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Post-Brexit Industrial Strategy: Will ‘Sector Deals’ Undermine Competition Policy?¹

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In January 2017, the UK Government published a Green Paper on Building our Industrial Strategy. In her Foreword, the Prime Minister stated that she wants “a new approach to government, not just stepping back and leaving business to get on with the job, but stepping up with a new, active role that backs business”. There are ‘ten pillars’ of the proposed industrial strategy covering investment in science, skills and infrastructure; supporting SMEs; encouraging trade and inward investment; delivering affordable energy and clean growth; cultivating world-leading sectors through ‘sector deals’; ensuring growth in the regions; and developing supportive institutions. Although the Green Paper provides little detail, most of these pillars seem reasonably uncontentious for competition policy. However, one pillar is inherently problematic – ‘sector deals’ present a substantial challenge for competition policy.

The Green Paper’s vision of a sector deal boils down to government support for business-led institutions to facilitate collaboration between firms in the same sector. Current institutions in the car and aerospace sectors are used to illustrate the possibilities for a much wider range of sectors. The Brexit context is revealed by an emphasis on developing British supply chains and joint R&D projects, both of which are likely to be disrupted. The sector focus aims to avoid a repetition of failed ‘national champions’ policies of the past, where a single firm was chosen for preferential treatment, or where mergers were actively promoted. So, what are the problems?

Suppose that a sector deal covers the whole sector in a balanced way. The emphasis on collaboration raises serious concerns about the balance between cooperation and competition. The formation and implementation of sector deals, including regular meetings to discuss technological and business opportunities, provide exactly the relationships and stable institutional environment which make collusion easier, for example, in pricing and product development.
Horizontal collaborations raise a much greater competitive risk than vertical collaborations, but the horizontal aspect seems inherent to the sector approach.

In practice it may be very difficult to achieve balance across a sector, and individual firms are likely to push for a deal that favours their own interests. A large individual firm has the incentive to lobby for a policy that enhances its own nuanced priorities (e.g. distinctive competitive advantage), so it will invest in capturing a sector deal for its own advantage (i.e. rent seeking behaviour). This risk is higher if a firm has the resources to engage actively and effectively in the formulation of a sector deal, if it has leverage/bargaining power (e.g. international mobility), and if it has more to gain (e.g. protection from international competition). SMEs do not usually have such advantages. So, unless very carefully established, sector deals risk distorting competition by unduly favouring individual firms.

It might be thought that rent seeking and ‘sector deal capture’ by large individual firms can be constrained, but this is not easy. The October 2016 assurances given to Nissan prior to a major investment decision remain secret. However, a freedom of information request by a BBC journalist indicates that Nissan had written to the Government highlighting that it was “the global leader in electric cars” and noting a number of policies that would make the UK more attractive for a major investment in electric cars. Several of these suggestions were announced as government initiatives in the following weeks. These may or may not be good initiatives, but the point is that sector deals are likely to be tweaked towards the advantage of individual large firms with a strong negotiating hand.

Collaboration in R&D is a potentially effective way to promote innovation, particularly where intellectual property is hard to protect by patents or where the project is expensive and particularly risky. However, careful consideration needs to be given to the organisation of research collaborations including joint ventures (RJVs). Horizontal RJVs involving product market rivals can be helpful if common standards facilitate downstream innovation, but they raise a significant risk of product and price coordination to the detriment of consumers. Vertical RJVs (i.e. between an individual firm and its supply chain) are more likely to be beneficial and without negative price effects – unless they allow a leading firm to foreclose innovative or more efficient rivals.

There is a further, Brexit-specific risk. Inasmuch as sector deals involve what the EU considers to be illegal State aid, they will compromise any proposed UK-EU trade deal. Remaining members of the EU will not be happy to allow free access to the Internal Market by subsidised UK firms.

In the light of this array of inherent dangers, we make the following recommendations as to how to protect competition in the presence of sector deals:

a) Draw a clear distinction between the horizontal and vertical aspects of each sector deal. Horizontal aspects present a particular challenge for competition policy enforcement. Sectors need very careful selection so there is sufficient competition to drive an efficient response. Beware of collaborations covering above, say, 30% of a particular market. Vertical aspects require measures to ensure access to the supply chain for all new entrants and expanding firms.

b) Beware also of aspects of a deal that disproportionately favour individual firms. Past national champion policies failed due to an inability of politicians to pick winners. The problem does not disappear if firms pick themselves as winners in proposing a sector deal.

c) SMEs have much less time and resources to be active in sector deals than do large leading firms. Business leadership of sector deals is likely to result in deals that favour the latter unless special representation is organised for (potential) new entrants and SMEs.
d) Careful, explicit and transparent explanation should be provided in relation to the specific market failures that make a sector deal necessary, and how the content of the deal will address them without harmful side-effects. This will both encourage productivity-enhancing deals and provide a positive discipline on firms to think through, in detail, why they say a proposed deal is a good thing.

e) Embed competition analysis at an early stage in the development of every sector deal – a one-off formulaic competition impact assessment of a fully worked out proposal is unlikely to be sufficient. Make clear that sector deals will face vigilant monitoring and enforcement of competition law.

f) In the spirit of the Great Repeal Bill, the Government should also adopt clear rules consistent with current EU practice on State aid for the control of any subsidies associated with a sector deal. Subject to being appropriately funded for this extended role, the CMA should be asked to enforce the rules transparently and publish its analysis.

