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IN THE COMPETITION

APPEAL TRIBUNAL

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

Victoria House,
Bloomsbury Place,
London WC1A 2EB

26 September 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

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HEARING (DAY 5)

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, 26 September 2011
 2 (10.00 am)
 3 Opening submissions by MR BREALEY
 4 **THE CHAIRMAN:** Yes, Mr Brealey, good morning, everybody,
 5 thanks very much for your note which we have read over
 6 the weekend, and we have our copies here.
 7 **MR BREALEY:** I know the Tribunal has read it. What I would
 8 do, probably, is if I can have just, say, an hour and
 9 spend 45 minutes of that on object, and then 15 minutes
 10 on the exclusion order, and then leave exemption for
 11 December, as it were. We have opened on exemption in
 12 writing, but given the time, we want to concentrate on
 13 object and exclusion order.
 14 I won't obviously now go through the note in order,
 15 but I would like to emphasise certain points. Could we
 16 then go to the bundle of authorities, I think there are
 17 only two bundles I will refer to, which is bundle 2 and
 18 bundle 11, but if we can start with bundle 2. So that's
 19 the joint authorities bundle 2 tab 37 {A2/37} where we
 20 find the opinion of the Advocate General in
 21 GlaxoSmithKline. We refer to this at paragraph 13 of
 22 the speaking note. Just for completeness, it's at
 23 13(a), it's not paragraph 80, it's paragraph 89.
 24 If I can start off at paragraph 89 of the opinion,
 25 where the Advocate General sets out the law on the

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1 notion of restriction of competition by object.
 2 At paragraph 89, the Advocate General refers to the
 3 two-stage examination. At paragraph 90, the
 4 Advocate General recites the case law of the
 5 European Court of Justice that agreements are by their
 6 very nature liable to restrict competition, can be
 7 object cases.
 8 That is a reference to paragraph 31 of T-Mobile. So
 9 paragraph 90 is referring to paragraph 31 of T-Mobile.
 10 But I would like to emphasise paragraphs 91 and 92,
 11 because as the Tribunal will have seen, we are
 12 submitting that the OFT has applied too low a threshold,
 13 and we say there has to be a high degree of probability
 14 that the restriction will occur before you get an object
 15 case.
 16 So at paragraph 91, the Advocate General says:
 17 "In this connection, regard must be had in
 18 particular to existing experience according to which in
 19 all probability certain types of agreement have
 20 a negative impact in the market."
 21 So she says, first of all, "Well, let's have a look
 22 at the experience, because experience can tell us
 23 whether the agreement can in all probability" -- and
 24 I emphasise the words "in all probability".
 25 Then the Advocate General goes on at paragraph 92

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1 where it may well be that you don't have existing
 2 experience, object agreements are not limited to only
 3 certain types of agreement, but I would like to
 4 emphasise the last sentence of paragraph 92:
 5 "The difference compared with an examination of the
 6 restrictive effects of the agreement lies in the fact
 7 that, with a restriction of competition by object, the
 8 negative interference with market conditions is so clear
 9 that the agreement can be presumed without any detailed
 10 market analysis to have a restrictive effect."
 11 So she is saying there that the agreement has to be
 12 so clear to have a restricted effect before that
 13 restrictive effect, that presumption, can be presumed.
 14 So I emphasise 91 because the Advocate General is
 15 referring to "in all probability", you look at
 16 experience, can you say in all probability that the
 17 agreement is restricting the competition. Then in 92,
 18 in an object case, you are looking to see whether the
 19 agreement is so clear that it can lead to restrictive
 20 effects. That is the Advocate General.
 21 If we can go back and just emphasise paragraph 136
 22 of European Night Services, which is at tab 31 of the
 23 same bundle. {A2/31}. We have really only one
 24 paragraph in European Night Services at tab 31, and
 25 that's paragraph 136, which, on the top right-hand side

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1 is page 22 of 38.
 2 It's two-thirds of the way down under "Findings of
 3 the Court". Here the general court is distinguishing
 4 between effects and object infringement:
 5 "Before any examination of the parties' arguments as
 6 to whether the Commission's analysis as regards
 7 restrictions of competition was correct, it must be
 8 borne in mind that in assessing an agreement under
 9 Article 85(1) of the Treaty, account should be taken of
 10 the actual conditions in which it functions, in
 11 particular the economic context in which the
 12 undertakings operate, the products or services covered
 13 by the agreement and the actual structure of the market
 14 concerned ..."
 15 So that's your effects analysis, they are talking
 16 about effects there, what you (inaudible) and then after
 17 the cites of the cases:
 18 "... unless it is an agreement containing obvious
 19 restrictions of competition such as price-fixing, market
 20 sharing or the control of the market."
 21 So the general court is referring there to obvious
 22 restrictions on competition in the context of object
 23 infringements. So we have the Advocate General in
 24 GlaxoSmithKline, is it so clear, the general court
 25 referring to obvious restrictions of competition.

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1 **DR SCOTT:** Just sticking with that paragraph, it does go on
 2 then to explain what happens if there is
 3 a pro-competitive argument --
 4 **MR BREALEY:** Yes.
 5 **DR SCOTT:** -- in the next stage of analysis.
 6 **MR BREALEY:** Yes. You will have seen from the note that
 7 when you have an object case the restriction of
 8 competition is presumed, and that is almost a conclusive
 9 presumption, because you can only argue whether there is
 10 any efficiency benefits in the exemption stage. So it
 11 is a very serious stage at the prohibition stage.
 12 That's one of the points we make in the speaking note,
 13 which says: if you are going to have such a strong
 14 presumption that has such conclusive effects, then that
 15 presumption itself has to have strong foundations. It
 16 can't merely rely on speculation or flimsy evidence.
 17 So we have the Advocate General in GlaxoSmithKline,
 18 the General Court in European Night Services.
 19 Can we put bundle 2 away and go to bundle 11.
 20 Before we go to Professor Whish, can we go to the
 21 Commission's guidelines on exemption, which is at
 22 tab 146. {A11/146} So these are the -- tab 146 --
 23 guidelines from the European Commission on exemption
 24 which, as you will have seen from the speaking note, the
 25 OFT says it has regard to, and there are two paragraphs

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1 I would like to emphasise, because we shall see, when we
 2 get to the decision, the OFT only refers to one of them.
 3 Those two paragraphs are 21 and 22.
 4 Paragraph 21, at page 100 of the official journal,
 5 on the top left it's C101/100:
 6 "Restrictions of competition by object are those
 7 that by their very nature have the potential of
 8 restricting competition. These are restrictions which
 9 in the light of the objectives pursued by the Community
 10 Competition Rules have such a high potential of negative
 11 effects on competition that it is unnecessary for the
 12 purpose of applying 81.1 to demonstrate any actual
 13 effects on the market."
 14 So again I emphasise, here is the
 15 European Commissioner saying that you have for an object
 16 infringement, the restrictions have to have such a high
 17 potential for negative effects. If you look at the
 18 serious nature of the restriction, experience again, and
 19 then at paragraph 22 we see the number of factors that
 20 you consider, for example the content of the agreement
 21 and the objective aims pursued by it.
 22 So you are always looking at the objective of the
 23 agreement, and you are asking yourself the question: is
 24 there such a high potential of negative effects that you
 25 can presume a restriction of competition?

6

1 We then go to Professor Richard Whish at tab 157.
 2 And at the same time if we could take out core bundle 4
 3 of the OFT's defence. I am trying to take this as
 4 logically as I can. So the OFT's defence at core
 5 bundle 4, tab 46, paragraph 141. {C4/46 paragraph 141}
 6 So the OFT's defence, paragraph 141. In my submission,
 7 this is where one really starts to see where the OFT has
 8 gone wrong, because we see at 141 -- in our notice of
 9 appeal, Imperial Tobacco referred to European Night
 10 Services, referred to the Advocate General In
 11 GlaxoSmithKline, referred to the Commissioner's
 12 guidelines, and in this section -- a lot of it we set
 13 out in the speaking note -- the OFT essentially deny
 14 what we are saying. But they say here at 141:
 15 "The CFI reference in (a) above is quoted out of
 16 context [that's the European Night Services]. The
 17 European Night Services case was argued out as an
 18 effects case with it being contended that if the
 19 agreement in question had anticompetitive effects, they
 20 were outweighed by the pro competitive effects. The
 21 passage in the judgment quoted by ITL, paragraph 136, is
 22 directed at the latter point. It has no relevance to
 23 object analysis."
 24 In my submission, that is quite a startling
 25 proposition, for the OFT to say in this appeal that

7

1 European Night Services has no relevance to object
 2 analysis. What the OFT is doing in its defence, as I've
 3 set out in the speaking note, it is denying that you
 4 need a high degree of probability for an object case, or
 5 that it needs to be plain and obvious, and it is saying
 6 that European Night Services has no relevance to object
 7 analysis.
 8 Now, to rebut that, I would like to refer
 9 the Tribunal to three documents. The first is
 10 Professor Whish, one of the leading academics in
 11 competition law. His textbook is at 157 of JAB 11.
 12 {A11/157} I haven't got time, obviously, to read it out.
 13 At page 116 he sets out his analysis of object. Then
 14 over the page at 117 effect. At 118 he refers to
 15 European Night Services v Commission, and puts in
 16 italics the reference to obvious restrictions.
 17 Then halfway down Article 81(1):
 18 "... allocates particularly pernicious types of
 19 agreement that are overwhelmingly likely to harm
 20 consumer welfare to the object box, with the
 21 consequences just described. This is done as a matter
 22 of policy ..."
 23 He then goes over the page at 119 and again we see
 24 the Professor expressly referring to European Night
 25 Services.

8

1 Then at the bottom of the page, the penultimate
 2 paragraph:
 3 "The CFI did not refer in European Night Services to
 4 agreements to limit output when discussing 'obvious'
 5 restrictions of competition, but they must also be
 6 allocated to the object box on the basis that they
 7 clearly restrict competition."
 8 So you are always looking to see whether there are
 9 clear restrictions of competition such that you can
 10 presume the restrictive effect.
 11 If I could just hand up -- I've handed the documents
 12 to the OFT -- two more documents which are the
 13 Construction Cartel decision and the Recruitment Cartel
 14 decision. (Handed). We will find a place to put them,
 15 but I imagine they will go into tab 12, we will make
 16 sure they are put into tab 12.
 17 **THE CHAIRMAN:** Do you mean bundle?
 18 **MR BREALEY:** Yes, Joint Authorities Bundle 12, or we can put
 19 them in the Ashurst ...
 20 **DR SCOTT:** Just to be clear for the transcript, this is the
 21 decision of the OFT?
 22 **MR BREALEY:** This is the decision of the OFT in
 23 Construction, decision of the OFT in Recruitment.
 24 **DR SCOTT:** I have Construction but not Recruitment.
 25 **THE CHAIRMAN:** I have Recruitment.

1 (Pause)
 2 **MR BREALEY:** We will insert these, but they will probably go
 3 into joint authority bundle 12 at the end. This is in
 4 the context of the OFT submitting to this Tribunal that
 5 we have taken paragraph 136 on European Night Services
 6 out of context and it has no relevance whatsoever to
 7 an object infringement. So it's in the context of
 8 a submission that "obvious" is not the test.
 9 So if we go first to the Construction decision,
 10 21 September 2009, we kick off with the section at
 11 page 354:
 12 "No need to prove anticompetitive effect when
 13 anticompetitive object established."
 14 We agree with that, and we agree that one relies on
 15 T-Mobile for that proposition. Then when we get to 356,
 16 paragraph III.68, the OFT says in this decision:
 17 "The 'object' of an agreement and/or concerted
 18 practice is not assessed by reference to the parties'
 19 subjective intentions when they entered into, but rather
 20 is determined by an objective analysis of the aims."
 21 Well, that is correct.
 22 "Where the obvious consequence of an agreement or
 23 concerted practice is to prevent, restrict or distort
 24 competition, that will be its object for the purpose of
 25 the chapter I prohibition. This will be the case even

1 if the agreement or concerted practice had other
 2 objectives."
 3 One sees that the authority for the obvious
 4 consequences of an agreement at footnote 2007 is exactly
 5 paragraph 136 of European Night Services. So how the
 6 OFT in the present appeal can say that Imperial Tobacco
 7 has taken European Night Services out of context by
 8 relying on paragraph 136 when the OFT, in the
 9 Construction Cartel, specifically referred to that
 10 paragraph is a mystery, and, with respect, needs some
 11 explaining.
 12 The Recruitment Cartel is exactly to the same
 13 effect. It kicks off at page 76 with a section:
 14 "No need to prove anticompetitive effect where
 15 anticompetitive object is established."
 16 We agree. One goes over the pages to page 79,
 17 paragraph 374, and again if one just goes to page 81,
 18 3.78:
 19 "Therefore, in considering whether an agreement
 20 and/or concerted practice has as its object the
 21 prevention, restriction or distortion of competition,
 22 the OFT will consider the aims of the agreement and/or
 23 concerted practice in the economic context in which it
 24 operates. In cases where the agreement or concerted
 25 practice contains 'obvious restrictions of competition'

1 it will be treated as having an anticompetitive
 2 object and no account need be taken of the actual
 3 conditions~..."
 4 Again, we see authority for the proposition as
 5 paragraph 136 of European Night Services.
 6 It all goes to support Imperial's submission that
 7 you do need a high degree of probability before the
 8 presumption of restrictive effect can be made in
 9 an object case.
 10 We have in the speaking note not only set out what
 11 we consider to be the correct analysis of the law. We
 12 have -- it starts at paragraph 21 of the speaking
 13 note -- tried to articulate three policy reasons why the
 14 law does require a more exacting standard, why the law
 15 does require a high degree of probability. Those three
 16 reasons relate to: firstly, the presumption of innocence
 17 in article 6 of the Convention on Human Rights;
 18 secondly, the desire to avoid type 2 errors, false
 19 negatives; and thirdly, the desire to achieve legal
 20 certainty in object cases.
 21 At paragraphs 23 to 34 we set out what we would say
 22 is well established law on the presumption of innocence.
 23 And essentially, if one is going to have such
 24 a conclusive presumption of restrictive effect in object
 25 cases, it has to have very strong foundations in order

1 to trump an article 6 presumption of innocence.
 2 Evidential rules, as we know, kick in in competition
 3 matters in order -- and the Tribunal requires quite
 4 strong evidence, and so does the European Court of
 5 Justice in Siemens, and I don't think Siemens is in the
 6 bundle, but we will insert that, that is referred to in
 7 paragraph 32.

8 **THE CHAIRMAN:** I think we had a copy on our desk this
 9 morning.

10 **MR BREALEY:** Maybe so, we will insert that. The Siemens
 11 case essentially just mirrors what the Tribunal has said
 12 in previous cases.

13 So the thrust of the first policy reason is that
 14 there must be some strong foundation for the presumption
 15 of restrictive effect in object cases.

16 Then the second policy reason are the type 2 errors,
 17 which we set out at paragraph 35, because in an object
 18 case, of course there is no finding of a distortion of
 19 competition. We pick this up at paragraph 36 of the
 20 note. There is, therefore, a constant risk with
 21 an object infringement that an agreement has been
 22 prohibited even though the market has not been distorted
 23 and a possibly competitive agreement has been prohibited
 24 because of the object.

25 We say it seems common sense to demand a high degree

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1 of certainty that the agreement would ordinarily
 2 restrict competition in order to minimise the risk, what
 3 are usually called type 2 errors.

4 So the greater the certainty you have of the
 5 restrictive effect, the less the risk. Whereas the less
 6 certain you are of the restriction, the greater the risk
 7 of a type 2 error, and perversely, the risk of the
 8 market will actually be distorted by the application of
 9 the competition laws.

10 We have set out just two -- we say it's common
 11 sense, but at paragraph 38 we set out paragraph 23 of
 12 the expert report of Derek Ridyard, and also in the
 13 Leegin case where the US Supreme Court, when it
 14 overruled its previous jurisprudence that RPM and
 15 vertical agreements was not a per se restraint of trade,
 16 one of the reasons for overruling its previous
 17 jurisprudence, and held that RPM was not a per se
 18 restraint of trade, was to avoid the type 2 errors.
 19 There is a risk in, if you almost automatically prohibit
 20 an agreement of having what are called type 2 errors,
 21 and that's the same whether it's a per se in American
 22 antitrust, or we say an object infringement in this
 23 country.

24 The third policy reason is legal certainty. We set
 25 out two passages from the opinions of the Advocate

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1 Generals, GlaxoSmithKline and T-Mobile where they say
 2 object infringements do perform a policy function, that
 3 is one of legal certainty, but again if the net of
 4 object infringements is cast too wide, then you are
 5 going to get a legal uncertainty.

6 So that is a canter through what we say is the
 7 correct approach of the law, and the policy reasons
 8 underlying it.

9 Can I now go to the OFT's decision to show how the
 10 OFT simply applied too low a threshold. It's the
 11 decision. If we could start at page 36. I am roughly
 12 at about paragraph 45 of the speaking note .

13 At paragraphs 2.120 and 2.121, we see the OFT
 14 setting out what it is finding, what it has decided not
 15 to find. One of the things it has decided not to make
 16 a finding of was that the agreements had the likely
 17 effect of restricting competition. As the Tribunal will
 18 be aware, this cannot just be swept under the carpet as
 19 the OFT tries to do and says, well, you have an object
 20 infringement, you have an effect infringement, it's
 21 alternative, everyone knows that, in circumstances
 22 where, on any view, the OFT accepted that these
 23 differentials, these maximum differentials, with
 24 opportunity to respond, are novel. So they have no
 25 direct experience of this type of agreement. When they

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1 investigated the agreement for the best part of seven
 2 years and have decided that they can't find any
 3 restrictive effect, and that is their only experience of
 4 this type of agreement, one has to wonder why it is that
 5 these trading agreements have as their object the
 6 distortion of competition.

7 But that is what they do, at paragraph 2.121. They
 8 say that they cannot decide the likely effect of the
 9 infringing agreement, but they do say that the agreement
 10 was by its very nature capable of restricting
 11 competition. I emphasise the word "capable", because
 12 that capability road is the road that the OFT goes down.

13 We see this when we go to page 47. As we say in the
 14 note, they refer to agreements by their very nature
 15 being capable, but what do they actually mean by that?
 16 How do they apply it? So page 47 is, essentially, the
 17 analysis on object. If I could ask the Tribunal to
 18 note, there are two subheadings here, so I am looking at
 19 (g), "Prevention, Restriction or Distortion of
 20 Competition", and as with Construction and as with
 21 Recruitment, there are two subheadings, one is the law
 22 on anticompetitive object, and the other is no need to
 23 prove anticompetitive effect where an anticompetitive
 24 object is establish. So we have the two sections that
 25 we saw in Recruitment and Construction.

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1 Just taking paragraph 346, the section beginning at
2 3.46 first: yes, we know this is consistent with what it
3 said in Recruitment and Construction, applying T-Mobile,
4 really applying the law, the well-established law, that
5 if you have an object infringement, you don't have to
6 prove effect. So that is a given.

7 But how, then, does the OFT approach the law on
8 anticompetitive object? So we now go back to
9 paragraph 3.38.

10 So 3.38, well, we obviously agree with that, in the
11 sense that the OFT has to consider the precise purpose
12 or objectives of the agreement. That is what an object
13 infringement is about, the precise purpose or object and
14 agreement.

15 Then we get to paragraph 3.39, and I would ask
16 the Tribunal to note at paragraph 3.39 the OFT is
17 referring to the exemption guidelines, but it only
18 refers to paragraph 22. It omits that critical
19 paragraph, paragraph 21, which, as we have seen, refers
20 to restrictions having such a high potential of negative
21 effects. Paragraph 21 is omitted.

22 Just to recap, paragraph 21 of the exemption
23 guidelines referred to restrictions having such a high
24 potential of negative effects, that has been omitted
25 from 3.39.

1 Then we have 3.40, which talks about considering the
2 objective aims, and then we have a very, very important
3 two paragraphs, 3.41 and 3.42, because the OFT at 3.41
4 refers to the well-established jurisprudence of the
5 European Court, it talks about agreements by their very
6 nature being injurious to competition, but the big
7 question is: how does the OFT interpret those words?,
8 and in our submission, the OFT wrongly interprets those
9 words, because it then goes on at 3.42 to emphasise
10 paragraph 31 of T-Mobile, and it is sufficient that it
11 has the potential; in other words, the concerted
12 practice must simply be capable in an individual case.
13 And it puts in bold the word "capable". We know that we
14 are not talking about the distinction between object
15 infringement and effects, because that is the next
16 section. The OFT in its analysis on the law of
17 anticompetitive object has gone from saying agreements
18 by their very nature can be regarded, to what does that
19 mean, they are simply capable.

20 There we see footnote 100, European Night Services,
21 paragraph 136, that apparently we have taken out of
22 context, but no reference to "obvious".

23 Wholly bizarre how the OFT, at paragraph 100, 136 --
24 so yes, paragraph 136 talks about the objective aims of
25 the agreement, but why does the OFT now deny what the

1 general court said at 136, that you have to look at
2 obvious restrictions of competition?

3 So did they apply a capability test? We submit that
4 they clearly did, because if one goes to paragraph 54 of
5 the speaking note, page 131 of the decision, in many
6 respects these are the most important paragraphs of the
7 decision, paragraph 6.212, basically page 131 to at
8 least 147, these are the paragraphs where the OFT is
9 speculating on the theory of harm. And we see
10 continuous reference to the agreement simply being
11 capable of leading to a restriction of competition.

12 So, for example, paragraph 6.214:

13 "A parity or fixed differential is capable of giving
14 rise ..."

15 Paragraph 6.216, this is talking about the ITL price
16 increase theory of harm:

17 "That requirement is capable ..."

18 That's the third line down. If one looks at 217,
19 halfway down, eight lines up, again "capable". We have
20 set out, this is the section on the OFT's theory of
21 harm, why are these trading agreements being prohibited?
22 What is it about these trading agreements that is so
23 wrong? You don't just say, well, it relates to price
24 and that is it. One is articulating what is it about
25 these agreements that are wrong, and it is littered with

1 "capable".

2 At paragraph 6.220 at page 133, where they talk
3 about -- there is much analysis on the restriction on
4 intrabrand competition, the thrust, as Mr Howard said,
5 of this decision is on interbrand competition.

6 Here we have one paragraph on intrabrand competition
7 and all the OFT says is:

8 "It is also possible that ..."

9 In our respectful submission, to say that something
10 is possible, we are a far cry from an object
11 infringement case. Anything is possible, but what the
12 OFT have to prove, in our submission, that it is highly
13 likely, highly probable; the mere possibility is
14 insufficient.

15 We set out at paragraph 54 of the speaking note the
16 passages where the OFT refer to "capable". They are
17 undoubtedly applying a capability test here. Quite
18 an important passage I would like to emphasise is at
19 page 147. This concerns the opportunity to respond
20 clause. As the Tribunal will know, it is a large part
21 of Imperial's case and the other appellants', that these
22 trading agreements had opportunity to respond clauses,
23 so if the Gallaher price went down, Imperial would seek
24 an opportunity to meet the price reduction and you have
25 the response and counter response, and at paragraph 271,

1 so that's paragraph 6.271, (b), this is in the context
2 of Imperial arguing that the agreements had
3 a pro-competitive effect, they submit:

4 "The infringing agreements afforded the manufacturer
5 the opportunity to respond to competitors' pricing
6 promotions, thereby stimulating interbrand competition."

7 So that is what Imperial are arguing, and they say
8 this attempt to throw more money at lower prices
9 stimulates interbrand competition. How does the OFT
10 reject that? It rejects it at page 151. Imperial are
11 saying this response and counter response is
12 pro-competitive.

13 At page 151, paragraph 6.283:

14 "The OFT considers that the submissions made as to
15 the alleged pro-competitive nature of the infringing
16 agreements do not undermine or negate the OFT's finding
17 as to competitive object in law."

18 Then if we could go back, dealing with that, at
19 paragraph 6.277, where actually it expressly deals with
20 this:

21 "In response to the argument at paragraph 6.271(b),
22 the OFT considers that even if the infringing agreements
23 did on some occasions facilitate a price reduction by
24 one manufacturer in response to a retail price reduction
25 instigated by another manufacturer, the long-term

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1 implementation of the parity and differential
2 requirements was capable of restricting interbrand
3 competition and does not negate the anticompetitive
4 object of the infringing agreements."

5 So again we get this word "capable", and that is
6 why, in Imperial's notice of appeal, they argued
7 strenuously that capability was not enough. This is
8 enough if you are looking at whether you have to prove
9 actual effects, we know that. Is that the end of the
10 story? We say no, there has to be a high degree of
11 probability, it has to be plain and obvious, it's got to
12 be so clear. A mere capability is insufficient. The
13 fact that you can say the agreement is capable of
14 leaving to a restriction of competition is far too low,
15 it will lead to all the type 2 errors, it will create
16 the uncertainty, it is not a sufficient foundation to
17 rebut the article 6 presumption. Capability is not the
18 test.

19 I don't have time, but we have set it out in the
20 speaking note, one sees in the defence the OFT defending
21 the capability test, and rejecting the plain and obvious
22 test, the high probability test. We saw at
23 paragraph 141 the OFT saying we have taken European
24 Night Services out of context, it has no relevance to
25 object cases.

