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IN THE COMPETITION

APPEAL TRIBUNAL

Case No. 1160-65/1/1/10

Victoria House,
Bloomsbury Place,
London WC1A 2EB

31 October 2011

Before:

VIVIEN ROSE
(Chairman)
DR ADAM SCOTT OBE TD
DAVID SUMMERS OBE

Sitting as a Tribunal in England and Wales

BETWEEN:

**(1) IMPERIAL TOBACCO GROUP PLC
(2) IMPERIAL TOBACCO LIMITED**

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

CO-OPERATIVE GROUP LIMITED

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

WM MORRISON SUPERMARKET PLC

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

**(1) SAFEWAY STORES LIMITED
(2) SAFEWAY LIMITED**

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

**(1) ASDA STORES LIMITED
(2) ASDA GROUP LIMITED
(3) WAL-MART STORES (UK) LIMITED
(4) BROADSTREET GREAT WILSON EUROPE LIMITED**

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

**(1) SHELL UK LIMITED
(2) SHELL UK OIL PRODUCTS LIMITED
(3) SHELL HOLDINGS (UK) LIMITED**

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

*Transcribed using LiveNote by Opus 2 International
1 Bell Yard, London, WC2A 2JR
Tel: +44 (0)20 3008 5900
info@opus2international.com*

HEARING (DAY 23)

Note: Excisions in this transcript marked “[...][C]” relate to passages excluded.

APPEARANCES

Mr Mark Howard QC, Mr Mark Brealey QC and Mr Tony Singla (instructed by Ashurst LLP) appeared on behalf of the Appellants Imperial Tobacco Group Plc and Imperial Tobacco Ltd.

Mr Rhodri Thompson QC and Mr Christopher Brown (instructed by Burges Salmon LLP) appeared on behalf of the Appellant Co-operative Group Ltd.

Mr Pushpinder Saini QC and Mr Tristan Jones (instructed by Hogan Lovells International LLP) appeared on behalf of the Appellants WM Morrison Supermarkets Plc and Safeway Stores Ltd and Safeway Ltd.

Mr James Flynn QC and Mr Robert O'Donoghue (instructed by Norton Rose LLP) appeared on behalf of the Appellants Asda Stores Ltd, Asda Group Ltd, Wal-Mart Stores (UK) Ltd and Broadstreet Great Wilson Europe Ltd.

Ms Dinah Rose QC and Mr Brian Kennelly (instructed by Baker & McKenzie LLP) appeared on behalf of the Appellants Shell U.K. Ltd, Shell U.K. Oil Products Ltd and Shell Holdings (U.K.) Ltd.

Mr Paul Lasok QC, Ms Elisa Holmes, Mr Rob Williams, Ms Anneliese Blackwood and Ms Ligia Osepciu (instructed by the General Counsel, Office of Fair Trading) appeared on behalf of the Respondent.

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1 Monday, 31 October 2011
 2 (10.30 am)
 3 **THE CHAIRMAN:** Good morning, ladies and gentlemen. Yes,
 4 Mr Howard.
 5 Submissions by MR HOWARD
 6 **MR HOWARD:** Good morning. We have now heard the evidence
 7 from the appealing retailers, and we have now heard the
 8 evidence from the only witness that the OFT is going to
 9 call, namely Fiona Bayley, the former buyer of
 10 Sainsbury's.
 11 It's therefore important at this stage, particularly
 12 before coming to the expert evidence next week, to
 13 pause, as it were, and to consider exactly where this
 14 case is, and that's particularly important in the light
 15 of the Tribunal's observations last week as to matters
 16 that need to be or you may want to be explored with the
 17 experts.
 18 We suggest that once one analyses it, there remains
 19 considerable confusion in the Office of Fair Trading's
 20 case, and before we go forward into the experts, we need
 21 to be clear as to what the case is, the question as to
 22 whether any of this is supported by the evidence, and
 23 I'll say something about that in a moment, but even
 24 leaving aside that, one needs to actually be clear what
 25 it is as to what case they are seeking to prove, and

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1 therefore what is the relevance of the expert evidence.
 2 As I've already made clear, we are also very
 3 concerned that new theories of harm are potentially
 4 being put forward which haven't even yet been
 5 articulated and which therefore would be totally unfair
 6 for us to have to deal with.
 7 The starting point is paragraph 40 of the OFT's
 8 skeleton. I need to address you about paragraph 40 and
 9 paragraph 41. I am going to come to paragraph 41
 10 separately. I just want to focus at the moment on
 11 paragraph 40.
 12 **THE CHAIRMAN:** Just remind me where that is.
 13 **MR HOWARD:** The OFT's skeleton is in volume 4, I think, at
 14 tab 45. {C4/45/1}. It's perhaps worth just, before we
 15 get there, remembering what the OFT's theory of harm is
 16 at paragraphs 11 and 12, the fundamental proposition,
 17 and you will remember that the theory of harm -- they
 18 make it absolutely clear in paragraph 12 -- well,
 19 paragraph 11 in the last sentence, they refer to:
 20 "... an agreement between two manufacturers always
 21 to price their rival products at identical levels ... is
 22 presumed to be anticompetitive."
 23 Then in the next paragraph they say there is no
 24 reason why it should be any different where the
 25 manufacturers use the retailers to provide the same

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1 horizontal link:
 2 "Underneath all of the economic analysis and
 3 detailed descriptions of the theory of harm is the
 4 rather obvious proposition that if one Manufacturer
 5 knows its rival Manufacturer's retail price will always
 6 be the same relative to its own retail price, then it
 7 can never win (lose) customers from (to) its rival. If
 8 it can never win customers there is no point lowering
 9 the price of its product as it will not profit. However
 10 both it and its rival can profit from raising their
 11 prices, given they will not lose customers."
 12 If you actually just think about what they are
 13 saying there, that is actually fundamentally this
 14 lock-step, which is if manufacturer, here Gallaher,
 15 lowers its price, it can't get any competitive advantage
 16 because the price of Imperial just comes down
 17 straightaway, so that there is no point. Therefore its
 18 incentive to price cut is taken away.
 19 Equally the other side of the coin is if it raises
 20 its price, it can do so without fear of losing out,
 21 because when it raises its price, the other competing
 22 product gets raised so you don't suffer the loss of
 23 market you would expect to lose by raising your price.
 24 That's what paragraph 12 is talking about, and
 25 that's why "always" is an important word in

3

1 paragraph 11, "always pricing it" and then you have the
 2 same horizontal link and you can never win and never
 3 lose customers.
 4 Paragraph 40 is then the paragraph which has the
 5 four constraints which reflect this.
 6 I will come back to paragraph 40 in a moment, but
 7 before we -- in order to understand where this all comes
 8 from, you need to go to the decision, and again just
 9 understand what is the core point in the decision. If
 10 you go to paragraph 1.12, that is explaining what is
 11 said to be the restrictive nature of the infringing
 12 agreements, which resulted from the linking of the
 13 retail price of competing brands since that restricted
 14 the retailer's ability to determine its retail prices
 15 from the manufacturer's brands and those of competing
 16 linked brands to any extent that differed from the
 17 proscribed parity and differential.
 18 Stopping there for a moment, we have heard a lot of
 19 evidence, what happens if Gallaher decides to go to the
 20 retailer and say "I want to reduce my wholesale price,
 21 whether originally or by paying you a bonus,
 22 Mr Retailer", is the retailer entitled to put down the
 23 price of the Gallaher brand? Answer: self-evidently,
 24 yes, he is. You see that happening all the time, and
 25 nobody has ever suggested they weren't.

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1 So one immediately wonders: well, how does that
 2 work? Because then you say, if you put down the price
 3 of the Gallaher brand, were you obliged to put down the
 4 price of the Imperial brand, even if Imperial didn't
 5 itself match or compete? The answer is no, no-one has
 6 ever thought that.

7 But the OFT's case is you couldn't do that, you
 8 couldn't put down Gallaher's price without at the same
 9 time putting down Imperial's price.

10 If you then go into 1.13, they then explain how this
 11 restriction is alleged to be capable of restricting
 12 competition, because in particular such a requirement
 13 precluded a retailer from favouring the brand of one
 14 manufacturer over those of another, and was capable --
 15 and this is where it's important -- of significantly
 16 reducing uncertainty both for a manufacturer which
 17 imposed the P&D requirement and a competing manufacturer
 18 which observed the consequences of such requirements or
 19 had knowledge of such requirements as regards the retail
 20 prices of the manufacturer's brands and those of the
 21 competing linked brands:

22 "The long-term implementation of the P&D
 23 requirements would therefore reduce the incentives both
 24 of the manufacturer which imposed the requirements and
 25 the competing manufacturer can engage in interbrand

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1 competition in relation to wholesale pricing."
 2 So what it's all about, the theory of harm, is the
 3 effect on the manufacturers and the extent to which the
 4 manufacturers will be incentivised or disincentivised
 5 from indulging in competition, which is basically what
 6 it amounts to.

7 Now, this theory of harm operating in this way, is
 8 in fact based on a theory of rigidity, and what the
 9 theory of rigidity is, that a wholesale price change by
 10 one manufacturer requires the retailers to change the
 11 retail -- if that wholesale price affects the retail
 12 price of that manufacturer's goods, then the retailer is
 13 obliged to adjust the retail price of the competing
 14 goods.

15 Now, that there is this notion of rigidity, you can
 16 see very clearly in the whole of the description in the
 17 decision, but it's also, as I pointed out to you
 18 previously, made clear in the defence at tab 46 in core
 19 volume 4, at page 227 {C4/46/227} of the bundle.
 20 Footnote 45. Just stopping for a moment, what's very
 21 important about all this is to be clear as to what the
 22 OFT is saying the P&D requirement is, because that is
 23 the starting point. One needs definition of what you
 24 are talking about. They provide the definition very
 25 clearly here. It says:

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1 "Paragraph 1.13 of the decision states that such
 2 a requirement, that is the restriction on a retailer's
 3 ability to determine its retail prices for competing
 4 linked brands, precluded a retailer from favouring the
 5 brand of one manufacturer over those of another. This
 6 was repeated in paragraph 6.7 of the decision.

7 "An example of that situation is this: if
 8 manufacturer A requires the retailer to price A's brand
 9 X at 3p above manufacturer's brand Y, that fixes A's
 10 preferred price relationship between X and Y. The
 11 retailer is precluded from favouring Y over X because,
 12 even if the price of Y is reduced, the retailer is bound
 13 to change the price of X accordingly in order to
 14 maintain the price relationship between those brands
 15 determined by A."

16 So in other words, it's got nothing to do with what,
 17 in that example, the rival manufacturer does, or rather
 18 it's only dependent on what one manufacturer does, and
 19 that is what triggers everything.

20 So if you then go back to the previous tab, tab 45,
 21 {C4/45/1}, paragraph 40, that's where we had the four
 22 constraints. You can see:

23 "If the retail price of Gallaher's brand increases,
 24 then the retail price of ITL's rival brand must also
 25 increase."

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1 So that's whatever ITL does or doesn't do, ITL does
 2 nothing, Gallaher puts up its price, ITL's brand must
 3 also go up in price.

4 "If the retail price of ITL's brand increases [so
 5 that's ITL puts up the price] then Gallaher's rival
 6 brand must also increase. If the retail price of ITL's
 7 brand decreases, then Gallaher's rival price must also
 8 decrease. If the retail price of Gallaher's brand
 9 decreases, then the retail price of ITL's brand must
 10 also decrease."

11 You will remember that when the question of how all
 12 of this operated was raised a week or so or two weeks
 13 ago, the OFT, through Mr Lasok, its original position --
 14 it was Day 16 -- was that paragraph 40 did not represent
 15 the OFT's case. What he said was -- it's at Day 16,
 16 page 155, lines 7 to 23. It's probably worth turning it
 17 up. So the initial riposte was -- this isn't our case.
 18 So he says:

19 "In our submission, it's important to bear in mind
 20 the relationship between the decision and paragraph 40
 21 of the skeleton argument. It will be observed that
 22 paragraph 40 of the skeleton argument is nothing other
 23 than a re-statement of four points that ITL have put in
 24 their skeleton argument as their interpretation of the
 25 main lines of the theory of harm espoused by

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1 Professor Shaffer. Paragraph 40 in fact is the second
 2 paragraph in a subsection of the OFT's skeleton argument
 3 that is dealing with a riposte to a particular point
 4 made by ITL, it is introduced by paragraph 39.
 5 "So what paragraph 40 is, is actually the OFT's
 6 re-statement of a case put forward by ITL which ITL say
 7 that they have derived from Professor Shaffer.
 8 "Now, what we do in the skeleton argument after
 9 paragraph 40 is to address ITL's re-statement of
 10 Professor Shaffer's theory of harm."
 11 So what on Day 16 the OFT was saying is: oh, well,
 12 all we are doing in paragraph 40 is responding to
 13 an argument that Imperial raised, which they appear to
 14 be saying, "Well, that isn't really our case, but we
 15 just thought we would knock down, as it were, a straw
 16 man".
 17 That is in fact patently false, as you can see, and
 18 I think the Tribunal itself pointed out. But the
 19 attempt to argue that paragraph 40 didn't represent the
 20 OFT's case was odd, particularly if one looks at the
 21 text of 40 and the following paragraphs, and even
 22 looking at paragraph 40, each of the subparagraphs (a)
 23 to (d) is footnoted by reference to documents which are
 24 supposed to, one presumes by the footnote, support the
 25 point in each of the subparagraphs.