References:
1. This short paper is based on our response to the Department for Business, Energy & Industrial Strategy Green Paper Building our Industrial Strategy (January 2017; our response dated 14 April 2017). We specifically address Question 32: How can the Government ensure that ‘sector deals’ promote competition and incorporate the interests of new entrants?. Our full response can be accessed at: http://competitionpolicy.ac.uk/documents/8158338/16525214/Lyons +and+Pappous+response+on+the+new+industrial+strategy.pdf.


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**CCP 14th Annual Conference**

**University of East Anglia, Norwich, June 2018**

**Competition Policy and Industrial Policy: Is there a need for a new balance?**

For many years there has been a wide consensus that competition policy should not be used as an instrument to achieve industrial policy goals. In fact, state aid policy was primarily seen as a competition policy instrument to assure that industrial policy intervention did not distort competition in markets, and thus focused on market failures.

This consensus has been increasingly challenged since the financial crisis. It has been criticized that merger policy has not allowed the emergence of national or European champions. In antitrust policy, part of the benefit of intervening against the large US-based internet companies is sometimes seen as protecting the future interests of European industries. The restrictions arising from state aid policy are increasingly seen as obstacles to nurturing industry and protecting jobs instead of creating an industry dynamic that fosters growth.

- Is competition policy too focused on prices instead of broader economic and social outcomes?
- Does the focus on competitive markets impede the competitiveness of UK and European industries?
- Is the strong position of US internet companies creating bottlenecks that bias the playing fields of the future industrial landscape?

To help delve deeper into these issues, this conference will explore and debate a broad range of topics concerning the tensions between competition policy practice and new goals for industrial policy. It will bring together insights from legal, political science and economic perspectives on how to rebalance policy goals and how to design the competition regime of the future in light of these challenges.

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From Principles-based Regulation to ‘Principled’ Regulation?

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The 2015 Inquiry of the Committee of Standards in Public Life (CSPL) – a non-departmental public body sponsored by the Cabinet Office – into ethics for regulators has now finished. The inquiry was set up to see how far regulators live up to the seven principles of public life (put forward by Lord Nolan in 1995): selflessness, integrity, objectivity, accountability, openness, honesty and leadership. In its own words, the CSPL’s review has been “a ‘health-check’ of the way in which regulators manage ethical issues in their own organisations and the extent to which the unique characteristics of regulators create or demand any specifically tailored ethical solutions”.¹ In September 2016 it delivered Striking the Balance: Upholding the Seven Principles of Public Life in Regulation.² The Report not only reviewed the practices of a sample of regulatory agencies in their approach to ethical issues but made recommendations as to best practice.³

The CSPL identified some key ethical concerns surrounding regulator’s activities, including managing conflicts of interest while upholding the public interest. These included potential independence deficits, issues of governance and the managing of conflicts of interest between the regulator and those being regulated. Recommendations covered the requirement that board members set standards for, and adhere to, ethical standards with non-executive and lay board members adhering to the Principles of Public Life by declaring conflicts of interest where appropriate. Recommendations included that corporate governance arrangements should minimize the risk of possible conflicts of interest with all regulatory bodies adopting a code of conduct applicable to all personnel at least equivalent to the Civil Service Code.⁴

Further, to uphold the integrity of the agency, it was recommended that policies and procedures be put in place to manage the “revolving door” syndrome (where personnel move between regulatory bodies and the regulated entity) by, if necessary, imposing contractual obligations on employees. The CSPL did recognise the importance of agency independence from Government and advised that operational independence be upheld. Further, regulators needed to be mindful of the risks of capture by those they sought to regulate and should act with openness by publishing publicly accessible data including corporate governance policies.

The outcome of the inquiry raises some interesting questions about the future direction of regulatory best practice and, indeed, regulation itself. This short piece takes a look at what this might mean in relation to how we view regulation more broadly. Understandings of regulation, and its impact, have moved light years from “command and control” (seeing regulation in terms of enforcement alone) to risk and principles-based regulation in which the regulator sets broad goals or principles which are then translated and acted upon by those being regulated. Such an approach shifts the focus to a more inclusive regulatory form that, if it is to be effective, works closely with and demands the co-operation of the community being regulated. Regulation becomes more efficient and effective by harnessing the knowledge of the regulated to produce more meaningful outcome-focused and outward-facing regimes, where those being regulated assume responsibility for implementing broad regulatory principles.

This idea of co-opting the activities of those being regulated, so that they assume greater responsibility for their actions at the outset, might be seen as creating a
“coalition of the willing”. By embedding smarter regulatory tactics within their everyday organisational activities, those regulated come to “own” both the regulatory approach and the response to it. Thus, having invested in regulation, they are more likely to comply with it.

Whilst a series of Governmental reports highlighting regulatory ‘best practice’ have been published, a series of other crises have again placed agencies exercising regulatory functions in the spotlight. The result has been to question not only the effectiveness of regulation but the relational nexus between regulatory agency and regulated community, and indeed Government itself. Although independent from Government given their statutory functions, regulatory agencies can be susceptible to significant external pressures from Government, those they seek to regulate and the wider public. While on the one hand regulating and regulated communities are required to work more closely with one another to achieve efficient outcomes, concerns regarding regulatory independence are amplified. As the OECD have identified, any form of iterative interaction is, “fraught with potential entry points for undue influence, from issues linked to finance, leadership, staff behaviour to links to the political cycle”. Concerns with regulatory “capture”, in all of its forms, can loom large.

