It is not that they all come out plus or minus 1 per cent. of each other, it is rather wider than that, but it is much, much narrower than the kind of prices that you see in the table at 3.21. So that was my point.

On the individual ones you can take any two. You can take Beta Interferon and you can take haemophilia, and you can discuss the differences, and there will be differences. One would be a bit more complicated, maybe, in one respect, another in another. All I am saying is that it seems to me that when the competitive market gets hold of these things it does push the pricing of homecare services to within a reasonably well-defined I say "range" again, not at all identical, but within a range which is far, far narrower than the range of estimates that you have got before you from the various interested parties. That to me suggests that although these factors do affect costs, of course they do, the quantitative effect of these variations in the service are not having major impacts on the price. It is very hard to see why it would because many of them are cold chain. They go through exactly the same process, they are delivered in similar ways. There will be differences in ancillaries of course, differences in value of drug which will give you some difference in insurance rates – that is a legitimate cost/causality link between value and charge. But by and large there is a tremendous amount of commonality in the physical process.

One way I would look at it is to say that if you were looking at cold chain delivery and say "Is this a market?" I think the answer would be "yes". There is a very similar set of activities going on with some variation.

MR. VAUGHAN: Can I help you on the numbers, Sir?

THE PRESIDENT: Before you do that, Mr. Vaughan. Just let me see whether I have followed it or not. In para.19 of your paper this morning you were pointing to a figure of £110 per delivery. Professor Yarrow has identified a haemophilia tender price of £--- per delivery.

MR. VAUGHAN: That is confidential.

THE PRESIDENT: Well, I have not said whose tender it was, a tender price, but thank you for reminding me to be careful. Three of the figures in 3.21 are at or below that price, others are above it. In 3.3, the figures from Clinovia and Central Homecare focusing on Cerezyme are substantially above that figure. What we need, I think, to understand, without looking at other factors for the moment, is what is explaining that.

PROFESSOR YARROW: In the hypothetical tenders?

THE PRESIDENT: In the hypothetical tenders, one of which I think you said could be understood as being not far off what you were doing.

PROFESSOR YARROW: Yes, I think this was an issue which was not fully resolved in the discussions with OFT, although I think it could have been if there had been more time. One of the issues is that in putting forward hypothetical tenders – and this is from recollection – I believe that the companies (or at least one of them) put in 2 per cent. for working capital. Now, that is 2 per cent. of the drug price which is a very large number. That takes no account of the evaluations that Professor Appleyard and I were doing, which was on the actual working capital position, and what was being proposed in terms of 90 day credit, which also is a very valuable item.

I think what you have is a tender being made against a spec. which has a different assumption on credit terms, which are terribly important in determining price than our evaluations. When you standardise those things I believe you get quite a lot of closing of those numbers. When you look at the actual numbers for delivery, the actual non-value related elements they are similar and, in fact, one of the two companies in its tender suggested a rate for nursing which is nearly 40 per cent. below my estimates on nursing, so one of the two major components of homecare it was suggesting I was over estimating the nursing costs by a very substantial amount. It was the reverse on delivery, and my interpretation of that was that perhaps there as a different way of allocating overheads as between delivery and nursing, because when you added the two together they came closer together.

I would say that at least for one of those hypothetical tenders, if you standardise on the assumptions that are made you will find that one of them falls within the range that we are suggesting – the other does not, I accept that.

MR. MATHER: Can I follow that and return to the differences which Mr. Turner was mentioning in his submission in this area. Picking up what you both have said it appears there are two

potential large differences coming out of this discussion. One is in the specification for the services in different drug areas and another is the requirements of different tenderers of different companies, of different businesses – the fact these are in different stages of development, they have different leads, the rest of their business is structured in a different way. Pulling those strands together, it is not quite so easy to expect the working of the market and the accountancy calculations to come so easily together, is it? Just developing the point in one more sentence, the variations are pretty enormous – one is on the procurement side, and another is on the tender side. There is no serious academic literature, you tell us, no peer review stuff, no methodology which allows us to take all these facts into account. So is it not a bit of a guess?

PROFESSOR YARROW: I do not think it is. I think what the evidence tells you is that these factors, although they exist, do not have very much effect on market prices. We observe these different drugs and we can look at each one of them and say "That has got this feature", "That has got that feature". Again, do not pin me down to saying the answer is my number plus or minus 5 per cent. Throughout this I have taken the approach that what you want to do is to put a bound on where you can reasonably get to and what I will say is that that evidence firmly tells you that you are in a particular band of cost.

What it revolves down to, I think ultimately – we will be coming to this no doubt – but it is really whether any of these charges should be related to the value of the drug, and that is where the big differences come. All the other differences the market is telling us are there. It is a significant band, it may be 125 it may be 100, it may be 80, but it is not 300 – that is the point. That is all I am saying. You can narrow it down quite considerably from the evidence that is available. Put it another way, suppose the hypothesis is that this is where the band is, is there any factor that you can point to, other than the value of the drug which would suggest that the homecare service element, the fridge, the picking, the putting in the van, the delivery in the van, the packaging, the delivery to the home, is there anything in that which would be significant enough to really move you from my estimate of about 110 to 300, 500, 700? I do not think there is.

MR. MATHER: Help me with this, conceptually if the NHS is, hypothetically speaking a very clumsy procurer and if the companies who want to tender have problems of particular sorts then, taking it slightly broader than a particular drug, but more generally, at least conceptually you can see why there might be a 300 variation or why you might find a much wider spread between your theoretical and the world of the market.

PROFESSOR YARROW: Mine are not theoretical, mine are the actual numbers. What I am saying is this is the ----

MR. MATHER: I am sorry, let me correct that, your theoretical, ultimate price, your approximation of the market price based on adding up the numbers and then adding some value, and what actually prevails in the market.

PROFESSOR YARROW: It is certainly possible that in any tender process, and this is one of the difficulties with tender processes you can get bid-rigging and all sorts of other things going on that can give you very high prices relative to cost. We try to design procurement systems against that, obviously to promote competition. It is not always got right, and you have only to look at the evidence on spectrum auctions around the world to see that it is not right, but there are certain principles. What I would say again is on the evidence that is available, it does not look as if – in tenders anyway – once the unbundling has taken place that the NHS has done very badly, there are no outliers as far as I know, but again it seems to me that if you are worried about that, the evidence is there and I am sure you have the powers to get it.

MR. MATHER: In the spectrum of the example you mentioned where there might be bid-rigging or other issues, it is the other issues which are important is it not? There is not much evidence of wide-spread bid rigging intenders, but spectrum is a very good example of something where the process yielded much higher bids than had been expected or perhaps were economically desirable?

PROFESSOR YARROW: It is partially bid-rigging, it is the tender design. One of the general principles of tender design is to encourage as many people as possible to bid, to get lots of people bidding. This is really the interest of the economist. One of the interesting thoughts that occurred tome looking at Mr. Farrell's evidence where he said he would not countenance a homecare provider that did not employ the nurses. I immediately thought "bad tender design", because the right way to do it is to say "I have a preference for employed nurses. I will make that one of the criteria against which I will invite bids, but I am going to invite as many people as possible to bid and I will see later whether this particular advantage – the employment of nurses – is the decisive one." They are the kind of practical issues that we have in public sector procurement. It is a difficult area because they are very immature systems, and there are a lot of people out there who think all you have to do is to set up a tender, invite bids, and you will get competition, and it "ain't that simple".

THE PRESIDENT: Picking up that last point, about the immaturity of the tender system, and the relative lack of experience that this great monolith actually has in operating in any way that replicates a competitive market.

PROFESSOR YARROW: No, but what those problems lead you to are higher than competitive prices, they do not lead you to lower than competitive prices.

THE PRESIDENT: What we need to focus on, to some extent, perhaps is the probability of this sort of thing happening in this sort of market. We are only dealing with a very small number of patients. There is an incumbent supplier that supplies most of them at the moment. There is Genzyme Homecare who supplies some – not very many – and, as far as we know, there are only two others who might contemplate entering the market. In relation to each of those four suppliers we have evidence as to how they conventionally would, or might, regard pricing in this market, and all those models, we can come to the historical Genzyme homecare one a bit later on, but certainly as far as Healthcare At Home are concerned, Clinovia and Central Homecare, they seem to be looking at it from the point of view of returns and charges that appear to be somewhat higher than some of these other figures would suggest in other markets where competition has already started to work.

It may be that over time those optimistic aspirations would get competed away if the degree of competition were to emerge in this market. But can we really start – take as a starting point – as if there already was competition in the market, or should we not assume that people will, at least to begin with, price as they say they do and let competition work its way down, if it is going to work at all?

PROFESSOR YARROW: It seems a very strange position. I would not be worried about competition. Once you open the smart kit and get unbundling I think the evidence is that you will get competition. I cannot quite understand it, it seems to me you are saying you are worried that competition might not work so the best thing to do is to is to set a high price, because it is not at the margin.

THE PRESIDENT: No, all I am saying is, to take a purely hypothetical example, if you set a price that gave a homecare provider 1 to 2 per cent., shall we say, and that homecare provider was customarily working, conventionally speaking, on a rather different idea as to what sort of business he was prepared to bid for, and that was below his threshold, however illogical or unreasonable that threshold might be, it was below it, would you not, in practical terms, run the risk of nobody very much wanting to come into the market?

PROFESSOR YARROW: In practical terms I think this comes down to Mr. Vaughan's "Y" factor, that you might want to build in a degree of comfort to ensure that the price to the NHS does not go up, which is where it comes out and that is reasonable. But it seems to me that then it is a question of where the "X" and "Y" are. You are now talking like Regulator, Sir, if I may say so.

THE PRESIDENT: Well, I will try not to.

PROFESSOR YARROW: You are doing an exercise that is very familiar to me, which I tend to argue should be rejected even by Regulators, let alone by competition authorities. My

experience with markets is you do not need to rig them in order to promote entry. I have been around this track many times. If you set up fair rules of the game, competition actually works, that is why we believe in it.