22

1 So we have the notice of appeal saying that
2 capability is not good enough, the OFT in its defence,
3 and one sees those paragraphs surrounding paragraph 141,
4 it is, "we misunderstood the law", then as we set out in
5 the speaking note, we get the skeleton.

6 I know you have gone through it, but the paragraph 6
7 and 7 of the skeleton, complete shift, we say, of the
8 OFT's case. Now, I remind the Tribunal, we have just
9 looked at paragraph 6.277 of this decision where it
10 rejected Imperial's arguments that the opportunity to
11 respond clause was pro-competitive and all it could say
12 was the long-term implementation was capable of
13 restricting interbrand, so they expressly use the word
14 "capable" in 277.

15 Then we get at paragraph 6 of the skeleton:

16 "It is not, and never has been, the OFT's case that
17 in order to constitute object infringements, the
18 infringing agreements need, without more, to be capable
19 of restricting competition in some general or
20 ill-defined way."

21 Paragraph 7:

22 "It is in this sense, in the light of the fact that
23 the infringing agreements can be expected to be
24 anticompetitive, that the OFT maintains that the
25 infringing agreements are object infringements."

23

1 So we don't have capability any more, we have now:
2 can the agreement be expected?

3 So where does that now lead us? It leads me to
4 paragraph 66 of the speaking note, or paragraph 65 of
5 the speaking note, because if, at paragraph 65 of the
6 note, the OFT did apply a capability test in the
7 decision, and we say it's quite clear that they did,
8 when one looks at the section on the analysis of object
9 and the words they used in the theory of harm section,
10 it applied a capability test, we say on that basis the
11 decision cannot stand.

12 But if the Tribunal accepts the OFT's case now that
13 it applied a "to be expected" test, we submit at
14 paragraph 66 onwards that that is still way off-beam.

15 We set out three reasons. First, as a matter of
16 law, a mere expectation that something will happen, it
17 still falls short of it being likely to happen. In
18 order for this presumption of restrictive effect to be
19 made, it has to be highly likely; it cannot just be
20 expected, because otherwise you are going to lead into
21 the type 2 errors again, you are going to have legal
22 uncertainty. Again, one is only looking at the content
23 of the agreement, the precise purpose of the agreement,
24 its factual context. One is not doing a full market
25 analysis. To expect something to happen simply falls

24

1 short of the degree of plain and obviousness that you
 2 need in an object case.
 3 Secondly, as a matter of fact -- and this is
 4 something that Mr Howard was referring to last week --
 5 we say it is wholly unrealistic to say that the maxima
 6 differentials could be expected to lead to the
 7 competitive harm alleged by the OFT. We do emphasise
 8 the differentials are contained in the trading
 9 agreements where Imperial is trying to get its products
 10 promoted and promoted at a competitive price. One looks
 11 at that, we look at the nature of the trading
 12 agreements, and even in the way they have been
 13 implemented, can you say that they can be expected to
 14 lead to the sort of competitive harm now advocated by
 15 the OFT? In other words, where Imperial seeks to
 16 respond to a Gallaher price cut, to fund a lower price,
 17 how can that be expected really to raise prices? It
 18 may, as Mr Howard said, have as an effect if you can
 19 prove that over seven years, the prices did go higher,
 20 then so be it. But to say, looking at the objects of
 21 that trading agreement, can it be expected to lead to
 22 higher prices? Can it be expected that Gallaher will
 23 ultimately disengage from competition? We say we are
 24 a far cry from the agreements expecting to lead to
 25 (inaudible) prices.

25

1 Lastly, I just want to, on object, and then I'll
 2 have to spend just five minutes, I think, on exclusion,
 3 but I would like just to emphasise the experience
 4 aspect, because one has the OFT's skeleton still to
 5 hand. There are two paragraphs that Mr Howard referred
 6 to last week, paragraphs 11 and 12, where the OFT sets
 7 out what it calls its fundamental proposition, and at
 8 the last sentence of paragraph 11 he says:
 9 "Well, not even the appellants would surely dispute
 10 the fact that an agreement between the two manufacturers
 11 always price their rival products at identical levels to
 12 each other is presumed to be anticompetitive."
 13 Then at 12:
 14 "There is no reason in logic that principle,
 15 et cetera, et cetera, why the position should be any
 16 different when manufacturers use retailers to provide
 17 the same horizontal link."
 18 This I would just like to pick up on, because
 19 I think it is an important error of the OFT in being so
 20 simplistic in saying, well, if it's the same in
 21 a vertical arrangement, then you lead ultimately to the
 22 same horizontal effects.
 23 I'm looking at paragraph 73 of the speaking note.
 24 We won't go to the 1998 Commission communication, but
 25 that is a starting point.

26

1 Can we just go back to JAB 11, tab 148 {A11/148}
 2 which are the 2000 vertical guidelines. We have similar
 3 provisions in 2010, but I would like to go to 2000.
 4 So these are the Commission guidelines on vertical
 5 restraints, JAB 11, tab 148. I am now at paragraph 74
 6 of the speaking note.
 7 If we can go, first of all, to paragraph 100, where
 8 the Commission repeats what it said in its 1998
 9 communication vertical restraints are generally less
 10 harmful than horizontal restraints.
 11 "The main reason for treating a vertical restraint
 12 more leniently than a horizontal restraint lies in the
 13 fact that the latter may concern an agreement between
 14 competitors producing identical or substituted goods or
 15 services.
 16 "In vertical relationships, the product of the one
 17 is the input for the other. This means that the
 18 exercise in market power behind the upstream or
 19 downstream company can normally hurt demand for the
 20 product of the other."
 21 So it is setting out its case, and the OFT in its
 22 guidance on the exclusion order says very much the same
 23 thing, that vertical restraints are generally less
 24 harmful.
 25 Then if we can go to paragraph 138, because

27

1 I emphasise two types of vertical restraint. The first
 2 is the single branding. Again if one takes
 3 paragraphs 11 and 12 of the OFT's skeleton, you have two
 4 competitors agree not to compete, well, you probably say
 5 there is a high likelihood that that would be an object
 6 infringement to competitors to agree not to compete. If
 7 one competitor in a vertical agreement with its retailer
 8 says "I want you to sell only my products, I do not want
 9 you to sell my competitor's product", so you put in
 10 a vertical agreement a non-competition provision, the
 11 rival manufacturer is foreclosed, there is no price
 12 competition in that retailer's business, and yet the
 13 European Commission is saying one has to look at the
 14 effects of that vertical non-compete to determine
 15 whether it should be prohibited. It's not an object
 16 infringement case, that is quite clear from the
 17 guidelines, you can't say it would be expected to lead
 18 to a restriction of competition, it's certainly not
 19 highly likely. So the single branding non-compete
 20 provision starts to eat away at paragraphs 11 and 12 of
 21 the OFT's fundamental proposition.
 22 But then what about if you then put in the mix
 23 a link between the wholesale prices, and that's why we
 24 referred to paragraph 152 of these guidelines, and the
 25 so-called English clauses. Because the OFT may say,

28

1 well, non-compete is non-compete. What about if you are
2 linking one wholesale price to the other wholesale
3 price?
4 "A so-called English clause requiring the buyer to
5 report any better offer and allowing him only to accept
6 such an offer when the supplier does not match it can be
7 expected to have the same effect among compete
8 obligations, especially when the buyer has to reveal who
9 makes the better offer. In addition, increasing the
10 transparency of the market may facilitate collusion
11 between the suppliers. An English clause may also work
12 as quantity forcing."

13 Then four lines up from the bottom:

14 "The assessment of all these different forms will
15 depend on their effect on the market."

16 So the European Commission is saying that English
17 clauses whereby I tell my retailer that he must report
18 a better offer to me from my rival, and then I have the
19 opportunity of matching my rival's price, and therefore
20 I get the sale, that that linking of the wholesale price
21 in a vertical relationship depends on their effects on
22 the market. It is not an object clause, one cannot say
23 it can be expected to lead to a serious restriction of
24 competition.

25 We have set out in the speaking note at paragraph 80

29

1 that Imperial's opportunity to respond clause, if it was
2 a restriction, is far less of a restriction, because you
3 are not foreclosing, Imperial is not foreclosing
4 Sainsbury's from selling Gallaher products, it is saying
5 "I want to have an opportunity to match a price
6 reduction".

7 So at paragraph 81, we again emphasise the very
8 cursory way that the OFT reject Imperial's submissions
9 on the opportunity to respond clauses. Again, at
10 paragraph 271(b) of the decision, Imperial submitted to
11 the OFT that its opportunity to respond clauses were
12 pro-competitive, and all that the OFT could do at 6.277
13 was say well, they are capable in the long-term of
14 leading to a restriction of interbrand competition.

15 We say, well, if that is correct, one is essentially
16 rewriting these guidelines, because it would mean that
17 the English clause would have an anticompetitive
18 restriction in the long-term. One can say, well, the
19 effect of an English clause is that all the rival
20 suppliers are going to give up, they are never going to
21 try and put any price into the retailer, because they
22 know it's not going to be worth it, because the
23 incumbent supplier will always match it, and the rivals
24 will disengage. One has to look at the effects, it is
25 not an object infringement.

30

1 So we finish the speaking note on this experience,
2 because we saw the Advocate General in GlaxoSmithKline
3 saying that regard must be had to experience to see
4 whether in all probability the restrictions are
5 injurious to competition. We saw experience being
6 referred to by the European Commission on its exemption
7 guidelines, and one takes a step back and says: well,
8 what is the experience of the sort of agreements that
9 are in issue on this appeal? This is 86. So we know,
10 prior to this decision, the OFT had no direct experience
11 of price maxima differentials, they are novel.

12 Professor Shaffer says they are novel. It is the OFT's
13 own evidence that these trading agreements are novel and
14 have never been subjected to economic analysis.

15 Secondly, the only experience the OFT has of these
16 is its investigation, and we saw at paragraph 2.121 that
17 it couldn't say on the basis of the seven year
18 investigation, and looking at how they were operating
19 that they were likely to distort competition.

20 Third, if one looks at analogous clauses like the
21 English clause we have just seen at paragraph 152 of the
22 guidelines, they don't have as their object the
23 distortion of competition.

24 So on object we say that something seriously has
25 gone wrong with the OFT's analysis, and the answer is

31

1 simple: they have applied too low a threshold to
2 an object infringement. The net has been cast too wide.

3 That is all I have to say on object. I apologise
4 for going -- and to the transcript writers -- at speed,
5 but we are a bit short of time. I will spend, if I can,
6 just five or ten minutes on exclusion, because I think
7 again that's important, and then ...

8 I think I just need on the exclusion to set out
9 orally the arguments. The last document I am going to
10 hand up until December, this is again the speaking note
11 on exclusion order, so it just helps everybody to know
12 where we are coming from (Handed).

13 The exclusion order is at JAB 8, tab 138. It may
14 well be the decision refers to the exclusion order in
15 only two paragraphs, and that's at page 537, at 7.44 and
16 7.45.

17 I haven't got time to go through this in great
18 detail, but if I can just give the Tribunal a sense of
19 where we are coming from on this.

20 If one looks at the exclusion order, the definition
21 section at the bottom, obviously the trading agreements
22 are vertical agreements, so on the face of it they are
23 excluded.

24 Then section 3:

25 "The chapter 1 prohibition shall not apply to

32

1 an agreement to extend (inaudible) agreement", so it's
 2 excluded.
 3 Then section 4 brings certain types of vertical
 4 agreement back in.
 5 Before we look at that, can I just emphasise
 6 section 7, because that is quite important for the
 7 analysis of the exclusion order, because if the OFT
 8 think that certain agreements should not benefit from
 9 the exclusion, it can withdraw the benefit of the
 10 exclusion. Really, essentially what we would say is
 11 that Imperial's trading agreements benefitted from the
 12 exclusion order, if the OFT had considered there was
 13 something wrong with it, they could have formally
 14 withdrawn the exclusion order under section 7.
 15 Let's see what section 4 does. So:
 16 "Article 3 shall not apply where the vertical
 17 agreement directly or indirectly has the object or
 18 effect of the buyer's ability to determine its sale
 19 price."
 20 So that is what we called the second limb, so having
 21 taken the vertical agreement, given it the benefit of
 22 the exclusion, now it's gone back into the prohibition,
 23 because it restricts the sale price, and I emphasise the
 24 words "sale price".
 25 That is then, subject to the first proviso:

33

1 "Without prejudice to the possibility of the
 2 supplier imposing a maximum sale price or recommending
 3 a sale price ..."
 4 So now the trading agreement comes back in, or the
 5 agreement falls within the exclusion again. Then it can
 6 be taken out if the maximum sale price amounts to
 7 a minimum sale price.
 8 We have article 3 shall not apply to the vertical
 9 agreement, so vertical agreements are out, unless they
 10 restrict the sale price, now they are back in, without
 11 prejudice to imposing a maximum sale price, so they are
 12 now with the benefit of an exclusion again, and then if
 13 the maximum price amounts to a minimum sale price, it
 14 doesn't get the benefit of an exclusion order.
 15 The OFT, at paragraph 7.44, sets out the terms of
 16 the exclusion order. Then at 7.45, page 537:
 17 "The OFT considers an infringing agreement
 18 restricted the ability of the buyer, in this case the
 19 retailer, would determine its retail prices for
 20 competing linked brands. This is because the restricted
 21 nature of the infringing agreement involves a linking of
 22 the retail price of competing brands."
 23 So the OFT says it falls within the second limb, and
 24 it doesn't fall in the third limb because it is not
 25 an absolute maximum resale price, it doesn't impose

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1 an absolute.
 2 So it restricts, and it doesn't impose an absolute.
 3 What do we say to that? In the speaking note, we
 4 have set out three reasons why we submit the OFT have
 5 wrongly interpreted the order, and I will just very
 6 quickly set them out before we break.
 7 The first reason starts at paragraph 6, and relates
 8 to what is meant by "sale price", because the order only
 9 relates to sale price. Now, we have just seen in the
 10 decision that the OFT have interpreted maximum sale
 11 price, in the third limb, as an absolute. It can't go
 12 above 3.99, it's an absolute sale price.
 13 Our first submission is that if the OFT is defining
 14 the maximum sale price as an absolute, sale price being
 15 an absolute, it should also interpret that in the second
 16 limb. So the second limb only catches absolute prices,
 17 and we know from various passages in the decision that
 18 there is no restriction on the absolute sale price.
 19 So that is our first submission, that is to say that
 20 if the OFT are going to be consistent on its definition
 21 of "sale price", and it is saying that maximum sale
 22 price is an absolute one, then surely sale price in limb
 23 2 has to be defined in the same way.
 24 That is the first submission.
 25 The second submission begins at paragraph 16 of this

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1 speaking note, and the Tribunal will have seen that,
 2 particularly in the defence, it's not really articulated
 3 in the decision but it's mentioned in the defence, that
 4 the reason is if indeed Imperial did set maximum
 5 differentials, if they were fixed we are not into this
 6 territory, but if Imperial did set maxima, the OFT says
 7 "Well, Imperial don't benefit from the exclusion order
 8 because the maxima for its product, for Embassy,
 9 resulted in a minimum for Benson & Hedges", so there is
 10 this corollary effect. If you have a maximum price
 11 differential, you have a minimum for the linked product.
 12 Our second submission is based on the argument that
 13 when one looks at the exclusion order and what really it
 14 was designed to do, what did the drafters have
 15 experience of, it was looking at where the maximum price
 16 for the Imperial product would lead to or amount to
 17 a minimum price for that product. It is not talking
 18 about a minimum price for another product. It just
 19 didn't have experience of that sort of agreement.
 20 So that is our second submission, that the exclusion
 21 order does not catch what the OFT call the corollary
 22 effect.
 23 Our last submission, which --
 24 **DR SCOTT:** Sorry, can we just stick with 4 for a moment?
 25 **MR BREALEY:** Yes.

36

1 **DR SCOTT:** 4 is interestingly worded when you begin to look
 2 at the documents which lie alongside the trading
 3 agreements, because it contains this phrase "Provided
 4 these do not amount to a fixed or minimum sale price as
 5 a result of pressure from or incentives offered by any
 6 of the parties", and no doubt in due course, when we
 7 come to the evidence, we will look at some of those
 8 documents --

9 **MR BREALEY:** Yes.

10 **DR SCOTT:** -- which, as we have discussed already, point to
 11 actual numbers associated with what may or may not have
 12 been pressure, but what was in some cases bonusing,
 13 which presumably is an incentive. So you have
 14 an interesting question about how the factual evidence
 15 actually relates to the very end of 4.

16 **MR BREALEY:** That is the third submission. On the second
 17 submission, we just disregard the incentives for the
 18 moment, the second submission is a pure point of
 19 statutory interpretation --

20 **DR SCOTT:** In relation to the word "sale price".

21 **MR BREALEY:** Sale price but also whether, it's the
 22 correlation between maximum and minimum, because in
 23 essence what we are submitting is that the intention
 24 behind the exclusion order is that the -- we are only
 25 talking about the supplier's own products, we are not

1 talking about third parties' products. So we all know
 2 that we can set a maximum price from a product, so I am
 3 the manufacturer, supplier, I set a maximum price at
 4 which the retailer can sell my products, and because of
 5 incentives or coercion, that maximum becomes a minimum.
 6 And where the maximum price for my product actually
 7 becomes a minimum, then the exclusion order wouldn't
 8 apply. But the second argument is simply based on
 9 a point of law, statutory interpretation, whether when
 10 the drafters were talking about a maximum sale price
 11 amounting to a minimum sale price it was talking about
 12 maximum referring only to Imperial and minimum referring
 13 to Gallaher. Because these are novel agreements, we all
 14 know, look at the vertical restraint guidelines, you
 15 can't have RPM, you can set maximum prices, but if you
 16 coerce or grant incentives in such a way that it becomes
 17 a minimum, then you don't benefit from it.

18 So the second argument is all about whether maximum
 19 and minimum apply to the supplier's own products, or it
 20 can be parted, maximum Imperial and minimum Gallaher.

21 The third argument essentially picks up what you
 22 said, sir, which is then let's assume that the second
 23 limb sale price refers to differentials, maximum sale
 24 price amounts to differentials, now does that maximum
 25 differential lead to a minimum differential, because of

1 incentives or whatever.

2 We say on the evidence, and Mr Howard has touched on
 3 this, and obviously we are going to get more over the
 4 course of the next few months, we flag the point right
 5 at the end of the speaking note, paragraphs 34 and 35,
 6 because you can have a maximum sale price, so we now
 7 interpret this as a maximum differential, so we can have
 8 a maximum differential, provided -- so we can have
 9 a maximum differential, this is now on the OFT's
 10 interpretation on the second limb, we have a maximum
 11 differential for Imperial, does that lead to a fixed --
 12 and I emphasise the word "fixed" -- minimum differential
 13 for the Gallaher product? We say as a matter of fact
 14 there was no fixed minimum differential for any Gallaher
 15 product.

16 Again, we emphasise the passages in the decision on
 17 the theory of harm, particularly -- I am at paragraph 34
 18 of the speaking note -- decision 6.223. This is in the
 19 context of the OFT having to show that there was a fixed
 20 minimum differential for the Gallaher product. At
 21 6.223, and 6.224 and 6.225, this is the OFT's treatment
 22 of the opportunity to respond. It's the first sentence
 23 of 6.225 I would ask the Tribunal to note, because it
 24 sets out at 6.223 there was no automatic changing. At
 25 6.224 the OFT accepts that the retailer may not have

1 automatically changed the retail price of a brand in
 2 response to a change in the price of a competing linked
 3 brand. So it has conceded here, which it has to, that
 4 there is no automatic fixing. The retailer is not bound
 5 to lower the Imperial price when the Gallaher price goes
 6 down. There is no obligation. Professor Shaffer's
 7 theory of harm, and that we have seen, is that the
 8 retailer is doing the dirty work for the supplier, so
 9 the Gallaher price goes down, the retailer has to reduce
 10 that price without really any input from Imperial. It
 11 is being used as the intermediary.

12 Here, because of the opportunity to respond clauses,
 13 Imperial is submitting, well, that's not right, there is
 14 no automatic reduction in the Imperial product, and the
 15 OFT is accepting that. Then it says:

16 "The OFT considers that the evidence of contacts
 17 between each manufacturer and the retailer shows there
 18 was a clear expectation on the part of the manufacturers
 19 that the prices would move in line."

20 The simple question of fact, part fact and part law
 21 actually, is whether the OFT having accepted there is no
 22 automatic changing but there is an expectation on the
 23 part of Imperial that it would be given an opportunity
 24 to respond, whether that amounts to a fixed sale price,
 25 a fixed differential within the meaning of the exclusion

1 order, because if it is not fixed then Imperial is left
 2 with its maximum and it does take the benefit of the
 3 exclusion order.
 4 I am sorry, it's there is quite a lot in this, but
 5 we will hopefully come back to it in closing.
 6 **THE CHAIRMAN:** Yes. Those are your submissions? Thanks
 7 very much, Mr Brealey. It's probably wise to have our
 8 mid-morning pause at that stage, then. Is it you, then,
 9 after the break, Mr Thompson?
 10 **MR THOMPSON:** It is, Madam. It will give us a chance to
 11 move the papers about a bit.
 12 **THE CHAIRMAN:** Very well. We will come back at 11.30 then.
 13 (11.24 am)
 14 Opening submissions by MR THOMPSON
 15 (11.35 am)
 16 **THE CHAIRMAN:** Yes, Mr Thompson.
 17 **MR THOMPSON:** Madam Chairman, gentlemen, I appear with
 18 Mr Brown on behalf of the Co-op Group, CGL. In my
 19 allotted two hours I will obviously have to move
 20 relatively quickly and I won't be able to go to every
 21 document but I will refer the Tribunal to a number of
 22 documents.
 23 The opening speech for CGL will address two broad
 24 points: the place of the CGL appeal in the context of
 25 the OFT's wider case and CGL's case in summary on the

1 central issues in the case, issues of fact, economic
 2 theory and law.
 3 Before embarking on those two points I should
 4 indicate CGL's overall position: we take the view that
 5 the OFT's case against CGL must fail for two broad
 6 reasons. First, the OFT's case relies on
 7 a comprehensive misreading of the contemporary documents
 8 involving CGL. These documents are in fact quite
 9 inconsistent with the theory of harm to which the OFT
 10 has harnessed itself. I note in this respect that after
 11 two and now a little more days of this hearing, there
 12 has been no mention of any document involving CGL, in
 13 particular paragraph 40 of the OFT's skeleton argument
 14 which Mr Howard went through as some detail as the high
 15 water mark of the OFT's case does not refer to a single
 16 CGL document.
 17 Secondly, the OFT's theoretical case must fall for
 18 a broader reason in that it rests on two factual
 19 hypotheses that clearly do not hold.
 20 First, as least as far as CGL is concerned, the
 21 manufacturers did not require CGL to observe rigid
 22 parities and differentials between competing brands;
 23 that is to say pricing relationships will remain
 24 constant, notwithstanding relative movements in
 25 wholesale prices. Parities and differentials altered in

1 line with relative movements of recommended resale
 2 prices.
 3 Secondly, and this is a point that emerges more
 4 recently from the latest report of Professor Shaffer, to
 5 the effect that there is some question as to whether
 6 manufacturers move their recommended resale prices in
 7 parallel with their wholesale prices. CGL contends that
 8 in fact manufacturers invariably raised or lowered their
 9 recommended resale prices in parallel with movements in
 10 their wholesale prices, as such movements in wholesale
 11 prices invariably led to parallel variations in parities
 12 and differentials.
 13 The evidence is consistent on both these points.
 14 CGL never agreed to observe rigid parities or
 15 differentials, and manufacturers invariably moved their
 16 RRP's in parallel with their wholesale prices. The
 17 inevitable consequence is that the OFT's theoretical and
 18 evidential case collapses. If anything, the theoretical
 19 model to which the OFT is wedded tends to indicate
 20 a reduction in prices and a sharpening of competition,
 21 a conclusion that's consistent with the documentary
 22 record.
 23 Turning to the first of my two main points, the
 24 place of the CGL appeal in the context of the OFT's
 25 wider case. I have a number of headline propositions

1 which I hope will make it easy for the Tribunal to
 2 follow. They are not propositions of law but just sort
 3 of headline points.
 4 The first point is that CGL's case must be judged on
 5 its own merits. That's a first and obvious point. As
 6 far as concerns CGL, the OFT claims to have identified
 7 two separate infringing vertical agreements, one between
 8 CGL and ITL and the other between CGL and Gallaher.
 9 This is not a case where the OFT has suggested that
 10 there was any overarching agreement or other form of
 11 understanding at either retailer or manufacturer level.
 12 The OFT has made some rather speculative comparisons
 13 between the present case and a manufacturer's cartel,
 14 but it's offered no evidence to support such a case, and
 15 certainly none that involves CGL.
 16 Further, there is no evidence that CGL was aware of
 17 the terms of ITL's or Gallaher's arrangements with other
 18 retailers, or that either manufacturer was aware of
 19 CGL's arrangements with the other manufacturer. Indeed,
 20 Mr Goodall gives specific evidence to the contrary to
 21 the effect that he had no real idea what the position
 22 was with Gallaher. That's at core bundle 3, tab 40,
 23 it's his third witness statement, page 495,
 24 paragraph 15. I don't think we need to look at it.
 25 The OFT's abandoned its case on horizontal