Whilst the appeal to principles in particular gives rise to both interaction and flexibility within regulated communities, it can also raise the expectations within the community in terms of information provision, intelligence gathering, guidance and support. This has an impact on the importance attributed to behaving in an appropriate way if credible and sustainable regulation is to be undertaken.

“Given their statutory functions, regulatory agencies can be susceptible to significant external pressures from Government, those they seek to regulate and the wider public.”
The question of ethics and ethical behaviour on the part of regulators becomes important in this context. The “ethical dilemma” centres not simply upon proximity and the propensity for capture, but also upon perception. At a time when public trust and confidence in the standards adhered to by public office holders remains low, it is hardly surprising that the CPSL has focused in its business plan on regulatory agencies. Those being regulated are concerned similarly with equal treatment during the course of the promulgation of the broad range of regulatory instruments including principles. Once the regulated participate in the formulation of regulatory strategies as, for example, principles-based regulation demands, this enhances and indeed amplifies the burden of expectations placed upon regulators, potentially making them more susceptible to criticism. The level of dependency between the parties becomes arguably greater the more, “open-textured” or principles focused regulations become and those regulated will inevitably look to the regulator for guidance on how to proceed. Adherence to objectivity and transparency throughout the regulatory process is critical to the effectiveness of strategies applying to the regulated community as a whole. Any fracture within that community can impact ultimately upon regulatory efficiency and effectiveness.

With the advent of Brexit, the role of ‘domestic’ regulatory agencies becomes even more important and it is through deploying ethical standards that regulators can become even more effective.

Similarly, end-users benefitting potentially from regulation are rightly concerned with regulatory ethics and independence. This can have an impact upon the reach of regulation and how it affects them, for example whether there has been any dilution in terms of the regulatory outcome. It can become troubling for example, when “gamekeepers turn poachers” and indeed vice versa. Where staff employed by regulators are recruited from the sector within which they have worked previously, they may be (whether actually or otherwise) perceived as being steeped within the culture of the sector to the extent of being blind to certain practices. Thus the benefits of intelligence (in the sense of knowledge) and customary practice can also have a trade-off unless appropriate structures are put in place.

Thus it is here that we might begin to discern a claim to ethical behaviour on the part of the regulator as a logical facet of, or indeed an extension to, principles-based regulation, partly by reason of the proximate relation between regulators and regulated. Regulators are required to act fairly, openly and to be accountable for their actions if their credibility is to be maintained. Such requirements are very close to the seven principles of public life and it is thus relatively easy to see how ethics for regulators became a focus for inquiry. Whilst in terms of causation it is rather too simplistic to identify a regulatory style as the sole basis for looking into the ethical behaviour for regulators, arguably the form of principles-based regulation lends itself to an interest into the activities of regulatory agencies from an ethical perspective and indeed may inform substantively future approaches. As the Committee identified, with the advent of Brexit, the role of ‘domestic’ regulatory agencies becomes even more important and it is through deploying ethical standards that regulators can become even more effective. Time will tell.
Healthy Competition to Support Healthy Eating?
An investigation of fruit and vegetable pricing in UK supermarkets

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Governments and public health officials are urging the public to eat more fruits and vegetables to contribute to a healthy diet. However, there is concern that a lack of effective competition amongst supermarket retailers has resulted in inflated prices of these products which is deterring consumers from eating more of these healthy foods. This paper investigates this matter by examining the nature and extent of price competition on fresh fruits and vegetables amongst UK supermarket retailers, drawing on a panel of weekly retail and corresponding wholesale market prices over a seven-year period. We find that the extent of supermarket competition varies across the products and retailers in our study. Competition is quite intense on some fruits and vegetables but much weaker on the others. The extent of retailer competitive interaction varies significantly with one another.

There is growing public health concern that consumers, especially from poorer families, are being enticed to switch away from eating healthy, fresh foods, like fruits and vegetables, to eating less healthy, processed foods as prices have been rising faster for the healthier option. This can have major consequences for the health of people and increase the costs of treatment for illnesses linked to poor diets. While governments may seek to deal with this by promoting healthy eating, like the UK’s “5-a-day” campaign, high prices of fresh fruits and vegetables can be a major obstacle to achieving improved diets.

Of particular concern is whether increasing concentration in grocery retailing might allow retailers to avoid intense head-to-head price competition even over relatively undifferentiated commodity products like fruits and vegetables. This paper considers this issue in the context of

“The competition authorities subjected the sector to a number of investigations over recent years but the popular perception is one of an industry fighting regular price wars and fierce competition.”
the UK food retailing sector which has become increasingly concentrated over time and is characterised as a relatively tight oligopoly with a limited number of nationally competing supermarket chains. The competition authorities subjected the sector to a number of investigations over recent years but the popular perception is one of an industry fighting regular price wars and fierce competition. If so, it might be plausible for one to expect low prices of fresh fruits and vegetables. Fruits and vegetables are unbranded products, supplied in the absence of producer power and retail competition in this area should be intense. Consumers are especially attracted by low prices of these items because they are a key part of a staple diet and perishable, representing a key driver of supermarket shopping trips.