THE PRESIDENT: That is why this case has been going on for some time.

PROFESSOR YARROW: Well you will have detected by now that I am a believer in unbundling, so I am with the NHS and with policy which is that what we need to do is to identify the charges for nursing services and for delivery services. One of the things that it will give you instantly is a specification of what is being done. It is extraordinary, I think, that you are contemplating setting a price and you do not know what you are setting a price for, because there is nothing in the file that tells you how much nursing service there is in 2004, because the nursing service is something which is set up to train people to do it themselves and which, therefore, will decline over time. There is always the residual of people who need that service. I have tried to put a bound but in fact my estimates of the level of nursing service I think are significantly too high but I just do not know because there is no evidence saying what is being supplied. Once you start specifying these things, and once the NHS starts to find out what it is actually buying, I would have more confidence in its ability to get a fair rate. It may not be a tender, unbundling does not necessarily mean a tender, it could be a negotiation or it could be asking people simply to set prices. The key thing is that there is the separate identification of the homecare element, and – I have to say this as somebody interested in public policy – the attachment of these things to drug prices, generally in health markets has cost the tax payer a lot of money over a lot of years.

THE PRESIDENT: Professor Yarrow, you have been giving evidence in support of a company that has been bundling all the way through. I am pleased to hear approach ----

PROFESSOR YARROW: I know but, Sir, you recognise that I am an expert witness with a duty to the court.

THE PRESIDENT: Thank you, but it would have been helpful to have it a bit earlier in the case.

PROFESSOR YARROW: Genzyme know this, they have heard my homilies on this several times, Sir.

THE PRESIDENT: The Tribunal is in a very difficult position. We have been left holding the baby, as a result of various other failures along the line.

PROFESSOR YARROW: I understand and I am trying to help, I can assure you.

THE PRESIDENT: Yes, well we appreciate all the help we can get from the various quarters.

MR. VAUGHAN: Could I help with one thing on the numbers.

THE PRESIDENT: Yes, I am sorry, Mr. Vaughan, I probably cut you off earlier on.

MR. VAUGHAN: Well, no, I interrupted, I expect. Lindsay McDonald's e-mail, which is in the recent bundle dated 16th July, makes clear that in fact there were 67 Gaucher patients at the Royal Free, and 69 haemophilia patients – all children. So the numbers are not necessarily a relevant factor in there. They were both small populations, as it were, and that is the population for which Healthcare At Home was tendering in the contract that we saw. So one is talking , in both terms, of a small population. So there is nothing here that small populations cause a difference and, indeed, I do not think there is anything in the OFT which would support the small population justifies a higher fee.

The other point is that in the haemophilia tender, Mr. Potter in his second witness statement goes through the criteria of the delivery, the work that is necessary, and says that is exactly the same as would be required for Cerezyme. So there is no difference in specification for the delivering service. I entirely accept that ----

THE PRESIDENT: According to him.

MR. VAUGHAN: According to him, he has gone through that exercise.

THE PRESIDENT: I do not think that Healthcare At Home would agree with him.

MR. VAUGHAN: Well they had the opportunity and they did not come back on it. They went through one bit after the other. They went through the haemophilia tender contract – we do not have time to go through it now – the exercise he did he looked through it all and said "That is exactly the same as happens on Cerezyme." Healthcare At Home did have an opportunity to deal with it and they have not come back at all on that. In fact, haemophilia is exactly the same form of delivery service – we entirely accept it is not nursing – the delivery service is identical.

THE PRESIDENT: I suspect we ought to park that set of discussions there for the moment and move on to another aspect – unless there was any particular point you wanted to make, Mr. Turner, on that?

MR. TURNER: Sir, it is a very brief point and it is this. In relation to what we have all been discussing, the question of what the homecare service provides, you have found in the judgment what the homecare service provides, paras. 325 onwards. It would be wrong, in our submission – profoundly wrong – to talk about this as being a simply a delivery operation. What I sought to emphasise was the customer service liaison logistics' element to this integrated service which can make a big difference. So for example in relation to what Professor Yarrow was saying about how one could simply fit in a particular rung another customer with a cold chain delivery, as though one is essentially dropping something off, is wrong. You will remember that it is necessary to arrange for the patient to be there, for the patient to be in to receive the delivery, to interface with the driver for reporting back to take

place and so on – there are other dimensions to the service beyond the delivery. That is the only qualification that I had sought to make at this stage.

THE PRESIDENT: Which you say would distinguish it from haemophilia or from Thalassaemia, or HIV or anything else?

MR. TURNER: On the evidence available that is how we apprehend the situation to be, and that is the evidence both from one of the customers involved – Mr. Farrell at the Royal Free – and from what you have heard from Healthcare At Home.

MR. VAUGHAN: Sir, I do not want to go on with this, but if one looks at the haemophilia contract for tender, I would invite you to look at it, all the things that Mr. Turner says are there. You have to have specified delivery, you have to have a key holder, you have to have planning, you have to have all of these things, they are all required in the criteria for that.

PROFESSOR GRINYER: We have been directing our questions to Professor Yarrow so far, so we might give him a break. The Office of Fair Trading, looking at complexity quotients express some reservations about it but still go on and use the two extremes, one with no allowance for the complexity, and the other with allowance. Where in that area would you actually be pitching roughly, because you do not actually come down at any point.

There are also worries which have been expressed by Professor Yarrow about the credibility for some of those figures, and Genzyme have obviously challenged that.

MR. THOMPSON: I do not know whether you want to speak to me or to one of the others.

PROFESSOR GRINYER: I am happy that you should deal with it as best you can.

MR. THOMPSON: As I understand it, the position that the OFT has taken is that they have taken as a lower bound to their range an average approach, the same approach as Professor Yarrow has taken, and they have then looked at the complexity factors and applied them to some of the costs issues, and treated that as the upper bound in relation to this, and they treat that as part of the range, and in fact that is the principle reason for the range alongside the number of nurses that are required – either 4½ or 6½.. Where exactly on the bound I do not think that the Office of Fair Trading has taken a firm view on that. Essentially what we are saying is that we think that Cerezyme is certainly at least at the average, and we include in the range that it might be, at least in the issues in which we accept that complexity is a relevant factor, up to the level that Healthcare At Home indicate. So that is the basis for the range. But whether we, on that issue, take a view as to where on the range it is I do not think that does appear in the report.

PROFESSOR GRINYER: You have taken two scenarios, the zero effect and the full effect.

MR. THOMPSON: Yes, we have established that as what we see to be the range. That is obviously a different question from the direct market comparators that Professor Yarrow has been talking about, where there is not only the issue of what is involved, but also the particular competitive

features of the market which have led to low or high prices in particular cases. So, for example, Healthcare At Home has alleged that there are particular reasons why the haemophilia price was low, and Professor Yarrow has pointed to another case where he suspects that there may be a particular reason why the price is high, but we have done our best to reach a view on that and these are the figures that we have come up with.

PROFESSOR GRINYER: Did the Office of Fair Trading actually look at the underlying logic behind the actual figures in scaling or not? Or did it just accept the Healthcare At Home estimate.

MR. THOMPSON: We pressed Healthcare At Home. I think it is fair to say that if we had had our full powers we would have gone further than we did, because I think the most we got were the fairly specific breakdown in relation to the differences between Cerezyme and a particular product, [*confidential*], where various factors were identified as variants. What I think we had some scepticism about is whether or not the 1 to 5 gradings were strictly answerable in terms of costs, and we have done our best in terms of allocating to particular factors where we think complexity is relevant.

PROFESSOR GRINYER: Thank you.

MR. TURNER: May I just follow on on one point on there. If you have the OFT 's main report?

THE PRESIDENT: Yes.

MR. TURNER: And look at para.3.92, you will see there – this is what happened, the OFT receives the complexity quotient, seeks to probe it and is give a particular comparison which you can then find set out in annex 9 a little bit further on.

THE PRESIDENT: Yes.

MR. TURNER: And at 3.94 it is recorded that it was not possible within the time available to go into this in much greater detail, and that that is therefore how we arrived at the bounds – the upper bound being taking Healthcare At Home's complexity quotient, and the lower bound the averaging.

On the possible further point, Sir, that you may have been referring to about the authority of the OFT's range, and where the OFT sits in relation to that in this case as a whole. I am not sure whether that is something officially that you were asking about.

PROFESSOR GRINYER: The complex quotient figure makes a considerable difference in terms of cost, returning to 3.2 in the supplementary report.

MR. TURNER: Yes, it does.

PROFESSOR GRINYER: And so therefore it is an important factor where either I have to take Professor Yarrow's view of one extreme of delivery numbers or return to your other extreme.

MR. TURNER: Yes.

PROFESSOR GRINYER: And I have tried to get some sort of fell from where we should put our decision in that range without just making a random choice.

MR. TURNER: Absolutely. Now, on that the OFT position is as follows. You will have seen at the end of the first report, although not stated, it is in the same terms at the end of the second, but the range is given and the OFT says that "Bearing in mind other factors…" by which it was meant what we are calling "historical information", taking that information, together with the other information, the OFT considers that the right figure in this case would be likely to be at the top of the range.

PROFESSOR GRINYER: That is taking all of the factors into account not just complexity.

MR. TURNER: That is taking all the various strands of information into account.

PROFESSOR GRINYER: And that is dealing with the final OOS in the margin?

MR. TURNER: It is as well, yes. Perhaps to pick up on one further point canvassed with Professor Yarrow in relation to that. If you do set a number which to some extent takes the higher end of the range where, in the light of uncertainty, you might have otherwise said it could be somewhere below that, if there were the possibility for review of how this worked in the light of information about actual tenders, when such a decision were made – first of all, not just a competing away of any excess in that margin – one would also be able to observe actual competition and be able to correct or adjust a figure which would have been established by the Tribunal. It is not a thought that had occurred to the OFT before this exercise began.