1 information exchange immediate initiated by the
 2 retailers, a case that never involved CGL in any event.
 3 Finally, the one undoubted point of relevance of the
 4 decision of the OFT to abandon its case against Tesco is
 5 that the OFT itself accepts that it must prove its case
 6 against the individual retailers on an individual basis.
 7 So the second point I would make is that the
 8 decision impermissibly seeks to use evidence in relation
 9 to other retailers as evidence against CGL. I would say
 10 that although the points I've just made are elementary
 11 and shouldn't be controversial, one cardinal and
 12 pervasive weakness of the decision is its tendency to
 13 make wholesale allegations in virtually identical terms
 14 against individual retailers whose relationships with
 15 the major tobacco suppliers were in fact distinct. One
 16 tiresome and confusing aspect of the decision is the
 17 indiscriminate use of the term "infringing agreement" to
 18 refer to all of the series of distinct bilateral
 19 relationships between individual suppliers and
 20 individual retailers.
 21 More importantly, the structure of section 6(a)
 22 headed "Overview" and (b) headed "Manufacturers' Retail
 23 Pricing Strategies" and section C2, which specifically
 24 refers to CGL, has the unfortunate effect of muddling up
 25 the OFT's case against individual retailers with a wider

1 case based on a variety of references across the market
 2 as a whole. Section 6(a) and (b) as they stand at over
 3 100 pages long, and in particular pages 80 to 129 where
 4 most of the evidence on which the OFT relies is set out,
 5 really have no place in a decision concerning a series
 6 of distinct vertical agreements.
 7 So far as CGL is concerned, many of the generic
 8 points made in section 6(a) are not even alleged to
 9 apply to CGL. Indeed, the 100 pages of sections 6(a)
 10 and (b) contain very few references to CGL documents at
 11 all, and section C2 itself is seriously defective in
 12 failing to provide any intelligent analysis of the
 13 extracts from contemporary documents to which it refers.
 14 A good example is the allegation that there were
 15 repeated contacts between ITL and CGL that support the
 16 OFT's case over a four-year period. One finds that at
 17 paragraphs 6.539 to 6.540. In fact, the OFT has only
 18 identified two instances that it now seeks to defend,
 19 neither of which in fact provides a slightest support to
 20 its case. It's clear that the wording has simply been
 21 cut and pasted from the OFT's case against other
 22 retailers: for example 6.410 to 11 in relation to Asda,
 23 and 6.768 to 69 in relation to Morrisons, precisely the
 24 same wording simply with the names changed.
 25 Overall, as Ms Rose has already noted in relation to

1 Shell, the individual retailers have in reality been
 2 found guilty in a trial by word processor rather than by
 3 any specific consideration of their individual facts and
 4 agreements. All this is, in our submission, obviously
 5 and highly unsatisfactory.
 6 The third point we would make is that CGL is
 7 a unique retailer and its arrangements with the tobacco
 8 manufacturers must be assessed individually for that
 9 reason too.
 10 First of all, the documentary and witness evidence
 11 of the trading agreements and the trading relationships
 12 with ITL and Gallaher is specific to CGL. There are
 13 three witness statements from Mr Goodall, witness
 14 statements from Mr Messom, Mr Goulthorp and Mr Owen and
 15 the terms of the individual agreements between Gallaher
 16 and CGL and ITL and CGL are themselves distinct and vary
 17 over time. The references are tabs 7 and 21 and 22 of
 18 annex 5 for the Gallaher agreements, and tabs 4, 7, 16
 19 and 24 of annex 15 for the ITL agreements. In relation
 20 to Gallaher, they had an agreement from 2000 to 2002,
 21 and then it appears to have been a draft agreement in
 22 2003. In relation to ITL there were four annual
 23 agreements.
 24 The second point about CGL's particular position is
 25 that the evidence of contact between CGL and the

1 suppliers is quite particular to CGL. It's important to
 2 bear in mind that the Co-op was, unlike most customers
 3 of the tobacco manufacturers, both a retailer in its own
 4 right and a negotiator on behalf of a broader group,
 5 CRTG. That enabled all member societies of CGL and CRTG
 6 to benefit from lower wholesale prices and promotions
 7 negotiated centrally by CGL.
 8 This became increasingly important during the period
 9 relevant to this case, in particular after 2001, when
 10 CGL increased its central buying power and organisation
 11 as a result of various mergers. There are some
 12 contemporary documents in the files relating to this
 13 issue, and the CGL witnesses are well placed to explain
 14 it insofar as it may be relevant.
 15 The third point is that the witness everyday adduced
 16 on behalf of CGL is clear and consistent with the
 17 natural reading of the contemporary documents which are
 18 themselves specific to CGL; and fourthly and perhaps
 19 most importantly there is no single contemporary
 20 document or witness evidence that gives any support to
 21 the OFT's theoretical case insofar as it relates to CGL.
 22 So overall we would say that the OFT's positive
 23 evidential case against CGL is in a parlous state and
 24 that our case on the facts is extremely strong, and we
 25 would say that it's not acceptable for the OFT to seek

1 to bolster that case by selective citation from other
 2 documents involving other retailers.
 3 I'll turn now to the position of witnesses of fact.
 4 So far as witnesses of fact are concerned, there are
 5 detailed witness statements both from Mr Goodall, times
 6 three, the main ITL point of contact with CGL, and from
 7 three senior employees of CGL at the relevant time.
 8 These experienced and knowledgeable witnesses, all of
 9 whom are well aware of their obligations to the
 10 Tribunal, tell a clear and consistent story that
 11 reflects their personal recollection of the contemporary
 12 documents and their knowledge of the industry over many
 13 years. Subject of course to the OFT's right to
 14 cross-examine them, there is every reason to think that
 15 they know what they are talking about.
 16 By contrast, and striking contrast, for the OFT
 17 there is nothing at all, not a single witness of fact
 18 with any knowledge of the commercial relationships
 19 between CGL and ITL or CGL and Gallaher. Instead, the
 20 OFT seems to be content to rely on a number of highly
 21 questionable inferences from a range of documents in
 22 sections 6(a) and (b) of the decision, the great
 23 majority of which were never seen by any employee of CGL
 24 and have no connection with CGL at all, together with
 25 bare citation from CGL documents in section 6(c)(ii).

49

1 In assessing the significance of the total absence
 2 of witness evidence in support of the OFT's theoretical
 3 case, the Tribunal will of course be aware that the OFT
 4 has entered into a series of leniency or early
 5 resolution arrangements with other addressees of the SO.
 6 Under these arrangements, the companies were promised by
 7 the OFT a percentage reduction in the penalty to be
 8 imposed upon them in return for which they were and
 9 remain obliged among other things to maintain continuous
 10 and complete co-operation with the OFT, including in any
 11 appeal proceedings. The companies of course include
 12 Gallaher, the counterparty to one of the allegedly
 13 infringing agreements involving CGL, and I think that
 14 document is worth looking at, it's annex D5 to the
 15 decision.

16 **DR SCOTT:** Is this in the decision or in the annex?

17 **MR THOMPSON:** It's in the annex to a decision, I have it in
 18 a slightly separate form, I don't know how it's been
 19 presented to the Tribunal.

20 **DR SCOTT:** Yes, it's in the back of our decision file, the
 21 one that refers to early resolution agreements.

22 **MR THOMPSON:** Yes, it's in separate tabs but it's annex D
 23 and then there are six agreements subject to an index.

24 (Pause)

25 I am told it could be in D3. In the decision bundle

50

1 there is a D3 tab, I am told.

2 (Pause)

3 There is a tab 3 and then a D3 behind it, I am told,
 4 if it was an ITL bundle that was provided.

5 **DR SCOTT:** We have D but we don't appear to have D3 and we
 6 don't appear to have an index to it.

7 **MR THOMPSON:** I am sorry, I do not want to take up time
 8 here, would it help if I simply read it out?

9 **THE CHAIRMAN:** Quite a lot of it is in red boxes. I think
 10 it's a letter of 23 June 2008. Is that right?

11 **MR THOMPSON:** Yes, that's right. Yes, I am grateful.
 12 I think the red boxes are probably ones that I can't see
 13 either.

14 **THE CHAIRMAN:** No. I see.

15 **MR THOMPSON:** It's the second page of the letter,
 16 Madam Chair.

17 (Pause)

18 Shall I go on?

19 **THE CHAIRMAN:** Yes.

20 **MR THOMPSON:** It's simply paragraph 2 where it states that:

21 "Gallaher will maintain continuous and complete
 22 co-operation throughout the investigation."

23 Then there is reference to the CAT proceedings. At
 24 the bottom, 3F:

25 "In relation to any CAT proceedings, Gallaher, using

51

1 reasonable endeavours to facilitate and secure the
 2 complete and truthful co-operation of its current and
 3 former directors, officers, employees and agents, even
 4 if Gallaher is not party to those CAT proceedings; 2,
 5 assisting OFT or its counsel with preparation and if
 6 requested by the OFT or its counsel attending those CAT
 7 proceedings; and 3, speaking to any relevant witness
 8 statements and being cross-examined on such witness
 9 statements in those CAT proceedings."

10 So that's the reference I was making.

11 The point I make, it's not a very subtle one, but
 12 it's a point I do rely on. You would have thought that
 13 these developments might be thought to put the OFT in
 14 a good position to obtain trade witness evidence from
 15 one or more of these companies, and in particular from
 16 Gallaher, one might have thought that Gallaher would be
 17 in a good position to give evidence in support of the
 18 OFT's case if it were correct, but the Gallaher
 19 agreement with CGL at least provided for both fixed and
 20 rigid differentials in the way that Professor Shaffer's
 21 theory and the OFT's theory of harm depends.

22 However, the OFT has not in fact obtained a single
 23 witness statement in support of its theoretical case, on
 24 this or indeed any other appeal, from any individuals
 25 connected with the leniency or early resolution

52

1 companies. The only two witness statements in the OFT
2 evidence bundle are from two retail competitors,
3 Sainsbury and Somerfield, one of which is in draft and
4 not apparently relied on.

5 These statements, which are at CB6/69 and 70 date
6 back to 2005 and 2006 respectively, when of course the
7 OFT's case was primarily an effects case, they were
8 clearly not intended to support the OFT's current case
9 on this appeal, and they do not and cannot shed any
10 light on the arrangements involving CGL.

11 Certainly it would be impossible to accept that
12 evidence contained in such statements as against the
13 testimony of witnesses with direct knowledge of CGL's
14 business, and as Mr Howard has explained in detail, the
15 OFT has now rationalised its arguments in so many
16 different ways since any of these statements were made
17 that it's not clear what support they could actually
18 offer to the case that's currently being argued.

19 Turning to the expert evidence, we would say that
20 the theoretical issues debated by the experts have to be
21 applied to the specific facts of Co-op's case, and so
22 much is perhaps self-evident, but we note in this regard
23 that Professor Shaffer, the OFT's principal expert
24 witness, was only apparently involved at the
25 administrative stage to the extent that he was consulted

53

1 in 2007 prior to the issuing of the statement of
2 objections, and of course prior to the adoption of
3 an object approach alone, in relation to the
4 plausibility of the OFT's effects case rather than its
5 object case. One finds that in paragraph 3 of his
6 report at CB6, tab 64. {CB/64}

7 In addition, Professor Shaffer makes it clear in his
8 2010 report -- I think it's been referred to before,
9 paragraphs 9 to 11, CB6, tab 65 -- {C6/65} that he has
10 not conducted any independent empirical analysis of the
11 facts said to sustain his new theoretical arguments
12 advanced for the purposes of defending the object case
13 now advanced in the decision. He has been asked by the
14 OFT to assume its factual findings in the decision are
15 correct. One sees that at paragraph 11 of his main
16 report. This was also confirmed in the joint experts'
17 statement at CB12, tab 125, section 4.2, page 49.

18 Given that CGL is of course challenging the factual
19 basis on which Professor Shaffer has been instructed to
20 offer his opinion was obviously incorrect, at least as
21 far as CGL is concerned, the relevance of his
22 theoretical opinions is inevitably very much in question
23 in the CGL appeal.

24 Turning to the documents which I'll come to in more
25 detail in a moment, we would say that the very limited

54

1 documentary evidence on which the OFT relied as against
2 CGL, and there is nothing else, when read carefully and
3 in context as cases since the Societe Technique Miniere
4 tell us they must be, tells a clear and persistent story
5 that is in reality wholly incompatible with the factual
6 allegations said to sustain the OFT's novel theory of
7 harm.

8 So our first broad submission in conclusion is that
9 whatever the overall legal or factual position may be in
10 relation to other retailers, and other trading
11 agreements, matters of which CGL has no knowledge, CGL's
12 appeal is in fact a straightforward one that must be
13 assessed by reference to its own particular facts and
14 merits.

15 **THE CHAIRMAN:** So do you say we have to completely put out
16 of our minds, when looking at the CGL arrangements, the
17 arrangements that may or may not exist between ITL and
18 other retailers?

19 **MR THOMPSON:** I think it's merely part of the context in the
20 same way as Mr Howard made various observations about
21 the tax regime and issues particular to the tobacco
22 market, that there may be issues that are relevant in
23 terms of your findings as to how, for example, ITL's
24 strategy or Gallaher's strategy that they could be
25 relevant to the interpretation of CGL documents. But

55

1 merely because Shell may be found to have agreed one
2 thing or have had an agreement in a particular form or
3 Morrisons to have had a different one, in my submission,
4 without any evidence that CGL was aware of that, or that
5 CGL took the same view, in my submission that material
6 is totally irrelevant to the OFT's case against CGL.

7 **THE CHAIRMAN:** The point that you made a moment ago about
8 the relationship of CGL and GCLT, is that a point akin
9 to the point that Shell was making or you are only
10 really dealing with the point here about the prices set
11 in CGL's own --

12 **MR THOMPSON:** I think it is fair to say we haven't taken
13 that point that we are, as it were, divorced from
14 individual pricing decisions in individual Co-op shops.
15 It's possible that that is a point we could have taken,
16 but it's not a point we have taken. The reason why we
17 have raised it is in particular in the context of the
18 pricing matrices, which is one of the few sets of
19 documents that the OFT do rely on, we make a particular
20 point that for the Co-op, which was negotiating
21 centrally, these pricing matrices actually formed quite
22 an important management tool, in that they set out for
23 the benefit of all the various little shops all over the
24 place under different organisations, what had been
25 agreed centrally by the Co-op or by CGL with the

56

1 manufacturers, and that the OFT's suggestion that this
2 was some part of a ruse by the manufacturers to force us
3 to do certain things is really just reading the whole
4 thing upside-down and back to front, and it's really in
5 that context that the point is of most importance,
6 I think, and obviously Mr Messom and the other Co-op
7 witnesses can explain that in more detail.

8 Turning to my second broad heading, the issues, we
9 say the Tribunal must determine three issues. None of
10 this is very controversial, I hope. Is the OFT's case
11 against CGL sound, first of all on the facts, secondly
12 in theory, and thirdly as a matter of law? These points
13 will be dealt with in turn in the course of this
14 hearing. The facts will be considered in more detail in
15 a week or so, and the consideration of the documents,
16 and the examination of the relevant ITL and CGL
17 witnesses. The theoretical case will be addressed in
18 the cross-examination of the economic experts at the
19 start of November, and we will set out our legal case in
20 our closing submissions in December.

21 In summary, our bald submission is that the OFT's
22 case is completely unsound on all three measures. First
23 of all, the factual position in relation to CGL bears no
24 resemblance whatsoever to the extreme factual premises
25 needed to sustain Professor Shaffer's model or the OFT's

1 theory of harm.

2 Secondly, that theoretical model and the OFT's
3 analysis that is now said to be derived from that model
4 does not in fact support the OFT's case, even on its own
5 terms given broader factual considerations that apply to
6 the market generally.

7 Thirdly, and I suppose inevitably, there are
8 impossible difficulties, both as a matter of black
9 letter law and in relation to the OFT's overall object
10 assessment.

11 So I'll take the facts first. Although I'll address
12 the theoretical and legal position briefly at the end of
13 this speech, the case involving CGL turns on a proper
14 appreciation of the facts reflected not only in the
15 terms of the agreements themselves but also in the
16 overall picture that emerges from all the evidence now
17 before the Tribunal in respect of the CGL appeal.

18 I'll focus on the facts specific to CGL rather than
19 the overall description of the tobacco market, but
20 I note that this is fully described in the witness
21 statement of Mr Batty in particular on behalf of ITL,
22 and more briefly in our witness evidence, the notice of
23 appeal, section 2. Mr Batty is at core bundle 3,
24 tab 33. {CB3/33}

25 These general issues have been covered in the

1 opening submissions of Mr Howard, in terms that
2 I generally endorse and adopt. The reference to our
3 notice of appeal is CB7, tab 74, pages 38 to 39.
4 {C7/74/38} It seems to be missing in my copy but we will
5 obviously check whether that's true of yours and provide
6 it if necessary.

7 So the first point under the facts, we would say
8 that CGL's pricing of tobacco products and dealings with
9 the major tobacco manufacturers offer no support to the
10 OFT's case if I set it out in positive terms, we would
11 say the factual position in respect of CGL that emerges
12 from the evidence can be summarised as follows: First
13 of all, CGL had a tiered pricing policy, generally three
14 tiers, although at some points it was more, based on
15 price comparisons with other retailers in each price
16 band. The details of this policy were and remain
17 confidential to CGL, and this is a point that's dealt
18 with first of all as an exhibit at annex 5, tab OB, this
19 is annex to the statement of objections. I don't know
20 if the Tribunal has seen that but it might be worth
21 looking at it brief. It's the first two tabs in annex 5
22 to the SO.

23 I am not sure how secret this actually is, but
24 especially ten years on, but I forebear from mentioning
25 any names. The Tribunal see at the bottom of the table

1 at tab OB, if you have it, there is a table headed
2 "Pricing Policy, June 2001". Then there are various
3 comparisons made under three headings [REDACTED]
4 [REDACTED], and it's of some
5 significance to see PE [REDACTED], PE [REDACTED] and PE [REDACTED], because that comes
6 up again in the price matrices, one frequently sees PE [REDACTED],
7 PE [REDACTED] and PE [REDACTED] and there is some correspondence reference
8 to it. You will see that [REDACTED]

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9 [REDACTED]
10 [REDACTED]
11 [REDACTED]
12 [REDACTED]

13 This is an exhibit to Mr Messom's statement, so that
14 sets out what the Co-op's basic pricing policy was in
15 June 2001.

16 The significance of all this is explained in some
17 detail in the first witness statement of Mr Messom,
18 which one finds in the seventh core bundle, tab 83.
19 {C7/83}

20 **THE CHAIRMAN:** Can we put this away now?

21 **MR THOMPSON:** Yes. Sorry, it's rather a heavy bundle to
22 take out for one document, but it's a significant one.

23 In fact, I don't know if it would be convenient,
24 I will be making some references to annexes 5 and 15,
25 I don't know whether it would assist the Tribunal to

1 have them out rather than to have to keep taking them
2 out and putting them back. Then obviously our main
3 bundle is bundle 7.

4 For present purposes I was going to go to
5 Mr Messom's first witness statement, which is core
6 bundle 7, tab 83. First of all, Mr Messom describes his
7 role at CGL, and the passage I was referring to was
8 paragraph 1.4, the last sentence:

9 "In 2001, I was responsible for drawing up CGL's
10 retail pricing policy."

11 Then he describes it in some detail in the following
12 section, and in particular paragraphs 2.3 and 2.4, he
13 refers to the document we have just looked at, says:

14 "There was a separate category for tobacco and
15 cigarettes, this reflected the importance to CGL of
16 tobacco sales which were an important driver of footfall
17 in the convenience sector."

18 Then at 2.4 he describes the comparison in narrative
19 terms.

20 So that was the first element, the tiered pricing
21 policy and the comparisons with other retailers.

22 The second point is that CGL operated its pricing
23 policy based on 17 and formerly 13 three or four week
24 periods each year, and one finds that at Mr Messom,
25 paragraph 3.3 over the page.

61

1 sentences, and it's an important background fact in
2 terms of the various pricing matrices that you find in
3 the documents, because all of them have numbers, and so
4 the numbers on the pricing matrices refer to these
5 promotional periods, so what they are doing is each
6 promotional period they are setting out the pricing
7 position so that everybody knows where they are in the
8 sort of Co-op empire.

9 So the third point is, as I've just said, for each
10 pricing period CGL prepared price matrices for CRTG as
11 a whole, setting out not only suggested retail prices
12 but also wholesale prices and categories of discounts
13 and bonuses negotiated centrally by CGL, and there are
14 a number of examples of these documents in the papers
15 before the Tribunal, and they are a valuable source of
16 information as to pricing and promotional support.

17 There is an example, I'll come to it in a moment, at
18 tab 19 of annex 15. The significance of all this is
19 explained in some detail at paragraph 5.2 of Mr Messom's
20 witness statement. In particular, the second half:

21 "A number of CRTG members were also too small to
22 develop sophisticated pricing policies and regard the
23 provision of CGL's recommendation as an important part
24 of their thinking on price. They were therefore
25 dependent upon receiving these matrices. In other

62

1 words, the matrices were primarily an internal tool to
2 assist CRTG members in checking that agreed cost prices,
3 whether or not in relation to promotions, were indeed
4 those invoiced to them by the manufacturers and in
5 deciding upon their own pricing policies."

6 So these points applied across CGL's product ranges
7 generally. However, given the complexity of pricing in
8 the tobacco market, the regular changes in manufacturer
9 promotions and the lack of retail margin, it was
10 particularly important to ensure that the regularly
11 prepared price matrices were correct. For example,
12 a retailer could end up funding tax increases or
13 promotions if it didn't shift retail prices in response
14 to changes in the tax regime or the ending of
15 manufacturer promotional support. This could be
16 an extremely expensive mistake to make, as Mr Messom
17 explains at paragraph 5.4. So the last sentence:

18 "When one considers that CGL's and CRTG member's
19 purchases at the time were across all categories worth
20 approximately £5 billion per year, even a penny out on
21 cost prices could result in very substantial losses and
22 cause substantial work for invoice clerks at both CGL
23 and other CRTG members."

24 There were therefore regular exchanges between CGL
25 and individual suppliers such as ITL and Gallaher, to

63

1 confirm that there were no misunderstandings and that
2 promotional support was reflected in retail prices. As
3 part of such exchanges, CGL would sent to each of
4 Gallaher and ITL prices matrices relating solely to the
5 recipient manufacturer's own brands. Each matrix would
6 enable the manufacturer in question to ensure that CGL
7 had accurately recorded the extent of promotional
8 support and other discounts together with wholesale
9 prices.

10 All the CGL specific evidence is consistent on this
11 point, and in particular the evidence of Mr Messom and
12 Mr Goodall will explain the issue in considerable
13 detail. However, given the fact that the OFT places
14 some reliance on the existence of these price matrices
15 as a significant part of its factual case against CGL,
16 I give a reference at 6.588, it's worth emphasising that
17 the price matrices are in fact quite irrelevant to the
18 OFT's case.