Review of the market context and related literature

UK food retailing is recognised as one of the most concentrated and differentiated retail grocery markets in the EU. For the past decade, the retail grocery sector in the UK has been dominated by the so-called “Big 4” retailers: Tesco, Sainsbury, Asda and Morrison, with their major followers M&S, Waitrose and Co-operative Food. A spate of media reports suggests that far from being competitively priced, fruits and vegetables are sold in the UK with high mark-ups and are evidence of ineffective price competition in the sector. More substantive investigations and analyses highlight the incentives and potential for exercising market power against consumers’ interests in the food retail sector. Narrowing down to particular types of products, several pricing studies provide empirical evidence that price leadership exists for UK beef, fresh produce, and packaged groceries. However, in these pricing studies either the range of products or the number of retailers included is limited, and they span different time periods.

Empirical analysis

Our empirical analysis draws on weekly retail prices of a varied assortment of twenty-six fruits and vegetables sold by seven leading supermarket retailers in the UK for a substantial time period spanning almost seven years from 2007-2013. Importantly, this was a time period that saw economic austerity and a deep recession which should have increased competitive pressure on retail pricing. We match the retail prices with wholesale prices from major UK fruit and vegetable wholesale markets to provide an indication of supply costs of these items to the retailers. We examine the movements of the wholesale and retail prices to provide an indication of pass-through rates between them. High or low
pass-through rates should, all other things held constant, indicate more or less competitive conditions. Furthermore, we examine the character and intensity of price interactions across retailers to assess the degree of product-level price competition. Through the combination of these empirical analyses we are able to provide a number of insights into the extent and character of price competition on different products and highlight the different forms of price interaction in this retail oligopoly.

Results and conclusion

The product-level results highlight that individual products are treated in different ways. Wholesale-to-retail price transmission competition appears more direct on roughly a quarter of the products, notably cauliflower, cucumber, iceberg lettuce, pear and parsnip, while distinctly weaker for the other three-quarters of the products in the sample. Equally, retail price interaction analysis suggests more vigorous competition on a similar set of products, consisting of broccoli, carrot, cauliflower, cucumber, and pear. This suggests some consistency in findings across the two sets of analyses, with the exception of broccoli where there is little correspondence in wholesale-retail pass-through but retail pricing behaviour suggests keen competition. With very low or even negative wholesale-retail margin, the pricing pattern of broccoli looks more akin to that of a loss leader item (not necessarily to the extreme example of bananas as a loss leader – e.g. The Guardian 2013).7

In addition to different degrees of competition at the product-level, we also find that there are significant differences in the extent to which different retailers compete and interact in setting retail prices. The prices set by smaller retail chains (M&S, Waitrose and Co-operative) are consistently higher and less responsive to competitors’ prices than those set by the Big 4 (Tesco, Asda, Sainsbury and Morrison). There is also a hierarchy within the Big 4 with Asda tending to have lower prices than the other three but with some variation. The retail price structures we observe may be a characteristic of vertical quality differentiation amongst the retailers, where higher prices reflect superior retail service or superior product quality. However, it could also be symptomatic of retailers understanding and adhering to a hierarchy of prices and avoiding intense price competition.

For consumers, there is clear merit in shopping around to obtain the lowest prices given that persistent and wide price dispersion is evident for most of the items studied here. None of the retailers in our study has universally the lowest prices on all products. Equally, some retailers have on average lower prices than the others and seem to be responding more competitively than some of their rivals. Reassuringly, prices do appear relatively fluid and indicative of keen competition on quick selling products, but less so for slower selling products where shopping around can perhaps pay the most dividends.

This article is based on the forthcoming paper “Healthy competition to support healthy eating? An investigation of fruit and vegetable pricing in UK supermarkets” by Hao Lan and Paul Dobson, which was awarded the 2017 Essay Competition Prize by the Agricultural Economics Society.

References:
5. Price leadership is when a dominant firm in its sector determines the price of goods or services which is then followed by other firms. See, e.g. Belleflamme, P. and Peitz, M., 2015. Industrial organization: markets and strategies. Cambridge University Press.
In their pursuit of delivering equity and justice to consumers in energy markets, successive British governments have sought to influence the design of energy policy via a host of legal and strategic policy reforms. Against this backdrop, the UKERC project charts the evolution of the statutory duties that have been assigned to the UK energy regulator since privatisation. Document analysis and elite interviews provide insights into (a) what motivations have driven legislative change within the general duties, and (b) how regulators have sought to deal with the trade-offs presented by conflicting duties in specific cases. Of particular interest is whether equity and justice concerns have driven statutory change, especially in times when perceptions of fairness and justice have heightened salience in political and media circles.

This legal landscape has developed against variations in the proportion of household expenditure devoted to energy over the past 25 years. In historical context, it is striking that many affordability support policies were first introduced when energy was at its cheapest. Casual empiricism suggests that the electoral cycle and government ideology are at least as important as energy expenditure shares in determining affordability support policies. Large variations in energy expenditure shares across households – and through time – provide background to the political prominence of energy and the dramatically greater challenges of energy price rises for low income households.

‘Regressive outcomes’ of energy markets can be conceptualised as unjust in three different ways. Firstly, distributional justice concerns can highlight the market’s ability to deliver prices that result in affordable energy services for all consumer groups. Procedural justice concerns can relate to incorporation of ‘consumer voice’ in decision-making processes and procedures that shape the operation of the market. Finally, recognition justice focuses on acknowledgement of the needs of specific groups, particularly socially excluded or vulnerable consumers.

