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IN THE COMPETITION

APPEAL TRIBUNAL

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

Victoria House,
Bloomsbury Place,
London WC1A 2EB

27 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

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

HEARING (DAY 4)

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 Tuesday, 27 September 2011
 2 (10.30 am)
 3 Opening submissions by MR FLYNN
 4 **THE CHAIRMAN:** Yes, Mr Flynn.
 5 **MR FLYNN:** Good morning, madam, sirs. Mr O'Donoghue and
 6 I appear for Asda in this case, as you know.
 7 Before we, as it were, metaphorically roll up our
 8 sleeves, it's worth remembering that in the decision
 9 which is challenged in these appeals, the OFT has
 10 characterised the arrangements it describes as an object
 11 infringement, despite both their admitted complete lack
 12 of precedent in law or economics and despite the fact
 13 that it couldn't prove that the arrangements had had any
 14 deleterious effects, even after an investigation that
 15 lasted so long that it felt obliged to give the parties
 16 a 10 per cent discount on the fine.
 17 For those novel and entirely open and undisguised
 18 arrangements, it has imposed extremely significant
 19 penalties which are entirely analogous with those for
 20 the most serious secret horizontal cartel.
 21 Obviously the level of penalty is for another day,
 22 but we say even that bare outline of what's happened in
 23 this decision shows that the OFT has gone wrong in this
 24 case.
 25 It expected, from the outset, to find serious and

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1 deliberate violations of competition law. It never
 2 found a horizontal case. It's been progressively forced
 3 to abandon an ABC or a legitimate indirect contact case,
 4 and its effects case. But although the alleged
 5 infringements are now said to be a series of purely
 6 bilateral arrangements between various pairings of
 7 retailers and manufacturers, the decision is littered
 8 with references to matters that might be relevant to the
 9 sort of case that it's had to abandon, but ones that are
 10 not relevant to the case that it now asserts. Mr Howard
 11 has given some examples of that. It is necessary to
 12 bear in mind the whole time what is the arrangement that
 13 the OFT is now seeking to prove.
 14 We say that in all these changes of the nature of
 15 the infringement and its theory of harm, the OFT has
 16 rather lost sight of the fact that it needs to prove, in
 17 respect of each manufacturer/retailer pairing, that the
 18 arrangement of the type it alleges was actually entered
 19 into, specifically in Asda's case then it bears the
 20 responsibility of showing that Asda entered into such
 21 an arrangement with each of Gallaher and Imperial.
 22 That's the importance of the point that these are
 23 vertical relationships, they are individual
 24 relationships, and they may vary significantly,
 25 depending on factors such as the nature of the written

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1 agreements, if any, that the parties have, the nature of
 2 the retailers' policies as well as those of the
 3 suppliers, and the substance of their dealings,
 4 descending almost into at certain points into questions
 5 of personal chemistry, which I shall come back to.
 6 The OFT has paid lip service to this need, and it
 7 supplied it in practice by finding that Tesco didn't
 8 have an infringing relationship with either Gallaher or
 9 Imperial. Now, obviously Tesco was accepting
 10 promotional bonuses and so forth from the manufacturers
 11 along with the best of them, but it's been found not to
 12 have accepted any restriction on its pricing freedom.
 13 We say you can't read across simply from one case to
 14 another, you have to find whether the retailer in
 15 question has accepted any restriction. Asda's principal
 16 contention is that it likewise accepted no such
 17 restriction, and the OFT has quite failed to demonstrate
 18 that it did.
 19 Now, madam, I'm mindful of your injunction, as it
 20 were, not to count any chickens on the evidence, but
 21 I think it is important that I set out our stall of what
 22 Asda's evidence-in-chief will be, not least because you
 23 will not be hearing that live, and that will mean that
 24 there will be no doubt as to what the OFT will have to
 25 aim at in cross-examination, if it wishes to disturb