PROFESSOR GRINYER: Thank you.

MR. BURROWS: Sir, just to give you a quick paragraph reference on the point that was just put as to where the OFT stand. I think it is important to refer to 3.4 of the supplementary report, where the OFT do reach a conclusion in respect of the choice of either relying purely on delivery numbers, or placing a great deal of weight upon a complexity quotient.

THE PRESIDENT: They say they should.

MR. BURROWS: Exactly, and that is carried on to 3.7, and I think all the rest of the paper is before you, Sir, so I do not need to trouble you any more.

THE PRESIDENT: We still have the conundrum, if we look at the table on 3.3 of the supplementary report, that the charge for delivering, including profit, arrived at by the OFT, even without complexity is still two to three times more than what Genzyme says the competitive price is albeit less than what Clinovia and Central Homecare thought it would be. That is where I am still quite confused.

PROFESSOR YARROW: Could I come back to one point as well?

THE PRESIDENT: Yes.

PROFESSOR YARROW: Shall I do that after I have helped you on this point?

THE PRESIDENT: Have a look at the table, and we will just kill that point and we will move on now to other points.

PROFESSOR YARROW: It is the table at 3.3.

THE PRESIDENT: At 3.3, you see the line "OFT without complexity quotient"?

PROFESSOR YARROW: Yes.

THE PRESIDENT: And you see the charge for delivery, including profit, "£"?

PROFESSOR YARROW: Yes.

THE PRESIDENT: And there is a figure there?

PROFESSOR YARROW: Yes.

THE PRESIDENT: That figure is at least twice your figure, the Genzyme figure, but less than the Clinovia and Central Homecare figures.

PROFESSOR YARROW: As I said earlier, I think you should treat the Clinovia figure cautiously because it is on a non-standardised comparison. I think we could meet and actually get a comparable Clinovia figure for you fairly quickly. So that one is problematic. The difference in the numbers – without profit, that is because the Office of Fair Trading have deviated from equa-proportionate allocation. What they have done is to go through certain categories, and they have essentially accepted Healthcare At Home's numbers on what the number should be. You will see the biggest one is directors. So they have allocated a very large slice of directors' costs, which is a large element, it is the biggest element of central overheads, to delivery. If you go to the first box in the table under 3.2 you will see a difference between zero and 78. As has already been said by the Office of Trading we do not think the directors' issue is a major issue and I can tell you that if directors were in that first number, which is zero, would be 17 on my numbers. So my numbers would be a bit higher here. But you will see that it is 78 and what that is saying is that an unusually large proportion of directors' costs should be allocated to Cerezyme and there is, so far as I can see, no basis at all for going through these individual cost components and allocating them on an arbitrary basis other than by activity levels. The strangest one of all is a very high proportion of sales and marketing costs are allocated to Cerezyme when, of course, this is a drug which, in this particular period, anyway, was not sold by tender. It is very difficult to see why a higher than normal percentage of sales and marketing costs should be allocated to this particular drug. So there are a variety of ad hoc assumptions drifting away from equa-proportionality, which cumulate to give this difference. My approach was, as I say, to take a swings and roundabouts approach. I think that a proportion of allocation on the basis of delivery numbers will give you too high in some of these components, and too low in others, but I do not think that those pluses and minuses will lead to a big bias either way, and that is where that number comes from,.

I should say that when that number is done the OFT number is the same as mine, and it is identical to Mr. Walsh's number in his witness statement. You will see that common number for operational costs of delivery.

THE PRESIDENT: Yes, thank you.

PROFESSOR YARROW: I will just come back to Professor Grinyer who was suggesting I was taking an extreme position and I always resist accusations of being extreme on these things. My position is that I took a central estimate of costs in 2002 which are likely to be on the high side for 2004 and, could I ask you to look at, para.23 in my witness statement, it is at tab 2.

THE PRESIDENT: Yes.

PROFESSOR YARROW: Paragraph 23 at tab 2. This is a market which has been changing quickly, and the numbers shown here are not all delivery costs. These are the operational costs of delivery, and this is where there is a consensus between OFT without complexity, Mr. Walsh, and myself, because we are all working from the same set of accounting numbers. Look how rapidly delivery costs have fallen over time, year on year. This is just a two year period and I think you will see there is a fall there, I think it is about 38 per cent. over the two years. There is no reason to expect that that fall has not continued, in fact, the accounting numbers for 2003 indicate that it would have, although I cannot give you an exact number because we do not have the delivery figures.

In 2004 it is likely to be lower still. I am working with the 2002 number, which is an historical number which is now out of date, and it is out of date on the high side. So throughout the exercise I have tried to find central estimates of things, but where there is an issue like this and where it cannot be resolved any further, rather than making a guess I have stuck with the actual numbers that come out of the calculations.

THE PRESIDENT: Yes, thank you.

PROFESSOR YARROW: So the numbers I have down for delivery I would say are not to be used as the extreme end of a range. If anything, my best guess is that actual delivery costs now will be significantly lower than these numbers – again, that would be my view.

PROFESSOR GRINYER: We are dealing here with the number of visits and the cost of nursing.

PROFESSOR YARROW: This is delivery. This is the number of deliveries, nursing is separate. In terms of nursing ----

MR. BURROWS: Can I just interrupt before we move on to nursing because we are going at quite a rapid flow and I did not want to interrupt you earlier. He said earlier that the OFT had simply accepted our figures on directors' costs. Well that is not the case, and if I can give you two references again shortly – 3.102 of the first OFT report.

THE PRESIDENT: Yes, they knocked it down.

MR. BURROWS: Exactly, and then you can seat 3.8 of the supplementary, that actually the OFT specifically state that they looked at directors' costs essentially on a time basis, they followed the activity based costing approach. I just wanted to give you those two short references.

THE PRESIDENT: Yes.

PROFESSOR YARROW: I accept that correction, Sir. The OFT did knock it down but the allocation on the time basis accepts HH's time allocation, so it is based upon that and it is much higher than an allocation for directors' costs that would be got by apportioning them out across deliveries on an equal basis.

THE PRESIDENT: Could we change the subject for a moment and think about the calculation of the profit element, if we need to go down that road. There does seem to be a difference (or maybe there is not any longer) between the parties as to how you should look at some notional computation of profit, either on the one hand looking at it in terms of return on capital or, on the other hand, taking a return on sales' basis. What I would quite like to do is to have some observations on that point in the light of the various arguments that have been exchanged, and to see whether there is still a major difference of principle between the parties on this issue.

PROFESSOR YARROW: Again, I would say to you that the best sight you can get of attitudes to profit is what people ----

THE PRESIDENT: Yes, Genzyme's primary argument is that you simply look at market comparables, and that solves the problem.

PROFESSOR YARROW: In terms of the detailed questions I think you raised in your letter, the normal approach would be to try and work out some rate of return on capital.

THE PRESIDENT: Would that be a normal approach in a service industry, Professor Yarrow?

PROFESSOR YARROW: Yes, there is no reason why services should be any different. In fact, many of our industries these days are service industries, as we all know. The issue is the following. It is what happens when you get situations where the ----

THE PRESIDENT: I suppose it depends what you include as capital.

PROFESSOR YARROW: Yes, it is a valuation of capital issue, essentially. What tends to happen is that when markets are observed where the turnover level is very high in relation to the observed capital numbers there is an assumption usually that there is a lot of intangibles in there, and that the capital number is relevant and reliable. I think the thing that you would normally look to first is the ratio of turnover to capital. In this particular case it comes back to the same old issue, namely, what is turnover? If turnover is homecare services then the ratio of turnover to fixed assets in the balance sheet, although it is higher than average for a UK industry is not out of a normal range. So there is no obvious reason why you should think that that fixed asset figure is undervaluing capital to a much, much greater extent than normally

occurs, because it is quite normal for the capital in the accounts to undervalue the actual capital and that is why accounting rates of returns which are used by the Competition Commission and so on tend to be much higher than the cost of capital. So when we do cost of capital calculations on an well valued asset base the number might be 10 per cent. When you are doing accounting rate of return calculations you will find that the average across leading companies is, maybe, 25 per cent. We do not believe they are making that much actually on properly valued capital, it is because there is an under valuation.

So the issue is whether there is any evidence which would suggest that these numbers are so extreme that you would want to deviate from the normal approach. My reading of it was that it was within a normal range – it was on the high side of a normal range, the turnover to capital.

THE PRESIDENT: The turnover for homecare services?

PROFESSOR YARROW: The turnover for homecare services' revenue. What I therefore did was took a ----

THE PRESIDENT: How do you arrive at the turnover in homecare services?

PROFESSOR YARROW: Gross profit roughly.

THE PRESIDENT: Right, okay.

PROFESSOR YARROW: It is the gross margin, it is an approximation, it is not exact.

THE PRESIDENT: And this is across the board, obviously?

PROFESSOR YARROW: Yes.

PROFESSOR GRINYER: So you are not allowing for intangibles in your capital base, you are still talking in terms of fixed capital?

PROFESSOR YARROW: Yes. Again these things are not terribly sensitive actually to the numbers, unless you go to very, very large numbers, to take a higher accounting rate of return from the kind of range that we normally observe, so that rather than using the kind of low 20s number that you would expect to find across industry in general, a number like 30 per cent. would give a sighting shot about what the rate of return would be and that was what I based my calculation on. It is a sighting shot, so this is not a definite answer. Again, all of this is trying to put matters within bounds, and to get a feel for where the levels are. Professor Appleyard did something slightly different.

PROFESSOR APPLEYARD: I work on the principles and would take a purer view of this, which is basically to try and identify what is missing off the balance sheet and then try to reconstruct the capital employed, and think what those intangibles are for a business like this and then apply the cost of capital as you would conventionally calculate it, try to identify what you thought the risk premium was in a business like this.

THE PRESIDENT: How, if at all, does one build in factors like the factor relied on by the OFT which suggests that one of these businesses was recently sold at a valuation that appeared to be very considerably in excess of the book value.