To what extent should perceptions of injustice be addressed? Our research into personal experiences, devolved administrations and overall policy development raises questions about the role of local agents, such as housing associations, and national agencies (e.g. the regulator) in meeting objectives of fuel poverty alleviation, particularly given its association with housing, health, debt management and consumption behaviours within households. In particular, fuel poverty objectives pose a significant challenge to the orthodox understanding of the appropriate roles and responsibilities of an economic regulator.

More information on the UKERC-funded Project: Equity and Justice in Energy Markets can be found on the CCP website.
A View from the Visitor’s Office

Andrew I. Gavil1, Howard University, School of Law, Washington D.C.

Andy Gavil, a long standing friend of CCP, returns for a second extended visit. Here he explains why he keeps coming back.

Half-way through my second extended visit to the CCP, it is readily apparent why I sought to return. CCP is a unique setting for the study of competition policy, providing a nurturing and stimulating atmosphere for graduate students interested in the field who work side-by-side with experienced and junior faculty. Its interdisciplinary nature is especially critical to its character, for it discourages narrow perspectives and invites deeper reflection about the role of competition policy – and its breadth – in market economies. It’s an honour to be invited back as a guest for the second time and I have been warmly welcomed.

My friendship with the CCP is now a decade old. I first visited in June 2007 to participate in one of its outstanding annual conferences and to attend its PhD Workshop, which traditionally precedes the Conference. That led in 2010 to my first extended visit, which created something of a model for my return this year. Over nearly a month in residence, I provided a series of lectures on the interaction of regulation and competition-related litigation in the U.S., focusing on their influence on the evolution of U.S. antitrust law. I also conducted comparative research on resale price maintenance, which led to a paper2 that I presented at the annual June conference. Each of my visits has spawned fresh thought and additional ideas for my own comparative research.

But the highlight of my visit was spending time with many of the graduate students, conferring about their thesis topics and providing guidance as needed on various aspects of U.S. antitrust law. I was impressed by their enthusiasm, dedication, and curiosity about comparative and interdisciplinary aspects of competition policy - and it left a lasting impression. It also inspired me to seek funding from the American Bar Association’s Section of Antitrust Law to create its first International Scholar-in-Residence program, which is now in its fifth year.3

I again returned to CCP to participate in its annual conference on “Competition in the Digital Age”4 in 2015, and with a sabbatical planned at my home institution for the spring 2017 semester, I began discussions about returning for another extended stay.

This year my focus has been on the change of Administration in Washington, D.C. and its possible consequences for competition policy. Through three lectures, I have focused attention on the key institutional actors in the U.S. - the federal antitrust enforcement agencies, private litigation, and the courts - examining the role that each plays in fostering, or sometimes impeding, policy change. For example, with respect to the enforcement agencies, one lecture examined how changes of policy direction can be implemented, contrasting the kinds of changes typically associated with a more interventionist philosophy with those of enforcers inclined to be less interventionist. The talk focused on the mechanisms of change and strategies available to each, the institutional checks that might impede any strategy, and the possible outcomes. I also participated in the CCP Seminar series, venturing some predictions about the likeliest future direction of U.S. antitrust enforcement in light of the new Administration and the institutional characteristics discussed in my first talk. It was also a great pleasure to join CCP faculty member Sebastian Peyer’s torts class at...
the UEA Law School to discuss how the U.S. and U.K. systems have each reacted to the Volkswagen “clean diesel” emissions cases, comparing U.S. class actions with U.K. Group Litigation Orders.

As with my last extended visit, I have also been enjoying one-on-one conversations with some of the graduate students and junior faculty, whose interests and topics vary widely, but whose enthusiasm does not. They are motivated and I look forward to seeing their careers develop in the competition policy field – it is an easy prediction that they will have a great deal to offer. I have also very much enjoyed conversation with my officemate, a visiting research fellow from the Korea Fair Trade Commission. And of course there is the daily ‘tea time’, held every morning at 11am – a not-to-be-missed feature of the CCP experience!

This brief account of my visit would be incomplete without noting my affection both for Norwich and for the friends I have made here at the CCP. Norwich is a fascinating city with a rich history that includes a medieval castle and historic district. It is a wonderful place to explore and a very easy place to visit for an extended stay. Most importantly, my visits have led to lasting professional and personal friendships with my colleagues here. I have enjoyed observing the career development of some of the graduate students who are now faculty members, the arrival of new faculty, and the maturing of some of the more junior faculty members. An important take away from my many visits is “Look Right, But Keep to the Left” – not necessarily a political philosophy, but a simple safety rule for navigating the streets!