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1 Asda's case. I will also try to focus principally on
 2 the evidential deficiencies in the way that the OFT has
 3 put its case.
 4 Now, before getting into those evidential points,
 5 I should say of course that isn't the only issue in the
 6 case, despite I think an indication to the contrary in
 7 the OFT's skeleton. The question whether its case is
 8 economically sound is also a relevant issue, we join the
 9 others in saying that it isn't, and you will have seen
 10 that our expert Mr Dryden's conclusion overall is that
 11 a small change in the form of the agreement can change
 12 the predictive effects from anti to pro-competitive, and
 13 the finding or the assertion in economic expert evidence
 14 that the case is so fact sensitive is a significant one,
 15 in our submission.
 16 That point also feeds into the question whether the
 17 arrangements, even if they are found to exist, even if
 18 the OFT proves the factual case, whether those
 19 arrangements are suitable for object characterisation as
 20 a matter of law. Again, we join in saying that they are
 21 not. I don't intend to supplement in any detail what
 22 Mr Brealey has said yesterday, by and large those are
 23 our submissions too. We say that the OFT has fallen
 24 into error by generalising from a horizontal context
 25 where really any price discussion might be suspect, and

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1 you can, as you know, start off a lasting cartel from
 2 a single meeting, whereas in the supplier/retailer
 3 context pricing discussions are normal and legitimate.
 4 We will come to the evidence, but many of the
 5 communications simply reflect manufacturer concern as to
 6 their own level of pricing, and we can't leap from that
 7 to a conclusion that it's in the context of a different
 8 sort of agreement. We have also made the point that
 9 mere capability, a propensity to harm competition, isn't
 10 enough; you have to show that it's overwhelming or
 11 preponderant, at least a very high one. We said in our
 12 skeleton that if you have a type of agreement where nine
 13 times out of ten it's not going to harm competition,
 14 it's inappropriate to treat that as an object
 15 infringement because in some remote circumstances, it
 16 may have a capability of harming competition.
 17 Mr Brealey has been through the case law, and we
 18 agree with that. We said in our skeleton it's
 19 particularly wrong of the OFT to suggest that the
 20 T-Mobile case represents step change in the law. We
 21 have made that point, and I won't go over it here.
 22 But all this, the object characterisation, is all
 23 the more problematic, because in the decision, the
 24 theory of harm is that the harmful effects would take
 25 effect over the long-term, and they recognise that the

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1 immediate effect may be to provoke competitive
 2 responses.
 3 We say it's not appropriate for the OFT, in the
 4 defence, to backtrack on that and say there is likely to
 5 be an immediate effect, it's not what the decision says,
 6 and it's not what Professor Shaffer said in his report
 7 to the OFT. We know that in fact the OFT has renounced
 8 any ability to prove those effects, despite having
 9 a fairly long-term view on it, so even the long-term
 10 suggestion we say is rather hollow.
 11 Turning to our evidence, it's a significant fact --
 12 and I don't think I am wrong about this -- that the
 13 OFT's skeleton doesn't address Asda's witness statements
 14 at all, there is not a single reference to the three
 15 witness statements from Mr Jolliff, Mr Mason and
 16 Mr Lang, which you will have read in volume 10 of the
 17 core bundle.
 18 In broad terms, without going into the detail,
 19 madam, unless that may be helpful for you, those
 20 witnesses are very clear that they would not be dictated
 21 to on pricing by the manufacturers, and statements to
 22 that effect you can find in paragraphs 4 and 5 of
 23 Mr Jolliff's witness statement, Mr Mason paragraph 12,
 24 Mr Lang at paragraph 5.
 25 They say that the pricing decisions, the retail