1 Secondly, what is clear is that what the OFT was
 2 saying that was that the four permutations in
 3 paragraphs 40(a) to (d), they say at paragraph 41, do
 4 not reflect all the constraints which the infringing
 5 agreements place on the retailer's prices. But if you
 6 actually ask: well, what are the other constraints?,
 7 what has become evident is the only other constraint
 8 that they are saying exists, which I'll come to later,
 9 is that the retailer was precluded from self-funding
 10 promotions without applying the operating in accordance
 11 with the P&Ds. So in other words, if the retailer on
 12 their case wanted to fund a promotion for a Gallaher
 13 product, he can do it, but their case is, well, then, he
 14 would have to do something similar for Imperial to keep
 15 the P&Ds operating.
 16 But subject to that point, the other constraints are
 17 the constraints, and you see that from paragraph 43,
 18 because in paragraph 43 what they there address is the
 19 difference between the situation in the foregoing
 20 analysis between the situation where the P&Ds are fixed
 21 as opposed to maxima. What paragraph 43 is saying is
 22 that -- and it says it in terms -- in the case of
 23 maximum P&D requirements, point (a) and (c) do not flow
 24 from the infringing agreements, and so what they are
 25 saying is (a)(b) and (c) are relevant to fixed

1 agreements, where it's maxima it's just (b) and (d).
 2 At paragraph 44, what they say is that where you
 3 have parallel and symmetrical situations, even where
 4 it's maxima, then all of the -- all four implications,
 5 all of the four restraints, (a), (b), (c) and (d) apply.
 6 So that's where they get in.
 7 So the position that the OFT was adopting on Day 16
 8 was simply wrong. On Day 17, they come back, through
 9 Mr Lasok, when we got his explanation of the position,
 10 and on Day 17 he appears to recognise what clearly was
 11 the case, that paragraph 40 is indeed their case.
 12 **DR SCOTT:** Do you have the reference for that?
 13 **MR HOWARD:** Yes, Day 17, it starts at page 103, and the
 14 position ran until page 113. That paragraph 40 is their
 15 case is absolutely clear from this. What is not clear
 16 is how paragraph 40 works. If you go to page 107, what
 17 Mr Lasok does, before you get to that line, he is at
 18 104 -- I think he really picks it up at 105 at line 3.
 19 He starts to deal at line 5 with paragraph 40(d) of the
 20 OFT's skeleton, which is dealing with the Gallaher price
 21 decrease, and what he runs through is explaining what
 22 their position is on price decreases, and he refers
 23 across to 6.223 and 6.225.
 24 Then if you go to line 17 at page 107, what you get
 25 is this:

1 "So we have, in 6.223, the OFT expressly recognising
 2 that the manufacturers' uncertainty regarding the retail
 3 price movement of a competing linked brand was not
 4 completely eliminated. It is for that reason that the
 5 OFT to say not assert [something has gone wrong there]
 6 that a P&D requirement in the context of the particular
 7 cases or agreements that we are looking at would have
 8 had all the features that are described in paragraph 40
 9 of the OFT's skeleton argument. That in fact is made
 10 abundantly clear in paragraphs 43 to 44 of the OFT's
 11 skeleton argument, because, for example, the full
 12 panoply of the features referred to in paragraph 40 of
 13 the skeleton argument apply where there are parallel and
 14 symmetrical agreements. That's what paragraph 44 says."
 15 Stopping there a moment, that is all a bit
 16 incoherent, as we say much of this is, for this reason:
 17 what paragraphs 43 and 44 are saying, paragraph 43 is
 18 saying: where it is maximum, not fixed, you have two
 19 elements, but paragraph 44 is saying: in the case of
 20 maximum but parallel and symmetrical, you have all four.
 21 So what Mr Lasok has said paragraphs 43 and 44 are
 22 saying is simply not right.
 23 Then you see at 108/6 he says:
 24 "The case made out in the decision is, therefore,
 25 that a P&D requirement is anticompetitive by object,

1 even if, in the particular factual circumstances in
 2 which it operates or applies, it does not possess each
 3 and every one of the features mentioned in paragraph 40
 4 of the OFT's skeleton argument.
 5 "The question: just how many of the features in
 6 paragraph 40 must exist for a P&D requirement to be
 7 anticompetitive by object?, is essentially a matter for
 8 expert evidence and submission."
 9 Now, he then goes on, at page 113, line 20, he says:
 10 "As I've said earlier, it isn't the OFT's case, and
 11 it's never been set out in the decision or anywhere
 12 else, that in order for a P&D requirement to be
 13 anticompetitive by object, you have to have each and
 14 every one of the particular features identified in
 15 paragraph 40 of the skeleton argument."
 16 Now, if you just go back to the skeleton argument,
 17 I've already made this point, but it is actually clear,
 18 clear in the decision as well, that what they are saying
 19 in paragraph 40 is: you either have all four or you have
 20 at least (b) and (d), because it's a maximum agreement.
 21 So that that's if ITL's price goes up, then the retail
 22 price of Gallaher's rival brand must also go up, and if
 23 the retail price of Gallaher's brand decreases, then the
 24 retail price of ITL's brand must also decrease.
 25 What one -- one then goes back to the decision for

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1 a moment, and then we go to paragraphs 6 -- if you pick
 2 it up -- again you have to see everything in context.
 3 If you start at 6.213, what you have at 6.213 is the
 4 statement that:
 5 "A parity or fixed differential requirement
 6 restricts a retailer's ability to determine retail
 7 prices of competing linked brands, because the relative
 8 prices are fixed on the basis of the required parity or
 9 differential. If the differential requirement is
 10 implemented, an increase or reduction in the retail
 11 price of one brand leads to a corresponding increase or
 12 reduction in the retail price of the competing linked
 13 brand by an equivalent amount."
 14 So that again, you have to ask yourself: what is it
 15 that is the requirement that you are talking about? And
 16 the requirement is that there has to be this
 17 relationship so that an increase or reduction in the
 18 retail price of one brand leads to a corresponding
 19 increase or reduction in the other.
 20 Then at 6.214 and 6.215 and 6.216 and 6.217, this is
 21 where, as it were, an economic theory is explained,
 22 which is basically just a rather simplistic theory that
 23 it's that there is no incentive to reduce prices and
 24 every incentive to increase prices. That's what it
 25 amounts to.

14

1 Now, look at 6.218:
 2 "Where a retailer was required to price Gallaher's
 3 brand Dorchester at parity with Richmond, that
 4 requirement would have significantly increased ITL's
 5 certainty that any change in the retail price of
 6 Richmond would be matched by change of equivalent
 7 direction and magnitude in the retail price of
 8 Dorchester."
 9 So if you put up the price of Richmond, you can be
 10 absolutely certain, or you have this certainty, they
 11 say, the way they put it here, in "significant increase
 12 in your certainty", in fact in their case it's
 13 100 per cent certain, because if you put up the price of
 14 Richmond, the price of Dorchester has to go up, and you
 15 will put down the price of Richmond, the price of
 16 Dorchester has to go down.
 17 We see that's this lock-step theory. Now, where the
 18 lock-step theory gets departed from is in 6.223 and
 19 6.224. 6.223:
 20 "In response to the SO, ITL submitted that the
 21 infringing agreements did not impose an obligation on
 22 the retailers to adjust the prices of one manufacturer's
 23 brand in response to a reduction or increase in the
 24 price of the other manufacturer's linked brand. As
 25 noted in the SO, the OFT recognise that the

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1 manufacturer's uncertainty regarding the retail price
 2 movement of a competing linked brand was not completely
 3 eliminated as a consequence of an infringing agreement.
 4 If the retail price of one brand changed, for example,
 5 as a result of a temporary promotion instigated by
 6 a manufacturer, the retailer was frequently under
 7 an obligation to inform the other manufacturer of that
 8 promotional price change and afforded a chance to
 9 respond. The manufacturer of the competing linked brand
 10 would then decide whether to ask the retailer to follow
 11 the price change in order to maintain or realign the
 12 parity or differential requirement."
 13 Of course, what that does not tease out is the issue
 14 as to whether or not if the competing, here Imperial,
 15 manufacturer wants to reduce his price, his retail
 16 price, whether he has to reduce his wholesale price.
 17 Because if he has to reduce his wholesale price, then
 18 that is competition in action.
 19 **THE CHAIRMAN:** Well, that seems to me to be the key to this
 20 question as to whether the decision recognises that this
 21 requirement to change the price is always or sometimes
 22 dependent on a change in the wholesale price.
 23 **MR HOWARD:** Yes.
 24 **THE CHAIRMAN:** Or whether it's drafted in a way that
 25 encompasses that as a possibility on occasion but how it

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1 affects the economic theory of harm, if in fact almost
 2 all or all of the time, the price change has to be
 3 brought about by change in the wholesale price.
 4 **MR HOWARD:** This paragraph is somewhat mealy-mouthed as to
 5 what the position is. But the difficulty is, you have
 6 to identify what it is that is the requirement. What is
 7 the P&D requirement? Because what, if you remember the
 8 starting point for this is a restriction on the
 9 retailer's ability to favour here Gallaher. So there is
 10 no restriction if -- for instance, we are looking at
 11 price decreases at the moment. If Gallaher is free to,
 12 in the case of Dorchester or any other Gallaher brand,
 13 to come along and say "I want to have a promotion" or
 14 "I want to reduce my price of Dorchester", or of any
 15 other brand, is the retailer free to do that? The
 16 answer is: I don't think anybody who has sat in court
 17 for the last few weeks could have any doubt that the
 18 retailers were free to do that. That was an everyday
 19 occurrence. You heard Fiona Bayley's evidence, which
 20 was pretty graphic about that.
 21 So nobody is inhibited from reducing their price.
 22 At most, you have an opportunity, from Imperial's point
 23 of view, to reduce your price. But that -- it
 24 doesn't -- if you reduce your price, then as you would
 25 actually expect you are interested in getting your price

1 cut fed through to the consumer. That doesn't restrict
 2 the retailer, because that doesn't, when you reduce your
 3 price, Imperial, he doesn't have to do anything to
 4 Gallaher. And if Gallaher want to respond to that by
 5 cutting their price, they are equally free to do so.
 6 Just so we see where we are going, the way in which
 7 both -- and you will see this in Professor Shaffer --
 8 the way in which the OFT try to analyse it, what they
 9 seek to say is that where this is happening, you still
 10 have a requirement.
 11 So if we take the case of the Gallaher price
 12 reduction, their case is there is a requirement that the
 13 retailer must reduce the price of Imperial. But
 14 somehow -- and this is what at one point Mr Lasok
 15 referred to as "well, the retailer is going to get
 16 sticky" or something like that. But what is actually
 17 perfectly clear is the retailer wasn't under any
 18 requirement where Gallaher reduced its price to do
 19 anything other -- yes?
 20 **DR SCOTT:** Mr Howard, I think my slight difficulty with this
 21 is the last sentence in 6.223.
 22 **MR HOWARD:** Yes.
 23 **DR SCOTT:** Which says:
 24 "On certain occasions, the manufacturer would accept
 25 or would accept or would inform a retailer that a parity

1 or differential requirement was suspended."
 2 As we have heard in the evidence, there are moments
 3 when people follow with wholesale price change and there
 4 are moments when they don't, and we have used the word
 5 "turbulence". What is not clear to me is how you
 6 address that. You have talked about not favouring
 7 Gallaher --
 8 **MR HOWARD:** Well, I haven't, the OFT has. That's their
 9 case.
 10 **DR SCOTT:** Yes. But as we understand the strategy within
 11 ITL was born of concerns that Gallaher was being
 12 favoured, and agreements which we understand from the
 13 evidence were becoming increasingly formal in some cases
 14 seem to have been designed, at least from ITL's point of
 15 view, to seek to avoid that favouritism occurring.
 16 Now, having said that, it's equally clear from the
 17 evidence there were times when ITL's cash was running
 18 short in the budget for promotions and they didn't
 19 follow.
 20 **MR HOWARD:** With respect, I think one has to work out what
 21 you mean by not being disadvantaged, or Gallaher being
 22 favoured. The premise, we say, of everything that's
 23 happening is linked to your wholesale price, which you
 24 can only expect not to be disadvantaged if your
 25 wholesale price is lower than that of -- or if your

1 wholesale price is lower or matches your RRP
 2 differential. So that if -- or is at least the same.
 3 **DR SCOTT:** Well, pause there, because the evidence that we
 4 have heard shows that the margins were not always the
 5 same. Indeed, as we understand it, part of the reason
 6 why ITL went in for this in the beginning was that they
 7 thought that retailers were charging a higher margin for
 8 ITL products than they were for Gallaher products.
 9 **MR HOWARD:** Quite.
 10 **DR SCOTT:** Now, what appears to happen, as we go on, is that
 11 people are adjusting the bonusing in various ways to
 12 maintain the margin as from one period to another for
 13 particular products, but we don't appear to have had
 14 much evidence that that was all about sustaining the
 15 same margin, because the manufacturers didn't know and,
 16 as we understand it, the retailers didn't reveal the
 17 relative margins between the wholesale prices and the
 18 retail prices that they were achieving from the
 19 different manufacturers.
 20 What has been clear is that where bonuses were being
 21 paid there was an expectation that pricing -- leaving
 22 aside for a moment whether it was fixed or maximum --
 23 would ensure that the bonusing manufacturer was not
 24 disadvantaged.
 25 **MR HOWARD:** I think there is an awful lot you are wrapping

1 up into there. Fiona Bayley's evidence actually was
 2 absolutely clear, that her intention was to apply the
 3 same or consistent margins, and whether in fact the
 4 wholesale price necessarily was always precisely in line
 5 with the RRP differentials, her understanding was that
 6 it was, and of course from the manufacturer or from
 7 Imperial's point of view -- and one needs to be very
 8 careful because Gallaher may have had a completely
 9 different understanding, we have no idea what their
 10 understanding was, we are never going to hear from them.
 11 But from Imperial's point of view, they are trying to
 12 achieve a situation where the net wholesale price is set
 13 at a level which will match the differentials.