References:
3. For information on the program, see http://apps.americanbar.org/dch/committee.cfm?com=AT939371&edit=1.
4. CCP 11th Annual Conference presentation ‘Litigating with Terabytes: The Challenges for Competition Enforcers and Courts’ can be found: http://competitionpolicy.ac.uk/documents/8158338/9330040/Andy+Gavil+-+CCP+Conference+2015.pdf/e60ffb41-4050-42b4-b53a-51dffc0e0c63

The Economics of Competition Policy for Economists
5-6 October 2017, etc. venues Moorgate, Bonhill House, London EC2A 4BX

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Speakers include: Matthew Bennett, Charles River Associates; Kate Collyer, Competition and Markets Authority; Laura Phaff, Compass Lexecon; Amelia Fletcher, CCP; Morten Hvid, CCP; Matthew Johnson, Oxera; David Parker, Frontier Economics; Adrian Majumdar, RBB Economics

Course is limited to 40 attendees maximum.
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At the beginning of December 2016 the UK Competition and Markets Authority (CMA) imposed a fine of approximately £90 million on Pfizer and a generic manufacturer Flynn Pharma, on the grounds that each abused a dominant position by charging excessive and unfair prices for phenytoin sodium capsules, an anti-epilepsy drug (brand name Epanutin). The price of a pack of 84 capsules of 100MG increased from £2.83 to £67.50 in October 2012. This came about as part of a deal where Pfizer sold the distribution rights in the UK to Flynn Pharma, who in turn ‘de-branded’ the drug, and sold the generic at an inflated price. The drug in question is not protected by any patents, so other generics are available and further generic entry is possible, yet the branded original drug was replaced by a higher priced generic. The CMA’s case is a rare example of an abuse of dominance finding (under Art. 102 and/or Ch.2 of CA98) in relation to exploitative pricing. While we await the full published decision, it is worth looking at industry price and quantity data to contextualise the CMA’s case. We also try to understand how this price hike was possible and ask whether the CMA should pursue more exploitative pricing cases.

Pfizer and Flynn: How are ‘excessive’ prices for generic drugs possible and should competition authorities do more about exploitative pricing?

Pricing and product idiosyncrasies

The National Health Service (NHS) is the main buyer of pharmaceuticals in the UK. While firms are free to set their own prices, the profit they each make on all branded drugs is capped and any increase in price must be approved by the Department of Health. Significantly, generics are exempt from this scheme – reimbursement to pharmacists is based on the average price of a basket of generics (for the same basic drug) from different manufacturers and wholesalers. The presumption is that competition will keep generics prices low.

This presumption failed in this case. When Pfizer sold the UK distribution rights to Flynn Pharma, who in turn marketed the drug as a generic, they were able to set a much higher price for their particular generic. Pfizer continued to manufacture the drug as before, and even sold it by the original brand name ‘Epanutin’ in the rest of Europe, but supplied it at a roughly 25 times higher price to Flynn Pharma, who then sold it, further marked up, as Phenytoin Sodium Flynn Hard Capsules in the UK.

Beyond the general quirks of pharmaceutical pricing, there is another idiosyncrasy specific to this product. Drugs are
characterized by their therapeutic ratio which provides a range of values over which a therapeutic agent goes from being effective to being toxic. Phenytoin has a low range and consequently, the UK’s Medicines and Healthcare Products Regulatory Agency (MHRA), classifies it as a category 1 antiepileptic and states that “Doctors are advised to ensure that their patient is maintained on a specific manufacturer’s product”. Thus if doctors and patients are used to one specific brand – Pfizer’s Epanutin – it makes it difficult for a new manufacturer to enter the market as patients may not switch. In fact, when Pfizer sold the distribution rights to Flynn and it changed the drug’s name to “Phenytoin Sodium Flynn”, a letter from Flynn to prescribers (published on the MHRA website) explained that this was identical to Epanutin, and that doctors should prescribe by the new name. When wholesalers tried to import Epanutin from other EU countries (where Pfizer retained the manufacturing and distribution rights) and apply the “Phenytoin Sodium Flynn” name to the drug, Flynn sued for infringement of trade name which made parallel importing unprofitable – doctors had been told to prescribe Flynn.

Price and quantity demanded (the ‘economic evidence’)

Figure 1 below plots the prices of 100MG Caps (sold in 84 capsule packs) by Pfizer and the completely identical unbranded (read Flynn Pharma) 84 capsule packs which entered in late 2012. There are other epilepsy drugs available in the UK, including those using the same molecule (phenytoin). For instance, the blue dashed line is a 100MG unbranded tablet. Here comes an interesting twist. The tablet is sold in 28 tab packs, so three £30 packs are equivalent to an 84 pack. Thus, a price comparison on per tablet vs per capsule basis shows that a 100MG capsule is cheaper than a 100MG tablet. This appears to be the basis of Flynn Pharma’s assertion that their capsules are less expensive than alternative equivalent drugs. It remains that the tablets do not meet the MHRA recommendation that a patient should be “maintained on a specific manufacturer’s product”, which excludes them as a safe substitute for existing patients.
We can learn more by looking at how demand responded to the price hike. When Pfizer withdrew its Epanutin capsules, it took a few months for the very much higher priced Flynn caps to pick up sales, but when they did, they more than compensated for lost demand before rocking back to the same gently declining trend found pre-2012. The interim may or may not have been wholesalers running down stocks then re-stocking, but it appears that there was almost exact substitution of Flynn for Pfizer in the longer term. There is no evidence of any substitution to the unbranded tablets. We cannot identify new patients, but the steady loss of a third of phenytoin sodium sales (similar for both capsules and tablets) over the last five years may be consistent with current patients being locked-in and few new patients being put on this drug either before or after the price hike.\(^3\)

**Should the CMA do more to tackle ‘excessive’ pricing by dominant firms?**

Competition authorities are very reluctant to intervene in pricing decisions, which is why cases of exploitative abuse on price by dominant firms are very rare across the world. They prefer to use their powers to tackle (less controversial)
Overall, there is a substantial danger of undermining the dynamic benefits of markets if firms are required to determine for themselves whether a price is “unfair” or “exploitative” and so could be challenged as illegal.