19 I make four points. Matrices of this kind were
20 compiled on a systematic basis to inform CRTG members of
21 the cost prices and bonuses agreed with suppliers,
22 together with recommended shelf prices across the full
23 range of products sold by the Co-op. As I have just
24 mentioned, manufacturer specific versions of these
25 matrices were sent by CGL to individual suppliers to

64

1 ensure that CGL had accurately recorded wholesale
 2 prices, including off-invoice discounts and bonus
 3 payments for individual manufacturers. This checking
 4 was generally an administrative matter with responses
 5 identifying corrections or anomalies within a matter of
 6 hours. For example, one finds at tab 13 of SO annex 5
 7 a reply by email approximately an hour after the CGL
 8 price matrix had been sent to, in that case, Gallaher.
 9 The price matrices sent to a manufacturer such as
 10 ITL or Gallaher did not contain information about CGL's
 11 pricing of competing products and could not therefore
 12 have been used for the purpose of monitoring P&Ds,
 13 parities and differentials. One sees that at
 14 paragraph 5.2 of Mr Messom as well.
 15 I think at this point it may be helpful to actually
 16 look at one of these pricing matrices, and the one that
 17 I think is most useful to look at is the one I referred
 18 to, tab 19 of annex 15, which is explained in detail by
 19 Mr Goodall in his witness statement. I am told that the
 20 number in the second line of page 159, as it appears, is
 21 confidential. It's difficult to know what benefit
 22 anyone could discover from this particular fact nine
 23 years after the event, but anyway, I won't mention it.
 24 You will see, what it is, it's an email from
 25 Mr Newton, who was the Co-op contact employee, he sends:

65

1 "Please see attached price files for you to check
 2 and confirm. Please note the only change to period 15
 3 are the lines featured with POS."
 4 So this is fairly late in the year so we seem to be
 5 to period 15, and then the response comes from
 6 Matthew Gamm, who I take it to be the ITL account
 7 manager, and you will see that the email is sent from
 8 Mr Newton at 11.30 on Monday, 30 September, and the
 9 response comes back at quarter past 1 on the same day.
 10 "Peter, please find attached the period plans for 14
 11 and 15. Please note the concept bonus of [X]p is retro,
 12 rather than off-invoice."
 13 So the correction that's made is to the form of
 14 bonus given for a single product concept. Then if you
 15 turn over the page, one will see one of these price
 16 matrices, and as I say, there is a detailed explanation
 17 of this particular document helpfully set out at
 18 paragraphs 46 to 54 of Mr Goodall's first statement, and
 19 in particular paragraph 49, which one finds at
 20 CB3/38/466 to 469, {C3/38/466} but I don't think it's
 21 necessary to turn that up now, I would simply commend it
 22 to the Tribunal in due course, if you want to get
 23 chapter and verse on what all this means.
 24 What you will see, it's in relatively small type so
 25 I'll put my glasses on, is in the left-hand column,

66

1 a series of products, then the sizes and cases involved,
 2 and then the MRP, which I think is sometimes called RRP,
 3 so it's the manufacturer's recommended price anyway.
 4 Then there is a list price given, which is for
 5 larger units which are supplied, if one sees under "Cost
 6 Structure" five columns, there is the list price, the
 7 O/I or off-invoice price, which you will see is not
 8 given in every column, and Mr Goodall explains that the
 9 off-invoice price depended on pricing below MRP, and so
 10 you will see that where, for example, in the second
 11 column, Embassy No 1 Kingsize, the MRP is given as 2.26,
 12 then I believe that the other figures are said to be
 13 confidential, I am not sure why, but they are higher, so
 14 there is no off-invoice discount given, whereas in the
 15 first column the RSPs are lower than the MRP, and then
 16 the off-invoice discount is given.
 17 So that's --
 18 **DR SCOTT:** Just to be clear, you said earlier on that this
 19 enabled the manufacturers to check the wholesale
 20 information in those columns, but presumably in doing
 21 so -- and this is the example you are just giving --
 22 they need to correlate the MRP with the three columns of
 23 RSPs.
 24 **MR THOMPSON:** Yes.
 25 **DR SCOTT:** -- in order to see whether, for example, the

67

1 off-invoice payment is correctly stated.
 2 **MR THOMPSON:** Yes, this is a complete document, as
 3 I understand it, that was sent to Imperial setting out
 4 the prices that the Co-op intended to charge at its
 5 different tiered outlets, we have seen RSP [REDACTED]
 6 before, so those are the superstores, market towns --
 7 **THE CHAIRMAN:** Is the fifth column under "Cost Structure"
 8 net, that is derived from deducting the O/I and the BDD
 9 from the list price?
 10 **MR THOMPSON:** That is correct.
 11 **THE CHAIRMAN:** So that is the ...
 12 **MR THOMPSON:** That's what the Co-op was actually being
 13 charged, for example for Embassy Filter, they were being
 14 charged -- I don't know if this is confidential, it
 15 looks like it might be. I don't know why it's
 16 confidential.
 17 **THE CHAIRMAN:** So they charged the figure under "Net", but
 18 the MRP is not -- that's the manufacturer's recommended
 19 retail price, so it's nothing to do with the wholesale
 20 price; is that right?
 21 **MR THOMPSON:** That's right. So that's part of the published
 22 price list.
 23 **THE CHAIRMAN:** Yes.
 24 **MR THOMPSON:** The MRP. So that's a published price. So
 25 it's put in from information. But its significance is

68

Confidential
CGL

1 that if it is higher than the RSP prices that one finds
 2 over on the right, then the Co-op gets the O/I discount,
 3 whereas --
 4 **THE CHAIRMAN:** So that, looking at the top one, the
 5 Embassy Filter, for a case of ten packs of 20, the list
 6 price is that first figure, and then the net price is
 7 the figure that would take account of ...
 8 **MR THOMPSON:** Exactly.
 9 **THE CHAIRMAN:** Yes. The deduction.
 10 **MR THOMPSON:** Yes. So we are getting a significant discount
 11 on the list price, that's already below ten times the
 12 MRP, but then we get an additional discount for pricing
 13 below RRP, and we get a further discount which is
 14 called a bulk drop discount just because of the amount
 15 of stuff we sell, so that's a further reduction which is
 16 effectively a bulk discount. Then perhaps the most
 17 interesting column which is blank on this page is
 18 "Retro", but if you turn on, over the page, for example,
 19 you see in relation to Superkings on the second page
 20 that there was a period 14 promotion for Superkings in
 21 various forms, and so that's reflected in a further
 22 discount which actually appears on the right-hand side
 23 and leads to a lower net price. I think that's perhaps
 24 not a good example.
 25 **THE CHAIRMAN:** What does it say in that blacked out heading

1 of the columns? I can't see what that says. It may or
 2 may not ...
 3 **MR THOMPSON:** I think "Normal Price", and ...
 4 **THE CHAIRMAN:** "Normal Pricing".
 5 **MR THOMPSON:** Sorry, it's not clear. "POS support,
 6 temporary pricing".
 7 **THE CHAIRMAN:** So you are going to go on and tell us what
 8 the RPSs --
 9 **MR THOMPSON:** I think a better example perhaps is Richmond
 10 Kingsize where there is an additional temporary bonus,
 11 one sees on the next column, "Period 14 pricing: change
 12 to temporary pricing", and there you will see
 13 a difference between the right-hand column prices and
 14 the normal cost prices.
 15 **THE CHAIRMAN:** I see.
 16 **MR THOMPSON:** Then if you look further down, Richmond
 17 Kingsize multipack, you will see that there was a retro
 18 bonus within the normal pricing, and that's explained
 19 over on the right in terms of a price marked pack.
 20 **DR SCOTT:** Then the manufacturer would assume that the
 21 members of the CRTG would comply with the matrix?
 22 **MR THOMPSON:** Yes, and you will see some documents which we
 23 will come to in a moment about what happened when that
 24 didn't actually happen. But the idea was that the Co-op
 25 was effectively setting these prices in different tiers,

1 and notifying the manufacturer to make sure there were
 2 no misunderstandings, so that suddenly they won't find
 3 themselves £10,000 out because they were selling
 4 Richmond Kingsize at one price and in fact they were
 5 receiving it at a different price, or rather ...
 6 **THE CHAIRMAN:** And the three different RSP columns, do those
 7 relate to different tiers of --
 8 **MR THOMPSON:** Yes, if you remember we looked at the pricing
 9 comparison box and there were three columns. RSP was,
 10 as far as I remember, the superstore, RSP was the
 11 market, and RSP was the convenience. So in general
 12 one will find RSP is the lowest, RSP is slightly
 13 higher and RSP is slightly higher than that.
 14 Yes, I think they are PB in the pricing boxes,
 15 pricing policy.
 16 **DR SCOTT:** When we looked at that we saw the policy in
 17 relation to various comparator retailers. Remind me
 18 what is being said about who was checking that.
 19 **MR THOMPSON:** That's something, as it were, on the Co-op's
 20 side of the fence, that we are watching what's going on
 21 in competing retailers, and we have identified who they
 22 were, and our policy was to match those.
 23 **DR SCOTT:** So you are not looking to the manufacturers'
 24 representatives visiting the stores to feed back to you?
 25 **MR THOMPSON:** No, we couldn't care less about that, except

1 insofar as we got grief from the manufacturers. Our
 2 policy was to be competitive with X and Y retailers.
 3 **DR SCOTT:** Yes. Sorry. But you are looking to the
 4 manufacturers to check these figures for internal
 5 consistency rather than come back to you and say "Well,
 6 actually, Tesco's are selling it at whatever, or somebody
 7 else is selling it at whatever?"
 8 **MR THOMPSON:** Yes, we were not relying on them for that, we
 9 were relying on them, and this 19 is quite a simple
 10 little example, where they tell us that we put the bonus
 11 for concept in the wrong column, and in fact I think
 12 this is the matrix that came back, because when you find
 13 concept, if I can find concept, it's here somewhere,
 14 concept is on page 168 of the numbers that one finds.
 15 **THE CHAIRMAN:** I see, they are saying that that figure,
 16 which is all alone there, is in the wrong column.
 17 **MR THOMPSON:** Yes, and they have moved it across, and
 18 I think Mr Goodall says this can be pretty important
 19 because if you start giving a discount in the wrong
 20 column, then the manufacturer can say "Well, you always
 21 give us that discount", and then there can be a dispute.
 22 So that's why they check. In this case, they said "You
 23 have put it in the wrong column" so they moved it
 24 across.
 25 **DR SCOTT:** Just for completeness, BDD is the business

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CGL

1 development -- bulk discount --
 2 **MR THOMPSON:** Bulk drop discount. It is essentially a bulk
 3 discount. I am not sure what drop has to do with it,
 4 but it's a bulk discount.
 5 **MR SUMMERS:** Could I just ask for information: when you say
 6 we are looking at what our competitors do, is that the
 7 Co-op's own staff or is that something which is
 8 subcontracted to an external agent?
 9 **MR THOMPSON:** I think this is the sort of thing that
 10 Mr Messom would be excellent at answering, and I think
 11 he may have dealt with it in his witness statement, but
 12 if he hasn't, I am sure he could answer that question
 13 very eloquently.
 14 **MR SUMMERS:** Thank you.
 15 **THE CHAIRMAN:** Just one final question on this: in the RSP
 16 columns, there is for each item an absolute price and
 17 then a percentage, and the percentage is, what, the net
 18 wholesale, the RSP over the net wholesale?
 19 **MR THOMPSON:** I think it's the margin, I couldn't quite tell
 20 you exactly how it is calculated.
 21 **THE CHAIRMAN:** It is the margin, but we are comparing what
 22 with what?
 23 **MR THOMPSON:** We will find there are some documents which
 24 refer to margins, and it may be that I can be told.
 25 Again, we maybe could tell you at 2 o'clock how we work

1 out that margin. It may be simply a margin as against
 2 some form of calculation from the list price, or from
 3 the net price.
 4 **THE CHAIRMAN:** From the net price, that's what I wanted to
 5 know, yes.
 6 **MR THOMPSON:** Anyway, our short, but in my submission
 7 somewhat devastating, submission is that the OFT has
 8 completely misunderstood the significance of these
 9 pricing matrices, but obviously this is a matter that
 10 can be explored in evidence.
 11 The second point on the facts I would like to make
 12 is that the OFT makes -- it hasn't really got anything
 13 else, the only other evidence it has is contacts between
 14 CGL and the tobacco manufacturers, and in particular in
 15 the context of price promotions, we would say were
 16 entirely convention supplier/retailer contacts.
 17 The first point I would make is that Mr Howard has
 18 emphasised the extent to which ITL in particular was
 19 concerned to ensure that it obtained full value from its
 20 promotional pricing. That's not a matter within our
 21 direct knowledge, but there are certainly documents in
 22 the CGL files that are consistent with that submission,
 23 and I think tab 13 of annex 15 is probably the best
 24 example. So this isn't a price matrix exchange, this is
 25 a case where Mr Goodall has obviously done some market

1 research and writes a somewhat testy fax or email to --
 2 a fax to Mr Newton, I think. Pricing, 29 April 2002,
 3 I don't think we need to look at all of it, but perhaps
 4 we can look at the Richmond family, which I think was
 5 the low priced sort of fighting brand for ITL.
 6 Mr Goodall says:
 7 "Having looked at the CRTG pricing for yesterday's
 8 calls, I am very concerned about the Richmond family
 9 pricing. The matrix [so this is the Co-op matrix]
 10 indicates that KS should be [redacted], and the
 11 Superkings should be [redacted]."
 12 I don't know if this is confidential. It's so long
 13 ago.
 14 **DR SCOTT:** It's not red-boxed, but it does say
 15 "Confidential".
 16 **MR THOMPSON:** Perhaps I'll stop citing the figures.
 17 "In the 82 calls covered yesterday, only 31 were at
 18 the right prices. The other 51 calls were [and he gives
 19 two higher figures] which are prices on the left of the
 20 matrix, not the promoted prices. As you are aware,
 21 there are currently price marked packs in the
 22 independent trade at [another price] so these error
 23 prices are above the normal market price."
 24 So it's pretty clear what's going on here,
 25 Mr Goodall has made phone calls and found the prices to

1 be too high, and then he makes the similar point in
 2 relation to Lambert & Butler Kingsize, Superkings
 3 family. Then he concludes:
 4 "I am very concerned about the situation as
 5 I continued our levels of investment over this post
 6 Budget period at your request but still the pricing is
 7 confused. I would welcome your urgent help with the
 8 situation. I'll ring to discuss asap."
 9 Now, in my submission, it's perfectly obvious what
 10 this is. This is ITL complaining that their promotional
 11 support is not being reflected in reduced retail prices
 12 in a large chunk of CGL's stores. I would submit that
 13 this exchange obviously has nothing to do with parities
 14 and differentials, but it's cited without explanation in
 15 the decision at paragraph 5.60 of section 6.
 16 **THE CHAIRMAN:** The relevance of the matrix there is that he
 17 assumes from the matrix that the intention of CGL was
 18 that it, the promotion, should be reflected in the shelf
 19 prices?
 20 **MR THOMPSON:** Yes.
 21 **THE CHAIRMAN:** That's what the information in the matrix
 22 gives him, but they were at least purporting to ITL to
 23 tell their constituents "This is how you should be
 24 reflecting the promotion".
 25 **MR THOMPSON:** Yes, and I think the complaint is that ITL is

1 giving a chunk of money to CGL on the understanding that
 2 it's being used to push down CGL retail prices and so
 3 it's getting a competitive advantage from that price
 4 reduction, but in fact --
 5 **THE CHAIRMAN:** Yes, but that they could do without this
 6 matrix business, they could have themselves compared the
 7 prices pre-promotion with the prices that they see post
 8 promotion and have seen that there has been no reduction
 9 in the shelf prices. I am just trying to see what it is
 10 that the passing of the information in the matrix would
 11 add to the situation.
 12 **MR THOMPSON:** I think they are saying that the promotional
 13 support is granted centrally and is reflected in these
 14 detailed matrices which, as you have seen in the
 15 right-hand column, sometimes sets out particular
 16 financial support and the prices that the Co-op is
 17 recommending because of that promotional support, and
 18 then they come along and they find that they are giving
 19 the promotional support but in fact the pricing is
 20 exactly the same as it was before, and then ITL says
 21 "What are we giving you this money for? We have given
 22 you money specifically to drop your prices in a way that
 23 you have set out carefully in your matrix, so we thought
 24 effectively we had a sort of deal between us that we
 25 were giving you this money for you to lower your prices,

77

1 then we find two-thirds of your stores aren't doing
 2 anything, so we are basically just shovelling cash into
 3 the Co-op and getting no benefit". I think that's the
 4 gist of the complaint here.
 5 In my submission, that's entirely consistent with
 6 the account I have given of the matrices, and has
 7 nothing to do with parities or differentials.
 8 **THE CHAIRMAN:** Yes.
 9 **MR THOMPSON:** Then I would say similarly there are various
 10 documents in the Gallaher files that evidence a concern
 11 by Gallaher to stimulate sales by promotional discounts
 12 or to respond to pricing initiatives by other
 13 manufacturers. Again, one can find examples of various
 14 kinds, but if one looks at annex 5, tabs 1 and 2, {D5/1}
 15 this relates to period 6, so a bit earlier in the year,
 16 and you will see that this is Mr Newton sending either
 17 a fax or an email, to somebody called Tony, who
 18 I believe is Mr McGuinness, you will see that from the
 19 next tab. There is some social chit-chat and then he
 20 says:
 21 "Please see attached period 6 pricing."
 22 And here this does at least get the OFT's case
 23 slightly off the ground, in that he says:
 24 "I can confirm that Royals 20s will be at 3.39 in
 25 all price bands during this period. Please advise as to

78

1 whether you are wishing to follow with Mayfair as we
 2 will have to agree an appropriate level of bonus that
 3 will not adversely affect the current margin in each
 4 price band."
 5 Royals was actually a Rothmans brand, and obviously
 6 what's happening here is that they are on promotion and
 7 the question has arisen as to whether or not Gallaher
 8 wish to respond. So it's a response clause case, as
 9 Mr Howard has called it.
 10 Then over the page, you see that in fact
 11 Mr McGuinness does want to respond. So:
 12 "You agree to review current Mayfair retails and
 13 reduce prices as soon as possible from 3.45, which is in
 14 line with our main competitors."
 15 So there you see Gallaher competing on price in that
 16 case with Rothmans. We set that out in some detail in
 17 a document which, in due course I will place some
 18 reliance on, which is annex 4 to our reply, where we go
 19 through all the contacts material that the OFT relies
 20 on, and it's paragraphs 50 to 60 of annex 4 to our reply
 21 where we deal with this in considerable detail.
 22 But for present purposes it's simply evidence of
 23 Gallaher responding to a price promotion by Rothmans,
 24 and we would say it has nothing to do with parities and
 25 differentials, it's simply competitive discount.

79

1 Nonetheless, it appears in the decision.
 2 Then at tab 10 there is a letter dated 12 July 2001,
 3 again from Mr McGuinness to Mr Newton. This concerns
 4 two discount initiatives. First of all in relation to
 5 Mayfair, there is an agreed discount bonus for
 6 multipacks and a price indicated there which Gallaher
 7 wishes to achieve. But, for my purposes, the more
 8 important point is the second product. There seems to
 9 be a mistake in the letter that a reference to
 10 Amber Leaf, whereas in fact I think it's Samson,
 11 Mr McGuinness says:
 12 "In addition, I have amended the Samson bonus [it
 13 says Amber Leaf but I think it should be Samson] and you
 14 will note a more generous contribution, swings and
 15 roundabouts. I am sure at £1.99 and £3.88 for the
 16 12 gram and 25 gram respectively, we should observe some
 17 encouraging offtake and demand."
 18 I think that may be a misprint, it should be
 19 "offtake in demand".
 20 Again, that's just a straightforward case of
 21 Gallaher offering a discount with the view to reduced
 22 retail prices generating additional demand for going
 23 products.
 24 **THE CHAIRMAN:** So those figures, the 1.99 and the 3.88,
 25 those are retail price, or are those the wholesale

80

1 price?
 2 **MR THOMPSON:** I am pretty sure they are retail figures.
 3 Again we deal with this in considerable detail at
 4 paragraphs 102 -- yes, I am told that the retail figures
 5 are on the next page, in the right-hand column. This is
 6 part of a promotional plan and the retail prices are set
 7 out in the bottom right-hand column.
 8 This is paragraphs 102 to 118 of annex 4 to our
 9 reply. It might be worth looking at that just for
 10 a second.
 11 **DR SCOTT:** Sorry, just looking at the chart for a moment, Q6
 12 as I recall was the -- has the bulk discounts in it.
 13 **MR THOMPSON:** Yes, I think that's right. The retro bonus is
 14 in the previous column. That's what leads to the
 15 discounted price in the right-hand column.
 16 **THE CHAIRMAN:** Yes. You were taking us to ...
 17 **MR THOMPSON:** Yes, I think if we look just briefly at
 18 core bundle 7, tab 77, {C7/77} I certainly don't have
 19 time to go through all of this material in this speech,
 20 but it may assist just to show the Tribunal what this
 21 is. It's a very detailed analysis of all the contacts
 22 evidence that exists for CGL, and the way it's been done
 23 is incident by incident, and so in relation to this
 24 particular incident, one finds it towards the back of
 25 the tab. It starts at page 283 or 36 of the document

1 itself, towards the bottom of page 36 of the document
 2 itself you see it's a letter from Mr McGuinness to
 3 Mr Newton on 12 July 2001. Then it goes right through
 4 to 118 on page 42, and it goes through all the evidence
 5 and also the price relativities at the time.
 6 This is a particularly striking instance, for the
 7 reasons set out at 116, because my diligent junior and
 8 solicitors have looked at the pricing matrices that we
 9 actually have and looked at the evidence as to what's
 10 actually happened, and in parentheses one of our
 11 complaints is that the OFT never appears to have done
 12 this sort of homework. At 116 we find:
 13 "Before the promotion, both Samson and Drum [which
 14 is the competing product] were priced at the same level,
 15 but following the promotion Samson was priced at between
 16 8p and 12p and 16p and 21p out of line with Gallaher's
 17 desired parity and differentials. The OFT's suggestion
 18 that Gallaher's promotional activity in this respect was
 19 to match a reduction in the price of the paired ITL
 20 brand is therefore simply wrong. To the contrary, it
 21 appears to be an instance of Gallaher using promotional
 22 pricing as a way of gaining market share as against ITL,
 23 hence the letter writer's comment that we should observe
 24 some encouraging offtake in demand. It's a clear case
 25 of price competition funded by the manufacturer."

1 So what I should perhaps explain, what these little
 2 coloured tables show, where they are green you see the
 3 brands are aligned, and where they are ... my colour
 4 scheme is ...
 5 **DR SCOTT:** Yes, there is a green one on table 15, if you
 6 turn back a page.
 7 **MR THOMPSON:** I think where they are dark green they are out
 8 of line. So I think what's being said is that they were
 9 aligned but they were pushed out of line. I may have
 10 that the wrong way around. But the gist of it is that
 11 the work has been done to see how the correlation worked
 12 and whether or not brands were or weren't in line at
 13 particular times, and the point we make is at some point
 14 promotions actually pushed parities out of line, and the
 15 other point we make is that on numerous occasions, the
 16 prices were out of line but there was no complaint made
 17 by the manufacturers, despite the fact that they pick up
 18 a variety of quite precise points but they repeatedly
 19 failed to pick up numerous cases where we were out of
 20 line.
 21 So that's a detailed document, and as I say, I do
 22 not have time to go through it today, but in that
 23 particular instance it's particularly revealing.
 24 So we say that although some of this sort of
 25 material finds its way into the decision as part of the

1 OFT's unexplained citations, the administrative file for
 2 CGL, it is in fact obvious that these sort of contacts
 3 were standard manufacturer/retailer interactions, it had
 4 nothing to do with the OFT's concerns over parities and
 5 differentials. On the contrary, they evidence price
 6 competition of a particularly obvious and direct kind,
 7 ie competitive discounting.
 8 I now turn to parities and differentials themselves
 9 insofar as they feature as a part of the Co-op case. We
 10 say that incentives to observe P&Ds formed a legitimate
 11 part of a wider commercial relationship and had no
 12 impact on CGL's pricing policy to maintain its
 13 competitiveness against rival retailers.
 14 Although one element of the various trading
 15 arrangements between ITL and CGL and Gallaher and CGL
 16 respectively did refer to parities and differentials
 17 until the end of 2002, it's apparent that these
 18 provisions formed part of a much wider commercial
 19 relationship and had no material impact on CGL's pricing
 20 strategy, which was based on maintaining retail price
 21 competitiveness with specified retail competitors.
 22 Again, both the contemporary and the witness
 23 evidence on behalf of CGL is entirely consistent on this
 24 point. I've shown you the pricing policy itself and
 25 I refer also to the statements of Mr Messom and

1 Mr Goulthorp, which are at tabs 81 and 83 of core
 2 bundle 7. {C7/81}
 3 There is no evidence at all of CGL being considered
 4 by either manufacturer to be under any obligation to
 5 observe rigid parities or differences. On the contrary,
 6 there is abundant evidence that is inconsistent with CGL
 7 being subject to any such obligation to either
 8 manufacturer, given the express terms of the Gallaher
 9 agreement in particular, the widespread non-compliance
 10 by CGL and the lack of any reproach in any contemporary
 11 document. If one looks first of all at the compliance
 12 statistics agreed between Dr Jenkins and Dr Walker,
 13 that's section 5 of Dr Jenkins' second report,
 14 {CB7/79/419} and following, annex 4 to the reply which
 15 we have just looked at, we would say that this is
 16 a common sense point, a dog that didn't bark point,
 17 given that CGL's pricing frequently did not conform to
 18 P&Ds it's revealing that there was no complaint from
 19 either Gallaher or ITL and bonuses were paid as a matter
 20 of course.
 21 **THE CHAIRMAN:** So just to try and work out what you are
 22 saying, then, is the relationship between the price
 23 matrices which we have looked at which appear to purport
 24 to say that the RSPs are derived or adapted in some way
 25 to reflect the different, particularly the temporary

85

1 promotions, and those are provided to ITL and to
 2 Gallaher in relation to their respective products, so
 3 how does that interrelate then with the policy to match
 4 the retail prices to AN Other retailer who may or may
 5 not be getting those same temporary promotions? Is the
 6 price matching done at some more local level, so that's
 7 part of the decision of the local shop whether to follow
 8 the recommendation, or is that tied into those RSPs in
 9 some way?
 10 **MR THOMPSON:** In the end, I think ours is a fairly unruly
 11 organisation at one level, in that I don't think that
 12 Mr Messom and Mr Goulthorp, who were senior offices of
 13 the CGL, were in a position to compel the individual
 14 shops to price in particular ways. I think the most
 15 that could be done was to have a central negotiation
 16 with a central set of recommendations, effectively.
 17 **THE CHAIRMAN:** But are you saying that, just looking at the
 18 price matrices, and the RSPs that are arrived at, when
 19 you talk about compliance, are you saying that actually
 20 most of the time or a lot of the time, the RSPs written
 21 there did not actually reflect any promotional activity
 22 on the part of ITL in the sense that there might be
 23 a temporary promotion noted in the price matrix which
 24 did not in fact lead to a change in the RSP figure for
 25 that period.