14 So of course when it finds that Gallaher's retail
 15 selling prices are lower than its, then it reduces its
 16 wholesale price. It can't ever be certain at day one,
 17 but if it looks in the shops and sees Dorchester is
 18 a penny below Richmond, its conclusion from that is:
 19 well, they, by their bonusing -- and the bonusing is
 20 just reducing a wholesale price -- have managed to get
 21 to a situation where they are lower than us, so you
 22 reduce your price by 1p and you pay a bonus to do it.

23 The net effect of that may be that you have come
 24 significantly below Dorchester because you may only have
 25 been out by a fraction, you don't know, you don't know

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1 the extent to which you are being played by the
 2 retailer. But of course you are trying to get to
 3 a situation where your net wholesale price is lower.
 4 **THE CHAIRMAN:** Mr Howard, I don't wish to take you out of
 5 the line of your argument, but it would help me if you
 6 could indicate where this is going this morning. Are
 7 you asking us to do anything or suggest that something
 8 should happen in relation to the remainder of this
 9 hearing? Or where is this leading?

10 **MR HOWARD:** Well, it leads into, in fact, the issue that
 11 the Tribunal itself raised, which is: what actually are
 12 the issues that the experts need to consider? And it
 13 leads into: what is left of paragraph 40 of the OFT's
 14 case? I think that's the important thing, to actually
 15 see, in the light of what Mr Lasok has said, which of
 16 these constraints apply at all. Because some of them we
 17 have not heard of at all, and some seem to have been
 18 modified in such a way that you can't recognise that
 19 they are still within paragraph 40. So what we have to
 20 do is get to a situation, particularly insofar as
 21 the Tribunal is suggesting we ought to be clear as to
 22 what hypotheses are put to the experts, we need to be
 23 clear as to first what the case is based upon
 24 paragraph 40, then from that one can decide whether or
 25 not any further alternatives can properly be put to the

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1 experts, or whether the issues have been put to them
 2 already based upon what are the appropriate scenarios.
 3 **THE CHAIRMAN:** Do you have a suggestion as to how we get
 4 ourselves to that position in practical terms?
 5 **MR HOWARD:** I don't, actually, in the sense that what we say
 6 is that the OFT's case, we say, is just not properly
 7 articulated and we have had a chance to do it, and the
 8 position remains obscure, and that therefore means
 9 really -- well, I suppose we go into the expert
 10 evidence, but we say there aren't further scenarios that
 11 need to be considered. We say essentially that, the
 12 reason I referred you to that paragraph in the joint
 13 statement, where wholesale prices, where the movements
 14 reflect movements in wholesale prices,
 15 Professor Shaffer's model, if you incorporate that into
 16 it, and that's all that our experts have done, they have
 17 tweaked his model by saying what if, accept everything
 18 else that he has assumed, which we don't accept, and
 19 accept everything else, but just change it so that
 20 wholesale prices or that the changes in retail prices
 21 reflect changes in wholesale prices. I think somebody
 22 else referred to this as floating on the wholesale
 23 prices, somebody might have called it.

24 **THE CHAIRMAN:** I think the floating on the recommended
 25 retail prices is something else.

23

1 **MR HOWARD:** Maybe that's something else.
 2 **THE CHAIRMAN:** I thought this P1 minus W1 equals P2 minus W2
 3 was the point about whether prices only shift in
 4 relation to changes in the wholesale price.
 5 **MR HOWARD:** Basically if prices only shift in relation to
 6 changes in the wholesale price, instead of
 7 Professor Shaffer's model predicting price rises it
 8 actually predicts, he acknowledges, price reductions.
 9 **THE CHAIRMAN:** So what we need to know now is: what is the
 10 factual situation that the OFT regards as having been
 11 established by the evidence so far, and whether that
 12 results in a further scenario needing to be put to the
 13 experts.

14 **MR HOWARD:** I would just like to go through the four to see
 15 where the case is at the moment.

16 **THE CHAIRMAN:** Well, I know where you say the case is. You
 17 presumably don't say that the case is any different
 18 from~...

19 **MR HOWARD:** What I mean by where the case is at the moment,
 20 I say on the evidence there is an overwhelming
 21 conclusion that everything is dependent on wholesale
 22 prices, but what I wanted to do was actually to look at
 23 what the OFT's case appears to be as they have
 24 ventilated it in the course of this hearing, and the
 25 extent to which each of these different constraints

24

1 appear to be part of their case.
 2 **DR SCOTT:** Can I clarify that? Are you saying that there
 3 was a rigidity between wholesale prices and resale shelf
 4 prices which replaced any understanding that existed
 5 between any pair of parties as to the relativities that
 6 would be applied as a result of a wholesale price move?
 7 Let me try to explain it.
 8 **MR HOWARD:** I can answer that, no, no doubt because of the
 9 way you phrased it.
 10 **DR SCOTT:** Let me phrase it in a different way.
 11 **MR HOWARD:** Yes.
 12 **DR SCOTT:** I think that the understanding that I have got
 13 from the evidence is that at least what the
 14 manufacturers hoped for was that when they made a change
 15 in wholesale prices --
 16 **MR HOWARD:** Which way?
 17 **DR SCOTT:** In either direction.
 18 **MR HOWARD:** Okay.
 19 **DR SCOTT:** -- they would end up in a situation where they
 20 were not disadvantaged against the other manufacturer.
 21 Now, that's --
 22 **MR HOWARD:** I think that's self-evidently wrong, that's the
 23 difficulty. If you think about it, we have not heard
 24 from Gallaher, when Gallaher reduced its price, they are
 25 trying to get a price advantage.

25

1 **DR SCOTT:** Yes.
 2 **MR HOWARD:** So they are not hoping to get to a situation
 3 where the price of Dorchester and Richmond are the same,
 4 they are hoping that Imperial won't respond and so that
 5 they will have that 5p advantage. Imperial, for its
 6 part in that situation, can't afford -- was its view --
 7 to have Dorchester at a much more competitive price, and
 8 that's why then they respond. But that's just a classic
 9 response and counter response, and that's the same with
 10 Pepsi and Coke. If Pepsi reduces the price to 89p
 11 a bottle and Coke is at 95p a bottle, they have to come
 12 to a decision whether we are frightened that they are
 13 going to steal part of our market by doing that.
 14 **DR SCOTT:** The question seems to me is whether, when people
 15 had both had the opportunity to respond, and you would
 16 say this is normal competition --
 17 **MR HOWARD:** Yes.
 18 **DR SCOTT:** -- and have done so, we end up back at the
 19 relativities that were expected by the respective
 20 manufacturers, which is where the similar point comes
 21 in.
 22 **MR HOWARD:** Well, but that's only like saying Coca-Cola and
 23 Pepsi may have a strategy whereby generally they think
 24 they need to be at a similar or the same price. One
 25 then breaks to try and gain market share, and the other

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1 has to decide: do I -- I mean, this is just how
 2 competition works, this is what's so odd about it. If
 3 in my example Pepsi go down to 89p, if you are
 4 a Coca-Cola executive, you have to say: well, I have to
 5 weigh up the fact that they are 6p cheaper than me, how
 6 much would that cost them and how much would they gain,
 7 and how much would it cost me if I go down? How deep
 8 are my coffers, do I want to enter into this price war?
 9 It all depends on economic considerations and so on.
 10 **DR SCOTT:** Let me just say that we are not at this stage
 11 trying to prejudge the issue of the theory of harm, we
 12 are trying to prepare the ground for putting cases to
 13 the experts.
 14 **MR HOWARD:** Absolutely.
 15 **DR SCOTT:** Now, the question, I suppose, that underlies this
 16 is: why have agreements, formal or informal, or
 17 arrangements between the manufacturers and retailers in
 18 relation to this? And what is the object of those
 19 because we are on about object?
 20 **MR HOWARD:** We are only on about object is the point.
 21 **DR SCOTT:** We are only on about object, and in talking to
 22 the experts, how do we get them to inform us in relation
 23 to the object of what was understood between the
 24 parties?
 25 Now, what we are trying to work out, it seems to me,

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1 is: what are we asking the experts to understand as
 2 being the understanding that existed between the various
 3 pairs of parties?
 4 **MR HOWARD:** Well, I am not sure that's the right approach at
 5 all, that's not what expert analysis here is about. what
 6 the experts are trying to do is to look at what is in
 7 the agreement, which is the agreement here is not just
 8 the pieces of paper, because you have to look at the
 9 course of conduct to see what is agreed, and then to
 10 decide in the light of that: is that an agreement,
 11 taking account of what that agreement does, is that
 12 anticompetitive by object?
 13 We are responding to the OFT's case, and so the
 14 OFT's case is -- this is what's so important. We are
 15 not involved here in a sort of general investigation.
 16 Subject to the point of what the Tribunal is entitled to
 17 do, which I may or may not have to come back to, but at
 18 the moment we can only respond to the theory that the
 19 OFT has put forward. The OFT has put forward
 20 an economic theory which is based upon a restriction on
 21 the retailer to favour Gallaher's brands, that
 22 restriction then feeds through to higher prices because
 23 it takes away the incentive to price cut, and it
 24 provides an incentive to price up. The reason it takes
 25 away the incentive to price cut is because you can't

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1 achieve anything by price cutting, and it gives you
 2 an incentive to put the prices up because you have
 3 nothing to fear. That's the theory that we have to deal
 4 with. Then one has to see how they have got there, and
 5 then what the experts are doing is testing whether this
 6 anticompetitive scenario does apply, and what they have
 7 done is -- I mean, Professor Shaffer embodies this
 8 theory, and he has produced a mathematical model in 2007
 9 which was to support it. Where we are at the moment is
 10 trying to work out which elements of the restriction
 11 continue to apply. If one sees that a number of these
 12 elements have fallen away, what then is -- have the OFT
 13 got a theory in the decision which continues to apply?
 14 That's really ... and what we in short say is that they
 15 appear to have abandoned large parts of what is in
 16 paragraph 40. We can't at the moment see how there is
 17 any theory of harm remaining once you abandon parts of
 18 this. It really would involve -- and this is one of our
 19 concerns -- a rather different theory of harm and
 20 different analysis, but in part that's what we have to
 21 see here this morning as to what it is in part
 22 the Tribunal is seeking to put to the experts and
 23 whether that is really raising what is a different
 24 scenario.
 25 **DR SCOTT:** Well, it's partly a question of: does that

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1 scenario fall within the theory of harm in the decision
 2 as distinct from any theory of harm that has been
 3 developed in exchanges between the experts since the
 4 decision?
 5 **THE CHAIRMAN:** Well, as far as I can see, perhaps the key
 6 elements that we need to understand from the experts is:
 7 is it an essential element in the theory of harm that
 8 the agreement required or incentivised price moves which
 9 were not always contingent on a wholesale price move?
 10 **MR HOWARD:** The answer to that is: we know the answer, and
 11 that's in the joint statement.
 12 **THE CHAIRMAN:** Yes. Whether it's a key element of the
 13 agreements and the theory of harm that the agreement
 14 required movements in price not only for that
 15 manufacturer's brands, but the other manufacturer's
 16 brands as well.
 17 **MR HOWARD:** Sorry --
 18 **THE CHAIRMAN:** What we need to establish is, if the facts
 19 turn out that those two elements, or either of them, did
 20 not exist actually, where does that leave us?
 21 Now, it may be you say, well, that's clear from the
 22 experts' joint statement, in which case then there is
 23 nothing more we need to put in. But I thought that you
 24 were also seeking to clarify whether, as far as the
 25 OFT's concerned, they have moved their case from the

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1 position it was in at the beginning of this trial,
 2 because of the evidence that we have had, and if so, in
 3 what way it has been moved.
 4 **MR HOWARD:** Yes.
 5 **THE CHAIRMAN:** If that is something that you are seeking to
 6 find out before we start the expert evidence, what I am
 7 looking for is what mechanism you have in mind for us to
 8 clarify that.
 9 **MR HOWARD:** Yes. I think what we say, we need to take it in
 10 stages. It is unsatisfactory that the OFT has said "Oh,
 11 well, it's a matter of expert evidence and submission
 12 which of the constraints in paragraph 40 have to be
 13 present". That can't be right, because the whole case
 14 has proceeded on the basis that it's four constraints in
 15 the case of fixed and two constraints in the case of
 16 maximum, and so -- and the point about that is, if one
 17 just remembers what the constraints are if we go back to
 18 paragraph 40.
 19 What one understands them to be saying is that there
 20 is a symmetry in the way all of this works, which is
 21 that -- if we take, for instance, (b) and (d), the
 22 retail price of ITL's brand increasing, clearly the
 23 opposite side of the coin to that is (d), the retail
 24 price of Gallaher's brand decreases, because effectively
 25 they are the same thing, it's just a different mechanic.