PROFESSOR APPLEYARD: Well one of the things that you would be concerned about is whether the business is being sold to reflect the market power of the business and it is not in a competitive process. One of the things that you would want to do in terms of the intangibles is to think of those intangibles, because ultimately it is the future cash flow of the business that you are looking at and if a lot of that future cash flow is coming from the fact that they have customers who are stuck with them then you would say then that is not in the competitive process. So the things that you might want to look at are things like in a service sector business are looking at staff acquisition costs, staff training, staff development and capitalising those and putting them on the balance sheet. Obviously, there is nothing to do with the major ones that you would see in other sectors like R&D and brands, they are the other major intangibles for lots of businesses but not here. So you would see it as a people's type business and that is what you would want to do.

Normally, you would look at customer acquisition, customer care and try and capitalise those costs, and take those on to the balance sheet. That is what I think we should *a priori* be thinking about, but I understand and can quite appreciate that we could easily do what is done in the PPRS and that is forget about all the intangibles, in fact, take them all out and then look and see what UK industry is earning in an accounting rate of return across that capital base and then look at possible ranges and say you might want to raise it. The current range is around about 20 to 25 per cent., so raising it up to 30 per cent. you err on the same side, in a sense, for profit. I would prefer not to do that.

PROFESSOR YARROW: Could I just say, in terms of the particular example used as a comparator by the OFT, this was discussed and there were very serious concerns about it. One is that it is partly a manufacturer as well as a service provider. Secondly, it had just had its accounts qualified, which is not something which happens usually which gives one a certain nervousness about relying on it. Thirdly, it comes back to a point that this is a market which is growing very fast and changing, and you often find when you have projections of future growth in profits then you are going to get high share valuations. If you capitalise all of that and put it in the balance sheet and then apply a rate of return today to it what you are doing is effectively charging high prices today because it is going to be successful tomorrow and that is slightly awkward.

PROFESSOR GRINYER: Given that Clinovia is partly a manufacturer you could expect its fixed assets to be higher relative to this kind of service business than, say, Healthcare At Home.

PROFESSOR YARROW: I do not think that is true because this is pharmaceuticals. There are a lot of IPRs here and know-how and all the rest of it. It is an industry famous for being heavy in intangibles.

PROFESSOR APPLEYARD: The R&D would be written off, although it is one of its major investments it would not appear on the balance sheet at all under UK or international GAPP – sorry Generally Agreed Accounting Principles.

THE PRESIDENT: Just help me conceptually – I suppose this question is more out of curiosity than anything else – if you are dealing with a profitable business that has really no capital in the conventional sense, for example, if you are dealing with an author or a barrister, or film star, or some kind of operation like that, a literary agent, or someone who is just making a living out of personal skill, what is the right approach to assessing what an appropriate profit margin is – capital is almost unusable?

PROFESSOR YARROW: I think the question why would you be wanting to do the exercise in the first place.

THE PRESIDENT: You might be the Monopolies Commission investigating lawyers' fees, or something.

PROFESSOR YARROW: I think it is tricky, in this particular case ----

PROFESSOR APPLEYARD: I do not think there is any real problem for someone like that, because you can take someone like Tom Cruise, you would evaluate his wealth at a particular point in time, and then evaluate his wealth at another point in time, and the increment is the profit, subject to him taking out and putting in and so on. So in principle I do not think there is anything too difficult about it, it is just a question of what do you want to put down for his wealth? How valuable is a marriage?

PROFESSOR GRINYER: Its asset base including intangibles! [Laughter]

THE PRESIDENT: The intangibles are extremely valuable in that context. But in this particular exercise we are trying to work out what is a reasonable approach and the further we get away from a business that depends on physical capital one may begin to doubt how far conventional approaches to return on capital are the right measure – I just do not know. There is certainly some evidence in the paper that the Competition Commission has tended to steer away from that measure in service industries.

PROFESSOR YARROW: When there are very high rates of turnover relative to the capital.

THE PRESIDENT: Very high rates of turnover and small capital base.

PROFESSOR YARROW: Yes. As I say, the ratio here is not out of a normal range, and there is a fair amount of physical capital because you have all the central locations and so on, the vans, the cars.

THE PRESIDENT: You have the vans and the storage, warehousing and so on.

PROFESSOR YARROW: So there is a real physical distribution network here. Part of the problem working back from share prices is the old circularity argument with which you are well familiar, Sir, and everybody at OFT will be. If, as we have seen, there are all sorts of variations and prices and I would say they are pockets of market power of one type or another due to this complex system that allows people to pick out good returns, you have to be careful that you are not just capitalising those and then saying "Here is the capital base, we will give you a rate of return on them", so you are giving people a rate of return on market power.

The main point is probably this, and again trying to be helpful, the way in which Genzyme has structured its offer, when it made the offer terms, was to give very generous credit terms, and because at the moment – and this may change in the future but at the moment ----

THE PRESIDENT: What offer are we talking about?

PROFESSOR YARROW: The offer of 20th April.

THE PRESIDENT: I do not know that we are allowed to know anything out this, are we, Mr. Vaughan?

MR. VAUGHAN: It was our letter to the OFT setting out ----

PROFESSOR YARROW: It is a letter I have read, Sir.

THE PRESIDENT: Would you like to control the situation, please, and let us know what we should do next?

PROFESSOR YARROW: Can I just explain, Sir, that Genzyme proposed to do the evaluation on the basis of 90 day credit terms. The effect of that is to inject very considerable amounts of working capital into any homecare supplier who bought Cerezyme from the company. What that does is it actually turns capital employed in the Gaucher segment negative. You actually get capital by entering this market because you get this valuable drug, you sell it ----

THE PRESIDENT: You have stock that you have not paid for.

PROFESSOR YARROW: Yes, exactly, you sell it, you get the revenue in and the valuation of that can be done – it is done in Mr. Walsh's witness statement 2, and we have no disagreement with Mr. Walsh's calculation save that we think he has a higher than justified stocking level, but we are very close on that, so that there is a very close agreement on the valuation of that working capital input. That transforms the position, it really makes it much easier for you because it effectively takes the capital employed out of play unless you believe the capital employed is huge.

THE PRESIDENT: A business with a negative capital, is it even practical to work out a profit margin on the basis of some return on capital.

PROFESSOR YARROW: Mr. Walsh did the calculations. They were identical to Professor Appleyard's. I took a slightly more conservative view on the cost of capital but the differences are not great, and it really does effectively nullify much of this issue about what capital is because ----

THE PRESIDENT: If we can just tie this down a bit, if we go to p.25 of the OFT's supplemental report. If you look at the table at 5.3, p.25, there is a line for delivery on various assumption, and there is a line for nursing on various assumption, and then there is a line for profit. You have a figure for the OFT report, and then you have a revised figure that is substantially less – that is on 4.5 nurses, then you have figures for 6 nurses – we have not discussed nursing yet, we will come to it in a moment – we have more figures and the revised figure is again less. Then you have some figures from Professor Yarrow which, on any view, are very substantially less than the OFT figures. This particular percentage does make quite an important difference to the way one might build up something for profit.

PROFESSOR YARROW: Yes.

THE PRESIDENT: Now is there any common ground in this respect or is this just something we have to take a view on?

PROFESSOR YARROW: I am not entirely sure because when we met with OFT in the first instance it was trying to identify where differences came from, and the working capital issues were parked, so I am not clear to what extent OFT have thought about the implications of 90 day credit terms. The differences come because this is the issue of "Do you link it to the drug price?" Should you allocate the cost of capital, unlike other costs, on the basis of the price of the drug? I think there is an issue of principle here – it is the cost causality principle – and I would argue that the effect of the OFT approach, by taking a percentage margin of the drug price, would be to mandate highly discriminatory prices. What it means is because of the very high price of the drug there would be a very high margin and you could see that when you see what the implied level of profit for a delivery would be, even at the lower of the two numbers, the 1.3 per cent. At 3 per cent. the profit for delivery that would be being mandated would be enormous, and that has no relationship with costs whatsoever. It is a pure discriminatory price. I find this baffling because in other case if you found a dominant firm setting these prices I am sure you would have found it guilty of abuse – I am not sure, but I think you would have found it guilty of abuse. It leads to very high price discrimination if you tie it to the list price.

THE PRESIDENT: Although we do know that certainly Healthcare At Home builds in – or appears to build in – a margin on the drug price in its conventional approach in deciding whether it is going to tender.

PROFESSOR YARROW: I cannot see any evidence for that.

THE PRESIDENT: We do know, and I think from memory it is Clinovia who have a figure, albeit a lower one, point something, and we have seen that certainly in the past Genzyme itself has done allocations on the basis of turnover, admittedly as more or less a one product company so perhaps it is a simpler exercise to do, so it may not contain a particular distortion. So I was wondering whether one could entirely exclude the drug price as part of the formula, as it were.

PROFESSOR YARROW: It is what they do, but it is a clear signal of lack of competition, because again I come back to the market evidence. As soon as there is competition for the homecare services these very high margins bid away.

THE PRESIDENT: I think that highlights the timing problem that we started with earlier. Do we start with the assumption that there is already competition or should we start with what they do and let competition takeover.

PROFESSOR YARROW: It is very difficult because ----

THE PRESIDENT: It may be the question we have to answer, it may not be a fair question for the parties.

PROFESSOR YARROW: If this is not a case where there was a regulated price that you were marking against I think it would be a very different set of circumstances, but it seems to me that if you take that approach what you are doing is saying that because we think competition might not develop we are going to set a monopoly price.

THE PRESIDENT: No, it is saying we are going to start, either from where we happen to be or from where we were before the abuse took place, and we are going to create conditions in which a competitive situation will, with any luck, develop.

PROFESSOR YARROW: But you have fixed the drug only price. You are in regulatory territory.

THE PRESIDENT: We have to start somewhere, Professor Yarrow.