86

1 **MR THOMPSON:** I think one needs to distinguish a number of
 2 things. I have just had a note handed up and it's a
 3 point I should have made, is that CGL was a retailer --
 4 I think I did make that point -- and insofar as it was
 5 a retailer then these figures were effectively firm, and
 6 one could -- they were more than recommendations.
 7 **THE CHAIRMAN:** Yes.
 8 **MR THOMPSON:** But CGL was also negotiating on behalf of
 9 a wider organisation, and for those, they were
 10 effectively recommended prices on our side of the fence,
 11 and I think that may be partly why Mr Goodall found it
 12 a rather unsatisfactory thing from time to time, because
 13 he thought he had done a deal and then he found a whole
 14 lot of shops didn't seem to be reflecting that deal.
 15 **THE CHAIRMAN:** That point is a separate point, it's
 16 an implementation point, but I am just asking: as far as
 17 the matrices are concerned, are you saying that the
 18 matrices noted that there was a particular temporary
 19 promotion or discount for a particular brand but a canny
 20 ITL person would say "Wait a minute, in the previous
 21 periods when we weren't doing that promotion, the RSPs
 22 were this and they are still that, because they have not
 23 actually changed the RSP to reflect this promotional
 24 discount".
 25 **MR THOMPSON:** I think Mr Goodall's letter that we looked at

87

1 would be an instance of that, but as I think as
 2 I understand it you are asking another question, which
 3 is: how did it work more everyday --
 4 **THE CHAIRMAN:** No, I am not asking how does it work
 5 everyday, I am asking: How does the pricing policy
 6 which seems to depend on comparisons with another
 7 retailer work in conjunction with reflecting temporary
 8 promotions which are offered by ITL or Gallaher to you,
 9 but you don't know, you say, whether they are being
 10 offered to that competing retailer who is your
 11 benchmark?
 12 **MR THOMPSON:** Yes, I understand that, I was thinking of, as
 13 it were, two situations. One, we are getting our bulk
 14 discount and our retrospective and then we are comparing
 15 our price, and our price may or may not be higher or
 16 lower, and that's based on Mr Messom's general policy.
 17 Then cutting across that, from time to time for
 18 particular products there will be promotions and I think
 19 now I understand what you are asking, it is how did the
 20 comparison with other retailers work, in the context of
 21 a promotion, and I suspect that the reality is that for
 22 major retailers, there was some similarity in terms of
 23 promotional activity, so as one finds in other products
 24 there will be a promotion for Pringles or whatever, and
 25 it may be across the market, but that there will be sort

88

1 of competition for promotional support and interaction
 2 you may or may not say, "Well, Asda is getting
 3 a particular promotion, so we must also have one", or
 4 else you may say, "Asda has a promotion but it is
 5 finishing on 1 October so we will not worry about that
 6 and we will look at the underlying price comparison".

7 So I doubt if there is a clear cut answer. I think
 8 it's part of competition in the market. But sometimes
 9 there will be price marked packs which go across the
 10 whole industry; sometimes there will be a CGL specific
 11 promotion, which isn't being offered to Asda or Tesco,
 12 but the comparisons will go on nonetheless.

13 **THE CHAIRMAN:** Okay. Perhaps it's a slightly different
 14 point, the first point, then, which is when you are
 15 talking about compliance, are you talking about not
 16 making any reductions in the RSPs in the price matrix,
 17 even though you are accepting a temporary promotional
 18 discount to bring the price down from ITL, or when you
 19 talk about compliance are you just looking at what the
 20 shelf price in the actual shops was?

21 **MR THOMPSON:** There is compliance with our policy, and
 22 I have just had a note handed that in fact our policy
 23 didn't apply, it was a non-promotional policy so it was
 24 sort of the standard price, that was what we were
 25 comparing, so if you notice that Tesco had a month price

89

1 or Asda had a month price you wouldn't necessarily seek
 2 to match that, although obviously it would be nice to
 3 have that promotional support. In terms of how one
 4 dealt with promotional money, I think that compliance
 5 issue is the one we have been looking at, where ITL says
 6 "We are giving you a chunk of cash to promote
 7 a particular brand, but we find that brand is still
 8 priced just the same, so you have effectively just
 9 pocketed the money". But that is nothing to do with
 10 parities and differentials.

11 **THE CHAIRMAN:** They are complaining that when they go to the
 12 shops they see that the price has not been brought down
 13 in accordance with what they were expecting to see
 14 because of the price matrix. What I am asking is: at
 15 an earlier stage, did the price matrix always
 16 incorporate a change to the RSP when CGL accepted
 17 a bonus for the temporary promotion of that product? It
 18 may be that's something we could explore, but that seems
 19 to me --

20 **DR SCOTT:** It's the figures that end up on the right-hand
 21 side of the matrix, I mean, CGL had its pattern of
 22 promotional periods, as we understand it, we have the
 23 reference in one of the documents to which you took us,
 24 price marked packs amongst independents, hinting to CGL,
 25 you know, these price marked packs are out there, so you

90

1 are out of line with your competitors, I think it's the
 2 Alldays level, so there are a variety of different
 3 things going on. As I understand it, the manufacturers
 4 from CGL's perspective were expected to try to tie their
 5 promotional period into the promotional periods that CGL
 6 had, and then that turned up on the right-hand side of
 7 the matrix.

8 **MR THOMPSON:** Yes, and CGL as a big retailer quite liked
 9 receiving promotional money that it could use for its
 10 own targeted promotions, so it may be that -- I can see
 11 the time, I have lost a little time here -- I will be
 12 better employed for me to get told by somebody who knows
 13 the answer rather than for me to just make it up.

14 **THE CHAIRMAN:** Yes. To be clear, what I am looking for is
 15 not whether the shops abided by the matrix or not, but
 16 whether the matrix changed the prices, the RSPs, in
 17 response to the acceptance of the promotional, temporary
 18 promotional discount from one of the manufacturers.

19 **MR THOMPSON:** Yes. I think the answer is yes, but I'll take
 20 instructions.

21 **THE CHAIRMAN:** Let's come back, then, at 2 o'clock.

22 (1.00 pm)

23 (The short adjournment)

24 (2.00 pm)

25 **MR THOMPSON:** Madam Chairman, if I can pick up and hopefully

91

1 draw together some points that arose from the discussion
 2 before lunch, I could give a short answer, which is that
 3 Mr Messom will be before the Tribunal and will be
 4 an expert on all these questions, but I will do my best
 5 to try and summarise the position now.

6 The first point is that CGL is a retail group that
 7 formed part of the CRTG group, and it's a point that
 8 I should have made before, but the decision and the fine
 9 were based on CGL's turnover rather than of the group,
 10 so that's why the Shell point, as it were, doesn't
 11 really arise.

12 Just for information, CGL's, roughly speaking, half
 13 of the whole group, I think it was in a majority up to
 14 2001, then a minority after various other independent
 15 groups joined, and then moved back into a majority when
 16 it took over Alldays. In terms of pricing policy,
 17 actual pricing was normally done rather than at the
 18 store level but at the member level. So, for example,
 19 if there was a Midlands group, they would have a policy,
 20 and the question would be whether that policy and its
 21 related stores were complying with the matrices. It
 22 would be that type of issue that would arise.

23 The normal position would be that CGL would price by
 24 reference to retail comparators, along the lines that we
 25 have said. In relation to promotions, the right-hand

92

1 column that we have looked at were normally retailer
 2 selling prices which were effectively conditional on the
 3 promotions, so they would operate as a sort of effective
 4 maxima to receive the promotional support.
 5 Mr Goodall gives evidence on this at paragraph 54 of
 6 his statement, and he says when a matrix came in he
 7 would not normally concern himself much with the RSPs,
 8 he would only protest if he saw an obvious error, so
 9 something that was inconsistent, or if they were too
 10 high, presumably either they were above RRP, if there
 11 was off-invoice discount being given or claimed, or if,
 12 more normally, if they were outside of the scope of what
 13 he would understand as the basis for the promotional
 14 payment.
 15 Then in the field, manufacturers might protest, as
 16 we have seen, if a proportion of CGL or independents
 17 were either pricing above RRP when the off-invoice
 18 discount was being paid, or if promotions were not being
 19 reflected in retail prices.
 20 **DR SCOTT:** Sorry, is what you are saying that independents
 21 in the correspondence refers to independent Co-ops
 22 rather than non-grouped retailers?
 23 **MR THOMPSON:** I would have to look on an individual
 24 document, but when I was using independent, I think
 25 I was meaning non-CGL members of the CRTG. So in

1 relation to whom these were price recommendations.
 2 **DR SCOTT:** Understood.
 3 **MR THOMPSON:** But the key point of all this is that these
 4 matrices were CRTG documents, in other sectors they
 5 might not normally be shown to suppliers at all. For
 6 example, if it was a straightforward and simple product,
 7 possibly baked beans might be an example. They were
 8 only shown to suppliers in this case because of the
 9 complexity of the pricing structure, and to make sure
 10 that there were no mistakes. The other key point is
 11 that the Tribunal will find in the documents a number of
 12 these matrices headed "Imperial" or "Gallaher" or
 13 "Rothmans", but at least in relation to CGL, it's
 14 absolutely fundamental to understand that there was no
 15 question whatsoever of CGL sending the Rothmans schedule
 16 to Gallaher or to ITL. We would only send the ITL one
 17 to ITL for the purposes that I've described, and there
 18 was no question of sending somebody else's schedule so
 19 that Gallaher would know what ITL pricing was; they were
 20 entirely separate documents.
 21 **DR SCOTT:** We had a question which relates to that, and that
 22 was this: looking at the matrix, we could see the
 23 bonuses which we understand to be related to pricing
 24 below RRP, the bulk discount ones on the right-hand
 25 side, those that were special to promotional activity.

1 What wasn't clear to us is where CGL price in accordance
 2 with parities and differentials or intended so to do,
 3 where does that bonus show up? Does it show up on that
 4 matrix or does it show up somewhere else?
 5 **MR THOMPSON:** No, not at all, it wouldn't be on the matrix,
 6 it was under the trading agreements there were simply
 7 payments made by reference to the trading agreements,
 8 and they would have nothing to do with the matrices.
 9 **DR SCOTT:** So paid into a central support --
 10 **MR THOMPSON:** Yes, and some of them were made by reference
 11 to particular periods but I think particularly towards
 12 the end they tended to be paid quarterly and so they had
 13 correlation.
 14 **THE CHAIRMAN:** So they weren't treated as bringing down the
 15 wholesale price in the way that the bulk drop discount
 16 or the other bonuses were treated?
 17 **MR THOMPSON:** They weren't included on that basis, although,
 18 as we will come to in a moment, the Gallaher agreement
 19 in particular, it was expressly as effectively
 20 a percentage discount per stick.
 21 I had been proposing to go to a little bit more
 22 detail on the contacts, but I think probably we have
 23 gone through quite a few issues in discussion, and it
 24 would be more helpful to return to that at the
 25 designated time.

1 What I think I should do is briefly show
 2 the Tribunal the trading agreements themselves, and in
 3 particular the Gallaher agreement, which is the only
 4 complete agreement we have for CGL. One finds that at
 5 tab 7 of annex 5 {D5/7} to the statement of objection.
 6 The Tribunal will see it's all in bold capitals, for
 7 some reason, and it's expressed as being a trading
 8 agreement for 2000/2001/2002, signed by Mr Newton, by
 9 Mr McGuinness, in September and October 2000.
 10 The first point I think, if you would turn over the
 11 page, you will see that it's based on a meeting in
 12 January 2000, and sets out a structure for three years
 13 including various regions, and mine is blanked out but
 14 they have agreed to pay a certain number of pence per
 15 thousand on all cigarettes from January to December. So
 16 that's how it worked. The payment was split in
 17 percentage terms with the largest percentage for
 18 advertising, then distribution, pricing the third, and
 19 merchandising at [redacted] per cent.
 20 I am sorry, those figures are confidential as well,
 21 apparently. Sorry about that.
 22 Anyway, they are break-out percentages, and one will
 23 see that pricing is a relatively modest proportion, [redacted]
 24 [redacted]. Then the second, the
 25 next page, page 3, one sees that there is a market share

Confidential
 CGL

1 multiplier set out, and the way that that worked, one
 2 sees in the box in the middle, is that the Co-op got
 3 a significant increase if it achieved a market share for
 4 Gallaher higher than that for the country as a whole.
 5 So effectively that was an incentive to the Co-op to
 6 improve its relative performance.

7 Interestingly as well, one sees on page 3 that the
 8 [redacted] range -- that may be confidential as well,
 9 I will be careful. There is a brand I should not
 10 mention, but there we are -- was excluded from the scope
 11 of the agreement. So apologies if that is another
 12 breach of confidentiality, again it's a long time ago.

13 One then turns in and you find the different
 14 disciplines identified. First of all, advertising,
 15 which one sees is a large proportion of the total, and
 16 I don't think there is any criticism made of the effects
 17 on competition of the provision for payment in relation
 18 to advertising.

19 Then at page 7 one finds, again in relation to
 20 distribution, and I don't think any criticism is made of
 21 that. Then page 8, you find the provisions in relation
 22 to pricing. The first one is that:
 23 "Gallaher will continue to offer bonuses."
 24 Then:
 25 "Gallaher reserves the right to alter bonuses as the

97

1 market dictates."
 2 Then the third one is what we have called the
 3 response clause:
 4 "If Gallaher competitors offer additional bonuses or
 5 support, CRTG should also allow the opportunity for
 6 Gallaher to compete equally."
 7 So so far so good, as I understand it, from the
 8 OFT's point of view, even in relation to price.

9 But then the next provision is:
 10 "Pre-agreed brand price list parities and
 11 differentials of Gallaher brands packings versus
 12 competitors for all market sectors must at least be
 13 maintained (they may be less expensive)."
 14 Obviously we rely on that wording as being notably
 15 inconsistent with the OFT's case that this was all about
 16 fixed differentials. We would say there was not
 17 a single shred of evidence or any document that
 18 derogated from that express wording.

19 Then there is reference to price sectors and house
 20 **variants. Then D:**
 21 "Gallaher pricing support bonuses must be passed on
 22 to shoppers."
 23 And we would say that that was consistent with the
 24 type of submission that was being made by Mr Howard on
 25 before of ITL on the first and second days.

98

1 **THE CHAIRMAN:** What is a house variant, remind me?
 2 **MR THOMPSON:** I think that's things like menthol cigarettes,
 3 so within John Player there may be a menthol brand, so
 4 it's a question whether the relative price of the
 5 menthol brand should be the same as that for the
 6 non-menthol, for example.

7 Just as there are different tiers of retailer, there
 8 are also different tiers of cigarette, so one of the
 9 things that was important was to maintain those
 10 differentials between upmarket, medium and low price,
 11 that was important to the manufacturers, and likewise
 12 there was some importance between variants within
 13 a brand. So that's all, sort of, in-house, as it were.

14 Then over the page is a very important document, and
 15 it's the only document, and virtually the only reference
 16 in the OFT's case to differentials in the context of
 17 CGL. What one finds under the heading "Pricing" is:
 18 "Market (RRP) parity/differential brand range
 19 include including packings", and then a selection of
 20 Gallaher brands in the left-hand column and then ITL and
 21 in some cases Rothman or BAT brands in the right-hand
 22 column.

23 Then at the bottom:
 24 "Range of products to be updated and agreed each
 25 year."

99

1 But we have no evidence that anything was actually
 2 done in relation to this. It's quite notable that
 3 Dorchester doesn't feature in the left-hand column
 4 there, even though I think it forms part of the OFT's
 5 case that there was pairing between Dorchester and
 6 Richmond over the period.

7 **DR SCOTT:** Are we right in saying that the pairings are
 8 similar between the manufacturers but not identical to
 9 the manufacturers?

10 **MR THOMPSON:** There are quite significant differences. For
 11 example, one finds here Mayfair is paired with Richmond
 12 rather than Dorchester, whereas I think one of the core
 13 areas of battlegrounds was Dorchester and Richmond,
 14 I think. That's an example.

15 When it comes to ITL, we are completely in the dark,
 16 because there are no ITL/CGL schedules, and the best
 17 evidence we have is Mr Goodall, who says he can't
 18 remember that there ever were any, which of course casts
 19 the idea of binding and fixed enforcement rather into
 20 a particular light, because we have no other evidence,
 21 so the best evidence is there never were any ITL
 22 schedules at all.

23 So that's how it is, and the importance of this from
 24 our point of view, it's a point that Dr Jenkins makes
 25 with some force in her various reports, is that at least

100

1 as far as Gallaher is concerned, the parities and
2 differentials, as we call it, floated on MRPs, so the
3 significance is if ITL or Gallaher put up their price by
4 5p, the MRP would also go up by 5p, and so the
5 differential would open, and that has quite a striking
6 effect, and I think is agreed by Professor Shaffer to
7 have quite a striking effect on the operation of his
8 model.

9 So it basically blows a hole in the basic mechanism,
10 in that one price goes up by 5p, there is no requirement
11 to move the other brand up by 5p; on the contrary, the
12 differential must be maintained at 5p, so it's really
13 quite the opposite of Professor Shaffer's model.

14 **THE CHAIRMAN:** Don't you mean the differential isn't
15 maintained at 5p, it widens?

16 **MR THOMPSON:** The relevant differential becomes -- supposing
17 the two products are a parity, and Gallaher puts up its
18 price by 5p or perhaps, given we are in the Gallaher
19 agreement, it's more appropriate to say ITL puts up its
20 price by 5p, the differential widens to 5p and if one
21 takes this as face value, what it required at that point
22 is for the lower priced brand to be 5p lower than the
23 price that's gone up.

24 So whereas Professor Shaffer says, ah, well, in that
25 situation the operation of this agreement was to force

101

1 the lower priced brand to go up we say, no, on the
2 contrary, insofar as this operated at all, the
3 obligation was to keep the lower price brand down. We
4 say that makes perfect sense with the Gallaher agreement
5 which says you must maintain the differential but you
6 may price lower, whereas we say that the OFT's machine
7 is really a complete nonsense, it makes no sense, there
8 is no evidence to support it, and it effectively forces
9 the Co-op to put up its prices of another brand when the
10 brand in question may deliberately have held its price
11 down in response to a price increase by a competitor.

12 So it's a very fundamental part of our case, and we
13 say this document --

14 **THE CHAIRMAN:** That's what you mean or that's what the
15 expert means by saying that the -- what is it that
16 floats over what, this floating term?

17 **MR THOMPSON:** Well, floating on MRPs, you start with
18 a differential of say -- it's easiest if you just say
19 nought, and you find it in the papers. If we take
20 a concrete example, Hamlet and Classic, I suspect they
21 were normally priced pretty much the same, or Hamlet and
22 Cafe Creme, then you anticipate, for example, Cafe Creme
23 goes up by 5p, on the Shaffer machine, the effect is
24 that Co-op says "Oh, Cafe Creme has gone up by 5p,
25 I must also raise Hamlet by 5p", and that's the whole

102

1 thrust of the OFT's case.

2 We say, no, it's quite clear on its face what
3 happens there is that the differential becomes, having
4 been at parity, 5p. So what, if anything, you are
5 required to do is not raise the price of Hamlet. You
6 must maintain the 5p differential that's opened up
7 between the MRPs.

8 **THE CHAIRMAN:** But this table at page 9 is different from
9 other schedules that we have seen, because this doesn't
10 say "equal with" or "not less than 3p less than", it
11 just sort of indicates that there needs to be some
12 relationship rather than saying whether it is a parity
13 or a differential.

14 Are you saying this these were all regarded as
15 parities rather than differentials, except for this
16 floating point that you --

17 **MR THOMPSON:** It doesn't matter what it is. You find it in
18 the papers, sometimes there will be a differential of
19 say 3p pre-existing, say Benson & Hedges may be 3p above
20 Embassy No 1, supposing that's the starting position,
21 but nonetheless we then say supposing Embassy No 1 goes
22 up by 3p, so the recommended resale price is then at
23 parity, what we are saying is this agreement then says
24 at that point Gallaher must be at parity, having
25 previously been 3p above, now the MRPs are the same, the

103

1 Gallaher product must be at parity or lower, and so at
2 that point the mechanism, as it were, goes into reverse,
3 and what it does is preclude the retailer from putting
4 up Gallaher prices. It precisely doesn't force you to
5 put up Gallaher prices, it forces you to keep them down.

6 **DR SCOTT:** So in order to understand the agreement, we have
7 to understand that there was an existing pricing
8 structure which was either being maintained or where
9 there was a differential manufacturer's price had
10 changed --

11 **MR THOMPSON:** Well, there was a relationship. There was
12 a price. I haven't gone into the detail, but supposing
13 that Hamlet and Classic were both at £4, then if --

14 **THE CHAIRMAN:** That's a different point. The floating point
15 is a different point. The point that we are now trying
16 to understand is: are we to read this as meaning that,
17 apart from when there is a disparity between the
18 manufacturer's wholesale prices, arising from an MPI or
19 whatever, that Old Holborn should be priced the same as
20 Golden Virginia, and that Sovereign should be the same
21 as Lambert & Butler, that these are all parities rather
22 than differentials, or is there somewhere preceding this
23 table that sets out that it's actually there should be,
24 generally speaking, a 3p difference in one direction or
25 the other, which is then, in shorthand, being maintained

104

1 by this, the floating point apart?
 2 **MR THOMPSON:** I think this is the difference between this
 3 agreement and the majority, at least, of the ITL
 4 agreements which have had schedules with specific
 5 differentials where the evidence is of Mr Batty, that
 6 the purpose of those schedules was to reflect relative
 7 MRP levels, but because it was done in schedules with
 8 specific financial differentials those schedules had to
 9 be changed, whereas the way this agreement worked was
 10 that whatever the MRP differences were, so they might be
 11 plus 3, minus 3, parity, those were intended to be
 12 reflected in the retail price differences.

13 You could price the Gallaher brand lower, but you
 14 shouldn't price the Gallaher brand any worse off than
 15 the differential between the MRPs. So supposing the
 16 Gallaher brand was at parity with the ITL brand, then
 17 the idea was that Gallaher could only be priced at
 18 parity or lower. So if the ITL --

19 **THE CHAIRMAN:** If there was a pre-existing differential
 20 between the manufacturer's recommended price, this is
 21 not intended to sort of iron that out by saying "Well,
 22 now actually these are parities, not differentials".

23 **MR THOMPSON:** No, it was like a sort of magic bullet, so
 24 whatever the differential was, between MRPs, then the
 25 CGL retail price for the Gallaher product had to be at

1 least as good as that differential. So you couldn't
 2 price Gallaher products above, say, parity of the MRPs
 3 at parity or above 5p below if Gallaher ran 5p below and
 4 that would change as the relative MRPs changed.

5 **DR SCOTT:** So it was related to the wholesale price?

6 **MR THOMPSON:** No, the MRP.

7 **DR SCOTT:** Yes, but that brings us back to the point of
 8 what's moving, that's why I raised the point of the
 9 wholesale price, that what you are saying is were the
 10 manufacturer to move their retail price rather than
 11 moving the wholesale price.

12 **MR THOMPSON:** The recommended retail price on its own
 13 without a movement in the wholesale price? Difficult to
 14 imagine why that would ever happen. Then there would be
 15 a --

16 **DR SCOTT:** It's more likely to happen the other way around.

17 **MR THOMPSON:** In fact, and you will be aware that we have
 18 done quite a lot of work on this, there is a very strong
 19 correlation, which is not a surprising correlation,
 20 between wholesale price and MRP movements. Given the
 21 correlation in incentives between MRPs and bonuses,
 22 that's equally not surprising, because obviously the
 23 retailers would be very unhappy if the wholesale price
 24 went up, the retail price stayed the same, but then you
 25 forfeited your bonus if you put the price above MRP. So

1 in practice they were bound to go up and down together.
 2 **DR SCOTT:** The advantage for the manufacturers is that they
 3 have certainly got visibility of the recommended retail
 4 prices, because that's all public.

5 **MR THOMPSON:** Yes.

6 **DR SCOTT:** So that it is obvious to them what the
 7 differentials between recommended retail prices are.

8 **MR THOMPSON:** I think the difference between Gallaher and
 9 ITL is that ITL say that was their policy, but they had
 10 this schedule system so they had to keep sending out new
 11 schedules, whereas this arrangement rather neatly just
 12 is self-regulating, as the MRPs vary, so the
 13 differentials vary, and then all that you have to do is
 14 keep your Gallaher price below the shifting
 15 differential.

16 So that's obviously a very important part of our
 17 case, but I think I also should say that the Gallaher
 18 agreement is also notable for the fact that
 19 a substantial percentage of the incentive payment
 20 provided for under the agreement had nothing to do with
 21 pricing at all, and even in relation to pricing the
 22 provisions in relation to P&Ds only form one part of the
 23 pricing incentive section, which is largely concerned
 24 with discounting and the right of Gallaher to respond to
 25 discounts by competitors, all of which we would say was

1 notably pro-competitive.

2 I have already made the point that the details of
 3 the ITL parities and differentials have been either lost
 4 or never existed, and the best evidence is Mr Goodall's
 5 first witness statement, paragraph 59, and that's
 6 CB3/38, {C3/38} which is that he doesn't think there
 7 ever were any schedules, and I don't really see how we
 8 can go behind that, because nobody else knows anything
 9 about it, as far as I am aware.