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1 You remember I put this to Fiona Bayley, but it doesn't
 2 actually matter how any of these situations arise, they
 3 are -- because obviously in economic terms they are
 4 exactly the same thing.
 5 So that if you take (b) and (d), which is their case
 6 on maximum, the case in the decision and in their
 7 arguments is that you have both of these constraints.
 8 **THE CHAIRMAN:** In each of the bilateral agreements that we
 9 are looking at?
 10 **MR HOWARD:** Yes. That's right. That's what they say is the
 11 effect.
 12 What they then say, I think, about price, the
 13 Gallaher decrease, they say there is still this
 14 requirement, but it's what Professor Shaffer talks
 15 about, uncertain compliance, because although there is
 16 a requirement in practice, it may be the retailer won't
 17 be prepared to go along with it unless you fund it.
 18 You will obviously appreciate we say that
 19 fundamentally that's just a misanalysis. There is no
 20 requirement, because it's perfectly clear the retailer
 21 is entitled to put down the price of Gallaher, simply
 22 Imperial, it may seek to respond.
 23 What I just wanted to do is just to see, to try and
 24 see -- then if necessary we can hear from the OFT -- but
 25 the question is -- before we hear from them, I just

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1 wanted to explain to you what we see the OFT has been
 2 putting to the witnesses, and therefore what its case
 3 does or doesn't appear to be at this stage.
 4 Perhaps the easiest one to start with is constraint
 5 (c), which is:
 6 "If ITL's price decreases, then the retail price of
 7 Gallaher's rival brand must also decrease."
 8 If one actually thinks about that for a moment, as
 9 indeed the witnesses to a man or woman have said, that
 10 is completely potty. Why would Imperial, if they are
 11 putting down the price of their product, want Gallaher's
 12 brand to come down as well? It doesn't make any sense
 13 at all. Constraint (c) I don't think has ever been put
 14 to witnesses, and what's more, Mr Lasok didn't mention
 15 this on Day 17.
 16 Now, it's important to bear this in mind, because in
 17 other words, once you recognise that under these
 18 agreements Imperial could lead the way, for instance it
 19 decides it wants to cut the price of Richmond, it can't
 20 stop Gallaher competing, but it obviously doesn't want
 21 the retailer itself to move the price of Gallaher down,
 22 it doesn't make any commercial sense whatsoever.
 23 Now, once you bear that in mind, that of course is
 24 very important when you come back to consider (a),
 25 because just as (b) and (d), one is the reverse side of

1 the coin of the other, (a) is the reverse side of the
 2 coin of (c).
 3 This is a case that seems to be being put, despite
 4 that, that where Gallaher's price goes up, then whatever
 5 Imperial does, the retailer is, as a result of the
 6 Gallaher brand going up, is required to put up the price
 7 of the ITL brand.
 8 Now, the witness who the OFT called entirely
 9 repudiated that.
 10 **DR SCOTT:** Except for the fact that what she explained to us
 11 was that it was likely that the bonuses would be reduced
 12 to have that effect, because on the whole neither
 13 manufacturer wanted to go on paying bonuses
 14 ad infinitum.
 15 **MR HOWARD:** Sir, with respect, that's entirely missing the
 16 point of the case. The point of this is that the
 17 retailer is required, without ITL doing that --
 18 **DR SCOTT:** Oh, yes, I understand, we are trying to work out
 19 what you will put to the experts, and we will listen to
 20 what Mr Lasok has to say in a moment.
 21 **THE CHAIRMAN:** I am just trying to explore what has changed
 22 in the 22 days which we have been hearing this case,
 23 which might indicate that the position of the parties as
 24 at Day 1 has shifted.
 25 **MR HOWARD:** Well --

1 **THE CHAIRMAN:** If I can continue. What I would expect you
 2 to say is that what has changed is that we have now
 3 heard from Mrs Corfield, and I would expect you to say
 4 her evidence as to how she said the Sainsbury's/ITL
 5 agreement operated during her time in post was in fact
 6 the same as you say the ITL agreement with the other
 7 retailers operated. You don't see, as I understand it,
 8 any difference between the evidence that Mrs Corfield
 9 gave as to the operation of the agreement, or no
 10 relevant difference, and the operation of the agreement
 11 as between ITL and the other retailers. Now,
 12 Mrs Corfield of course is the OFT's witness, so what we
 13 need to know, it seems to me, is whether they accept her
 14 evidence as to how the agreement operated during the
 15 time she was in post, whether they accept that that's
 16 how it operated throughout the infringement period,
 17 whether they say that the agreements with the other
 18 retailers also operated in that way, or whether they say
 19 those other agreements operated differently from what
 20 Mrs Corfield described.
 21 Now, if, once we know the answers to those
 22 questions, then we are in a better position to work out
 23 how far apart the parties are now, on the facts of the
 24 case, and whether that affects the scenarios that should
 25 be put to the experts.

1 If the OFT say -- well, I do not want to put forward
 2 any suppositions as to --
 3 **MR HOWARD:** But you are entirely right. Our starting point
 4 is that the OFT have called Fiona Bayley, references to
 5 her statement as to how things operate are used in the
 6 decision, but they use it across the board as being
 7 relevant evidence as to how these things operate. Her
 8 evidence, it's self-evident, is entirely contrary to
 9 every single aspect of their case, and we do say that
 10 the net effect of that is that none of this applies.
 11 So you are entirely right, that's our position, but
 12 what I was actually just trying to do is to see, well,
 13 leaving that on one side for a moment, what aspect of
 14 paragraph 40 do we actually even see the OFT appearing
 15 to be putting forward? There are two things that
 16 the Tribunal needs to understand. One is obviously you
 17 have understood that Fiona Bayley's evidence appears to
 18 entirely undermine the paragraph 40 in its entirety; but
 19 the other aspect, whatever the OFT may say, and let's
 20 see whether they seek to distance themselves from
 21 Mrs Corfield's evidence, that you still have to see what
 22 actually, even if they were able to do that, what
 23 actually have they been putting forward as their case.
 24 So that they do appear to have been putting forward
 25 paragraph (a), even after Mrs Corfield gave evidence

1 they were trying to cross-examine about paragraph (a),
 2 to cross-examine Mr Matthews to say that paragraph (a),
 3 where Gallaher's price went up, "you must have expected
 4 the retailer" -- and of course "expected" is a very --
 5 it's deliberately used as a word that doesn't make clear
 6 what it is you are saying. Because I can expect things
 7 because that's part of my arrangement, or I can expect
 8 it because I understand that's how they will behave.
 9 I expect if I kick Mr Brealey, he will react, but
 10 I don't necessarily want him to react and hit me back.
 11 **THE CHAIRMAN:** Well, yes. The restriction of competition
 12 which is identified has to derive from the arrangement
 13 between the parties, not from the ordinary operation of
 14 this market.
 15 **MR HOWARD:** What I am saying is it has to derive, that's why
 16 if you ask somebody: wouldn't it be good for you if
 17 something or other happened?, that doesn't actually mean
 18 that's a part of your arrangement. It might be good for
 19 you if the stock market goes up, it doesn't mean you
 20 have an arrangement with somebody to cause the stock
 21 market to go up. There are lots of things where you can
 22 say: that will be good for you, but it doesn't
 23 necessarily follow that's part of an arrangement.
 24 If I can perhaps just complete very briefly the
 25 point I was making on these paragraphs. So the first

1 point is, as you say, we say Mrs Corfield says none of
 2 it arises. Insofar as we can then ascertain what the
 3 case is that the OFT has been running, they seem not to
 4 run the (c) at all.
 5 Then what Mr Lasok said about (b), he seems to have
 6 abandoned that as well, because (b) is "if the retail
 7 price of ITL's brand increases, then the retail price of
 8 Gallaher's rival brand must also increase".
 9 Now, on Day 17, when Mr Lasok explained what their
 10 case was about this, what he appeared to be saying is
 11 that where ITL increased its wholesale price and altered
 12 the P&D requirement, then this wouldn't apply, because
 13 you would be altering the differential. But that
 14 appears to be covering a situation where Imperial has
 15 an MPI first. In other words, if it has an MPI, it may
 16 hope and anticipate that Gallaher will follow with
 17 an MPI, but unless and until it does, then this, the way
 18 he put it, appears to anticipate that the differential
 19 just widens because you have gone first with your MPI.
 20 In other words, where there is an MPI, you are not in
 21 this territory at all.
 22 So then the alternative he says where there's
 23 a situation where ITL increases its wholesale price and
 24 doesn't alter the P&D requirement. As I understand him,
 25 he then says there is not a requirement on the retailer

1 to do anything because Gallaher would be expected to
 2 follow with a wholesale price increase of its own. But
 3 that's not a P&D requirement, that's just again
 4 an expectation that Gallaher will react in this market
 5 by following your price increase.
 6 If that's right, it doesn't appear in this scenario,
 7 which was described as the central plank, that there is
 8 any P&D requirement at all, and therefore that appears
 9 to fall out of the picture.
 10 Then finally (d), which is the retail price of
 11 Gallaher's brand decreasing, this is where Mr Lasok drew
 12 a distinction between the two situations. One is the
 13 situation where Gallaher funds the reduction, and
 14 I think he then accepted on Day 17 at page 106 that --
 15 I mean, he puts it as a manner of implementation. He
 16 says that -- he appears to accept that unless ITL
 17 provided the additional funding there wouldn't have been
 18 a decrease in the retail price of the ITL brand. In
 19 other words, it's departing from the requirement or
 20 their case on the requirement.
 21 The other situation was the situation where the
 22 retailer itself funds a discount. Now, that's
 23 a separate situation which I need to address separately.
 24 But what one -- where you appear to get to, even before
 25 you consider Fiona Corfield's evidence, is that the

1 OFT -- leaving aside the damage that she has done to
 2 their case -- does no longer seem to be espousing 40(b),
 3 (c) and (d) so far as we can understand it, and the only
 4 one that seems to be left is 40(a).
 5 Now, the reason that that is of course important is
 6 that it's quite difficult to actually understand how
 7 anyone sensibly can say that you could have constraint
 8 (a) independently, because how could it actually
 9 operate? Because if one just thinks about it, you are
 10 accepting in the case of price decreases that everything
 11 is susceptible to wholesale price increases. Let's say
 12 Gallaher puts up its price. ITL of course can always
 13 follow and put up its wholesale price, but if ITL
 14 doesn't choose to do that, how is it that ITL's brand
 15 price will increase, and how is it that you are not just
 16 actually in the same scenario which is a decrease where
 17 in effect ITL is paying a bonus, because it's exactly
 18 the same situation.
 19 The Tribunal, I think, understands that
 20 Professor Shaffer in his 2010 report didn't append his
 21 model. That was appended to his 2007 report, which we
 22 only got at a later stage. What is clear is that his
 23 2010 report is articulating in exactly the same way,
 24 more or less exactly the same words, what was in his
 25 2007 report, and the mathematical model in 2007 is still

1 the model for what he has done.
 2 Now, where we get to on what the OFT have said to
 3 you about this, they say firstly which of these
 4 ingredients 40(a) to (d) applies, or the extent to which
 5 they need to apply they have said is a matter of expert
 6 evidence and submission, whereas up to now it's
 7 perfectly clear they have either been saying all four or
 8 two in the case of maximum.

9 Then what Mr Lasok explained is Professor Shaffer's
 10 report, and this was on Day 16, he said it can be
 11 loosely described as a paradigm situation, and that
 12 somehow has to be dropped in to the facts of this case,
 13 that's the way he put it, Day 16, pages 156 to 157.

14 But Professor Shaffer's report and his model doesn't
 15 in any way draw a distinction, for instance, between
 16 price increases and price decreases. He is working on
 17 the basis that if Gallaher's brand increases, then ITL's
 18 brand must decrease, and if, on the other hand,
 19 Imperial's decreases, then Gallaher's must decrease. In
 20 other words he hasn't in his model made allowance for
 21 considering, as it were, some hybrid situation which
 22 appears to be where the OFT's case may be heading.

23 So that what we say is that if you go to the
 24 paragraph of the experts' joint statement that
 25 I referred you to on Friday, and if I can just pause for

1 a moment just to remind the Chairman of the
 2 circumstances in which this joint statement was drawn
 3 up, you may remember there was considerable essentially
 4 argy-bargy about this with resistance on the OFT and
 5 Professor Shaffer to consider alternative scenarios, and
 6 there was a lot of debate about what was to be done.

7 If you go to page 17 of the joint statement, page 57
 8 of the bundle:

9 "Under Shaffer's interpretation of the P&Ds, retail
 10 prices would expect to be higher with P&Ds than in the
 11 absence of the P&Ds."

12 Professor Shaffer says he agrees with that.
 13 Mr Ridyard says he's unclear exactly what it's relating
 14 to, but he agrees that Professor Shaffer's theory of
 15 harm predicts P&Ds lead to higher prices.
 16 Mr Luke Froeb, Professor Froeb, agrees in the context of
 17 Professor Shaffer's 2000 model:

18 "... though I find it unlikely they would be agreed
 19 to in the first place. If the agreements were to
 20 operate as interpreted by Professor Shaffer, I don't
 21 have a sufficient basis to achieve a general agreement
 22 then these effects may vary with other assumptions."

23 Then Helen Jenkins says there is a more nuanced
 24 position.

25 If you go over the page, this is under the appellant

1 experts' interpretation of the P&Ds, retail prices would
 2 be expected to be lower with P&Ds than in the absence.

3 It's what Professor Shaffer says here which is
 4 important. He says he agrees:

5 "Under Froeb and Dryden's interpretation of P&Ds, in
 6 those circumstances in which we see P&Ds, I would expect
 7 that at least some retail prices would be lower than in
 8 the absence of P&Ds. However, if those periods where
 9 there is a lag between two manufacturers' announcements
 10 of their wholesale prices, I would expect to observe one
 11 manufacturer's retail price going up and the others
 12 going down in order to maintain the margin parity."

13 I am not really sure that that point takes us
 14 anywhere. What is important is to understand what he
 15 means and what is meant by the Froeb interpretation of
 16 the P&Ds. That is very simple. Professor Froeb has
 17 assumed that the P&Ds were not rigid but that they were
 18 sensitive to changes in wholesale prices. So in other
 19 words, if a retailer agreed to set prices at parity, but
 20 ITL increased its wholesale price while Gallaher did
 21 not, then the retailer would no longer be required to
 22 keep prices at parity, and the retailer would be allowed
 23 to increase the price of ITL's brand without
 24 a corresponding change in Gallaher's brand.

25 It's explained by Professor Froeb at page 8 of the

1 joint statement, page 48 of the bundle. The appellant's
 2 experts' interpretation of P&Ds is that the agreements
 3 were about relative markups. They interpret a parity
 4 requirement that P1 minus W1 equals P2 minus W2 and the
 5 relative maxima, as we can see.

6 If you go down to Luke Froeb, if you look at
 7 Professor Shaffer, he says:

8 "I agree that this is the way that LF and ND have
 9 interpreted the parity requirements. I consider this to
 10 be a fundamentally different type of restraint between
 11 manufacturers and retailers than the one I had
 12 considered."