PROFESSOR YARROW: I just wanted to be clear – I think you are becoming a Regulator.

THE PRESIDENT: Whatever we do we have to fix a price and the philosophical and conceptual issue is how you approach that.

PROFESSOR YARROW: I thought the principle was that you set a price such that an efficient competitor could survive, not such that an efficient competitor can make a large margin.

THE PRESIDENT: It is the man who is going to Dublin, I mean we have to start from somewhere and where we are is where we are.

PROFESSOR YARROW: But surely you have to set price related to the principle you stated so clearly, what is the margin that would allow an efficient competitor to be viable and prosper in this market – not more than that.

PROFESSOR GRINYER: To make at least a normal profit.

PROFESSOR YARROW: A decent normal profit, yes.

PROFESSOR APPLEYARD: Could I just add, if you looked at virtually any firm, unless they set themselves some sort of performance measure, like economic value added, they would always be looking in their plans and budgets at return on sales, because they would not be looking at the balance sheet. So if you said "I will just observe and see what they do", that is what you would see, return on sales. But that is not how we would evaluate that. We would evaluate them back with the cost of capital and the capital employed, that is how we would do it, and then we have clear guidelines about what it is that we do there. Return on sales can be anything in terms of practicality given in terms of what the firm does for a start. It tells you how it allocates its costs. So when you looked at produce line profitability they could be all over the place and we have no reference points for that. The theory is firmly in return on capital, and that is where I think we should be looking.

THE PRESIDENT: What we have in this case, and maybe it is the time to come to it, we have tried to some extent to anchor ourselves where we can to evidence that we have already because generally speaking evidence that came into existence *in tempore non suspecto* – if I may use a Latin phrase for a moment – is to be preferred to late constructs that may have been constructed, however carefully they may have been done. What we actually have in this case is a certain amount of evidence, particularly from Genzyme's own figures, of the kinds of cost structures they were looking at, I think it was in 2000 but they were looking five years ahead, on the basis that they would by then have had a very large share of this particular market, building up their costs and saying in comparison with what we are paying Healthcare At Home at the moment we will save ourselves a certain number of percentage points. But the final figure is considerably higher than these figures would suggest, and it is a conundrum for us to know what weight to put on that.

PROFESSOR YARROW: This is the historical issue.

THE PRESIDENT: Including very recent historical evidence from Dickson Wilson, and Mr. Williams.

PROFESSOR YARROW: You will know, Sir, that I did not use that evidence when I wrote my report of 18 months ago which was in a totally different context so it was not constructed for this particular set of arguments.

THE PRESIDENT: No, I was not suggesting that it was.

PROFESSOR YARROW: But I want to just make it clear on p.4 of that report I gave my cost estimates by what I thought at the best time was the right way to do it given what I had. I talked to Mr. Williams and I saw the accounting evidence and I dismissed that even then as not the way to assess what homecare costs are. There were the traditional problems, one is start of

business and Professor Appleyard can go on at length about the relationship between accounting numbers and economic rates of return in the first few years of a start up business.

THE PRESIDENT: Although that particular document I have in mind, which was the Genzyme business plan, was discussing the beginning of the Genzyme Homecare business in a sense was a start up document it was actually looking to what the situation would be five years down the line.

PROFESSOR YARROW: It was indeed, it was the plan. But in terms of the accounts themselves it was the familiar issue that you have a vertically related business and certainly in looking at it – I only looked at it briefly – because my question was whether by doing what Genzyme had done Genzyme thought it was going to get lower costs, because I think of the purpose of competition to drive prices towards costs and so I was looking at that issue – was it a course of business conduct which, for the company was going to lead to a significant cost reduction. So I was looking at it narrowly in that sense. But there were familiar issues of where the costs are allocated in the vertical chain and it was not at all clear to me at that stage that there was any clarity whatsoever – it is the transparency point.

You will see that the way I did it then was to use the bottom up approach, not from the accounts but actually to go and see what the activity was, see the driver, see the fridges, look at the kit, talk to the nurses, see what they did and then to use what knowledge you had about market rates to effectively build up the cost, and that is where you get, what I called at that stage my "back of envelope costs" which, I must say on later reflection do not look at all bad in terms of market realities.– they have wobbled up and down as new evidence has come in. The difficulty more generally with historical evidence is if you go back to 1998, and we are looking at that particular set of issues that is a near eternity ago, because on the "big bang" theory, somebody comes along and says "This is how the universe looks at 5 seconds out" and somebody comes and says "Five minutes later it will be roughly the same", what that misses out is the rate of change. So the crucial question on how reliable historical evidence is, is the rate of change in the market, and very unusually for a competition policy case you are dealing with the market right at the very beginning of its existence with a very high proportionate rate of expansion. That is why, when I took you to that table at para.23 ----

THE PRESIDENT: We are talking about homecare services generally?

PROFESSOR YARROW: This is homecare services generally, yes. Delivery costs are falling very rapidly year on year and have been. Nursing costs have been falling, probably not quite as quickly, unit overhead costs will have been falling more quickly than those numbers have shown because if you have a fixed cost and the market expands by a factor of 10 the unit fixed cost will fall by a number of 90 per cent. So you do not need to go very many years back

before you are looking at a different set of circumstances in the cost levels and market conditions, and also the demand side too because the NHS is developing all these services and new ways of procurement.

I would say, with particular respect to 1998 – it is not quite as strong for the later period – but you are looking at very dissimilar conditions and, in particular, very dissimilar cost conditions, and you can see that from the evidence, limited though it is, on the speed on which unit costs have been falling. In my view right from the outset it seemed clear from the evidence that the prices of the contract were an excessive cost at the time it was struck in 1998. One sign of that was the increase in profits of the company as a whole that occurred after the contract was struck. It is also evident when the contract was terminated in what happened to profits as a result of the contract. It is also apparent from statements made in HH's accounts, which actually draw attention to this litigation and the importance of this contract and its margins. It is also apparent from the documents submitted by HH to the OFT in bringing this complaint in the first place. I am absolutely clear that in 1998 a deal was done in which charges then were excessive in relation to costs even at that stage, and that costs have fallen quite dramatically since, and that is the problem.

THE PRESIDENT: One implication of what you are saying is that the information that was put in to the Department of Health in 1999 was grossly misleading.

PROFESSOR YARROW: If you read my report, Sir, I said "blatant cost padding" – they are my own words, and I stress I am an expert witness and that is my view.

THE PRESIDENT: Well I am grateful for your view, Professor Yarrow, but this is quite a serious issue because when we got to the OFT and, indeed, the case before the Tribunal quite a lot of further evidence was put in, and I am thinking particularly the Dixon Wilson Report, that purported to tell us what the costs of homecare were, and your position is that that was pretty misleading as well, really.

PROFESSOR YARROW: Well "misleading" is a strong word. You have my words in my original report what I thought about the submission to the Department of Health – you can read that again if you wish to. In mitigation – although it is not my job to do that ----

THE PRESIDENT: If we leave 1999 aside, what are we to do about Dixon Wilson? It allocated a figure – tab 47, p.4274 para.8.8. That explained what the staffing levels were and then it gave us various figures for direct costs and overheads and allocated the very substantial to Cerezyme on the basis that that was the bulk of the business.

PROFESSOR APPLEYARD: I think what it shows is that this is just accountants again making allocations of overheads or costs that have been allocated. Here we can see on the basis of

turnover 93.6 per cent. allocation to Cerezyme when these costs are actually not related to cost causation as such. You have finance £285,000 for this operation.

THE PRESIDENT: If it is virtually a one product company why is turnover not an appropriate allocation?

PROFESSOR APPLEYARD: At this time, I think obviously as Professor Yarrow said times have changed, and there are other activities in here, so when you set up an infrastructure at the start you expect to make losses. What I am suggesting is that perhaps these cost allocations in the first place, which are done on the basis of an allocation on staffing, I believe, here, probably do not reflect cost causation and, if you were to look and say "How much do I really need to run this business with these – HR finance and so on – they would be quite dramatically different costs. So it is a start up situation, it is a cost allocation issue. It is the very issues that we have been talking about actually, and therefore unreliable, and I think we should just park it on the side.

THE PRESIDENT: Well we are in a very difficult situation as a Tribunal if we are told that a lot of evidence upon which we have previously been invited to base our judgment turns out, after all to be unreliable.

PROFESSOR YARROW: It is unreliable for the purposes of determining what competitive homecare prices are likely to be, and I say to you, Sir, that is what I said in my report. I gave the numbers (p.4) and there was an obvious inconsistency between those numbers and these, so I can only say that my view throughout has been the same. I can remember one of the issues I had when I was first trying to find out what was going on here was that when Genzyme Homecare was set up there were certain people employed in the parent company and then part of their cost was just allocated across to the new business. Clearly, there is no causality there, it was just a new business was formed, and this was a new unit to which costs could be allocated. I can remember talking to Mr. Williams and saying "No, you have to look at this in terms of incrementality. What are the extra costs that are being incurred as a result of setting up this new business. As I say, it was not my primary purpose at that stage of what I was doing, my opinion was asked for on the competition issues at that stage. All I wanted to do was to satisfy myself that Genzyme could, in fact, or would be able to supply at a lower price than the charges it had previously been paying to see if this was a normal step in the competitive process whereby high charges were being competed down in some sense – I use the word "competed" very loosely, as you appreciate.

THE PRESIDENT: Do you want to come in on the relevance of historical information, Mr. Turner or Mr. Thompson?

MR. THOMPSON: Could I say something briefly about profit first of all?

THE PRESIDENT: Yes, I should have asked you to.

MR. THOMPSON: The OFT's essential position on profit is that, as far as we can see, the reason why Professor Yarrow and Professor Appleyard have come to such a very low figure is that they have effectively made no provision for what you might call intangible capital at all. As I understand it Professor Appleyard has simply looked at working capital and fixed assets and applied a very low rate based on the rate used for working capital, whereas Professor Yarrow has used a figure which was described by the OFT in its report as essentially arbitrary, because it was a figure that was used for a quite different purpose under the PPRS, and although he gave a slightly more elaborate explanation today the OFT does not find either of those approaches very satisfactory.