10 The third point on the agreements is the incentives
 11 point, which I think the Tribunal has already discussed
 12 at some length with Mr Howard, so I'll take that
 13 shortly. It's ground 1 of our appeal about whether
 14 there ever was an agreement to comply with these
 15 incentives, and we essentially rely on two points.
 16 First of all, the compliance statistics, and then,
 17 secondly, the level of the incentives. I'll just give
 18 the reference, that's paragraphs 230 and 441 of
 19 Dr Jenkins' first report. That's CB7/78, pages 333 and
 20 335. {C7/78/333}

21 The basic point is, I think, the point that Madam
 22 Chair raised with Mr Howard. We say that this was
 23 essentially a one-way incentives arrangement similar to
 24 a sponsorship deal for somebody to walk from London to
 25 Edinburgh. You are not under any obligation to walk

1 from London to Edinburgh, but if you do do it then you
2 are entitled to your sponsorship money. There is no
3 grounds for reproach if you don't do it.

4 We say, as I think was raised in argument, that the
5 relatively low level of incentives is relevant to
6 whether or not we ever bound ourselves to do anything,
7 and the contacts documents are also relevant to that,
8 given the notable absence of any reproach to the Co-op
9 for its repeated failure to comply with these parities
10 and differentials, and more generally the fact that the
11 language of "obligation" is notably absent from any of
12 the documents passing between CGL and either of the
13 manufacturers.

14 So I think I have probably said enough about the
15 facts, but I'll just summarise. I would submit that our
16 position on the facts can be summarised as being that
17 this is not what one might call a woodpulp case, and by
18 that I mean where there are two plausible explanations
19 of the facts, and I on behalf of CGL would have to rely
20 on the burden of proof to say my plausible explanation
21 is as good as the OFT's plausible explanation.

22 We would say this is not a case where there are two
23 plausible accounts of the facts. This is the case where
24 the appellant is advancing a straightforward case on the
25 facts, while the regulator has based its decision and

109

1 its theory of harm on an account of the facts that is
2 divorced from reality.

3 To take the wording of Mr Justice Rimer in the
4 Racecourse Association, the OFT's case is an account of
5 events that never happened in a world that never was,
6 a triumph of theory over commercial reality,
7 paragraph 170 of Racecourse Association.

8 I think in the first minutes of the first day,
9 the Tribunal asked if there was any pre-reading that
10 might be helpful, and I might as well deal with it now.
11 I think it would be helpful in relation to our case on
12 the facts to review annex 4 to our reply in some detail,
13 which deals with both the contacts and also the more
14 general documentary evidence in addition to the CGL
15 witnesses and also of course the witness statements of
16 Mr Goodall.

17 If I can turn briefly to the issues of theory,
18 I think some of them we have already touched on so
19 I think I can take it reasonably quickly.

20 We say that the OFT's theoretical case depends on
21 the establishing very strong findings of fact that are
22 clearly not supported by the evidence. The OFT must
23 maintain that CGL and other major retailers accepted
24 a rigid obligation to one manufacturer, say manufacturer
25 A, in the following form and for at least one pair of

110

1 brands agreed between CGL and manufacturer A, and it's
2 the two I think central planks that Mr Howard discussed.

3 First of all, whenever CGL decided to raise its
4 retail prices for manufacturer A's product, in response
5 to a wholesale price rise by manufacturer A, it would
6 also raise the retail price of manufacturer B's
7 competing brand, and it would do that despite the fact
8 that there had been no wholesale price rise for that
9 competing product, product B.

10 The second obligation, whenever CGL decided to
11 reduce its retail price for manufacturer B's brand, it
12 would also reduce the retail price for manufacturer A's
13 competing brand at its own cost. We would say as
14 a matter of impression those are implausible obligations
15 for a major retailer to accept, and that there is no
16 evidence that CGL at least ever accepted either of they
17 were. I have already noted that the references to
18 section 40 of the OFT's skeleton, or rather in
19 section 40, don't contain a single reference to a CGL
20 document.

21 So far as price rises go, as Mr Howard has pointed
22 out, even the OFT's sole factual witness, Fiona Bayley,
23 denies any such obligation existed. That's paragraph 55
24 of her statement.

25 So far as CGL is concerned, there is no other

111

1 witness evidence, not a single document, that suggests
2 that CGL ever accepted any such obligation or was even
3 alleged to have accepted such an obligation by either
4 manufacturer. Moreover, it's commercially incredible to
5 suggest that in the highly competitive retail market in
6 which it operated, CGL would voluntarily have bound
7 itself to increase its prices in respect of
8 manufacturer B's brands and risk losing sales of those
9 brands to its rivals. Such an approach would have been
10 completely inconsistent with CGL's pricing policy,
11 discussed by Mr Messom at part 2 of his statement, which
12 was to ensure that CGL was competitive as against
13 certain named retailers.

14 So far as price reductions are concerned, the
15 Gallaher agreement itself makes it clear that no such
16 obligation existed. The obligation, such as it was, was
17 to allow Gallaher to match competitive price reductions
18 which on the face of it would increase competition.

19 That notification requirement, if one can put it so
20 high, obviously negates any purported obligation on CGL
21 to do so at its own cost. Again there is not a single
22 document that suggests anything inconsistent with the
23 terms of the Gallaher agreement, either in relation to
24 Gallaher or ITL.

25 So that's the first point we make.

112

1 The second point, which I have just adverted to
 2 a moment ago in answering a question, is that on
 3 realistic assumptions, the OFT's theoretical model
 4 actually generates pro-competitive outcomes. The OFT
 5 has now somewhat grudgingly accepted CGL's case that the
 6 incentives provided for under the trading agreements
 7 were offered in order to persuade CGL to observe
 8 differentials in line with differences in retail price
 9 levels. That's clearly correct, and set out in the
 10 first Jenkins report, which is CB7/78/2.7 to 2.17,
 11 {C7/78 paragraph 2.7} and in the terms of the Gallaher
 12 agreement itself.

13 Then, as Dr Jenkins shows in her second and third
 14 reports, that would suggest on the OFT's own theoretical
 15 case that Professor Shaffer's 2007 model has a tendency
 16 to reduce consumer prices.

17 Those points would be explained in greater detail by
 18 Dr Jenkins in due course, but they can be explained in
 19 intuitive as well as theoretical terms.

20 So taking the same two examples, the price rise and
 21 the price reduction, as I said, in response to Mr Scott,
 22 the effect would be in the case of a price rise to
 23 constrain CGL from increasing a relative retail price of
 24 manufacturer B's product unless and until B chose to
 25 follow manufacturer A's wholesale and recommended retail

1 price rise for a competing brand, and it would thus be
 2 consistent with a policy of manufacturer B holding down
 3 its wholesale and recommended retail prices in response
 4 to a price rise by manufacturer A, and at least in
 5 relation to ITL, Mr Howard suggested that was exactly
 6 what they were trying to do or would on occasion do.

7 In relation to price reductions, the effect would be
 8 to encourage a retailer such as CGL to reflect the full
 9 extent of the relative price differential resulting from
 10 any wholesale price reduction by manufacturer A by
 11 requiring that the relevant differential between the
 12 retail prices of competing brands was observed and
 13 unless and until manufacturer B also reduced its
 14 wholesale price and recommended retail price. That
 15 again would be consistent with a policy on the part of
 16 manufacturer A to use price cuts as a means of gaining
 17 market share.

18 In either case, the idea would be to ensure that the
 19 relevant manufacturer obtained the full competitive
 20 benefit of either holding down its wholesale prices and
 21 recommended prices in the face of a price rise by
 22 a competing brand, or of reducing its own wholesale
 23 prices and recommended prices on a unilateral basis.

24 Our understanding, I should say, is that P&Ds were
 25 not intended to operate in the context of tactical

1 promotions, but the same strategic considerations would
 2 have applied in such cases, and there are numerous
 3 examples in the papers of such price competition in the
 4 context of promotions.

5 I should just say why we take the view that P&Ds
 6 didn't apply in the context of promotions. That's
 7 because Gallaher itself said that in response to
 8 questions from the OFT. One finds that at SO annex 3,
 9 tab 17. I think it's worth looking at this. Annex 3 to
 10 the SO.

11 This is a point Ms Rose made, but given that the OFT
 12 hasn't called any Gallaher witnesses, there is no reason
 13 not to take their answers at face value, at least as
 14 against the OFT.

15 SO annex 3, tab 17, and you should see a letter from
 16 Mr Gilbert to the OFT dated 17 March 2005.

17 The relevant passage as far as I am concerned is
 18 page 2 of the document that's inside, which you will see
 19 is called "Response of Gallaher group to section 26
 20 notice of 27 January 2005", and then there is
 21 a description of how parities and differentials were
 22 supposed to work.

23 Then on page 2 there is a specific question:
 24 "How was the clause supposed to work?"

25 Then there is a two paragraph answer:

1 "Under a parities and differentials clause,
 2 a retailer would be required to maintain the
 3 differential between a Gallaher brand and competitor
 4 brands in the same price segment, ie premium or economy,
 5 as set out in the published list of RRP's (again see
 6 section 4 below). For example, if the RRP for
 7 Dorchester was 2p lower than the RRP for Richmond, the
 8 clause would require the retailer to price Dorchester 2p
 9 below whatever retail price it set for Richmond."

10 Then the point I rely on, 1.9:

11 "The clause did not apply where a tactical PCP was
 12 in place, see section 2 below."

13 So as we understand it, that describes the same
 14 mechanism as the Gallaher agreement we have just looked
 15 at, but then says that the clause didn't apply in the
 16 context of promotions, presumably because in that
 17 context one got into the world of right to respond
 18 clauses rather than any question of binding parities and
 19 differentials insofar as Gallaher had considered them to
 20 be binding in any circumstances.

21 Going back to the main thrust of our -- yes, the
 22 point has been handed up that normally MRPs would
 23 stay -- I think they would always stay the same in the
 24 context of a promotion. I don't think we would change
 25 the MRP. What you would have is a promotional payment,

1 so the parities would nominally stay the same, so what
 2 Gallaher is saying is nobody expected the prices to go
 3 up and down in the context of progresses; there it was
 4 a question of promotional initiative and promotional
 5 response, which was quite independent of the parities
 6 and differentials obligation, and that's certainly how
 7 we understand it.

8 **DR SCOTT:** That's what I meant by the fact that the retail
 9 prices could stay stable, the effective wholesale price
 10 could move up and down beneath that.

11 **MR THOMPSON:** You mean the recommended retail price would
 12 stay the same?

13 **DR SCOTT:** The recommended retail price would stay the same,
 14 but behind the scenes, as it were, the effective
 15 wholesale price changed.

16 **MR THOMPSON:** Yes, if you put it in those terms, taking into
 17 account the one-off promotional payments, if that is
 18 treated as part of the wholesale price then that would
 19 go down and then there would be an issue about whether,
 20 if you noted another retailer seemed to be on promotion,
 21 can we have the money that must be underlying that, and
 22 if one manufacturer's products goes on promotion, then
 23 the question is whether the other manufacturer is going
 24 to respond, but we say that is totally independent of
 25 the P&Ds issue and the Gallaher document makes that

117

1 clear.

2 Of course that's another big hole in the OFT's case,
 3 given contacts are almost entirely about promotions.

4 Going back to the main drift of my point and whether
 5 P&Ds floating on MRPs are pro-competitive, and the point
 6 I made that the effect would be to ensure that the, as
 7 it were, price cutter or the price non-riser got the
 8 benefit of their lower prices, we would submit and
 9 adopt, really, what Mr Howard said about ITL. That is
 10 at least an intelligible commercial strategy and one
 11 that's put forward by the witness statements sworn on
 12 behalf of ITL, notably by Mr Good, at tab 36 of CB3,
 13 {C3/36} and the position is really the converse of that
 14 described at paragraph 6.216 of the decision.

15 Indeed, this is another curious weakness in the
 16 OFT's case, the OFT's expert, Professor Shaffer, has
 17 rightly accepted that such an arrangement would tend to
 18 reduce rather than increase prices, at least in respect
 19 of some retail prices, and one finds that, I think it's
 20 a passage we were shown, the experts' joint statement
 21 for A2, CB12/125, {C12/125} and it's a point we make at
 22 paragraph 40 of our skeleton at CB7/73. {C7/73}.

23 However, in the face of these concessions,
 24 Professor Shaffer has belatedly and surprisingly raised
 25 the factual question of whether manufacturers in fact

118

1 moved their recommended prices in parallel with
 2 movements in their wholesale prices, and one finds that
 3 at paragraph 40 of his second report, which is CB6/66,
 4 {C6/66} and to the extent that they didn't do so, then
 5 Professor Shaffer argues that his original modelling
 6 conclusions could still be achieved. He even seeks to
 7 characterise Dr Jenkins as a potential ally to the OFT's
 8 theory of harm. With respect, we would say this is an
 9 absolutely hopeless form of last ditch defence.
 10 Professor Shaffer is forced to argue that the OFT's
 11 theory of harm could still hold good in the following
 12 really quite incredible situation. If we go back to
 13 manufacturer A again, manufacturer A raises or lowers
 14 its wholesale price but it doesn't raise or lower its
 15 RRP's, so the relevant parity or differential is
 16 unchanged.

17 Then the second step is that manufacturer A then
 18 insists any consequential increase or decrease in CGL's
 19 prices for its product is matched by an equal increase
 20 or decrease in manufacturer B's competing product on the
 21 basis that RRP's remain in the same relation as they did
 22 prior to the price rise or cut.

23 So you have Cafe Creme and Hamlet at a parity, one
 24 of the products, the wholesale price goes up, but
 25 unaccountably, the MRP is held constant, so the parity

119

1 is still constant. So CGL then, its margins being
 2 squeezed, then wants to push up the price. Even though
 3 the MRP hasn't changed its forced, on the OFT's case, to
 4 put up both prices.

5 We would say that this unlikely scenario didn't
 6 feature in the decision, it's highly implausible,
 7 contrary to all the witness evidence, and finds no
 8 support in the contemporary documents. In effect,
 9 Professor Shaffer, in order to preserve any relevance of
 10 his modelling conclusions and the OFT's theory of harm
 11 to this case is forced to hypothesise that manufacturers
 12 might not alter their recommended retail prices in line
 13 with their wholesale prices but might nonetheless insist
 14 on strict enforcement of P&Ds. Given the late stage at
 15 which this surprising suggestion has been made, it's not
 16 clear whether the OFT endorses this suggestion or how it
 17 proposes to establish it as a matter of fact.

18 The actual evidence included in the decision itself
 19 is that changes in wholesale prices almost invariably
 20 lead to changes in MRPs, and in fact it's quite clear on
 21 the face of the decision itself, if one looks at
 22 paragraph 5.19 of the decision, page 76. The OFT says
 23 this:

24 "During the infringement period, both Gallaher and
 25 ITL regularly introduced MPIS at least once and, on

120

1 occasions, twice a year. These MPIs were usually
 2 preceded by written notice one month in advance of their
 3 specified date. The MPIs of Gallaher and ITL would
 4 typically be announced or introduced within a few days
 5 of each other. Both manufacturers typically
 6 communicated the details of MPIs in terms of increases
 7 in RRP. A typical MPI communication from Gallaher and
 8 ITL would therefore set out for each brand the absolute
 9 increase in the retail price to be applied for single
 10 and multipacks together with the new RRP for each
 11 brand. In some cases, MPI details were communicated
 12 more briefly with a communication such as an email
 13 informing the retailer concerned of the absolute
 14 increase being applied and an attachment providing
 15 a list of revised cost prices and RRPs."

16 So against that background, Professor Shaffer, who
 17 the Tribunal will recall has said that he knows nothing
 18 about this and is simply taking the facts as stated in
 19 the decision, his latest suggestion is strikingly
 20 inconsistent with this paragraph, notwithstanding that
 21 assertion.

22 Secondly, it's inconsistent with the witness
 23 evidence, and I'll just give the references, Mr Batty,
 24 CB3/33, {C3/33} paragraphs 4.6 to 4.10, and
 25 Mr Goulthorp's first witness statement, CB7/81,

121

1 paragraph 2.4. {C7/81} It's also completely
 2 inconsistent with the evidence on retailer incentives
 3 and margins and their relationship to MRPs which one
 4 finds explained by Mr Goodall, first statement, CB3/38,
 5 {C3/88} paragraph 52. For good measure it's completely
 6 inconsistent with the data analysis which one finds in
 7 Jenkins 3, CB7/80 {C7/80} and I note that Dr Jenkins
 8 noted her figure there was likely to be understated
 9 because she had included temporary price promotions in
 10 the statistic.

11 So we would say that the OFT's theoretical case is
 12 thus in a state of collapse, on the simple basis that
 13 the prevailing factual situation puts
 14 Professor Shaffer's modelling conclusions into reverse
 15 and generates pro-competitive outcomes on two reasonable
 16 hypotheses, first of all that P&Ds were based on
 17 differentials that vary in accordance with changes in
 18 RRPs, and secondly, that movements in RRPs are made in
 19 line with movements in wholesale prices.

20 Put in intuitive terms, such arrangements tend to
 21 sharpen competition by providing incentives, however
 22 modest, to manufacturers not to follow wholesale price
 23 rises by competitors and to make price reductions of
 24 their own. They tend to increase the pass-through of
 25 wholesale price changes, thereby sharpening the

122

1 incentives of manufacturers to undercut their rivals.

2 There are two other problems at the theoretical
 3 level. First of all, even on its own terms, there are
 4 other serious defects in the OFT's theoretical case.

5 **THE CHAIRMAN:** I am just thinking about where we are
 6 timewise, Mr Thompson, whether we need this level of
 7 detail at this stage of the case.

8 **MR THOMPSON:** I will be about another ten minutes.

9 **THE CHAIRMAN:** Who else is expecting to go next this
 10 afternoon?

11 **MR SAINI:** I am next.

12 **THE CHAIRMAN:** All right, let's proceed.

13 **MR THOMPSON:** If I finish by 3.00?

14 **THE CHAIRMAN:** Yes, but let's deal with these other matters
 15 briefly.

16 **MR THOMPSON:** I will deal with them swiftly, if I may.

17 We are assuming that the OFT's theoretical case
 18 stands up at all, and we would say that it is crude and
 19 insufficient OFT's legal case under four headings.

20 First of all, it ignores the point I have already
 21 made that this is a market where retail pricing
 22 decisions are largely determined by commitment to
 23 pricing competitively with major competing retailers,
 24 and we have that, Mr Messom, section 2. It ignores the
 25 point that CGL was incentivised to price below RRP,

123

1 which one finds in the trading agreements, the matrices
 2 and Mr Goodall, paragraph 52. It's undermined by the
 3 extensive evidence of non-compliance and the lack of
 4 effective enforcement and one finds that at annex 4 to
 5 our reply generally. And it fails to take account of
 6 a wide range of other non-priced determinants of
 7 competition, and that's part 4 of Dr Jenkins' second
 8 report.

9 Then finally, the Tribunal may recall that there is
 10 another plank to this theoretical case, the so-called
 11 micromanagement theory whereby it's said that the
 12 manufacturers used promotions to micromanage parities
 13 and differentials. One finds that at 6.129 of the
 14 decision, and then in more detail in the defence to the
 15 CGL notice of appeal.

16 We would say there are several more impossible
 17 difficulties in this part of the OFT's theory of harm.

18 We would say the evidence is exceptionally weak, for the
 19 reasons we give in annex 4 to the reply.

20 Secondly, we would say there is an obvious gap in
 21 the OFT's reasoning, in that it's incoherent for the OFT
 22 to maintain that manufacturers made promotional payments
 23 to CGL to reduce its prices in order to sustain price
 24 rises. That's the point at Dr Jenkins' second report,
 25 section 3.

124

1 Thirdly, we would say that it makes no sense in that
 2 there is no point in paying promotions to the retailers
 3 to do something that they are allegedly required to do
 4 under the agreements themselves. Had there been
 5 obligations to maintain parities and differentials,
 6 contrary to the facts, the obvious step would have been
 7 to remind CGL of those obligations, not to make
 8 additional promotional payments on an ad hoc basis. We
 9 say the obvious explanation for the so-called
 10 micromanagement that we have seen is repeated
 11 promotional competition on price of a perfectly
 12 conventional kind and that that's the best explanation.

13 So far as the law is concerned, I can be very brief.
 14 We would say that the exclusion order, construction
 15 points are strongly in our favour, that the OFT's case
 16 is incoherent and obviously self-serving, and we have
 17 set out the points in some detail at part 5 of our
 18 notice of appeal, page 72 of CB7/74 {C7/74}.

19 And in relation to object, we would adopt many of
 20 the points made by Mr Brealey this morning, and what we
 21 have said is that there must be either an obvious or
 22 a necessary consequence for an object infringement to be
 23 demonstrated. We would say there was no such obvious or
 24 necessary presumption here, even on the OFT's best case
 25 far too much depends on the facts and we refer to

1 Dr Jenkins' first report for a general analysis of the
 2 effects of this type of agreement, section 4 of her
 3 second report for a discussion of the oversimplified
 4 approach taken by Professor Shaffer, and her third
 5 report for analysis of the sensitivity of the OFT's
 6 theoretical analysis to the facts even on its own terms.
 7 Perhaps I'll end by reference to paragraph 44 of our
 8 skeleton argument where we say that if the effect is
 9 ambivalent, and we say at least it's ambivalent, given
 10 the points I've made about floating on MRPs and
 11 wholesale and recommended resale price rises, then
 12 that's a hopeless basis for an object infringement,
 13 because it precisely requires one to look at the facts
 14 to see whether or not the hypothesis that
 15 Professor Shaffer and the OFT put forward factually
 16 obtains, or whether the facts which we say much more
 17 credibly obtain, but in any event it's a factual inquiry
 18 and so the agreement can't possibly be an infringement
 19 by object.

20 I think that's the points I wanted to make in rather
 21 a rapid form. Can I see if anyone wants me to say
 22 anything else? Blank faces behind, so I think those are
 23 my submissions at this stage.

24 **THE CHAIRMAN:** Thank you very much, Mr Thompson, I think we
 25 will take our short break there before we hear from

1 Mr Saini. Would the parties please bear in mind that
 2 these are opening submissions and we are going to hear
 3 the evidence from all the witnesses, so to ask you at
 4 the moment to draw conclusions from their witness
 5 statements is a little premature, it remains to be seen
 6 what their evidence actually is, and the time to draw
 7 conclusions or invite us to draw conclusions from their
 8 evidence is after we have heard what they say under
 9 cross-examination, so people may wish to bear that in
 10 mind, those who have yet to make their opening
 11 submissions.

12 But thank you very much, Mr Thompson, and we will
 13 come back at ten past 3.

14 (3.00 pm)

(A short break)

16 (3.10 pm)

17 Opening submissions by MR SAINI

18 **THE CHAIRMAN:** Yes, Mr Saini.

19 **MR SAINI:** Madam, in our submission this is a one issue
 20 case. The single issue is as follows: is the use of
 21 bonuses by a manufacturer to increase or decrease the
 22 wholesale prices of his products lawful? That's all
 23 this case is about. You will hear a lot about bonuses
 24 and a lot about incentive payments, but this is a case
 25 solely about ITL and Gallaher seeking to alter the

1 prices of their own products within retail outlets,
 2 because, as you will see, hopefully before we get to
 3 Christmas, what happened is that the OFT have
 4 fundamentally misunderstood the facts in each of these
 5 appeals, and they seem to believe to this day that ITL
 6 had the ability to require my clients or indeed the
 7 other retailer appellants to change the prices of
 8 Gallaher products, and that simply is not the case on
 9 the facts.

10 What's particularly important to note at the outset
 11 is what the OFT do not allege. They do not allege that
 12 there was a price-fixing agreement between ITL and
 13 Gallaher under which they would use the retailers to
 14 achieve overall increases in prices. That's not their
 15 case. That would have been an obvious case to make, to
 16 suggest a simple agreement between ITL and Gallaher or
 17 a concerted practice to achieve price rises, but they
 18 haven't done that. Instead, they have a rather
 19 convoluted case that through the use of bonuses, the
 20 same net result was achieved.

21 So it's effectively a highly indirect allegation of
 22 a price-fixing agreement between ITL and Gallaher when
 23 the OFT are not willing to make the allegation through
 24 the front door and charge both ITL and Gallaher with
 25 price-fixing.