13 If you drop down to Mr Ridyard, he in the second
 14 sentence explains that it's his understanding that:

15 "... relative retail price criteria were subject to
 16 adjustment in the event of a unilateral change in the
 17 wholesale price of any one manufacturer, and
 18 Professor Froeb agrees that his interpretation is that
 19 they allowed for adjustments to retail price
 20 differentials upon changes in wholesale price. The
 21 specific mathematical form is merely one mathematical
 22 formulation consistent with my interpretation. I agree
 23 I used this mathematical form in my manipulation of
 24 Professor Shaffer's 2007 model."

25 DR SCOTT: As I understand it, Professor Shaffer, as we saw

1 in a bit you didn't read, 4(a)2 says:
 2 "I am currently unaware of the plausible
 3 circumstances under which manufacturers would find it
 4 profitable to offer P&Ds under LFs", and so on.
 5 **MR HOWARD:** I understand that's what he says. There is
 6 a debate, that's a different debate, he says he can't
 7 understand why manufacturers would offer, would enter
 8 into these arrangements, and equally there is
 9 an overwhelming case that what he is suggesting doesn't
 10 make any sense at all from the retailers' perspective.
 11 **DR SCOTT:** I think that the question, it goes back to why
 12 have trading arrangements, and I suppose the question
 13 is: are we, the Tribunal, going to end up at the end of
 14 the expert testimony with greater illumination as to
 15 three things, the nature of the arrangements as seen by
 16 the experts, the object of the arrangements as seen by
 17 the experts, and the anticompetitive effects that such
 18 arrangements with such an object may have been intended
 19 to achieve?
 20 **MR HOWARD:** Taking the first one, what was the first one?
 21 **DR SCOTT:** The first one is the nature of the arrangements.
 22 **MR HOWARD:** No, that's not a matter for these experts.
 23 **DR SCOTT:** I think our hope is that between the people in
 24 this room, we shall end up being able to give the
 25 experts an idea of the nature of the arrangements as

1 seen in the evidence that we have received, that they
 2 can consider.
 3 **MR HOWARD:** That I agree, but they obviously haven't heard
 4 the evidence, so they can't opine on the nature of what
 5 the facts do or don't show.
 6 **THE CHAIRMAN:** Yes. I want to take a break in a moment, and
 7 when we come back, I do want to press you, Mr Howard, as
 8 to what we should do, if anything, about the situation
 9 that you see as arisen. I've thrown out some
 10 suggestions. An alternative way might be that, given
 11 that Mr Lasok has said that it's not the OFT's case that
 12 all four of (a) to (d) apply in relation to each
 13 agreement and the question of what the effect on the
 14 experts' theory of harm is of one or more not being
 15 present whether it would be useful to know in relation
 16 to those bilateral arrangements in respect of which we
 17 have now heard all the evidence, what the OFT's case is
 18 as to which of these four they say the evidence
 19 supports.
 20 **MR HOWARD:** Yes. It's up to the Tribunal whether they
 21 require Mr Lasok to provide further clarity. From our
 22 perspective, we say he has not identified firstly which
 23 requirement is the core requirement, other than actually
 24 it's two or four. In other words, he hasn't run a case
 25 and he hasn't got any expert evidence to say "Well, if

1 I am only right on one, that still has
 2 an anticompetitive effect".
 3 Now, we say that being where we are that is the end
 4 of the case, they have to prove in respect of every
 5 agreement either that it is a maximum one and it has
 6 these two requirements, or it's a fixed one and it has
 7 the four. We say it's not actually open at this stage
 8 to start saying "Oh, well, I would like to say I have
 9 an alternative theory".
 10 **THE CHAIRMAN:** Well, that's a different point, but let's
 11 take a break now, and come back at ten past 12.
 12 Certainly it is up to the Tribunal whether we do
 13 anything now in order to move things along, but I would
 14 value any views you have as to what would be useful,
 15 given that you are the one who is raising these
 16 problems.
 17 **MR HOWARD:** Can I say before we rise that there is one
 18 point, which is about paragraph 40, and the extent to
 19 which each of these paragraphs is still alive, and if
 20 their case is they no longer rely on it, we have to then
 21 decide and the Tribunal may have to decide: where does
 22 that leave your case, OFT?
 23 There is a separate point, which is: where in the
 24 theory of harm do we see anything about the retailer
 25 being restricted from funding promotions for one brand

1 and what is alleged to be the effect of that? The
 2 answer is you don't, the whole of the theory of harm is
 3 about the effect on manufacturers, and that's why it
 4 hasn't featured, and we say that is simply not a case on
 5 any view that is open to the OFT. There are all sorts
 6 of reasons why it doesn't work, but there is no theory
 7 of harm which on any view relates to that.
 8 **THE CHAIRMAN:** Very well. We will come back at ten past 12.
 9 (12 noon)
 10 (A short break)
 11 (12.10 pm)
 12 **MR HOWARD:** It may be that the result of the exchange is
 13 that we are, as it were, going too far along the track,
 14 and what one really needs to do is, as I think you were
 15 indicating, is to ascertain what the OFT's case is at
 16 the first stage, and then decide in the light of that
 17 whether that's the end or not, or whether the expert
 18 case continues, and so on.
 19 What we would say is this: firstly, it's perfectly
 20 clear, again if you look at 6.226, for instance, of the
 21 decision, that their case actually is that all four of
 22 the restrictions applied, because they go on to say that
 23 each manufacturer was part of the parallel and
 24 symmetrical infringing agreement, although query where
 25 that stands in the light of the defence.

1 Insofar as you are saying "What should we do now?",
 2 in our submission, the right way to approach it is this:
 3 firstly, in the light of the evidence, in respect of
 4 each of the four permutations in paragraph 40 of the
 5 OFT's skeleton, they should identify -- and I think the
 6 retailers would also say they need to do this in respect
 7 of each retailer -- what was the requirement, in
 8 particular was a change in the retail price of the rival
 9 brand dependent on a corresponding change in the
 10 wholesale price of the rival brand by the rival
 11 manufacturer? In other words, putting it very simply,
 12 was it all subject to changes in the wholesale price?

13 Two, if the answer to that is yes, in respect of any
 14 of the permutations, then what is the OFT's case as to
 15 the nature of the requirement that they are relying on
 16 and what is the nature of the restriction on the
 17 retailer that they are then relying on, because of
 18 course you will remember the restriction was that the
 19 retailer is not able to favour one brand over another.
 20 It's quite difficult to see, on this basis, where that
 21 restriction continues to apply.

22 So that's how we would suggest you approach
 23 paragraph 40. As I said before we broke, paragraph 41
 24 and what Mr Lasok said, not I think expressly, in
 25 relation to paragraph 41 does raise a separate concern,

1 which is: if it is part of the OFT's case that the
 2 retailers were precluded of their own initiative from
 3 reducing the retail price of, say, a Gallaher brand
 4 without reducing the retail price of the competing ITL
 5 brand, and if they are saying -- forget whether that is
 6 how it operated -- that is anticompetitive by object,
 7 where is the theory of harm that is supposed to support
 8 that articulated in the decision? We say it's perfectly
 9 clear it isn't.

10 So that is not a point that, it would appear to us,
 11 to be within, on any view, the expert analysis for next
 12 week.

13 **THE CHAIRMAN:** Our thinking is that questions as to: has
 14 a case been put to a witness sufficiently in order for
 15 the OFT to maintain that case in its closing
 16 submissions, and questions as to how far that case is
 17 consistent with what is said in the decision are for
 18 a later time.

19 **MR HOWARD:** Yes.

20 **THE CHAIRMAN:** At the moment what we are interested in is
 21 working out where we are on the evidence in respect of
 22 those bilateral arrangements where we have already heard
 23 all the factual evidence, and what the OFT says is the
 24 content of the arrangement in relation to each of those,
 25 having regard to the subparagraphs in paragraph 40. As

1 far as we understand it, in the decision, there is no
 2 particular distinction made as to the content of the
 3 arrangements for each of the individual retailers or
 4 each of the individual manufacturers. I am putting
 5 Shell on one side, so far as there is a separate point
 6 about Shell.

7 What we want to know is whether the OFT now say
 8 that, or still say that their case is that all the
 9 arrangements operated in the same way, or whether they
 10 now say they accept that the evidence shows that it may
 11 have operated in one way with some and in a different
 12 way with others, and that they accept that in relation
 13 to some or all, not all these requirements have been
 14 made out.

15 Our feeling is that if we had answers to those
 16 questions, we would be in a better position to make the
 17 most of the expert witnesses when they come to give
 18 their evidence.

19 Now, we haven't so far this morning heard from
 20 Mr Lasok, and I certainly don't intend to put him on the
 21 spot now, as to what their answers would be to those
 22 questions, but you may want, Mr Lasok, to say something
 23 about whether you are able to answer those questions
 24 before we get to the expert witnesses. But it seems to
 25 us that that, if we are going to do anything at this

1 stage, is the most that we could usefully do to take
 2 stock, as it were, as to where we have got to on the
 3 factual evidence and as I say, leaving to a later stage
 4 questions about where that leaves the appeals, if I can
 5 put it like that.

6 **MR HOWARD:** Yes. I don't think I am saying anything
 7 radically different to that, save that the OFT to say
 8 does need to deal with that, to answer the points
 9 that I, I think, raised, which is making it -- they have
 10 to identify in relation to each of these four things
 11 what it is they are saying is the requirement.

12 I mean, it is pretty odd that we are at this stage
 13 and one still doesn't really know, as it's developed.
 14 But still, that's what they need to identify.

15 **THE CHAIRMAN:** Well, that's the way these things go, when
 16 one has witnesses you then have to take into account
 17 what they have actually said, or it may be the OFT will
 18 say the documents speak for themselves and they --

19 **MR HOWARD:** I think there is a slightly different point.
 20 Yes, obviously as a case develops you may realise that
 21 what you were saying you have to modify, that's the
 22 nature of life. But a case of this sort, where what you
 23 are saying is dependent upon an economic theory which
 24 you have then articulated, you have to identify at each
 25 stage: what am I actually saying in relation to each of

1 these four so-called requirements? Because if you are
 2 saying, well, actually, it's all dependent on wholesale
 3 prices, it's self-evidently a very different scenario.
 4 **THE CHAIRMAN:** Yes, I take that point, I think that's right,
 5 that it's not only a question of in respect of each
 6 bilateral arrangement which, if any, of these four
 7 requirements does the OFT say the evidence establishes
 8 existed, but also does the evidence establish that the
 9 requirement was not contingent or not wholly contingent
 10 on a corresponding change in the wholesale price?
 11 **MR HOWARD:** Yes.
 12 **THE CHAIRMAN:** I agree that that is an additional point
 13 which is important in working out how the theory of harm
 14 is affected by any such developments.

15 **MR HOWARD:** Yes.

16 **THE CHAIRMAN:** Yes, thank you, Mr Howard.
 17 Mr Lasok, is there anything that you would like to
 18 say at this point? I do not want to hear necessarily
 19 what the answers are. Just as a practicality, would it
 20 be possible, and do you accept it would be useful, for
 21 the OFT in the course of this week, before we get to the
 22 experts, to clarify where you stand on the issues that
 23 we have been debating?

24 Submissions by MR LASOK

25 **MR LASOK:** We have been considering that at length for the

1 last few days. Our difficulty is that in a normal case
 2 an answer to factual questions of the nature posed by
 3 the Tribunal and also Mr Howard would appear in closing
 4 submissions. In this particular case, the reason why
 5 it's risen at this stage is because of the interposition
 6 of experts before we get to closing submissions. But
 7 I think the Tribunal recognises that the kind of thing
 8 that Mr Howard would prefer is something that would
 9 normally be advanced in closing submissions right at the
 10 very end of the case, when a party had had time to
 11 digest and analyse properly the implications of all the
 12 evidence. We have not at this stage had that
 13 opportunity, and we will do our best to comply with what
 14 would be most helpful to the Tribunal. We will try and
 15 get something together as soon as we possibly can.
 16 **THE CHAIRMAN:** Yes. I am not looking for a document which
 17 purports to set out why you maintain that particular
 18 requirements still apply, cross-referencing to the
 19 evidence, or anything like that. In our view, I think
 20 this stock take, if I can call it that, is useful not
 21 only because it affects the expert witnesses but it also
 22 affects what legal submissions the parties are going to
 23 want to make in their closing submissions. So it may be
 24 that it would be a useful exercise to undertake for that
 25 reason as well.

1 **MR LASOK:** Yes, but as I am sure the Tribunal appreciates,
 2 one of the difficulties in this case, it's probably not
 3 unique to this case but it is particularly evident in
 4 this case, is that you may have a discrepancy between
 5 what was agreed, what a particular person at one time
 6 understood had been agreed, and how things were
 7 implemented or done. That complicating factor means
 8 that it's not as easy as all that to give a response to
 9 rather simplistic questions, because they have to be
 10 nuanced by reference to the evidence.

11 I think we had thought in our reflections on this
 12 over the last few days that the best way of helping the
 13 experts was not to produce something that
 14 cross-referenced all the evidence, but sought to distill
 15 a kind of factual scenario that appeared on the -- to be
 16 one conceivable interpretation of the evidence, and to
 17 put that to the experts. But that's a train of thought
 18 that we had been working on but which we have not yet
 19 had the opportunity to set down properly in a document
 20 that we can put to the Tribunal. But as I say, we will
 21 do that as soon as we possibly can.

22 **THE CHAIRMAN:** Well, I hope that once you have a chance to
 23 read the transcript of this morning, you will have
 24 a clear idea of what would be helpful. If there is any
 25 further guidance that you need, then of course we are

1 going to be here this week, you can come back and ask
 2 us. But I suggest that we leave it there for the
 3 moment, and move on to calling Mr Cheyne, unless anyone
 4 in the room has anything else that they want to add
 5 before we move to that step?