In relation to working capital, we recognise that were it to be the case that there were some binding commitment from Genzyme that it would give 90 days credit that that would need to be taken into account and, as I understand it, the effect would be equivalent to approximately 0.6 per cent. by value. But at the moment that is not part of any binding commitment, and if it were to be included it would need to be regulated or at least subject to some form of binding assurance from Genzyme that that were to be the position. I am not clear at the moment what the position is with Healthcare At Home, but I am not at the moment clear that they are getting the benefit of any such commitment.

In relation to the percentage rates of return on sales that have been used the Tribunal will be aware that there have been three figures, the highest of which is, I think, Healthcare At Home's. The middle one is central, and the lower one is Clinovia. I will not mention what they are but in principle the approach of the lowest rate, whereby some proportion has been given as a percentage of costs and some proportion as a percentage of turnover has some attractions but, as appears in the supplementary report, the Office of Fair Trading has some concern that the underlying cost figures for Clinovia are too low and, therefore, although in terms of approach that may be a reasonable compromise approach, the OFT has taken the view that the central figure is a reasonable upper band and may be the best way to approach it, although the Tribunal may wish to take into account the Healthcare At Home approach. But in all the circumstances the OFT thinks that that is the better way forward, because of the considerable difficulties in attributing a sensible valuation to the capita of a company of this kind within the bounds of the exercise that the OFT is seeking to perform.

In relation to Professor Yarrow's general points – I think there are really four general points he makes. One – bundling, two – discrimination, three – his own earlier evidence; and four – what he calls a "floor price". In my submission there is curious feature which links to some of the questions the Tribunal was putting. As I understand it, Professor Yarrow is saying

that Genzyme should unbundled on the basis of a competitive market whereas the Tribunal will recall that the bundling that was found was based, as it were, on the pre-competitive price. So Genzyme would effectively have bundled in at a relatively high margin but would bundle out at relatively low one and, given the context of this case, that is the somewhat curious and unfortunate feature given the somewhat self-serving arguments that have been put forward in various contexts by this company.

THE PRESIDENT: So what you are saying there is that if we take hypothetically, for argument's sake, the type of margins that were being thrown up in the 1999/2000 period – or perhaps even before that – whether it was Caremark, Healthcare At Home, the figures give to the DOH or whatever – and I think this is actually in the judgment so it is not a confidential figure and I do not think it matters now anyway it is too long ago, we find in broad terms at that stage from a number of points of view one could see people working on margins of around 10 per cent. If we are now, four years later, invited to unbundled at, shall we say, for argument's sake, 2 per cent., "bundling out" as you put it at that margin one has transferred 8 per cent back into the drug price.

MR. THOMPSON: Indeed.

THE PRESIDENT: Which was not regarded as part of the drug price at the time that the abuse took place, which you would submit is a somewhat perverse result.

MR. THOMPSON: How exactly it fits into the margin squeeze issue with which we are concerned is perhaps a difficult one, but it does at least, in my submission suggest that the benefit of the doubt in relation to Genzyme should not be strenuously in favour.

THE PRESIDENT: This is a thought that has only very recently occurred to me, and it may be completely misplaced, Mr. Thompson, I do not know whether you have thought of it, would this argument involve a *de facto* increase in the drug price which would require the permission of the Department of Health under the PPRS?

MR. THOMPSON: I have no idea, I think that is a matter for Mr. Brownlee rather than for me, or indeed for the OFT. I do not know what the position would be taken by the NHS if this was brought to their attention.

THE PRESIDENT: Yes, so you have bundling in and bundling out.

MR. THOMPSON: In relation to discrimination, I had some difficulty in understanding the point that Professor Yarrow is making because, of course, there is no allegation that either Healthcare At Home or any other of these homecare service providers are dominant. I am not quite sure why it would be problematic that they should have different prices.

THE PRESIDENT: Different prices for this business as distinct from other sorts of business.

MR. THOMPSON: Indeed, I do not know quite who was alleged to be discriminating. In relation to Professor Yarrow's earlier evidence, the Tribunal will, of course, recall that the very low figures found there were also found in the context of a report whose general approach to homecare services was markedly different from the approach that recommended itself to the Tribunal in its Judgment, and so the fact that the same low figures now put forward for homecare services may not necessarily be the strongest point in favour of Professor Yarrow and Professor Appleyard's findings.

Finally, in relation to the floor price point, I think it was already put to Professor Yarrow by the Tribunal but in my submission there is nothing in that, there is no limitation on what price could be negotiated down by the buyers such as Mr. Farrell and so there is nothing in the suggestion that supra competitive prices would automatically be paid to suppliers such as Healthcare At Home simply because a larger margin was available. There is no reason why that margin should not be whittled away by competition. So those four points I would think are relevant for the Tribunal's consideration.

In relation to the historical position generally which I think was the position the Tribunal asked me about. I think Mr. Turner already made submissions about that this morning. We do consider they are of some little weight and, in particular, the 1998 negotiations where the Tribunal will recall that a memo was put in from Mr. Walsh which has been denied in rather general terms by Genzyme, but I do not think has been disputed specifically, about the circumstances of that negotiation. Even if that were the case, in 2000 I think it is accepted by Professor Yarrow in his report and, indeed, by Genzyme in their business plan that at that point Genzyme had quite considerable reasons to impose pressure on Healthcare At Home to reduce their prices and, indeed, did achieve a reduction in price of some 14 per cent. and in the business plan Genzyme suggested that they had done as well as they could in terms of lowering prices. So in my submission the 2000 price can be taken to be quite a good indicator of what the market price was at that time, and the Tribunal will recall that at that time the margin was about 9.5 per cent. Can I just take you to those two references?

THE PRESIDENT: Yes. I think I have probably got them open, but take me to them.

MR. THOMPSON: The first is at tab 32, p.1196, at the bottom of the page:

> "For the start of 2000 we successfully negotiated a reduction in fees from Healthcare At Home resulting in an approximate annual saving of [*confidential figure*] based on year 2000 sales' volume. At that time they were reluctant to give the discounts without reciprocal concessions and to which we offered extended credit terms. Future attempts at price concessions are unlikely to be fruitful in times where costs are increasing and maybe only possible by conceding other concessions."

In my submission that is quite a significant piece of evidence. I think it is difficult to suggest that Genzyme were in a weak bargaining position at that time. They clearly managed to extract quite considerable concessions and they were under a degree of cost pressure from the NHS at that time. Likewise, Professor Yarrow appears to recognise that, and that is at tab 2.p21 of the first report, A1.8:

> "However, that position changed with the introduction in late 1999 of the new PPRS, which imposed a 4.5% reduction on list prices."

Then, towards the end of A1.9:

> "The list price reduction therefore had immediate implications for Genzyme's profits and, for the first time, the level of homecare service charges seriously affected the company's shareholders. That is, post the end of 1999, Genzyme had 'RPI-X like' incentives to seek to reduce those charges, albeit only up to a certain level. The associated behavioural shift in the company's approach to homecare provision is manifest in the documents in the file and, indeed, in the entirety of this case."

So Professor Yarrow appears to recognise that the negotiation in 2000 was under price constraints and the Tribunal will obviously have our submissions as to the general market power of Genzyme in the market. So we do place some weight on the figure at the start of 2000, and it appears to us to be consistent with the tendering evidence from Central and Clinovia and Genzyme itself, also in the business plan, even if one accepts that there has been a degree of reduction in costs, because the figures that are being put forward now and the figures that are put forward by the OFT, the range of figures, is somewhat lower than the figure negotiated by Genzyme at the start of 2000. So in my submission the market evidence is quite strong confirmation that the general approach of the OFT is in the correct range in its two reports and, in particular, in its supplementary report, and that the correct figure is towards the higher end of the OFT's range, but that is directly consistent with the market evidence.

THE PRESIDENT: Yes.

MR. THOMPSON: The only other point that is put is not only the cost figures, but also the actual figures – we have not looked at nurses ----

THE PRESIDENT: No, we perhaps ought to spend just a minute or two on nurses.

MR. THOMPSON: Just a simple point, within the Genzyme business plan, as reflected by Dixon Wilson, you will recall that there were eight nurses and one head nurse for precisely this business, although the suggestion that it could be done by two or three nurses needs to be read in that context.

THE PRESIDENT: Yes, Mr. Burrows?

MR. BURROWS: If this an appropriate moment, we have Mr. Hughes here, who is the director of economics from Ashurst, and he wanted to make a few short points in respect of the previous issue of profit – cost of sales or otherwise – together with a few points about historical evidence, the nature of the historical evidence that is before you and the relevant weight.

THE PRESIDENT: Yes, very well, thank you.

MR. HUGHES: Thank you, Sir. I just want to make a couple of comments firstly about return on capital employed and return on sales, and why the competition authority use what they use. A lot of the literature on return on capital employed, which Professor Yarrow would be an expert on, as would his colleague, is in the context of regulating dominant utility companies. We have an awful lot of fixed assets and indeed they will have something typically called a regulatory asset base on which they are allowed to earn a certain return, and there are debates about the size of that regulatory asset base, but it is called something, it has a name, and they usually have some idea what it is.

What we are discussing here, of course, is a rather different category of businesses. These businesses have also been subject to competition investigations by expert bodies such as the Monopolies & Mergers Commission, and our submission to the Tribunal earlier referred to to:

> "Thus the MMC generally prefer the Return on Sales (ROS) when considering non-manufacturing companies and manufacturers with small capital bases relative to sales".

This is a report by Martin Graham, formerly at the Office of Fair Trading, and Professor Anthony Steele, and he is referring there to various reports such as the supply of newspapers, and also fine fragrances. There is also a more recent report by the Office of Fair Trading relating to BT Yellow Pages, which was another Monopolies & Mergers Commission Report and if you do not mind I will read a couple of sentences from that.