The CCP Competition Policy Blog comments selectively on a variety of issues related to competition policy. It could be on something in the news, on policies from either the Government or agencies, or it could be on a new piece of academic research that particularly catches our eye. All our posts are founded in our understanding of the latest academic research and have been written to be accessible to practitioners, academics, students and journalists.

References:
1. Under the Pharmaceutical Price Regulation Scheme (PPRS)
2. “Phenyton is a drug with a narrow therapeutic index (NTI) and, as such, there may be concerns amongst prescribers and patients regarding any change to the product. Please be assured that the Flynn Pharma product is identical to Epanutin. There are no differences in formulation and the site of manufacture remains unchanged. The capsules continue to contain the same identicode markings as Epanutin, including the word ‘Epanutin’. Prescriptions should be written as Phenyton Sodium Flynn x mg Hard Capsules.”
3. A procedural feature of the case makes public one piece of information that is not contained in the CMA press release. Pfizer was fined £10,000 for failing to provide evidence in the required time to support something it said in an oral hearing. Pfizer had claimed that “phenyton sodium capsules and tablets are substitutable for new third line patients” and this was “2-5%” of “the relevant market”. Unfortunately, the CMA’s penalty notice does not say what products constitute “the relevant market”.
5. E.g. Port of Helsingborg (2004) where there was no finding of excessive pricing.
6. E.g. the CFT found against Napp Pharmaceutical (2001). A private action example is when the Court of Appeal (2007) overturned a Chancery Division judgement that the British Horseracing Board had charged Atheraces excessive prices (in relation to costs) because this did not take account of the value of the product to the buyer.
7. In fact, the Health Service Medical Supplies (Costs) Bill passed its third reading in the House of Commons the day before the Pfizer decision by the CMA was published. This aims to “control high prices of generic medicines”.

exclusionary abuses, such as preventing new rivals from entering the market. A chapter in a slim volume authored by one of us investigates the competition law around high prices. In brief, high prices signal opportunities for new entry, providing an incentive for investment and are the incentive for providing customers with what they value. There is also the crucial practicality that it is often hard to provide a benchmark for excessive prices (“excessive relative to what?”). Overall, there is a substantial danger of undermining the dynamic benefits of markets if firms are required to determine for themselves whether a price is “unfair” or “exploitative” and so could be challenged as illegal.

The US Supreme Court has gone as far as to say: “The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful, it is an important element of the free market system”.4 The European Commission also shies away from prosecuting exploitative abuse but does not completely rule it out.5 In the UK, the CMA’s predecessor (OFT) was slightly less reserved and some private cases have been attempted.6 The CMA has hitherto focussed on high prices in the context of market investigations, but that is another story.

Returning to the Pfizer/Flynn case, we cannot determine on the basis of the very limited published evidence whether the CMA was right to decide this was illegal pricing. It seems clear that de-branding allowed Pfizer/Flynn the opportunity to implement a very large price increase to the cash strapped NHS. The drug was long off-patent so the legal entitlement to reward for innovation had already been received. On the face of it, this appears to be a blatant attempt to manipulate the complex system of pharmaceutical price regulation, and the extreme sensitivity of patients to a precise capsule formulation, in order to milk the last bit of profit out of a declining drug. All this is unpalatable. However, the even higher unit price of the generic tablet raises a serious question about what the CMA finds to be an exploitative price – why is the capsule price (but not the tablet price) illegal?

The answer is important for understanding the precedent being set and so the expectations of the CMA going forward. As we go to press, we note that the CMA has this morning published a press release saying it has provisionally found that Activas has been charging excessive prices to the NHS for hydrocortisone tablets. This looks like a very similar case of a firm de-branding (genericising) a drug to evade price regulation. This is consistent with poorly designed pharmaceutical price regulation being the root cause of the problem, and the implication is that the legislation needs urgent fixing.7 On the other hand, if the CMA sees this as a wider precedent for prosecuting unregulated firms for setting high prices, it would herald a major change in competition law enforcement.
**CCP 13th Annual Conference:**
**Just Markets: Distributional Effects of Competition Policy and Economic Regulation**

**Day 1 Thursday 15 June**

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<td>10:00 – 10:30</td>
<td>Registration</td>
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<td>10:30 – 10:45</td>
<td>Introduction &amp; Welcome</td>
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**Session 1: Setting the Scene & Macro Interactions**

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<tr>
<td>10:45 – 11:30</td>
<td>Setting the Scene: View from the Authorities.</td>
<td>Joe Perkins Ofgem</td>
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<td>Daniel Gordon Competition and Markets Authority (CMA)</td>
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<td>Amelia Fletcher Norwich Business School &amp; Centre for Competition Policy, UEA</td>
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<tr>
<td>11:30 – 12:20</td>
<td>Competition, Market Power and the Distribution of Wealth</td>
<td>Sean Ennis Organisation for Economic Co-operation and Development (OECD)</td>
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<tr>
<td>12:20 – 12:50</td>
<td>Affordability and Infrastructure Industry Regulation: Lessons from Economic History</td>
<td>Jon Stern Centre for Competition and Regulatory Policy (CCRP), City, University of London</td>
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**Session 2: Explicitly Including Distribution in Competition Policy**