6 Further submissions by MR HOWARD

7 **MR HOWARD:** There are two things I want to add.
 8 Mr Lasok's response is not satisfactory, that's the
 9 first thing. The reason is this: it's not a question of
 10 Mr Lasok and his juniors going through the transcripts
 11 to sort out which bits they want to rely on to support
 12 an argument for this or for that. That I agree is for
 13 closing. It is entirely conventional that you have
 14 experts, not only in this sort of case but in most cases
 15 of any complexity. Before the experts come, you have to
 16 be clear as to what the case is that the experts are
 17 considering, and here -- because of the peculiarities of
 18 what we are doing -- you have to be clear as to what the
 19 theory of harm is and the OFT has to know what its case
 20 is, and it must at this stage know what its case is as
 21 to the reliance on the constraints in paragraph 40 as to
 22 whether or not it is saying each of those is not
 23 dependent on wholesale price. In other words, it's the
 24 lock-step, which is what they appear at least in
 25 relation to one bit only to put in cross-examination, or

1 whether they are saying something different. It is
 2 actually fundamental that that is identified, because
 3 fairness requires that we actually properly know what
 4 case the OFT is continuing to advance before our experts
 5 give evidence, and so again equally the type of document
 6 that Mr Lasok was talking about is not the type of
 7 document which I believe the Tribunal is indicating,
 8 which is not the scenarios that you may want to put to
 9 a witness, the question is what is your case on
 10 paragraph 40, and what is your case on each one of (a)
 11 to (d). I think, with respect, the appellants are
 12 entitled before their experts go into the box to know
 13 that, because we may have a submission -- it just
 14 depends -- that they are not entitled to put certain
 15 points, I don't know, but we do need to know that.

16 The other point is that again Mr Lasok, he must know
 17 the answer to this, but if the Tribunal doesn't want to
 18 put him on the spot now, so be it, but there is
 19 a question as to whether they are saying there is
 20 a separate theory of harm which is said to be based upon
 21 the retailers being precluded from running promotions
 22 themselves. Because the question is: where is that in
 23 the decision? If they hold up their hands and say "No,
 24 that isn't the theory of harm or a theory of harm we are
 25 pursuing" then we all know where we are stand. But if

1 they are saying that is -- at the moment, all they have
 2 to say is yea or nay, if they are saying yes, it is part
 3 of our case, they need to say where, and then we will
 4 have to have a debate before you as to whether they are
 5 right about that and whether it's open.

6 **THE CHAIRMAN:** Yes, I wasn't envisaging that the exercise
 7 that we have been discussing this morning was the same
 8 as the exercise we posited a week or so ago about
 9 further scenarios; this is a prior step, as it were, to
 10 those scenarios, but we didn't want to have to try and
 11 glean from new scenarios what the answers to the
 12 questions are. We have the answers to the questions and
 13 from them we decide whether there are any further
 14 scenarios that need to be put. I certainly agree with
 15 that.

16 Your second point about is there further constraint
 17 relating to the ability of the retailer to accept
 18 a promotional bonus from a competing retailer, that
 19 would be a useful question to answer, particularly in
 20 the light of the last sentence of paragraph 41 about the
 21 four permutations not reflecting all constraints which
 22 the infringing agreements place on the retailer's
 23 prices, in that we do now need to know what is the
 24 totality of constraints which it is suggested is placed.

25 **MR HOWARD:** The thing is, what is the theory of harm that

1 relates to any other constraint. Is there a theory of
 2 harm that relates to any other constraint? We say there
 3 isn't, but if the OFT says there is, they need to
 4 identify where it is in the decision. That's the first
 5 step.

6 **THE CHAIRMAN:** I see I misspoke at line 22.
 7 It is:
 8 "Is there a further constraint relating to the
 9 ability of the retailer to accept a promotional bonus
 10 from a competing manufacturer", not "a competing
 11 retailer".

12 **MR HOWARD:** No, that's not what we are talking about at all.
 13 That's within their paragraph 40. It's very important
 14 you understand this: they appear to be suggesting there
 15 is a case where, nothing to do with the other
 16 manufacturer, that the retailer is precluded from itself
 17 deciding it wants to have a promotion of, say,
 18 Dorchester. The case that seems to be being now
 19 articulated is: if you reduce the price of Dorchester,
 20 then -- say you want to have a 5p reduction in
 21 Dorchester, because you, Mr Retailer, think it's a good
 22 idea -- then you couldn't do that without having
 23 a corresponding reduction in the price of Imperial. So
 24 one assumes then what is being said is, well, the
 25 retailer may be disincentivised from doing that. In

1 other words, it has nothing to do with the manufacturers
 2 and their prices, it's somehow that this is said to give
 3 rise to a theory of harm.

4 We say that is not how these agreements operated and
 5 that's what Fiona --

6 **THE CHAIRMAN:** Well, the agreement, this arose right at the
 7 start in relation to the opportunity to respond clause,
 8 where it seemed that the OFT was drawing a distinction
 9 between changes in the competing brand's retail price
 10 which are triggered by the competing manufacturer which
 11 generated the opportunity to respond clause and if there
 12 was no response then it was accepted that the
 13 differential would change, contrasted with the situation
 14 where the retailer itself decides to self-fund
 15 a reduction in the competing manufacturer's brand where
 16 the opportunity to respond clause does not then -- is
 17 not triggered --

18 **MR HOWARD:** We can argue about whether that's right or
 19 wrong, but I am on a different question, which is: let's
 20 assume for the sake of argument that the retailer is
 21 restricted from self-funding a promotion of brand A
 22 without maintaining the P&D. Let's assume that for the
 23 moment. The question is: where is a theory of harm
 24 which relates to that? Because the theory of harm at
 25 the moment is all about the effect on manufacturers not

1 cutting -- and it's not, we say, in the decision. There
 2 are lots of reasons why it isn't there.
 3 **THE CHAIRMAN:** Are you saying if, because the theory of harm
 4 that might arise from that would be a greater stability
 5 of pricing than one might otherwise expect at the retail
 6 level, or it might be a diminution in inter-retailer
 7 competition, but you say, well, that's not something
 8 that has been relied on in the decision.
 9 **MR HOWARD:** Yes, what I say is this is a different economic
 10 analysis and if that had featured in the decision, we
 11 would have investigated that with expert evidence, and
 12 would have put forward the expert evidence, and it's not
 13 part of the decision at all. One can imagine lots of
 14 reasons why it isn't, because firstly the economic
 15 background actually you have heard from everybody is
 16 that margins for the retailers were low, so that's one
 17 of the reasons they were not self-funding. The other
 18 thing is tobacco is a taboo product, so they didn't want
 19 to be seen to be doing this.
 20 But the other thing is, of course, you can see all
 21 sorts of economic reasons why, for instance, even if it
 22 were true that you have to treat everybody equally if
 23 you were doing this, so let's say instead of reducing
 24 Dorchester by 5p you would have to reduce both brands by
 25 2.5p, well, does that have any adverse impact on the

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1 consumer? It's a different economic analysis, and we
 2 say it's simply not part of the case and it's something
 3 which is sensitive clearly to expert evidence, it isn't
 4 something where you can just say, well, of course this
 5 is the position. What we certainly need to understand
 6 is (a), is the OFT saying this is part of a theory of
 7 harm, if so, where in the decision is it, if it's not in
 8 the decision, on what basis do they say they are
 9 entitled to put this forward? It's not in the decision,
 10 it's not in the skeleton, all you have in the skeleton
 11 is paragraph 41, saying this is not the only restraint.
 12 Beyond that, they don't address this --
 13 **THE CHAIRMAN:** Well, I think this is wrapped up with the
 14 question of what the OFT's case is now on whether the
 15 four constraints identified in paragraph 40 operated
 16 independently of changes in wholesale price or were
 17 wholly or mainly contingent on wholesale price, changes
 18 in wholesale price, and if they maintain that they were
 19 not contingent on wholesale price changes, but arose
 20 where the retailer itself decided to change the price of
 21 a competing brand, what is the theory of harm in
 22 relation to that constraint? And where is it in the
 23 decision?
 24 **MR HOWARD:** The starting point is where is it in the
 25 decision.

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1 **THE CHAIRMAN:** Well, yes.
 2 **MR HOWARD:** What we don't accept is that you can -- we will
 3 obviously have to see how had he answer. But if it is
 4 in the decision they have to identify it, if it's not in
 5 the decision then we say it is open to them to run a new
 6 theory of harm, then obviously we have to have a big
 7 debate about that.
 8 **THE CHAIRMAN:** Which is a debate that at least we need to
 9 know whether we are going to have it or not before the
 10 experts give their --
 11 **MR HOWARD:** The other point is it's our -- I am sorry, I am
 12 not trying to be tedious, but it is just important that
 13 I make these points. Our experts are coming next week
 14 on Tuesday. Fairness really requires that we know where
 15 we stand before we break at the end of this week, so
 16 that (a) insofar as there is anything we need to
 17 consider with the experts we can, and (b) insofar as you
 18 need to make any rulings, you can, before we start.
 19 Otherwise obviously we will bite into the expert time.
 20 **THE CHAIRMAN:** Yes. Perhaps the best way to proceed, then,
 21 is to say: could we have an update from you, Mr Lasok,
 22 as to how you are getting on by no later than close of
 23 play on Wednesday, and then we will be able to see where
 24 we are up to.
 25 **DR SCOTT:** We are also conscious of the fact that things may

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1 vary (a) as between pairings and (b) as between times
 2 within a pairing in that things --
 3 **MR HOWARD:** I am not sure that I follow that.
 4 **THE CHAIRMAN:** Well, let's see where we get to.
 5 **DR SCOTT:** Sorry, the manufacturer/retailer pairings and
 6 time, because there was an evolution of trading
 7 arrangements.
 8 **MR HOWARD:** Yes. Again, that isn't the OFT's case.
 9 **THE CHAIRMAN:** Right. Thank you. Mr Thompson?
 10 Submissions by MR THOMPSON
 11 **MR THOMPSON:** I certainly don't want to delay things, Madam,
 12 but I do endorse the good sense of what has been said
 13 and from the perspective of the Co-op, which is not
 14 a marginal player in this appeal but has been subjected
 15 to a very substantial fine, I would emphasise that the
 16 paragraph 40 analysis in the skeleton makes no reference
 17 to the Co-op, that there was no reference to the Co-op
 18 in this respect in the opening submissions of the OFT or
 19 in the cross-examination of any of my witnesses. We put
 20 in a schedule specifically on all the documents which
 21 are relied on, which is all that we have, and nothing
 22 was put to my witnesses, to which there has been no
 23 response. So in my submission, there is now an acute
 24 need for the OFT to make clear what its position is in
 25 relation to the Co-op, if indeed it has any case, on

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1 paragraph 40 or indeed 41 of the skeleton argument.
 2 **THE CHAIRMAN:** My understanding as to where we have got to
 3 is that we are going to hear from the OFT as to where
 4 they stand in relation to each of the pairings, as
 5 Dr Scott calls them, and so you will know, all being
 6 well, where they stand in relation to the ITL/Co-op
 7 arrangement and the Gallaher/Co-op arrangement.
 8 **MR THOMPSON:** I am grateful. I just found Mr Lasok's
 9 representations somewhat vague, and I did not want any
 10 doubt that there needed to be clarity in relation to my
 11 client.
 12 **THE CHAIRMAN:** Thank you.
 13 Submissions by MR SAINI
 14 **MR SAINI:** Can I say a few words?
 15 **THE CHAIRMAN:** Well, I do want to get on to Mr Cheyne, not
 16 least because we absolutely have to finish at 4.30. Do
 17 you have something to say --
 18 **MR SAINI:** I am expecting that the OFT will do what the
 19 Tribunal has indicated it will find helpful. One
 20 particular point I want to emphasise, however, relates
 21 to the retailer initiated promotions which Mr Howard
 22 mentioned a few moments ago. This is the case where the
 23 retailer himself decides he would like to, for example,
 24 reduce the price of Dorchester unilaterally. It's very
 25 important well before expert evidence begins that we

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1 know what the Tribunal's position is in respect of that,
 2 and what I am going to seek -- not now, but I simply
 3 give notice to Mr Lasok of this -- is a direction from
 4 the Tribunal before expert evidence that that case is
 5 not open to the OFT for three reasons. First of all, it
 6 doesn't appear in the decision. Secondly, there was no
 7 cross-examination of Mr Eastwood about it. Thirdly,
 8 it's not been addressed by the experts. So we would
 9 want clarity as and when Mr Lasok puts his case, which
 10 he is going to give an update on on Wednesday, as to
 11 where the OFT says one finds in the decision
 12 a description of the restriction under which retailers
 13 were prohibited from themselves initiating a promotion
 14 without giving the same benefit to the opposing
 15 manufacturer.
 16 **THE CHAIRMAN:** Right. Let's crack on with Mr Cheyne.
 17 **MR HOWARD:** He is not here until 2.
 18 **THE CHAIRMAN:** Oh.
 19 **MR HOWARD:** So I am afraid you have to hear a bit more.
 20 Further submissions by MR HOWARD
 21 **MR HOWARD:** Until we went off on a slight but important
 22 tangent about the OFT's case, and it's actually
 23 extremely important, of course this morning we were
 24 going to say something in opening about the other
 25 appeals relating to the remaining retailers.