> "For regulated industries, such as the utilities, standard practice would be to assess a company's profitability by looking at ROCE [*Return on Capital Employed*] (in relation to a company's capital asset base). If such an approach were adopted mechanically in the case at hand, it would point to a much greater tightening of the price control on BTYP [*BT Yellow Pages*] than that proposed below. It is not, however, an approach that can b e readily applied to businesses such as printed directories which have few tangible or physical assets in relation to turnover. Although BTYP has intangible assets, valuing these will always be subjective."

Then it goes on to make the circularity point that was made very eloquently by Professor Yarrow. Where this takes you is – what are the intangibles here? Professor Appleyard said "There are none, there are no brands, there is nothing going on here."

PROFESSOR APPLEYARD: I did not say that.

MR. HUGHES: Well it is not an industry where brands are important.

THE PRESIDENT: You tell us what you say the intangibles are, Mr. Hughes.

MR. HUGHES: I think the intangibles here deal with the point that any fool can run a professional service business, and I think running these businesses is actually very difficult because getting it right consistently all the time, which is why people employ you to do the job, and why reputation is very important in this market place, and why reliability, delivery, all the material from the NHS is about getting it right, not just generally, but on the wet Wednesday when things go wrong – what do you do when it goes wrong? I think that is an important thing to bear in mind here. This is an area much like legal services, or economic advice, where consistency of delivery is very important. So I think there is a very big intangible in here which I call "the getting it right" factor. Although it is true that people do say that any fool can run a service business, in fact running a service well all the time, or at least in my experience of my own little business – and what do I know about anything – is something I find quite hard in terms of managing my teams.

I will make another small point about the return on sales which is that this is exactly the measure that is used by the Pharmaceutical Price Regulation Scheme in terms of regulating businesses with small capital employed which, of course, might well apply to someone not sitting a million miles away. In terms of historical data, there is an old joke amongst economists, and if I might be permitted one joke, and it is that there are two laws of economics. The first law of economics is that for every economist there is an equal and opposite economist; and the second law of economics is that they are both wrong. The concern I have with manufactured data, as opposed to relying on historical data for Genzyme is how can you be absolutely certain that it is accurate within the defined level which the Tribunal is looking for here. Bearing in mind also that the purpose of this inquiry is not a utilities type inquiry where you are trying to prevent excessive pricing by someone and the purpose of this particular inquiry I would submit, and with the opening comments of the Tribunal, is you want to have a market opening price in order to engender and develop competition. Typically Regulators do not have price controls where they want to engender competition here in terms of setting price levels that are too tight. What they want to do is select looser price levels where they want to engender competition. I think that should be a theme of this exercise.

You can tell me to sit down now, but I have two other small points, if that is all right?

THE PRESIDENT: Very quickly, please.

MR. HUGHES: The first of those was the increase in profits which was observed, which Professor Yarrow has emphasised, if you compare 1997 and 1999. We did observe in our submissions

that there was no evidence of substantial increase in profits and Professor Yarrow says that in fact they made £700,000 when they got the contract, and they did not make it previously. What is missing with that statement, of course, is a mass of amount of turnover and the mass of amount of costs that went in order to get that £700,000 profit, and the fact that that £700,000 profit is a return on sales of about 3 per cent. which is a familiar number by now.

A final comment I wanted to make, which was about Genzyme's costs. A comment made by Mr. Vaughan this morning was that in settling the unbundled price what he wanted to make sure was – and he will correct me if I am wrong - if that price is not sufficiently profitable going forward they will exit the market, they will not stay in the market. That was the comment he made, and that does beg to me another aspect to the margins of these tests, which is the cost base of Genzyme, which has not been the subject of any of the discussions here, but I am rather concerned that this appears to be dismissed on the basis it is a start up business and it does not have big economies of scale, because that seems to me to give it an awful lot of room for manoeuvre – to cross-subsidise, which is very relevant for any subsequent remedies – and indeed to act with free will in terms of how it operates in the market price regardless of whether it is any cheaper than another service operator. I think if that element of the margin squeeze test were to be missed out there is quite a lot of scope initially here which would be unfortunate if it were not caught, particularly in the context of these proceedings which have been going on for a long time.

Thank you.

PROFESSOR YARROW: Sir, could I just say one thing about the quotation that the OFT made, because it is quite important. They are right to say that I said that post 1999 PPRS Genzyme, for the first time, had significant incentives to reduce costs. The operative words are "up to a point". In other words, the difficulty with the PPRS system ----

THE PRESIDENT: By which you meant until they hit the PPRS.

PROFESSOR YARROW: Exactly.

THE PRESIDENT: They were way below the PPRS level at which they had to put in any returns, were they not?

PROFESSOR YARROW: They did not have to put in any returns, but they operated under the PPRS, as far as I understand it. So the AFR requirement, the reporting requirement, is really is really a kind of small firm issue, it is just you do not have to report, but you are supposed to comply. It is the difficulty with the regulatory system, it kind of switches between a price cap and a rate of return, depending upon where you are. I think, as I pointed out, both in my first report and then later, Genzyme' behaviour is consistent with the incentives you would expect from this system in that it was pretty laid back about costs before 1999. It became more

interested, but only up to a point, and it did indeed renegotiate the contract – up to a point – and that behaviour I think is quite consistent with what we would expect.

The other quick point, on price discrimination – price discrimination can be as damaging if not practised by a dominant firm as practised by a dominant firm, because in this particular context it is contrary to the interests of the NHS to face these discriminatory prices, because it will distort its own decisions. I saw an example in Newcastle, where they were looking at whether to go out to homecare or to provide the service internally, and they decided that they would move towards internal provision because the homecare cost was very high – it was one of these very high numbers like the one I showed you first time around. If that price had been truly cost reflective then it is likely that the Trust would have taken a different decision, because a competitive price, or a cost reflective price would have told them that it was better to subcontract and to leave the homecare to the private service operator, rather than take it into the NHS. So non-discriminatory prices are really quite important for the NHS for its procurement policy. I certainly was not implying that there was any dominance, but whatever the cause of this, and it might be that it is almost in the first instance a mandated price discrimination, that is not in the interests of the NHS. The NHS has said, I think, quite clearly, that it wants to see unbundled prices. It does not want to see things linked to the drug price and I think that requirement for the NHS is as good for the profit level, which is a cost of capital, as it is for any other cost.

PROFESSOR APPLEYARD: Could I just come back on being misquoted?

THE PRESIDENT: Yes, of course, Professor.

PROFESSOR APPLEYARD: I did say that there would be intangibles in terms of staffing, it is a people's business. I also said, in terms of what I have done, that I did not think it actually amounted to much. This stuff on reputation, I think, is just a red herring. All firms that are in business are interested in reputation, so it is really the intangibles in the staffing that matters and, from what I could see, having looked initially at the nature of this business – a nurse providing an infusion, a person delivering to someone's house at an agreed time, is nothing much in the way of investment, so I was prepared to see it as quite small. My position is that what you see on the balance sheet is a good representation of the business.

I said initially that I thought the capital employed was very small, but probably positive. My latest report says:

"In the light of the working capital and the further evidence on stocking that it is small and probably negative."

THE PRESIDENT: Thank you.

PROFESSOR GRINYER: I am still somewhat worried about these intangibles, Professor Appleyard. What worries me slightly is that Clinovia was sold for 13 times its fixed assets. Now, that has to have some implication for the level of intangibles, and suggests it is very great. Admittedly, I agree with some of your other ----

PROFESSOR APPLEYARD: I would not be too concerned about that. There is something very peculiar about that transaction and if you look at the accounting subsequently when things are corrected as a result of that transaction, you will see that the company re-states the asset position. In concluding things that are extremely unusual like in identifying creditors in millions that apparently were not there before. So I find it not a reliable piece of evidence.

PROFESSOR GRINYER: A market price has been set by the buyer presumably on the basis of his anticipated earning stream. That value is a market value which has been placed in the company, and therefore it has some relevance.

PROFESSOR APPLEYARD: Oh, I am not saying it does not.

PROFESSOR GRINYER: The fact that the price was 13 times the fixed assets suggests in fact that although it is very difficult in practice to measure intangibles precisely, as we know, they are fairly considerable and maybe one should not ignore them utterly or dismiss them very largely.

PROFESSOR APPLEYARD: I was not suggesting that we ignore it, it is just I think it is not a good reliable piece of evidence because we do not know about the market power position here, what people are buying. We know the books are crooked and require qualification, it is serious issue, and that what comes out subsequent to them being put right are things that are extremely unusual. So, as I say, I agree there are intangibles.

PROFESSOR GRINYER: I accept your qualification on this, and I understand.

PROFESSOR APPLEYARD: But could I say again, these are all indirect measures, you have bids for tenders - one of the bidders is Clinovia, and so you can see fairly precisely what the bounds must be of the profits that it is bidding into its charges.

(The Tribunal confer)

THE PRESIDENT: I think from our point of view, the one topic that we have not really discussed so far is nursing. The hour is getting somewhat late, but we might just spend a few minutes on that. We cannot sit much beyond 5 o'clock. As far as we can see, and I am now on table 5.3 of the OFT's second report, which is at tab 55, p.25. There is still quite a major difference between the parties on how many nurses you need, how many nursing visits you need, what level of efficiency you achieve with your nurses and to what extent you need back up cover and whether you can, as it were "get away with" agency nurses, or whether you should rely on specially trained and full-time nurses as Mr. Farrell I think at one point says you should.

I think we have broadly understood what the differences between the parties are on these points, but again in the light of the exchange of reports and reflection I think we would like to know whether there are particular points in relation to nursing in relation to which one or other party feels able to accept at least some of the points made by the other side. Is there anything on the nursing side that you would like to add, Professor Yarrow, having had the opportunity of reading the OFT's supplemental report?

PROFESSOR YARROW: Yes, I think how many visits are made currently, and what duration each visit is. Once that is known ----

THE PRESIDENT: How many visits per patient?