1 With that introduction, I want to set out a map of
 2 what I am going to say, and there are going to be three
 3 main parts to my submissions, and I am going to be
 4 conscious to avoid repeating what others have said.
 5 The three main parts will be, first of all, I want
 6 to identify what the core difference is between each of
 7 the appellants and the OFT on the facts. That will be
 8 by a brief reference to the decision.
 9 Secondly, I want to look in some detail at the issue
 10 of bonuses, or incentive payments as some of the
 11 appellants call them. I want to show some documents to
 12 the Tribunal in relation to the provision and withdrawal
 13 of bonuses to explain how what's happening here is
 14 perfectly benign. It is simply alterations in wholesale
 15 prices. Thirdly and finally I want to touch briefly on
 16 the trading agreements, and you will appreciate that
 17 I am making submissions both on behalf of Morrisons and
 18 Safeway, therefore I need to address the position of
 19 each appellant separately. You will have already seen
 20 from your pre-reading that there is not identity of
 21 position as far as Morrisons and Safeway are concerned,
 22 because in particular, in respect of certain of the
 23 appellants, there aren't any agreements or there are
 24 agreements only with certain manufacturers.
 25 With that introduction I want to go straight to the

1 core factual dispute which divides the parties, and if
 2 I could ask the Tribunal to please take up the decision
 3 and if I can ask the Tribunal to go yet again --
 4 I apologise for this -- to page 77, section 6 of the
 5 decision, where the OFT sets out its essential case as
 6 to the infringing agreements.
 7 Now, although Mr Thompson has rightly said that
 8 the Tribunal has to approach the facts as regards each
 9 retailer separately, as far as the OFT is concerned,
 10 the Tribunal will have seen this is a one size fits all
 11 case, because section 6 and in particular section A1,
 12 that section is adopted and repeated verbatim for each
 13 separate agreement. So one goes on and looks later on
 14 at the sections on Morrisons and Safeway, and they say
 15 refer back to section 6, the OFT, as being our analysis
 16 of the infringing agreement. They do that for all of
 17 the retailers. Therefore there is a one size fits all
 18 case.
 19 **THE CHAIRMAN:** You need to slow down a little bit in order
 20 for the transcript writers to follow you.
 21 **MR SAINI:** I am sorry.
 22 The essential allegation which appears again and
 23 again, one can pick it up at various places, but I would
 24 like to pick it up on page 77 at 6.2, and it's the last
 25 three lines of 6.2:

1 "After referring to the infringing agreement, the
 2 following words appear in the last three lines:
 3 "In that way the infringing agreement between each
 4 manufacturer and each retailer restricted the retailer's
 5 ability to determine its retail prices for competing
 6 linked brands."
 7 One sees that repeated as a mantra again and again,
 8 I will not give you the references because you have been
 9 given far too many references already today, but that's
 10 the essential case.
 11 Now, there is a very simple factual answer to that
 12 case, which is it just didn't happen. On no occasion
 13 can the OFT point to a document or communication where,
 14 for example, ITL had the ability to dictate the price of
 15 a Gallaher product. It just did not happen. What did
 16 happen is that both ITL and Gallaher, in relation to
 17 each of the appellant retailers, modified its wholesale
 18 price from time to time, and the way it modified its
 19 wholesale price from time to time was by providing
 20 a bonus or withdrawing a bonus, and that led to, as
 21 night follows day, a change in the retail price, because
 22 as you are aware, the margins in this industry are very,
 23 very slim and you would have to be pretty stupid as
 24 a retailer not to reflect a change in wholesale price in
 25 your retail price. That's all that was happening. On

1 no occasion was ITL able to dictate the price of
 2 a Gallaher product.
 3 Now, it's clearly shown in the communications that
 4 ITL hoped that there might be a change in the price of
 5 a Gallaher product. One sees in the case of Safeway
 6 there are some suggestions. But it cannot be
 7 demonstrated in the evidence that either ITL or Gallaher
 8 had the ability to dictate the price of a competing
 9 product.
 10 Now, submissions have already been made that the
 11 OFT's case in relation to rigidity appears to have been
 12 dropped. They appear to accept that there was no rigid
 13 linkage between price changes. The case has been
 14 modified now, and while we are in this decision I'll ask
 15 you please to turn forward to what appears to be the
 16 current case that's being run, but we will hear from
 17 Mr Lasok as to whether or not this is still the case
 18 that's being run, and if you would go a few pages ahead
 19 to page 134, at paragraph 6.225. I won't read 6.223 or
 20 6.224 but what happened was in response to the SOs, ITL
 21 and the retailer submitted there was no automatic price
 22 changing. So the new theory came out at 6.225 that
 23 rather than there being a rigidity, there was clearly
 24 an expectation according to the OFT that retail prices
 25 will be moved in line with parity and differential

1 requirements.

2 But this is still a case, you will bear in mind,

3 where they are alleging that ITL price changes would

4 lead on their own to changes in the prices of Gallaher

5 products. First, it's put in terms of a rigid movement;

6 now it's put in terms of an expectation of movement.

7 But again, this alternative case on the facts just

8 doesn't work, it just never happened. What in fact

9 would happen -- and we will see some examples of this --

10 is that if Gallaher reduces price of a product, Gallaher

11 had no expectation that ITL would reduce its price, but

12 ITL would see that, ITL would go to the retailer and say

13 "Well, we want to compete with Gallaher, we want to

14 reduce our price as well, how do we do it? We do it by

15 offering you a bonus to reduce the retail price".

16 That's what would happen. It wouldn't happen

17 automatically. So there was the decision-making process

18 on the part of each manufacturer as and when they saw

19 a price change, and in particular, a price decrease by

20 the opposing manufacturer, they would enter into

21 a bargaining process with the retailer and say "We would

22 also like to reduce our price, can we offer you

23 a bonus?" and then it was for the retailer to decide

24 whether or not he would take the bonus.

25 Of course 99 times out of 100 the retailer would

1 take the bonus because it's in his interests to reduce

2 prices, to keep his margin, but as you will see from the

3 evidence of Mr Eastwood in relation to Morrisons in

4 particular, on some occasions they might decide not to,

5 because there might be some other commercial imperative

6 for them.

7 So all that's going on in these many exchanges which

8 fill many files is this process of one manufacturer

9 responding to an attempt by the other manufacturer to

10 undercut him, and the mechanism by which one responds as

11 a manufacturer to that undercutting is to go to the

12 retailer with the offer of a bonus. That's what

13 characterises this case.

14 It's said by the OFT "Hold on a moment, sometimes

15 the prices rise". Our answer to that is: so what?

16 Because if Gallaher increases the price, there is no

17 automatic price change as far as ITL is concerned, but

18 ITL may say, "Well, Gallaher has increased its price, we

19 would also like to increase our price, what we will do

20 is we will withdraw a bonus so that our price will rises

21 in the shop".

22 Again that's perfectly lawful. It is just

23 a wholesale price increase.

24 So we say that when one identifies the core factual

25 allegations made by the OFT, there is a very simple

1 answer to them. It is not an answer based in

2 competition law, it is not an answer based in the

3 reports of many learned professors of economics, it's

4 a much more prosaic answer which is that the OFT just

5 has the facts wrong.

6 Now, you may ask: well, we wouldn't be here in

7 a case that's going to last until Christmas if it was as

8 simple as that. But unfortunately it is as simple as

9 that, and what's happened here -- and various of the

10 economic experts identify this problem but again you

11 don't need to be an economist to say this -- is that the

12 OFT have seen a few documents which they think fit the

13 theory that they gave to Professor Shaffer in 2007 and

14 then they have approached every other communication with

15 a confirmation bias. Anything they look at is said to

16 fall within that theory. That's what I wanted to say in

17 relation to the core factual dispute.

18 I should also just say right at the outset that

19 although Mr Thompson suggested rightly that one has to

20 again look at the case of each retailer separately, what

21 the Tribunal will see is that there is a striking

22 similarity between the way both Gallaher and ITL dealt

23 with each of the retailers. So there are certain things

24 you will see again and again. You will see what one can

25 call a matrix, or in the case of Safeway it's called the

1 price file. So ITL would prepare or the retailer would

2 prepare an equivalent document, and we will see one of

3 those certainly as far as Morrisons is concerned. You

4 will also see very similar communications between each

5 of the retailers and the manufacturers where the

6 substance of the communication is that our opponent, the

7 opposing manufacturer, appears to have changed his

8 price, we want to react to that. We appear to be being

9 undercut, we are going to offer you some funding so you

10 can bring our price down as well so we can compete.

11 There is no real distinction, it seems, between any

12 of the appellants in that regard. It's all very, very

13 similar. That's no doubt why the OFT considers this is

14 a one size fits all case. But the communications are

15 very, very similar, with some differences of

16 terminology.

17 You will have seen some evidence already about the

18 margins in this business, and I do not want to take you

19 to Mr Grant Eastwood's evidence or indeed the evidence

20 of ITL, but I hope the Tribunal can take it, because

21 these are confidential figures, that the margins for

22 tobacco are very slim. In fact, looking at the margins

23 for tobacco compared to the general margins within

24 supermarkets, you would wonder why they bother selling

25 it at all. The reason is, which appears again and again

1 in the evidence, the footfall factor, which is sales of
2 tobacco drive the sales of other products. Tobacco in
3 itself earns very little money for the supermarkets, but
4 competing aggressively on price will bring customers
5 into the supermarkets and they will do their weekly shop
6 there.

7 When one bears in mind that the margins are so slim,
8 the Tribunal will appreciate that price changes of 1p or
9 2p, so if a manufacturer offers a bonus which is going
10 to lead to a 1p or 2p price change, which in the general
11 world may not seem like a huge amount of money, those
12 price changes are to be magnified in their importance
13 when one looks at the margin of a retailer. Therefore
14 it's highly likely that if a manufacturer wants to
15 reduce his price, so ITL wants to undercut Gallaher,
16 it's highly likely that the retailer will jump on the
17 ability to reduce the price of the product by accepting
18 the bonus payment, because it will drive more people
19 into that supermarket.

20 If I can then turn to my second main subject which
21 is the issue of bonuses. As I said at the outset,
22 understanding the use of bonuses is crucial to this
23 case, because the misunderstanding on the part of the
24 OFT in relation to the use of bonuses is largely why we
25 are in this position now.

137

1 I am going to use some terminology which again
2 appears throughout the case as far as each retailer
3 appellant is concerned, applying both to ITL and to
4 Gallaher. The Tribunal will appreciate there are two
5 kinds of bonuses: ongoing bonuses and tactical bonuses.
6 That language is used by the Co-op witness, it's used by
7 Mr Eastwood on behalf of Morrisons, it's also used by
8 the Sainsbury's witness, Ms Bayley.

9 The Tribunal will appreciate that ongoing bonuses
10 are provided for pricing below RRP. Both Morrisons and
11 Safeway, and it seems all of the other appellant
12 retailers, consistently received ongoing bonuses for
13 pricing below RRP.

14 You will also see from the evidence that those
15 bonuses only made up a proportion -- and in the case of
16 Morrisons, a pretty small proportion -- of the price
17 below RRP. In other words, the retailers themselves had
18 to fund a large part of the sub RRP price, only part of
19 that was made up through the bonuses.

20 Perhaps I should ask the Tribunal just to look at
21 Mr Eastwood's statement where he describes that. It's
22 in core bundle 8, tab 94, page 433. {C8/94 paragraph
23 433}. If the Tribunal could please read paragraph 8,
24 I will not read it out because there are some
25 confidential figures in there, at page 433.

138

1 (Pause)

2 **DR SCOTT:** And this approach, as is rehearsed in
3 paragraph 5, was largely predicated on inter retailer
4 competition?

5 **MR SAINI:** Absolutely. There is a similar paragraph in
6 relation to Safeway in the evidence of Mr Culham for
7 ITL. I won't ask you to turn it up, I'll just provide
8 a reference for the transcript, it's core bundle 3,
9 tab 35, page 426, paragraph 158. {C3/35/426 paragraph
10 158}.

11 The general proposition one gains from this is that
12 of the sub RRP price, a significant proportion of it is
13 being funded by the retailer himself.

14 **THE CHAIRMAN:** I don't quite understand what you mean by it
15 being funded. There is the wholesale price, which is
16 a certain number of pence less than the manufacturer's
17 recommended price, and that is the margin I suppose
18 which you could say if you price at the recommended
19 price, then all of that margin is, you would say, funded
20 by the manufacturer.

21 **MR SAINI:** I accept your point, Madam, it's a notional --

22 **THE CHAIRMAN:** But necessarily if you are as a retailer
23 priced below the RRP, then you are just accepting having
24 a lower margin than is posited by the manufacturer's
25 retail price.

139

1 **MR SAINI:** I accept that. It's potentially a question of
2 how much of the margin you are foregoing.

3 **THE CHAIRMAN:** Yes.

4 **MR SAINI:** I think one needs to bear in mind part of the
5 context here, which is supermarkets are a small part of
6 the universe of retail entities. There are many other
7 retail entities selling cigarettes. Most of them will
8 sell at retail price or above.

9 **THE CHAIRMAN:** The recommended --

10 **MR SAINI:** Recommended retail price or above and one will
11 see when one looks at the Safeway documents it becomes
12 very controversial when Safeway in their petrol stations
13 start selling RRP or sometimes above RRP. So notionally
14 a supermarket could be selling at RRP. What's happening
15 is both the supermarket wants to sell below that because
16 it wants to drive people into its stores --

17 **THE CHAIRMAN:** Yes, I understand that, I am just trying to
18 understand what you mean by "funded" in that case.

19 **MR SAINI:** I agree with you, I suppose it is funded in
20 a notional sense, which is your point, Madam, which
21 I think, with respect, is correct, which is they are not
22 actually --

23 **THE CHAIRMAN:** There is no money changing hands.

24 **MR SAINI:** -- losing money in a sense because the wholesale
25 price is going to be a wholesale price which gives them

140

1 a separate margin anyway. I agree with that. I was
2 only showing you this, Madam, for the purposes of
3 identifying principally (a) the very low margins and
4 secondly the fact that some percentage of the sub RRP
5 price, only some percentage of it is funded by the
6 manufacturer.

7 I gave you a reference --

8 **MR SUMMERS:** Sorry, with regard to that, are you saying that
9 that is common to all retailers? Because I think there
10 is evidence that not all retailers did seek to fund part
11 of the reduction and so on.

12 **MR SAINI:** Again I can only talk for Morrisons.

13 **MR SUMMERS:** Yes, you are being quite specific about
14 Morrisons in this case.

15 **MR SAINI:** Yes, that's Morrisons, I don't know what the
16 position is so far as others are concerned.

17 **MR SUMMERS:** Thank you.

18 **MR SAINI:** I can say in general terms we don't have direct
19 evidence from Safeway but we have evidence from
20 Mr Culham on behalf of ITL who describes in his witness
21 statement in core bundle 3 at tab 35 {C3/35} the extent
22 to which Safeway priced below RRP, make a similar point
23 there.

24 So that's the issue of RRP and the issue of ongoing
25 bonuses for pricing below RRP.

141

1 However, there is a completely separate type of
2 bonus which again, common across all the appellant
3 retailers and common across both manufacturers is called
4 a tactical bonus or a promotional bonus.

5 Now, those bonuses were paid to fund reductions
6 below the price the retailer would otherwise charge
7 already taking into account the ongoing bonus. So to
8 give you an example, if Morrisons is selling Embassy
9 cigarettes for £4, and that £4 already has built into it
10 an ongoing bonus, bear that in mind, ITL wants to reduce
11 the price to £3.90 in Morrisons supermarket, ITL would
12 offer a 10p tactical bonus which will be conditional on
13 Morrisons passing the 10p along to consumers. That's
14 one of the typical examples of the use of a tactical
15 bonus.

16 Equally, it may be the case that a tactical bonus is
17 withdrawn, so there is a tactical bonus been going on
18 for a while and one of the manufacturers decides: I am
19 going to withdraw that bonus or withdraw that retro, as
20 it's sometimes called.

21 Now, the OFT with their sinister spectacles on
22 think, "Ah, that's a price increase", but that's just
23 simply another way of describing the withdrawal of a
24 bonus.

25 So on day one there was a tactical bonus, it led to

142

1 a 10p price reduction, the next week ITL may say "We no
2 longer need to compete with the opposing Gallaher
3 product or there is some other reason why we don't want
4 to give you that bonus, we will withdraw it". That will
5 lead naturally to an increase in the price of the
6 product in the store because it's just simply
7 an increase in wholesale price.

8 **THE CHAIRMAN:** Well, that's the question, isn't it? What
9 the OFT say is that ITL and Gallaher weren't prepared to
10 take that chance and they write to the retailer saying
11 "We have withdrawn this so this is the price that you
12 now need to price at".

13 **MR SAINI:** Absolutely, and as you will hear from the
14 witnesses, they will say: on nine occasions out of ten
15 of course we will do that because this is simply
16 effectively an increase in wholesale price, but there
17 may have been other reasons why in a particular case
18 they may not have wanted to increase their price.

19 Even if one takes the example you give me, madam, we
20 ask: what's unlawful in that? Which is at any point in
21 time a manufacturer can increase his wholesale price,
22 and one would expect a rational retailer would increase
23 the retail price unless he is willing to have his margin
24 wiped out. But there is nothing in itself unlawful
25 about that, unless -- which is what the OFT do not

143

1 allege -- this is part of a price-fixing agreement
2 between ITL and Gallaher. Having not made that
3 allegation, they can't make it by the back door and say
4 that the effect of these arrangements is that. Because
5 all that's happening as far as the retailer is concerned
6 is that bonuses are coming in and going out, the
7 retailer will modify his prices accordingly. There is
8 nothing unlawful in that activity; in fact its normal
9 commercial behaviour.

10 **DR SCOTT:** You characterise the bonuses as being of two
11 types and I am conscious that you are coming to trading
12 agreements in a moment.

13 **MR SAINI:** Absolutely.

14 **DR SCOTT:** But you have not mentioned the concept of any
15 sort of payment for maintaining parities and
16 differentials.

17 **MR SAINI:** I am coming to that in the very next section of
18 my submission. I am going to show the Tribunal that in
19 the OFT's one-dimensional view of the world, they view
20 every communication which leads to a bonus being
21 provided or withdrawn as being no more than the
22 retailers and the manufacturers giving effect to the
23 desired parity and differential arrangements.

24 In fact the position is much more complicated. On
25 some occasions manufacturers are providing or

144

1 withdrawing bonuses because they would like to see their
 2 prices compete in a particular way with an opposing
 3 product by way of a parity or a differential, but on
 4 many other occasions, the withdrawal and provision of
 5 bonuses have nothing to do with that, they are simply
 6 ad hoc commercial decisions.

7 The OFT would have it that every single one of the
 8 documents one sees in these many files is about parities
 9 and differentials but in fact on many occasions, it's
 10 nothing to do with parities and differentials, it is
 11 simply one manufacturer deciding he wants to undercut
 12 the other manufacturer or later on he no longer needs to
 13 undercut him and therefore he will change the price.
 14 But I am going to come to that in a moment.

15 Before I do, can I show you what I call a price file
 16 or a matrix or a very common document, and Mr Thompson
 17 has shown you one in relation to CGL, I would like to
 18 show you an equivalent for ITL and Morrisons. If you
 19 would please go to annex 17, which is the annex of the
 20 ITL, would you please go to document 6. I know this is
 21 marked "confidential", I'll avoid reading any figures
 22 from it. You will see this is a fax sent on 3 July 2000
 23 from Mr Wragg of ITL to Mr Addison of Morrisons, and he
 24 says:

25 "Promotional Schedule. Please note the attached

145

1 schedule. This supersedes the previous schedule.
 2 Please note bonuses and price changes in the right
 3 column, Morrison codes are on the left."

4 What I want to focus on, I am not at this stage
 5 interested in the text on 33, but if one goes over the
 6 page, please, to the table, you will see going from the
 7 left:

8 "Bulk box discount rates."

9 You will see again that's very similar to the
 10 document you were looking at, the top column is very
 11 similar to the document Mr Thompson showed you:
 12 "BDD rate per outer. Off-invoice bonus per outer."
 13 That's what I called earlier the ongoing bonus.
 14 A net figure then a retro, and retro is the tactical
 15 bonus. It's called a retro, as you may have seen from
 16 the evidence, because it was paid retrospectively, in
 17 other words after a retailer had bought a product he
 18 would be provided with this bonus. Then one sees
 19 a selling price.

20 This is a document that's been created by ITL, one
 21 saw a similar document created by CGL earlier this
 22 afternoon, and the evidence you will hear both from
 23 Morrisons and from the ITL witnesses is that such was
 24 the complication in terms of introduction of retro
 25 bonuses and changes in prices that it was

146

1 an administrative convenience for both the retailers and
 2 manufacturers to have these forms of documents. Again,
 3 nothing sinister in this.

4 If you could please also open core bundle 3, I want
 5 to show you what's said in relation to Safeway. This is
 6 a Morrisons document, but a very similar thing happened
 7 in relation to Safeway. If you would please go to
 8 Mr Culham's statement at tab 35, page 426, {C3/35/426}
 9 please. Again, I don't believe this part is
 10 confidential, but one sees at page 426 above
 11 paragraph 152 the heading "Price file", and then there
 12 Mr Culham says:

13 "When I was in charge of the account ITL compiled
 14 and maintained a price file for the Safeway account.
 15 The purpose of this document, which was prepared at the
 16 behest of the retailer, was to record the cost prices in
 17 the various elements and margins support in respect of
 18 each ITL product sold at the Safeway account."

19 At 163 he describes the headings on the file which
 20 are again very similar to both the Morrisons document we
 21 are looking at and the document Mr Thompson showed you
 22 in relation to the Co-op.

23 I would ask the Tribunal to note in particular
 24 without me reading it paragraph 164 in relation to the
 25 retail price specified.

147

1 (Pause)

2 So these are not documents created by ITL in order
 3 to force prices on the retailers, these are documents
 4 which are requested by the retailers and which record
 5 the price at which the retailer will sell the products.

6 Would you please put that away and, if the Tribunal
 7 still has Mr Eastwood's statement open, I would like to
 8 show you one further passage in that which explains the
 9 use of -- which is in core bundle 8, tab 94. {C8/94}

10 This is a passage which explains the use of tactical
 11 bonuses. It's page 450, paragraph 10 going over to
 12 page 434, paragraph 11, and the substance of what he
 13 says there is that:

14 "If a promotional bonus was withdrawn or reduced
 15 [this is paragraph 11], it would be up to Morrisons to
 16 decide whether the price would be increased, but
 17 generally they would increase the price but not always."

18 What's of particular note is that, in paragraph 11,
 19 Mr Eastwood stresses that in some cases there may be
 20 a good independent commercial reason for Morrisons to
 21 maintain the low price.

22 (Pause)

23 Please put that away, I am going to turn next to
 24 this issue of why bonuses were paid. One has to answer
 25 that question by asking which bonus, first of all,

148

1 tactical bonus or an ongoing bonus. It's the OFT's case
 2 that both types of bonus, both ongoing bonuses and
 3 tactical bonuses, were paid in order to achieve
 4 manufacturers' parity and differential requirements.
 5 I said earlier that was far too simplistic a view of
 6 what was going on here. What I am going to show
 7 the Tribunal is that tactical bonuses were provided or
 8 withdrawn for many different reasons. It wasn't always
 9 about parity and differentials. We will come back in
 10 due course to look at the trading agreements and the
 11 reason for provision of the ongoing bonuses, but just
 12 sticking with tactical bonuses from a moment, there were
 13 a variety of reasons.

14 One example -- and I am going to take this very
 15 speedily -- if one could please go back to annex 17,
 16 which is the Morrisons documents, and if you could
 17 please go to tab 38, the bottom of the page, you will
 18 see this is a letter from ITL to Mr Giles, tobacco buyer
 19 at Morrisons.

20 At the bottom of the page under "Richmond".
 21 "[redacted] PMPs [that's price marked packs, he
 22 says] have been ordered, thank you, I agreed to pay the
 23 total bonus ie [redacted] [well, I won't read that]
 24 off-invoice for the duration of this PMP".

25 This is an example, one amongst many, of a tactical

149

1 bonus being paid which has nothing to do with parity and
 2 differentials, it is simply a decision to promote
 3 a specific product on an ad hoc basis.

4 Another example, sometimes Morrisons itself sought
 5 bonuses, nothing to do with the manufacturer, Morrisons
 6 said "We want to run a promotion on a particular product
 7 in our stores. Can you please pay us the tactical
 8 bonus". One sees in this same bundle, I am just going
 9 to give you the references, at 5.714 we see Morrisons
 10 seeking a bonus for 100, and 200 multipacks, which has
 11 nothing to do with the manufacturer, Morrisons itself
 12 wants that bonus. I am sorry, I gave you the wrong
 13 reference. If one can please go to -- if you have the
 14 file open I will show you very quickly -- it's most
 15 easily demonstrated if one goes to document 7, one sees
 16 at the top of the page, these are minutes of a meeting
 17 between Imperial and Morrisons:

18 "Multipack pricing. JA [that's Justin Addison] gave
 19 the two individuals from ITL a deadline of next Friday
 20 to respond to" -- again this seems to be in a square, so
 21 I assume it's confidential and I won't read the rest of
 22 that out.

23 What's going on there, one can pick up if you go
 24 please ahead, and it's confidential again, at tab 9 and
 25 if you would please go to what in my bundle is the very

150

1 last page of tab 9, it has a mark 47 in the bottom
 2 right-hand corner. I am sorry, it's the last page but
 3 one, it's 45. You will see under "Multipack Support":

4 "I understand that you wish to give your customers
 5 better pro-rated discounts on cigarette multipacks."

6 This is a reference back to that earlier discussion
 7 at tab 7. What's happening there is that Morrisons
 8 itself wants a tactical bonus, and for a certain quid
 9 pro quo, ITL are agreeing to that.

10 **DR SCOTT:** What you are saying is this is normal supermarket
 11 behaviour with suppliers.