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<tr>
<td>13:50 – 14:05</td>
<td>Introduction to Distribution and Competition: A video tribute to Sir Tony Atkinson</td>
<td>Andrew Leigh MP Australian Labour Party</td>
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<td>14:05 – 14:55</td>
<td>The Distributional Implications of Regulation and Competition Policy</td>
<td>Tembinkosi Bonakele South African Competition Commission</td>
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<td>14:55 – 15:45</td>
<td>The (Increasingly Difficult) Equity Implications of Getting Residential Electricity Prices ‘Right’</td>
<td>Severin Borenstein Haas Business School, University of California</td>
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**Session 3: Equity and Justice in Energy Markets**

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<tr>
<td>16:15 – 16:25</td>
<td>Overview of CCP Project funded by UK Energy Research Council (UKERC)</td>
<td>Catherine Waddams Norwich Business School &amp; Centre for Competition Policy, UEA</td>
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<td>16:25 – 17:00</td>
<td>UK Energy Expenditure Shares in the Long Run</td>
<td>David Deller Centre for Competition Policy, UEA</td>
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<td>17:00 – 17:45</td>
<td>Beyond Economic Regulation: Delivering Equity and Justice in Energy Markets</td>
<td>Michael Harker &amp; David Reader Centre for Competition Policy, UEA</td>
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<td>Justice and Energy Markets: The Case of Social Housing Tenants</td>
<td>Elizabeth Errington &amp; Noel Longhurst Centre for Competition Policy, UEA</td>
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<td>17:45 – 18:15</td>
<td>Commentary and Discussion</td>
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### Day 2 Friday 16 June

#### Session 4  Distributional Issues in Specific Markets

**09:00 – 09:50**  Collective Purchasing as a Means for Social Ends  
**Morten Hviid** UEA Law School & Centre for Competition Policy  
Discussant: Urs Haegler, Compass Lexecon

**09:50 – 10:40**  One Markup to Rule them All: Distributional Effects of Liquor Pricing Regulation  
**Eugenio Miravete** University of Texas; School of Economics & Centre for Competition Policy, UEA

#### Break

#### Session 5  Macro Perspectives

**11:10 – 12:00**  The Fracturing of the Post-war Free Trade Consensus: Challenges of Reconstructing a New Consensus  
**Michael Trebilcock** University of Toronto

**12:00 – 12:50**  Parties’ Stance Towards Antitrust Policy: The Role of Trade Unions and Party Competition  
**Mattia Guidi** LUISS Guido Carli

#### Lunch

#### Session 6  Political and Economic Interactions

**14:00 – 14:50**  Robber Barons, stupid: Why More Market Competition Would Promote Equality Now  
**Shaun Hargreaves-Heap** King’s College London  
Discussant: Oliver Latham, Charles River Associates

**14:50 – 15:40**  Discussion | Where next?  
**Kate Collyer** Competition and Markets Authority (CMA)  
**Nigel Cornwall** Cornwall  
**Alex Plant** Anglian Water

#### 15:40 – 15:45  Final Remarks | Catherine Waddams & Morten Hviid

#### 15:45 – 16:30  Farewell Drinks

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Welcome to the Spring 2017 edition of the CCP Research Bulletin. As our Annual Report for 2016 demonstrates, the Centre has once again delivered on its key performance indicators both in terms of academic publications, reports, engagement, impact and funding. A full copy of our 2016 Annual Report can be found on our website.

The work of Centre members continues to be recognised by others. This time I want particularly to mention Subhasish Modak Chowdhury who was not only awarded a 2017 Hind Rattan Award by the NRI Welfare Society of India, but also a British Academy Rising Star Engagement Award for a project on “The Micro and Macro Foundations of Conflict and Conflict Resolution: Theory and Evidences”.

I am looking forward to CCP’s Annual Conference 2017, this time on Just Markets. Reflecting on elections in the last 12 months, it seems clear to me that on so many levels we have lost sight of creating just, as well as efficient, outcomes in the economy. Exploring what can be done within the enforcement of competition law and the regulation of markets to ensure more just or fairer distributions of wealth and opportunities is timely and important. For the conference venue, we are pleased to be back on the UEA Campus, at the new Enterprise Centre which, when it opened in July 2015, was hailed as Britain’s greenest building and one of the most sustainable buildings in Europe. The conference also provides CCP with the first opportunity to showcase some of the research from our large UK Energy Research Centre funded project “Equity and Justice in Energy Markets”, led by Catherine Waddams.

An important task for the Centre is the development of the next generation of researchers. During the last six months, Khemla Armoogum, Natalia Borzino, Richard Havell and Liang Lu have all completed their PhDs. While the scarcity of funding for research degrees makes it challenging to attract new research students, CCP so far continues to welcome new students to the Centre.

Recent Working Papers

UK Competition Policy Post-Brexit: In the Public Interest?
Bruce Lyons, David Reader & Andreas Stephan  
CCP Working Paper 16-12

Behavioural Sources of the Demand for Carbon Offsets: An Experimental Study
Kai-Uwe Kühn & Neslihan Uler 
CCP Working paper 17-1

Market Transparency and Collusion under Imperfect Monitoring
Luke Garrod & Matthew Olczak  
CCP Working Paper 17-2

Information Strategies of New Product Introduction in Vertical Markets
Nikolaos Korfiatis, Franco Mariuzzo, Yu Xiong & Li Yimeng  
CCP Working Paper 17-3

You can find our Working Papers Series at: http://competitionpolicy.ac.uk/publications/working-papers