PROFESSOR YARROW: How many visits in total are made across the patient base. You could turn that into how many visits per patient. We simply do not know the output, we do not know how many hours of nursing services are being supplied, and if that was known – nursing is one of the areas where there are market rates.

THE PRESIDENT: Well you know, presumably – although I do not think we have been told – what Genzyme's nursing visits are?

PROFESSOR YARROW: No, the problem is Genzyme is a small sample from the edge of the market, as it is at the moment, and the issue is what is the pattern across the market. How much is being supplied? What is the output that is being provided for the price that you are going to determine. We do not know the average duration of a visit. We have been assuming it is two hours, but the actual evidence in the file suggests it is considerably shorter than that. We do not know how many visits are made.

THE PRESIDENT: Has anybody checked to see what Genzyme's own position is on this?

PROFESSOR YARROW: No, because I think the relevant issue is the market as a whole.

THE PRESIDENT: I think they are only nursing five patients, or something of that sort.

PROFESSOR YARROW: Exactly, and they will be typical patients by virtue of the Genzyme position in the market. Now, OFT have had a similar concern in the past that they have asked for the information ----

THE PRESIDENT: How many visits and how long a visit?

PROFESSOR YARROW: Yes. We do not know that in current market circumstances.

THE PRESIDENT: That is your principal problem?

PROFESSOR YARROW: I think that is a major factor – I think I make the point in my witness statement, how can you set a price for something until you know what that thing is?

THE PRESIDENT: Yes, thank you. Do you want to come back on that, Mr. Thompson?

MR. THOMPSON: I think our position is fairly clearly set out in the report. The main difference is that we do not think that Professor Yarrow has given sufficient weight to the inevitable

inefficiencies and he has essentially calculated the number of hours and divided to reach the minimum number of nurses to achieve that, and we do not think that that is a realistic approach. There are some differences about the way in which rates have been worked up, and of course there are issues about profit, but I think it is reasonably clearly set out in our report. There are obviously some defects in the evidence, but I think it is fairly clearly set out how we have built up the two scenarios that we have worked on, and we regard them as reasonable, although it seems to us possible, particularly looking at the actual levels of nursing that have been historically put up, particularly by Genzyme itself, that the approach we have taken is somewhat conservative, but we have tried to do it on the basis of the best evidence that is available to us, extrapolated to the current pool of patients being serviced by Healthcare At Home.

There are two points on the capital issue. The first issue was raised by Professor Grinyer, that although there was a qualification of the accounts the OFT was relying on the balance sheet which was not qualified and so we would not accept that that was a valid criticism. The other point, it is more a point of reference – I do not know if Professor Appleyard wants to answer it – it is tab 3 of the bundle, para.4.1(b) of the report that appears immediately there, where he states that:

> "…working capital is just one element of the capital employed by a business, the other element is the fixed assets."

It was that point I had in mind where I said that he did not seem to have given any weight to the intangible capital, but I may have misunderstood that sentence, but it seems fairly clear.

PROFESSOR YARROW: It is an incorrect statement to say that my estimates assume perfect efficiency of nurses. I have assumed that one visit absorbs four nurse hours. On the very limited information on the file the average duration of a nurse visit may be around an hour over the recent period. That is a contact hour to absorb our ratio of 25 per cent. which is about half the level achieved by NHS District Nurses. So it is simply not true that those estimates assume perfect efficiency.

PROFESSOR APPLEYARD: Could I make one observation as well?

THE PRESIDENT: Yes, please do.

PROFESSOR APPLEYARD: Originally, I said when you do these calculations you want to look for confirming evidence, and the confirming evidence for me, and it is the material that I was producing, is to be found in schedule 1 of Mr. Walsh's first statement, in the cost of nursing. I have roughly the same cost in there as he does – slightly higher in fact.

THE PRESIDENT: Yes, thank you. Do you want to come back on that last point, Mr. Burrows?

MR. BURROWS: Yes, Sir, just very briefly. I think the estimate that his being referred to at the back of CW1 was prepared for the basis of the interim measures which of course is a basis, i.e. how many nurses do we have to sack, assuming perfect efficiencies. That is the basis upon which it was prepared, and I do not think there should be any confusion about that on the papers. Just in case there was we have dealt with the points separately in correspondence with Taylor Vinters, so the Tribunal has our answer to that on the papers. That is in the schedule that is attached from memory, I think, at tab 3 of our submissions to you. I can give the bundle reference ----

THE PRESIDENT: We will find it, thank you.

MR. BURROWS: Just very, very briefly on nurses. You referred us to p.55 of OFT 1 with the table. Holding the existence of the complexity quotient standard, i.e. using it, one can see at that table that it does actually make a great deal of difference a one increases from 4.5 nurses, or one takes the OFT figure used in report 1 of six nurses, and we, of course, would say you have a choice. You can either accept the approximation that the OFT have done, to the best of their ability and with all the mathematical assumptions that underpin it – or, you can look at the evidence which you will find at para.3.80 of OFT 1, which is as assessed by Dixon Wilson for Genzyme – how many nurses do you need to deliver this service? Of course, that figure is there. The important point is that the figure somewhat above – I do not think it is confidential, but I will not mention it – is assumed on the basis of the full-time equivalent nurses.

Finally, just to give you one final reference which has thus far escaped certainly me, if one goes to the transcript of Mr. Farrell's evidence, originally given to the Tribunal, he gives comments on the number of nurses, that is at tab 75, p.51, where in his estimate, when he thought about doing it himself essentially, he needed 10 nurses, and that, of course, is the simple geographical point that we have always said in our submissions to the OFT, that if you are going to be setting up this specialist nursing network to provide the service, and covering the whole country, then you need 10 nurses as a minimum to deliver the service.

THE PRESIDENT: Yes.

MR. BURROWS: Thank you.

THE PRESIDENT: I think we have come to the end of the things that we can usefully raise this afternoon. If there is anything else we feel we need to raise we will let you know. I think we would propose to adjourn now unless there is anything else anybody would like to say?

MR. VAUGHAN: What about my discovery application? [Laughter]

THE PRESIDENT: Yes, quite – how about it, indeed! I think the position is this, Mr. Vaughan. We have a written submission from you.

MR. VAUGHAN: Yes.

THE PRESIDENT: We now need to reflect more deeply on the files as a whole, and the discussion this afternoon. Then I think we need to take a view on where we are in the case generally, and probably signal that view to you in writing, and then either we are with you on the discovery application, or we are not with you, or you want to seek still to persuade us then we are going to need to fix a separate appointment to deal with it, and we will deal with it.

MR. VAUGHAN: Just to be quite clear, we are not going to find a Judgment tomorrow ----

THE PRESIDENT: You are certainly not going to find a Judgment tomorrow! [Laughter] You can be quite clear about that. We will not give Judgment in this case without giving you a fair opportunity to deal with discovery issues.

MR. VAUGHAN: Because obviously we would like to make further submissions about it ----

THE PRESIDENT: Yes.

MR. VAUGHAN: ---- in writing, if not orally, at some stage.

THE PRESIDENT: Have we not got your written submissions?

MR. VAUGHAN: Yes, you have, but obviously we would like to try and bring things together on the basis of today, there were points that were made which we will certainly want to come back on, to wrap it up.

The only other point, in point 22 of our discovery there is a reference to 2.21 that is the list of six products. If you could look also at those particular products and define, and describe Mr. Potter's first witness statement at para.9, it concerns the fact that Proposinil, which is a very expensive one, is not cold chain delivery and there is no question of having to make it up on the site, you get it by itself, so that price by itself ----

THE PRESIDENT: Does not help you.

MR. VAUGHAN: And the other one is the product which is a pill, which Mr. Potter says that Birmingham send out by registered delivery ----

THE PRESIDENT: Yes, and it requires no servicing at all.

MR. VAUGHAN: So it does not require anything other than a postman who remembers where to deliver the post, for which they manage to charge [confidential]. That is the only basis of the value based delivery charge, that para. 3.22. If value base does play any part clearly one needs to see the whole basis of that and look at it, it is such an extraordinary list of non-comparable prices, that it begs for investigation, but we would invite you anyhow to disregard that, even if you were not going to give us discovery about that.

Thank you very much indeed.

THE PRESIDENT: Thank you very much. Thank you all very much indeed. Sorry, Mr. Turner?

MR. TURNER: May I just touch on two matters – one procedural and one substantive?

THE PRESIDENT: Yes.

MR. TURNER: The substantive matter is particularly short. It is in relation to the suggestion made a moment ago that Genzyme's experience of the nursing for Gaucher could perhaps be treated as *de minimis* because of the small number of patients. Just to record the OFT's position is that that should not be the case. They have a homecare operation, it was prominent in the main trial. They have a head nurse, they have evidence from the head nurse in this case, and on issues such as hours spent with the patient, hours travelling, matters of that kind, and what could be charged for, they do have relevant evidence that should be brought in – if it is going to – in opposition to the OFT's submissions.

The procedural point relates to Mr. Vaughan's suggestion of written submissions going forward, we would just wish to clarify from our point of view what that will involve. Our understanding is that until the Tribunal has produced something of its own, that there will be no further rounds of written submissions. If there are to be such then the OFT is in the position of also needing to perhaps respond to something that Genzyme may wish to put in.

THE PRESIDENT: Well it is a fair point to raise, and we do sometimes find ourselves in the position of getting an avalanche of uninvited submissions that do or do not go over ground that has already been covered and sometimes have things in them that are useful but very often do not. The OFT then has to respond, and the appellants feel they have to respond to the response and so forth, and so before we know where we are the thing has mushroomed out of control. I think our general position is that at the moment we do no want any more written submissions until we have signalled that we do, but we will not decide this case without giving Genzyme a proper opportunity to discuss and address the discovery issue.

MR. TURNER: I am obliged.

THE PRESIDENT: Thank you all very much indeed.

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