12 **MR SAINI:** Absolutely.

13 **DR SCOTT:** Tobacco or otherwise.

14 **MR SAINI:** Nothing to do with parity and differentials, this
 15 is just: could you please give us a reduction in
 16 wholesale price so we can pass it on to our customers.
 17 That's the second example I've given you.

18 A third example is sometimes bonuses were given to
 19 avoid or lessen the impact of a manufacturer's price
 20 increase. Again, nothing to do with parities and
 21 differentials, but there might be a manufacturer's price
 22 increase. The manufacturer realises it's going to lead
 23 to an immediate rise in the price of his products in
 24 a supermarket, and we see some examples of a bonus being
 25 given to soften the impact of that, and if you would

151

1 please go to annex 7, which is a Gallaher document, it's
 2 document 4, please, there are some confidential figures
 3 in here in relation to bonuses, I won't read them, but
 4 what's happened here is there has been a manufacturer's
 5 price increase by Gallaher, we see from the fax
 6 reference line that:

7 "Post MPI prices from 15 August."

8 And we see the new prices. What's going on in the
 9 far right column is that because there is a promotion
 10 they are going to lessen the impact of that MPI by
 11 providing certain bonuses per 100 or 200 units, and the
 12 particular bonuses are blanked out in my copy.

13 (Pause)

14 Now, similarly, that's an example of an MPI.
 15 Similarly, one might see a Budget increase. What
 16 happens, Mr Howard I think referred to this last week,
 17 is sometimes there was a Budget increase and
 18 manufacturers would provide a tactical bonus to lessen
 19 the impact of a Budget increase. I can show you
 20 a document but I won't at this stage show you another
 21 document establishing that as far as Morrison is
 22 concerned, but that's another reason why a tactical
 23 bonus might be provided.

24 A yet further reason is there might be a special
 25 Christmas promotion. There are examples of documents in

152

1 the bundles where at Christmas time, one manufacturer
2 may decide, nothing to do with parity and differential,
3 he wants to promote a particular product.

4 So I've given you four or five examples of
5 circumstances in which tactical bonuses would be used
6 where there is no parity and differential in issue, but
7 there were on some occasions bonuses provided to achieve
8 what the manufacturer desired in terms of parity and
9 differentials. That did happen sometimes but not all of
10 the time. I just want to show you one example of that
11 since it featured so heavily in the OFT's case.

12 If you would please go back to annex 17, which is
13 the ITL/Morrisons documents, it's document 26, and this
14 document is useful for two purposes. I was going to
15 show you it as an example of parity and differentials in
16 play, but it's also useful as an example of Imperial
17 seeking to keep down prices despite a Budget increase.
18 You will see that the first paragraph says:

19 "Dear Grant, find attached a new schedule of costs,
20 bonuses and margins. This document is effective from
21 Monday 19 March, the date you have decided to implement
22 the Chancellor's Budget, the Budget increase, 7 March,
23 and supersedes the last schedule."

24 One sees at items 1 and 12 that despite a Budget
25 increase, they want to hold their prices down and

153

1 therefore they are going to be paying an additional
2 confidential bonus nothing to do with parity and
3 differentials, but the part I was interested in for
4 present purposes is at (iii), this is rolling tobacco:

5 "Drum 12.5 grams to be at parity with Amber Leaf at
6 shelf price [redacted]. This represents a [redacted]
7 reduction and this is with an additional bonus of" --
8 sorry, again I read that in error.

9 That's an example of where ITL would like its
10 product to be at parity with Amber Leaf. You will note
11 as well in passing that when we come to look at the
12 trading agreements these two products, Drum and
13 Amber Leaf, are not mentioned at all in those trading
14 agreements as being products where there is a parity or
15 differential aspiration. This is just an example of
16 a bonus being paid. You will see from the balance of
17 this document that the tactical bonuses are there being
18 paid principally in respect of the other brands to
19 protect customers from this Budget increase.

20 **MR SUMMERS:** Before we get too far into the case, can I be
21 absolutely certain that I understand the meaning of
22 "bonus" in this context. Is it something which is paid
23 with regard to goods ordered or is it paid when goods
24 have been sold?

25 **MR SAINI:** Retro bonuses, the tactical bonuses, are after

154

1 goods are sold.

2 **MR SUMMERS:** So if I use the word "discount" --

3 **MR SAINI:** That's another way of describing it.

4 **MR SUMMERS:** A bonus is in effect a discount in this
5 context.

6 **MR SAINI:** Indeed. By contrast, an ongoing bonus will
7 affect the price at which the product is bought.

8 **MR SUMMERS:** The word implies a certain generosity which
9 "discount" perhaps doesn't.

10 **MR SAINI:** Absolutely. I have no doubt that manufacturers
11 regard it as a bonus and retailers just regard it as
12 being the price of the product, and it's a matter of
13 timing as to when you get the benefit of a lower price.

14 Before I finish on the question of bonuses, I need
15 to go back to what I showed the Tribunal at the start
16 about the OFT's case, because, as you will have seen,
17 the OFT's case is that the manufacturers had a comfort
18 that when they increased their price, the price of
19 a competing product would also increase. That's the
20 core of the OFT's case. But if one just looks at a few
21 documents, one sees that there is no comfort on the part
22 of a manufacturer that the price of the competing
23 product would increase. He is desperate because he
24 doesn't know what's going to happen to the price of the
25 competing product.

155

1 Now, I am going to show you just two documents to
2 establish that proposition, and we can put away the
3 annex 17, and could you please take out annex 26.

4 I am going to hand up a document which is of general
5 use but may be of use particularly in relation to these
6 documents, which is a schedule we prepared, and I am not
7 sure if there is a file that is going of documents that
8 are provided to the Tribunal during the course of the
9 hearing but it may be it can be usefully added there.
10 (Handed).

11 This is I hope an uncontroversial document, and if
12 any of the parties want the underlying documents to
13 establish the facts in this document, we would be happy
14 to provide them, but this is meant to be a useful
15 document identifying in the three-year period between
16 March 2000 and July 2003 each occasion on which there
17 was a Budget and the manufacturers' price increase.

18 If I could ask the Tribunal please to go to page 5
19 of that, you will see in the second entry on
20 3 September 2001 there was an Imperial price increase as
21 regards most products, and in particular you will note
22 that there was to be, if one goes to the right-hand side
23 of that second entry under "Increases, Cigarettes",
24 second entry:

25 "Superkings and Richmond Superkings, 5p for 20."

156

1 So ITL were going to put up their prices.
 2 **THE CHAIRMAN:** Do you mean their wholesale prices or do you
 3 mean their MRP, or both?
 4 **MR SAINI:** Both.
 5 **DR SCOTT:** So just to clarify what happens, the RRP's get
 6 published and the wholesale price lists, as we
 7 understand it, are distributed to a multiplicity of
 8 retailers, but not automatically to the other
 9 manufacturer.
 10 **MR SAINI:** Yes.
 11 **DR SCOTT:** So the other manufacturer sees the change in
 12 retail prices?
 13 **MR SAINI:** It's public knowledge that there is going to be
 14 an MPI. What's important, though, to bear in mind is
 15 that -- let's put ourselves in the shoes of Gallaher on
 16 3 September 2001. They know, if you look at the second
 17 entry, that they are going to have their own MPI,
 18 a little bit later, on 11 September 2001, and they are
 19 going to be putting up Superkings and B&H:
 20 "For B&H, Superkings, Dickens and Berkeley, 5p for
 21 20."
 22 If we go back, please, to the document I asked you
 23 to turn up in annex 26, tab 30, I want us to bear in
 24 mind these MPIs when looking at this document, this is
 25 an internal document within Gallaher, and it's marked

157

1 "Confidential" so I won't read it out, it's not clear to
 2 me which part is confidential. The bit that appears to
 3 be confidential is the mobile number of the individual
 4 rather than the body of this email.
 5 If I can then perhaps read the body of the email,
 6 because that doesn't seem to be confidential. Who is
 7 Trevor, you may ask? Trevor is Trevor Thomas of
 8 Safeway.
 9 "... Safeway has confirmed that Imperial will be
 10 holding Richmond and Superkings 5p ..."
 11 The 5p is a reference to the 5p price rise you have
 12 seen on 3 September:
 13 "... until advised. As you are aware, Safeway are
 14 also running 15p off next purchase of 20 Superkings" and
 15 I won't read the rest of that other than the he comments
 16 by saying that this will hit sales of Berkeley and B&H
 17 Superkings.
 18 "Based on this, I have agreed to hold B&H Superkings
 19 and Berkeley Superkings until 1 October."
 20 So within Gallaher, they are saying that ITL,
 21 despite what it's published -- I am sorry, have I given
 22 you the wrong reference?
 23 **THE CHAIRMAN:** No, but I nonetheless have the wrong
 24 reference. (Pause).
 25 **MR SAINI:** Stepping back from this exchange, there is a very

158

1 simple point which flows from it which completely
 2 contradicts the OFT's case. Gallaher clearly does not
 3 think that an increase in the price of Berkeley and
 4 Benson & Hedges will lead to an increase in the price of
 5 Richmond and Superkings. Otherwise Gallaher would
 6 simply put those up as planned in its MPI. Instead it
 7 knows it has to hold them down if it wants parity. The
 8 point which flows from this exchange and many others is
 9 that one manufacturer has no assurance that its prices
 10 will go up or down or remain the same according to the
 11 price of the other manufacturer. He has no assurance.
 12 They have to make their own commercial decisions. If
 13 the OFT's case is right, both Gallaher and ITL can sit
 14 back and relax because they know that each of them can
 15 cause a price increase and the other will follow.
 16 That's just not happening here.
 17 **THE CHAIRMAN:** It's not that the other will follow, it's
 18 that the retailer will --
 19 **MR SAINI:** The retailer himself, absolutely, I suppose I am
 20 doing it in shorthand. The retailer will himself
 21 because he is giving effect to an agreement,
 22 automatically or by way of expectation move the prices
 23 of a competing product. One sees throughout these
 24 bundles many examples of ITL and Gallaher having no idea
 25 what the retailer will do.

159

1 One can see the same, if one stays in this bundle,
 2 if one goes back a few tabs to tab 21, please, and again
 3 bearing in mind where we are chronologically, this is
 4 12 February 2001, and according to our schedule, on
 5 13 February 2001 there is going to be a Gallaher MPI.
 6 It's page 4 of our schedule. If you would please look
 7 at point 5, in relation to Dorchester and Richmond, and
 8 the second entry says, I don't think this is
 9 confidential, I'll read it:
 10 "Dorchester. Further to our discussion, we now
 11 understand that Richmond is to stay down in price until
 12 the Budget. Would you please ensure Dorchester brands
 13 and packs will be in line?"
 14 You will see that underneath that, after the
 15 brackets "20":
 16 "We will fund the MPI increase to achieve this."
 17 So there is going to be an MPI, one knows, from
 18 page 4. They want to prevent the actual retail price
 19 from going up so they are going to provide funding for
 20 this. Stepping back, the simple point is that Gallaher
 21 is not going to increase Dorchester because it knows
 22 Richmond will not follow. Richmond is going to stay
 23 down until the Budget, that's what they believe is going
 24 to happen.
 25 If Gallaher was confident that the retailer would

160

1 put up the price of Richmond, together with Dorchester,
2 they would be delighted, but it's not going to happen.
3 **DR SCOTT:** Sorry, just to clarify, ITL had had an MPI on
4 29 January, and they had raised cigarettes by 5p across
5 the board, that's followed by Gallaher raise cigarettes
6 by 5p across the board. But what you are suggesting is
7 that Imperial were already funding not implementing that
8 in relation to some of their cigarettes.

9 **MR SAINI:** Correct. Imperial are not putting their price
10 up, and Dorchester -- what Gallaher want to do is ensure
11 that Dorchester remains in line with Richmond.

12 **DR SCOTT:** So they know that -- one might ask how do they
13 know, but the letter doesn't answer that. So the
14 published wholesale prices have gone up, and presumably
15 the RRP's have gone up.

16 **MR SAINI:** Yes.

17 **DR SCOTT:** But in fact ITL --

18 **MR SAINI:** ITL are maintaining one of their products at
19 a lower price, and Gallaher are concerned not to
20 increase their price, but if the OFT's case were right,
21 they would have no worry about that, because once
22 Gallaher increased its price, no doubt ITL would
23 increase their price. The retailer would increase the
24 price of the ITL product, to be completely precise.

25 But these are just a few examples of where there is

161

1 no confidence on the part of one manufacturer that the
2 retailer will change the price of a competing product.

3 The Tribunal can put that one away. I was going to
4 turn now to the third area I wanted to cover, which is
5 the question of the trading agreements. What I hope
6 I've shown there, but in rather a rapid fashion, is two
7 points: number one, that bonuses are paid for many
8 reasons, sometimes to achieve parity and differential
9 aspirations but on many occasions for other purposes,
10 and that's part of the normal commercial interplay
11 between manufacturer and retailer; and secondly,
12 contrary to the OFT's case there is no comfort on the
13 part of one manufacturer that a retailer will increase
14 or in any way modify the prices of the competing
15 product.

16 The written trading agreements, I can deal first of
17 all with the question of Morrisons, and you have already
18 been shown by Mr Howard the agreements, and they are in
19 annex 17, perhaps I'll ask you to please turn them up,
20 there are two. The first one is at tab 4. If you would
21 please go to the second page under "Pricing", I want to
22 make two points that flow from the section on pricing
23 and the appendix.

24 The first point that flows is that ITL is going to
25 pay Morrisons ongoing bonuses, the first type of bonus,

162

1 provided that Morrisons' retail prices were in line with
2 ITL's maximum parity and differential aspirations.
3 Crucially this is an incentive on Morrisons not to
4 increase the price of ITL products. That's what it's
5 about.

6 Now, there is nothing in this agreement or indeed
7 the other agreement which prevents or discourages
8 Morrisons from reducing the retail prices for Gallaher
9 products, it doesn't touch on that. All that this
10 agreement provides for, and indeed the other agreement,
11 is that in the event that there is a promotion on
12 a Gallaher product, ITL will continue either paying
13 bonuses in the normal way, that is that it will not
14 penalise Morrisons despite the fact that Morrisons'
15 retail prices are not in line with ITL's parity and
16 differential aspirations, or it will offer Morrisons
17 a taxable bonus to fund a reduction in the ITL product
18 price.

19 You will have noticed the point, I believe Mr Howard
20 emphasised under the "Pricing" wording, that if one goes
21 halfway down that:

22 "William Morrison confirm instore promotional
23 activities which may affect pricing strategy. ITL agree
24 to maintain bonus levels in line with appendix 1, should
25 we elect not to respond to other manufacturers' pricing

163

1 initiatives."

2 So we are always going to get those bonuses. So we
3 are going to get those bonuses, whatever happens, and we
4 are going to provide an opportunity to respond.

5 To the same effect, staying in the same bundle,
6 going ahead to tab 17 --

7 **DR SCOTT:** Just staying with that agreement, this doesn't
8 have an ongoing bonus for the pricing below RRP.

9 **MR SAINI:** Well, if you go to page 4, it has O/I bonus per
10 outer off-invoice, you will see that on the schedule.

11 **DR SCOTT:** So that's paid on the RRP basis rather than the
12 P&Ds basis.

13 **MR SAINI:** That's going to be paid whatever happens, that's
14 always going to be provided, and that no doubt reflects
15 whatever pricing aspiration the manufacturer has,
16 provision of that bonus.

17 **DR SCOTT:** What it says is:

18 "In line with our current strategy, see appendix 2."

19 And appendix 2 is about relativities between brands,
20 not about relativity with the RRP.

21 **MR SAINI:** I think I understand the question now, sir. The
22 off-invoice bonus is paid both for pricing below RRP and
23 for maintaining the parity and differentials that the
24 manufacturer desires.

25 **THE CHAIRMAN:** So your price matrix, then, is different from

164

1 Mr Thompson's in that your one does include the parity
2 and differential?
3 **MR SAINI:** Absolutely, absolutely. What they are
4 recognising is that there may be price changes which put
5 the parity and differential aspirations out of kilter,
6 but we are going to continue receiving these ongoing
7 bonuses or there may be a further tactical bonus
8 offered.

9 I was going to go to tab 17, the second trading
10 agreement.

11 **THE CHAIRMAN:** Is it tabs 45 and 85?

12 **MR SAINI:** I am grateful. That's right, 85. Again, the
13 point that we made later in TA1, the first trading
14 agreement, applies here, which is that there is nothing
15 in this agreement which inhibits Morrisons from reducing
16 the retail price of Gallaher products. All it's doing
17 is it's incentivising Morrisons not to increase the
18 price of ITL products.

19 You will see, if one goes to the body of the pricing
20 section, which is on page 463, using the numbering in
21 the bottom right-hand corner, and there one sees in the
22 second paragraph:

23 "Based on the continued achievement of those
24 differentials and the shelf prices highlighted in the
25 ongoing schedule of bonuses and margins, Imperial will

165

1 pay all of these bonuses off-invoice."

2 So returning to Dr Scott's question, one sees there
3 what is implicit in the first trading agreement but
4 express here, which is that the ongoing bonuses are
5 motivated by the desire to achieve differentials.

6 **THE CHAIRMAN:** So where is the bonus related to pricing
7 below RRP?

8 **MR SAINI:** Again we say it's part and parcel of that.

9 **THE CHAIRMAN:** This may or may not become clear once we hear
10 the evidence about it.

11 **MR SAINI:** We don't have a similar schedule to the one we
12 have in relation to the first trading agreement, the
13 table, but no doubt Mr Eastwood will answer this, but
14 I anticipate that he will say that pricing below the RRP
15 is built into the provision of these bonuses.

16 What's interesting to note in relation to this
17 particular agreement is that it also makes explicit
18 another point which we say was implicit in the first
19 trading agreement, that is that funding is going to be
20 withdrawn if Morrisons increases the price of an ITL
21 product, even if it maintained ITL's parity and
22 differential aspirations by simultaneously increasing
23 the retail price of a competing Gallaher product.

24 So there can't be any suggestion that ITL is going
25 to reward Morrisons for increasing the retail prices of

166

1 its products and Gallaher products in tandem. What ITL
2 will do is punish Morrisons if it increases ITL product
3 prices whatever happens to Gallaher prices.

4 Mr Howard has already made submissions in relation
5 to the particular wording of the differentials, the
6 parity and differential angle, page 464, and I won't
7 repeat that. I just wanted to address the position of
8 Safeway in relation to which agreements existed.

9 Now, as between -- we can put away annex 17 --
10 Safeway and ITL, there appears to be no agreement, no
11 written trading agreement. As between Safeway and
12 Gallaher, there is an agreement, which we can look at,
13 which is in annex 26.

14 **DR SCOTT:** Sorry, just to clarify, was there a suggestion
15 that there was an agreement that hadn't been found, or
16 that --

17 **MR SAINI:** It's a matter for evidence ultimately, but
18 I would say this: one can see references to -- well,
19 I think I can put it no higher than saying that neither
20 we nor ITL have found an agreement.

21 **DR SCOTT:** Yes, that's my understanding, I just seem to
22 remember that there were some references to
23 an agreement, but nobody had actually found one.

24 **MR SAINI:** Well, I think it's probably safest for me, prior
25 to any evidence being given by ITL, I would say that our

167

1 position is there isn't any agreement in place,
2 certainly not an agreement of the type that the OFT rely
3 upon, because the OFT are saying there are P&D
4 agreements, I don't think there is any evidence of that
5 as between Safeway and ITL.

6 As between Safeway and Gallaher, I ask the Tribunal
7 please to go to annex 26, and at 54A -- I am told that
8 all of 54A is confidential. I'll perhaps just point up
9 the document and the particular paragraph.

10 This is a signed trading agreement, and if you would
11 please go to page 259, I will not read it, and read
12 paragraph 3, please.

13 (Pause)

14 Without giving too much away as to what's said
15 there, this is clearly a million miles away from the
16 type of agreement which the OFT alleges was in place
17 between Safeway and Gallaher.

18 Perhaps I could put it neutrally by saying that at
19 most there is an opportunity, it's an opportunity to
20 respond provision. In particular, nothing in this,
21 nothing appears here in relation to parity and
22 differentials.

23 So that's the sum total of the written agreements
24 between Safeway and Gallaher. But you will have noted,
25 and I'll provide the reference and read it out, but

168

1 Gallaher's own position in the document that Mr Thompson
2 showed you a short while ago, that was the document in
3 SO annex 3 at tab 17, which was effectively the
4 evidential position of Gallaher. At page 17 of that
5 document, they are asked a question in relation to their
6 agreement with Safeway, and they say and I quote -- this
7 is confidential? I don't know. I am told it's not
8 confidential, this part, but I'll read it. It says:
9 "Safeway never had [this is Gallaher's position]
10 a 'parities and differentials' clause, nor was there any
11 understanding between Safeway and Gallaher that Safeway
12 would observe parities and differentials. However,
13 Safeway knew this to be Gallaher's objective and would
14 not have wanted to price differently in any event."

15 So so far as an agreement is concerned, or
16 understanding, it appears to be Gallaher's position that
17 there was never any such agreement with Safeway.

18 Madam, would that be a convenient moment? I think
19 I have only ten minutes left. I am happy to continue
20 now.

21 **THE CHAIRMAN:** If you would be prepared to go on and finish
22 this afternoon that would be convenient for everyone.

23 **MR SAINI:** I just need to finish off an issue in relation to
24 the agreements, which is that I've shown you what the
25 sum total of the evidence that exists in relation to

169

1 those. There is one subject, though, which emerges in
2 the evidence which I broadly call administration, and
3 it's addressed in the evidence of Mr Culham on behalf of
4 ITL, which is in core bundle 3.

5 **THE CHAIRMAN:** I think we have been taken to that part of
6 Mr Culham's evidence.

7 **MR SAINI:** I just wanted to make sure, I'll give you the
8 reference, and this is actually a specific Safeway
9 related point. I've shown you the part, it is at
10 tab 35, core bundle 3, {C3/35} the evidence of
11 Mr Culham. I showed you the part that dealt with the
12 price file and the fact that as a matter of convenience
13 ITL and retailers would agree that ITL would undertake
14 certain work in terms of producing spreadsheets. There
15 is a slightly different subject, which is also called
16 administrative assistance, which is at page 428,
17 paragraphs 170 and 173.

18 The thrust of the point I want to make that's
19 encapsulated in those paragraphs is as follows: on many
20 occasions, as regards Safeway in particular, and we also
21 in fact see it from the documents Mr Thompson showed you
22 earlier, that this also happened with Co-op, that there
23 were errors made by the retailers. Now, the Tribunal
24 asked: how can there be errors? What kind of errors are
25 you talking about here? This looked like, and no doubt

170

1 the OFT will have these errors as meaning really, the
2 ITL or Gallaher are dictating prices to retailers. The
3 reality is that these are errors in a different sense.
4 They are errors in the sense that the retailers
5 themselves, and in this particular context Safeway,
6 Mr Culham is dealing with, were pricing contrary to
7 their own policy, and by that I mean, and we will see
8 examples of this when the evidence begins, that Safeway
9 were very disorganised and they would often be pricing
10 the same product in different stores differently, by
11 mistake. We see persistent monitoring by both ITL and
12 Gallaher both of Safeway prices and indeed of Co-op
13 prices, and they go back to the retailers and say "You
14 are making errors. They are not errors because we want
15 the prices corrected to give us an advantage as
16 manufacturers, but you are creating errors according to
17 your own pricing policy. These are simple cock-ups.
18 You are very disorganised", and you will see that there
19 is evidence that, as far as Safeway is concerned in
20 particular, individuals at both ITL and Gallaher didn't
21 think much of Mr Trevor Thomas' organisational abilities
22 and they uncharitably call him 'incompetent' on certain
23 occasions. Incompetent in a very specific sense which
24 is that he is not doing his own job for his own employer
25 properly, he is mispricing.

171

1 Now, OFT will say that's sinister, but you will see
2 when we get to the context that the mispricing is to the
3 effect that Safeway is doing itself out of money. That
4 was the only point I wanted to make in relation to that,
5 and the Tribunal will no doubt hear from Mr Culham in
6 relation to 170 and 173 in due course.

7 Thank you very much.

8 **THE CHAIRMAN:** Thank you very much, Mr Saini.

9 So it's you tomorrow morning at 10.30, Mr Flynn?

10 **MR FLYNN:** At 10.30, Madam, and I will endeavour to shorten
11 my submissions as much as I can overnight.

12 **THE CHAIRMAN:** It is not just a matter of shortening them,
13 it is take on board the point that I made that we have
14 not yet had the evidence and much as I am sure you hope
15 that everything will turn out in the way it is in the
16 witness statements, one can't know where we will be by
17 the middle of November.

18 **MR FLYNN:** I think it's important simply to indicate the
19 battle lines.

20 **THE CHAIRMAN:** Yes. Very well, 10.30 tomorrow morning,
21 thank you.

22 (4.35 pm)

23 (The court adjourned until 10.30 am on
24 Tuesday, 27 September 2011)

25

172

1	INDEX	
2		PAGE
3	Opening submissions by MR BREALEY	1
4		
5	Opening submissions by MR THOMPSON	41
6		
7	Opening submissions by MR SAINI	127
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		