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1 **THE CHAIRMAN:** Yes.
 2 **MR HOWARD:** So it's Somerfield, First Quench and TM Retail
 3 and T&S. Obviously in 15 minutes there is not much
 4 point trying to do that, except there is one point I do
 5 wish to raise, which is an evidential point, and it's
 6 this: if we take Somerfield, firstly each of the
 7 remaining retailers have entered into agreements with
 8 the Office of Fair Trading. The Office of Fair Trading
 9 has also entered into an agreement with Gallaher. The
 10 effect of that is the Office of Fair Trading is entitled
 11 to interview anybody they want and entitled to call
 12 evidence from anybody they want from any of those
 13 parties. In fact, the Office of Fair Trading's powers
 14 allow it to, as you know, interview people across the
 15 board anyway, but particularly in respect of these four
 16 parties plus Gallaher, we have serious concerns -- and
 17 the Tribunal should have serious concerns -- about the
 18 way in which the OFT is proceeding, and not calling
 19 relevant evidence and allowing it to be tested.
 20 In the case of Somerfield, what the OFT has relied
 21 on is an unsigned statement from the buyer, Liz Smith,
 22 and two company statements. The simple point that we
 23 want to make at this stage is that the company
 24 statements, a statement by the secretary of Somerfield
 25 which, for their commercial reasons, they have entered

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1 into, isn't evidence for the purpose of the Tribunal.
 2 Not least if the company secretary, who has signed it,
 3 came along and one asked him: were you the buyer? No.
 4 What do you know about it? Well, it would all be third
 5 hand hearsay.
 6 So we say the fact that Somerfield, or Gallaher,
 7 makes an admission is not evidence against Imperial or
 8 anybody else. And frankly if the OFT is suggesting to
 9 the contrary, I simply cannot imagine on what basis they
 10 think they can do that. It's a mistake which the OFT
 11 appears to make, I've seen it elsewhere, although once
 12 the error of their ways is pointed out, I think they
 13 usually resile from it. But it's a very simple point.
 14 An admission by one defendant is not evidence against
 15 another. So it's really as simple as that.
 16 Now, the statement of Liz Smith, the unsigned
 17 statement, the Chairman in the construction appeals, has
 18 already said something about the unsatisfactory nature
 19 of relying I think there on a signed statement or
 20 transcripts, I think it was. Here we have an unsigned
 21 statement, we have no opportunity to cross-examine, and
 22 I think Mr Justice Barling makes similarly trenchant
 23 remarks, I am sure you are aware of those.
 24 We say, I can't say that the Liz Smith draft or
 25 unsigned statement is inadmissible in the sense that if

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1 it's proved that that is her statement then -- which at
 2 the moment I am not sure it is, but under the Civil
 3 Evidence Act then it can be tendered. But there is
 4 a question of weight, and particularly the Tribunal
 5 should be concerned about this having seen what happened
 6 when Fiona Corfield came along to give evidence and the
 7 appellants, and particularly Imperial, were afforded the
 8 chance to actually test her evidence, and we saw not
 9 only did her evidence fall short but essentially it
 10 turned full circle and was entirely supportive of our
 11 position.
 12 So the short point, and I do not want to labour it
 13 at this stage, is that in respect of Somerfield the
 14 Liz Smith statement is of very limited value, and the
 15 company statements are themselves not evidence, save
 16 insofar as you identify within there, the company
 17 statement, some hearsay statement which you say is
 18 admissible. In fact --
 19 **THE CHAIRMAN:** When you refer to the company statements, do
 20 you include in that the responses to the requests for
 21 information, or are you talking about the leniency
 22 statements?
 23 **MR HOWARD:** I am talking about the two leniency statements.
 24 Insofar as there are in the files from a number of the
 25 parties responses to requests for information, again one

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1 needs to look and see exactly what was being said and
 2 the evidential value. But that's where somebody is
 3 purporting to state a fact. So if they are asked, for
 4 instance, say the question is: did you have an agreement
 5 with Gallaher? Answer: yes. What was its date? Blah
 6 blah blah 2000. What were its terms? These are the
 7 terms. That's evidence, that's evidence of fact, I'm
 8 not disputing that. But if, on the other hand, they
 9 have a leniency statement, and they say "Yes, OFT, we
 10 entirely agree with you, it's all terrible and all
 11 anticompetitive", that's of absolutely no value
 12 whatsoever, and the regulator shouldn't even be trying
 13 to suggest it is.
 14 **THE CHAIRMAN:** Well, I am not aware that they are trying to
 15 suggest that. There is certainly authority from the
 16 Court of Justice, I think, that the fact that one party
 17 to an agreement admits the existence of the agreement
 18 does not preclude the other party from arguing that no
 19 agreement existed at all, and certainly as far as I was
 20 aware the fact that one party may characterise a set of
 21 facts as constituting an infringement doesn't bind the
 22 other party either to saying that those facts existed or
 23 that if they did exist that they amounted to
 24 an infringement. The question of whether a set of facts
 25 amounts to an infringement is a question of law and

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1 economics, I suppose, for the Tribunal to decide, and
 2 what Somerfield or whoever may have decided they were
 3 prepared to agree is a matter for them. But certainly
 4 it doesn't preclude you or any of the other retailers
 5 either from arguing a different factual matrix or from
 6 arguing a different characterisation of those facts.
 7 **MR HOWARD:** The thing is, I entirely agree with you, but
 8 that's not how the OFT are putting it.
 9 **THE CHAIRMAN:** Well, they may be able to persuade me
 10 otherwise.
 11 **MR HOWARD:** The thing is, they have sought to rely on, for
 12 instance -- I am just looking at a bit -- the fact that
 13 First Quench entered into an early resolution agreement,
 14 that that fact is indicative of something so that the
 15 evidence that is put forward, for instance via
 16 Cynthia Williams, has to be discounted because
 17 First Quench has entered into an early resolution
 18 agreement. Now, the fact that First Quench, for its own
 19 reasons, entered into an early resolution agreement is
 20 not evidence of anything which is relevant or of any
 21 probative value.
 22 **THE CHAIRMAN:** Well, that sounds as if it's a slightly
 23 different point, if they --
 24 **MR HOWARD:** It's exactly the same as the Somerfield point.
 25 The fact that Somerfield entered into a leniency

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1 agreement or other retailers entered into an early
 2 resolution agreement, that of itself is of no relevance
 3 to the Tribunal. That's not a relevant fact. It
 4 doesn't prove anything in relation to the facts that you
 5 have to consider. That's the starting point. I mean --
 6 or the fact that Gallaher has entered into an agreement,
 7 or that Sainsbury's did. We actually saw Sainsbury's
 8 were the ones who entered into the early leniency
 9 agreement before anybody else. But when you actually
 10 test the evidence, it doesn't support the OFT's case at
 11 all, which rather shows that Sainsbury's may have had
 12 other perfectly good reasons for wanting to do this,
 13 which is they may not want to be bothered with the OFT
 14 and so on. I don't know. But my simple point is: that
 15 of itself is not evidence.
 16 In relation to Somerfield, where we have got to is,
 17 in relation to various retailers, the OFT didn't
 18 actually seek to investigate by interrogating witnesses
 19 but the retailers themselves have appealed, so you have
 20 heard from a number of the retailers, for Shell, for
 21 Co-op, Asda, Morrison and so on, and so you actually
 22 have the evidence of what they thought and you can
 23 assess that. In respect of Sainsbury, the OFT have
 24 called Fiona Corfield, and you have that evidence. In
 25 respect of Somerfield, they are not calling anybody,

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1 they are relying on an unsigned statement, and we say
 2 that has very little value where we don't have
 3 an opportunity to examine it. And in respect of the
 4 others, they are not calling any evidence at all. And
 5 in respect of Gallaher, they are not calling any
 6 evidence. We say all of that is something that
 7 the Tribunal -- obviously it's a matter we will explore
 8 further in closings, but I think it's a matter that
 9 I think it's important the Tribunal reflects on,
 10 particularly where all sorts of assertions are made from
 11 time to time as to what Gallaher thought and understood,
 12 what -- and we are not going to hear ever from them.
 13 **THE CHAIRMAN:** Thank you. Well, we will come back at
 14 2 o'clock, and, as I say, I would like both parties to
 15 bear in mind that we must finish at 4.30, so please work
 16 out between you how long we are going to take, and we
 17 will endeavour to stick to that. Thank you.
 18 (1.00 pm)
 19 (The short adjournment)
 20 (2.00 pm)
 21 **THE CHAIRMAN:** Yes.
 22 **MR HOWARD:** Yes, I'll now call Mr Cheyne, with your
 23 permission.
 24 MR DAVID GEORGE THOMSON CHEYNE (affirmed)
 25 Examination-in-chief by MR HOWARD

1 **THE CHAIRMAN:** Thank you very much.
 2 **MR HOWARD:** Mr Cheyne, please sit down, and could you please
 3 just tell us for the record your full name and address?
 4 **A.** David George Thomson Cheyne, [redacted].
 5 **Q.** Thank you. Could you be given core bundle 3, and could
 6 you turn to tab 34, where there should be a copy of your
 7 statement of 8 June 2010.
 8 **A.** Yes, I have that statement.
 9 **Q.** Could you identify that and confirm (a) that it's your
 10 statement and (b) that it's true?
 11 **A.** Correct, yes. There is one error in number in terms of
 12 numbers of years experience, where it says "25" and it
 13 should say "15", but that's it.
 14 **MR HOWARD:** Thank you for pointing that out. Now Mr Lasok
 15 will ask you some questions.
 16 **THE CHAIRMAN:** Where is that?
 17 **A.** On the first page section A1.
 18 Cross-examination by MR LASOK
 19 **MR LASOK:** Mr Cheyne, as I understand it from paragraph 1 of
 20 your witness statement, you joined Watson & Philip Plc,
 21 the precursor to Alldays. When was that?
 22 **A.** 1993, December 1993.
 23 **Q.** That later became part of the Co-op, and you say that
 24 you were the director of strategic planning. Was that
 25 as from 1993?

1 **A.** That was from 1993.
 2 **Q.** You say that you were appointed to the board as
 3 commercial director in 1999?
 4 **A.** Correct.
 5 **Q.** Then you, as I understand it, left Alldays in 2003; is
 6 that correct?
 7 **A.** That is correct, when it was bought by the Co-op.
 8 **Q.** You then moved to First Quench, where you say that you
 9 were engaged to provide consultancy services?
 10 **A.** Yes, that's correct, there were two projects started off
 11 in early 2003 on a convenience store project where they
 12 were looking to develop their business into more
 13 convenience rather than just liquor, and then in
 14 June 2003 I started a tobacco project for them.
 15 **Q.** The details that you give are in paragraphs 6 and 16,
 16 I think, of your witness statement?
 17 **A.** Yes, correct.
 18 **Q.** In paragraph 16, it talks about extrication of
 19 First Quench from a furniture agreement with Gallaher,
 20 a contract to fund and supply shelf units and
 21 counters --
 22 **A.** That's correct.
 23 **Q.** -- and negotiation of a gantry supply agreement.
 24 That was all you did at First Quench, was it?
 25 **A.** Yes, it was, I was there as a consultant, two projects,

1 very specific, and in doing the tobacco one I brought in
 2 Cynthia Williams who had been my tobacco buyer, because
 3 she was the expert in the category.
 4 **Q.** Now, she moved in June 2003 to First Quench, wasn't it?
 5 **A.** That was within weeks of me starting the tobacco
 6 project.
 7 **Q.** I thought you started the project, the tobacco project
 8 in January 2003?
 9 **A.** No, there were two projects. The first project was the
 10 convenience project in January, and the second project
 11 was tobacco in June.
 12 **Q.** So you started the tobacco project in June 2003?
 13 **A.** Correct.
 14 **Q.** So that means that your involvement in tobacco in
 15 First Quench was just from June 2003?
 16 **A.** In detail, correct. In the time leading up to that, as
 17 to why the project came about, I had spotted just from
 18 looking at the general business, that that category was
 19 underperforming, but I had no detailed involvement in
 20 the category prior to June.
 21 **Q.** So you only have very limited knowledge and experience
 22 of First Quench's tobacco business?
 23 **A.** Prior to that, prior to that date, correct.
 24 **Q.** And your knowledge of First Quench's tobacco business is
 25 actually limited to the specific project that you were

1 engaged in?
 2 **A.** That's not wholly correct. I -- in getting involved in
 3 the gantry agreement, I had to make sure that there was
 4 nothing that would preclude the type of negotiation
 5 I knew I was going to have to engage in to extricate
 6 from Gallaher and get into ITL. I didn't get involved
 7 in the detailed agreements, I didn't even see the
 8 detailed agreements from beforehand, but I did obviously
 9 know how the category was performing, how they were
 10 running the category, and actually there wasn't a lot
 11 different going on there than there had been at Alldays,
 12 where I had been before.
 13 **Q.** Then you moved to Somerfield, and, as I understand it,
 14 you joined Somerfield in January 2004?
 15 **A.** Correct.
 16 **Q.** Now, again, as I understand it, if you go to your
 17 paragraph 43, if you just look for a moment at the
 18 second sentence, where you say:
 19 "My tobacco buyer at Alldays, First Quench and
 20 Somerfield, Cynthia Williams, supervised this
 21 independent approach."
 22 Why do you refer to her as "my tobacco buyer" at
 23 First Quench?
 24 **A.** Because when it became apparent that there was a tobacco
 25 project required at First Quench, I fully acknowledged

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1 that I had the senior knowledge, I had a bit of legal
 2 knowledge in terms of the agreements generally, and
 3 I could do that piece, but their category was
 4 underperforming in lots of areas, their availability of
 5 product, their securing of bonus income, their sticking
 6 to their own pricing strategy, it was just out of
 7 control, and Cynthia I knew was in the same position as
 8 I was, having effectively been transferred to the Co-op
 9 but wasn't sure of her future after Alldays, and
 10 I thought there was a good job for her to do for
 11 Threshers and First Quench at First Quench. So my
 12 tobacco at Alldays because I was trading director,
 13 I secured her into Threshers to come and do the project,
 14 she did a good job on the project with me and they chose
 15 to employ her.
 16 **Q.** So you brought her in first to help you with the tobacco
 17 project --
 18 **A.** As a consultant.
 19 **Q.** -- in June 2003, I see, so she was first a consultant
 20 with you on the tobacco project in June 2003?
 21 **A.** That's correct, and she was working with me on the
 22 project and working with the First Quench general buyers
 23 on tobacco and starting to show them where they were not
 24 maximising the category.
 25 **Q.** Do you happen to know when she became the tobacco buyer

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1 at First Quench?
 2 **A.** I suspect October -- July or September, October time.
 3 I honestly don't know the exact date, but it would have
 4 been a couple of months after she started at
 5 First Quench.
 6 **Q.** Right. In paragraph 43 you say:
 7 "In my experience, the ability of the retailers,
 8 convenience or supermarket, to price as they wished
 9 remained unfettered by the tobacco manufacturers'
 10 promotional strategies, and the trading agreements which
 11 they entered into."
 12 As I understand it, you never saw the First Quench
 13 trading agreements, so how exactly could you say that if
 14 you hadn't seen the trading agreements?
 15 **A.** I hadn't seen them, I knew broadly what was in them
 16 because I had asked Cynthia what was in them as we were
 17 negotiating our contracts with Gallaher and Imperial
 18 Tobacco and she said there was nothing unusual in them.
 19 **Q.** So you are getting this statement from Cynthia Williams?
 20 **A.** I am getting my knowledge and understanding at the time
 21 from the fact that she told me categorically there was
 22 nothing in there that she hadn't seen before in similar
 23 agreements at Alldays.
 24 **Q.** Then so far as Somerfield is concerned, where do you get
 25 your knowledge from?

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1 **A.** I -- we lost our trading director, which wasn't a clever
 2 thing to do, in early 2004, and whilst being finance
 3 director I was also interim trading director for
 4 a spell. They put me into that role because they knew
 5 I had been trading director at Alldays before. So at
 6 that stage, I was involved in running the overall
 7 trading team, but with senior people underneath me
 8 running it.
 9 Not long after getting involved in that I found once
 10 again that tobacco was in a mess and this time
 11 I encouraged my tobacco buyer to join Somerfield, but
 12 this time it wasn't my decision, it was actually the
 13 team below me's decision to interview her and employ
 14 her.
 15 **Q.** But it seems to be fair to say that you don't have any
 16 knowledge of how the tobacco business was run in
 17 Somerfield in 2000 to 2003?
 18 **A.** I don't have any detailed knowledge in that respect,
 19 that is correct.
 20 **Q.** All right. What's the source of the knowledge that you
 21 do have?
 22 **A.** Again, in speaking to Cynthia, after she joined, making
 23 sure that I understood the plans she had in place for
 24 changing the tobacco category and the way it was run,
 25 knowing from her that there was nothing fundamental

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1 requiring change, it just needed better control, better
 2 discipline, and she needed to apply her standard
 3 techniques and models to make the category work. She
 4 again -- as you can imagine, my question as a trading
 5 director would have been: is there anything here that's
 6 going to stop you doing what you did first at Alldays,
 7 second at First Quench to make this a more profitable
 8 category for us, she assured me not. Obviously we
 9 talked then: is there anything in the agreements that's
 10 going to stop you doing that? No, there is nothing
 11 unusual in there that I haven't seen before.

12 **MR LASOK:** Since the source of Mr Cheyne's knowledge is
 13 Cynthia Williams, I am not going to ask any further
 14 questions.

15 Questioned by THE TRIBUNAL

16 **THE CHAIRMAN:** There is just one factual point I wanted to
 17 ask you, Mr Cheyne, which is at paragraph 10(b) of your
 18 witness statement, at (ii) you refer to:
 19 "Government health warnings and labelling
 20 requirements changed frequently, meaning that stock has
 21 to be rotated to ensure compliance and to make sure that
 22 the retailer is not left with unmerchantable stock."
 23 Another witness that we heard from indicated, as
 24 I recall, that a retailer can return unmerchantable
 25 stock of that kind to the manufacturer, who can then

1 destroy it and get the duty back from the Government.
 2 Is that right?

3 **A.** That is absolutely correct, but if I could expand on
 4 that for you, just to explain what happens. Because the
 5 category is so difficult to manage by junior staff in
 6 shops across, in Alldays' case, 2,000 shops, Threshers,
 7 1,000 plus shops, Somerfield at one stage 2,000 shops,
 8 and the records and the stock is either on the gantry or
 9 it's out the back or it's in a safe, what tends to
 10 happen is that the first sweep inevitably in too many
 11 shops it is missed and so it doesn't go back under the
 12 normal armistice, we call it, and then it appears on the
 13 shelves and we are trading illegally, and it's just
 14 another example of where retailers lose money on this,
 15 because sometimes the tobacco manufacturer will say
 16 "Look, I will take it back" and they will try and force
 17 it through the system and get some money back themselves
 18 on duty. Other times the tobacco manufacturer might,
 19 out of their goodwill, take it back and return us the
 20 money, in which case they are taking a loss. Other
 21 times frankly they will take it back and take it away
 22 for us but we won't get anything back, so it's
 23 a straight loss. And it's all about the complexity and
 24 cost of running this category.

25 **THE CHAIRMAN:** Thank you for clarifying that.

1 **DR SCOTT:** Mr Cheyne, if you can turn to your statement, to
 2 26(a), as we understand it, tobacco is a fairly
 3 inelastic product overall insofar as people who smoke
 4 have to buy cigarettes and they don't seem put off by
 5 rising prices and duties. And in 26(a) you say:
 6 "In my experience, even larger supermarkets are
 7 driven by a desire to increase their margins to the
 8 highest level possible without reaching a point at which
 9 the loss of sales outweighs increasing margin."
 10 That's presumably a bit conditioned by them all
 11 doing that rather than one stepping out of line in
 12 inter-retailer competition?

13 **A.** Well, that's right, and again I can only talk about it
 14 from what I saw and how I was involved, and because we
 15 weren't talking to each other as supermarkets, we were
 16 always pricing within our own sphere of influence and
 17 making our own judgments that way.

18 **DR SCOTT:** But in fact you have already told us in 23 that:
 19 "A self-funded promotion by a convenience retailer
 20 is only likely to increase its overall tobacco sales by
 21 the smallest degree, but at the same time will
 22 cannibalise sales from its higher margin non-promotion
 23 variants to sales of the promoted variant at a lower
 24 margin."
 25 So you have explained the rationale for --

1 **A.** Why would we do that? We wouldn't do that.

2 **DR SCOTT:** Back in 21, you have said:
 3 "It's therefore obvious to me why the tobacco
 4 manufacturers offered the ongoing bonus payments under
 5 trading agreements as a means of incentivising
 6 convenience retailers to pass on the bonuses to
 7 consumers by charging below RRP."
 8 And we understand that there are bonuses for doing
 9 that?

10 **A.** (Witness nods).

11 **DR SCOTT:** But from the point of view of a tobacco
 12 manufacturer, what do you think matters to them in terms
 13 of sales of inelastic tobacco as between their brands
 14 and other brands?

15 **A.** I am pretty clear that what they were both trying to do,
 16 the two key tobacco suppliers, is increase their market
 17 share. Imperial Tobacco were more aggressive in that
 18 respect, so supporting price reductions below RRP was
 19 entirely, as far as we were concerned, them trying to
 20 increase market share. From our point of view, as long
 21 as it was right within the category and improved our
 22 sales and because it was funded improved our margin and
 23 cash margin, that was something we were perfectly happy
 24 to do.

25 **DR SCOTT:** So you were understandably concerned about the

1 funding of any reductions --
 2 **A.** Absolutely.
 3 **DR SCOTT:** Yes.
 4 **A.** Absolutely.
 5 **DR SCOTT:** In paragraph 22 you say:
 6 "These bonuses usually operated by reference to
 7 a schedule which stipulated relative maxima by reference
 8 to a competing brand's prices."
 9 Yes?
 10 **A.** Yes, that's generally it.
 11 **DR SCOTT:** Given your evidence as to the lack of
 12 a likelihood of a retailer like those with whom you
 13 worked wanting to sacrifice its own margins, in practice
 14 do you think that the relative maxima operated as
 15 relative maxima, or do you think they operated more like
 16 fixed relativities because the retailer was unlikely to
 17 sacrifice their own margin?
 18 **A.** I think as a contractual obligation they absolutely
 19 worked as relative. I think within convenience
 20 operators in particular, where frankly we would move the
 21 price as high as we could because it was a big category
 22 for us and we needed to maximise margin, I can see where
 23 the argument comes from that says: well, of course you
 24 are going to go as high as you can. It didn't always
 25 happen, but it happened often that way and it often

1 happened late and it often happened inconsistently, as
 2 you see from some of the correspondence that then flies
 3 around from our own people going round shops and from
 4 Imperial's people going round shops.
 5 **DR SCOTT:** Oh yes, we have seen quite a lot of what goes --
 6 **THE CHAIRMAN:** Sorry, what happened? That the --
 7 **A.** Where the pricing instruction from the centre at
 8 Somerfield, for example, wasn't implemented properly at
 9 the shop end, and at that stage, the worry from the
 10 centre as trading director, my worry would then be that
 11 a price on the gantry said one thing but the till was
 12 applying another thing and we would be trading
 13 illegally. So it was very important to me from two
 14 points of view: margin protection and trading legally,
 15 that our pricing was as we thought it was at the centre,
 16 whereas because of the retail disciplines and
 17 indiscipline we have talked about, it often wasn't.
 18 **DR SCOTT:** Given, as you say in 23, the deep-seated
 19 reluctance by convenience retailers to self-fund any
 20 below RRP prices, they were unlikely to get the below
 21 RRP bonus if they were doing that, and then it's very
 22 much a matter of whether they get bonused on the
 23 relativities; is that right?
 24 **A.** It is, if we are talking working in practice again now,
 25 I have no knowledge or working experience of ever having

1 lost any bonus monies, and I won't speak for Cynthia but
 2 she would have told me if she had. The reason being,
 3 these agreements within the overall trading portfolio of
 4 a retailer and then within tobacco, in each case we were
 5 large customers of the tobacco manufacturers. If we
 6 stepped out of line by mistake, through indiscipline,
 7 through a real reason, by saying that within what we
 8 wanted to do couldn't happen, the monies would actually
 9 find themselves being reallocated to another place.
 10 These monies, as far as we were concerned, were our
 11 entitlement. We viewed these monies in global terms
 12 each year, as we grew they needed to grow and whether
 13 they were allocated to pricing, product placement,
 14 number of gantries across the estate, new product
 15 listings, actually the split of those monies was less
 16 our concern, the gross number was, and it was Cynthia's
 17 job to make sure that by the end of the year we have
 18 collected that full lot of money, and so the monies
 19 would move around if we didn't quite comply with this
 20 agreement. And because we were so large in terms of
 21 both those manufacturers, you would end up sitting down
 22 trading director to trading director to have
 23 a discussion and renegotiate if we felt we didn't want
 24 to comply with something.
 25 **DR SCOTT:** So although you have told us that you didn't get

1 into the detail, at trading director to trading director
 2 level you just saw this as a reduction in the overall
 3 cost of --
 4 **A.** Absolutely, and this is viewed as our money. In all
 5 cases of the businesses I was involved with, whilst we
 6 were quite large, we were always smaller than the
 7 Tesco's, the Sainsbury's, and the Morrisons, whatever,
 8 so we wouldn't get the wholesale prices that they all
 9 got, we were always slightly behind. I genuinely
 10 believe and hear from the manufacturers that we were
 11 disproportionately outpunching our weight in terms of
 12 these other monies for compliance, because compliance
 13 brought more sales to the category which brought greater
 14 revenues to everybody.
 15 **DR SCOTT:** Were you using P&H as an intermediary in terms of
 16 distribution.
 17 **A.** We did latterly at Somerfield, we didn't at the
 18 beginning. That was a distribution. When I say
 19 distribution, that was a vehicles and sheds decision at
 20 our end, because we were looking to rationalise our
 21 distribution estate and simplify it, and back to the
 22 complexity of the category, distribution was another way
 23 we lost money because tobacco used to vanish off lorries
 24 and between lorries and stores and stores said they
 25 didn't get it and distribution said they'd sent it.

1 So not distributing it and having a third party
 2 doing it was seen as another way of closing the door in
 3 terms of lost margin.
 4 **DR SCOTT:** Thank you very much indeed. Thank you.
 5 **MR HOWARD:** I have no re-examination.
 6 **THE CHAIRMAN:** Well, that's been short but sweet, Mr Cheyne.
 7 Thank you very much for coming along, it's been very
 8 helpful, and I can release you from the witness box.
 9 **A.** Thank you.
 10 (The witness withdrew)
 11 **MR HOWARD:** The next witness is Mr Hall, but I am afraid he
 12 is not scheduled until tomorrow morning, so we have run
 13 out of witnesses for this afternoon.
 14 **THE CHAIRMAN:** So we have him tomorrow morning and then do
 15 we have Cynthia Williams?
 16 **MR HOWARD:** Then we have Mr Culham and Mr Wragg.
 17 **THE CHAIRMAN:** Is there anything else we can usefully do for
 18 the rest of today?
 19 **MR HOWARD:** No. Is there anything ...
 20 **THE CHAIRMAN:** Is there anything you wanted to say in
 21 opening which you cut short this morning for lack of
 22 time?
 23 **MR HOWARD:** The important point I wanted to make was about
 24 the witnesses. I am not sure there is a great deal of
 25 utility in going through the files and adding

1 a commentary on them, because we are either going to go
 2 through them with the witnesses or insofar as we don't,
 3 then they be during the closing submissions. Unless you
 4 would find it useful, I wasn't proposing to do it.
 5 **THE CHAIRMAN:** If we start at 10.30 tomorrow morning are we
 6 going to get through everything you need to?
 7 **MR HOWARD:** That's a question for Mr Lasok.
 8 **MR LASOK:** I would have thought so.
 9 **THE CHAIRMAN:** Very well. We will meet again, then, at
 10 10.30 tomorrow morning.
 11 (2.25 pm)
 12 (The court adjourned until 10.30 am on
 13 Tuesday, 1 November 2011)
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