6

1 prices, were theirs to set, and they alone took them.
 2 They took them essentially on the basis of making
 3 a small margin, it's a tight market, as we know, they
 4 make a small margin on the cost price, and always being
 5 extremely price competitive vis-a-vis their chosen
 6 competitor set. I think there is some ambiguity in the
 7 documents as to whether it's confidential with whom they
 8 were competing, but I think you will have seen those.
 9 An example, and we could turn it up, is Mr Mason at
 10 paragraph 27. That's tab 110 in volume 10. {C10 tab
 11 110 paragraph 27} If the Tribunal has that,
 12 paragraph 27, page 414 in the bottom right-hand corner,
 13 paragraphs 27 to 29 set out his account of pricing and
 14 the pricing policy that Asda has, notably its Every Day
 15 Low Pricing proposition, where he said:
 16 "It's of crucial strategic importance to be as
 17 cheap, if not cheaper than, its competitors wherever
 18 possible and it is fundamental to everything we did in
 19 tobacco."
 20 Then something apparently confidential.
 21 "We wouldn't price above RSP, and we wouldn't price
 22 more highly than the rivals."
 23 He says:
 24 "Of course the prices were influenced by cost prices
 25 and promotional funding. If we were offered promotional

7

1 or tactical funding at a discount price for a brand we
 2 would always accept it in order to offer lower retail
 3 price for the benefit of our customers", and they would
 4 try to resist cost price increases, especially if they
 5 thought they were being disadvantaged vis-a-vis other
 6 retailers and their cost prices.
 7 It's worth mentioning the routine monitoring that he
 8 talks about in this paragraph because I think
 9 the Tribunal expressed some interest in that yesterday,
 10 Dr Scott did, and it's not merely that they take
 11 information of course from their suppliers, although if
 12 that information is available they will, but they will
 13 always check it themselves and they themselves keep
 14 a close eye on the shelf prices of their competitors.
 15 Mr Jolliff, in his witness statement, just for your
 16 note, I think it's paragraph 20, he gives a graphic
 17 example of getting into his car every Monday afternoon
 18 and driving around himself to have a look at what prices
 19 are being offered by other supermarkets.
 20 The Asda witness statements go very thoroughly
 21 through the documents mentioned in the decision. For
 22 example, I think on the first day of this hearing,
 23 Mr Howard took you to paragraph 40 of the OFT's
 24 skeleton, which sets out their core proposition, as it
 25 were, and as to the Asda documents that are mentioned in

8

1 the footnote there, they are addressed by Mr Jolliff in
2 his witness statement at paragraphs 90 and 91. There it
3 can be seen those price increases are the result of
4 a withdrawal of a tactical bonus, as it made expressly
5 clear, and he accepts that, as he must, and agrees
6 a date for the implementation, knowing that he has to
7 put up his shelf price if he wishes to maintain his
8 margin.

9 Now, just for your note and just for the sake of the
10 good order, there is a second quotation in footnote 41.
11 That does not appear to be an Asda document at all. You
12 can see, if you look across, I don't suggest you do it
13 now, but as I say it's just for the sake of good order
14 because there is obviously a glitch, paragraph 6.149 of
15 the decision gives that same quote and it's a Somerfield
16 document, not an Asda document. So that's not something
17 that Asda can speak to.

18 All in all, what the witnesses say, they didn't have
19 a cosy relationship with the manufacturers, they were
20 always alert to the possibility of being disadvantaged
21 vis-a-vis their competitors, they didn't take anything
22 on trust, they always checked up for themselves.

23 There are plenty of examples in the witness
24 statements, we will not go to them now, but Asda
25 retained pricing flexibility and it exercised it, and

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1 you can see this at a more abstract level by the fact
2 that it's the agreed position between the OFT's expert
3 Dr Walker, and Asda's expert Mr Dryden, that Asda's
4 pricing, actual pricing, matched the manufacturer parity
5 and differential aspirations, that phenomenon non-being
6 called adherence, 40 per cent of the time. In other
7 words, 60 per cent of the time it didn't.

8 So on the agreed basis between the experts, Asda was
9 only complying 40 per cent of the time with manufacturer
10 aspirations.

11 I think the OFT relies at one point on, I think,
12 an Imperial report inside saying "Asda is doing jolly
13 well and they comply most of the time with our
14 requirements or our desired P&Ds", not so apparently
15 according to the actual evidence.

16 Mr Dryden also shows that Asda's adherence in that
17 technical specialised sense is higher if you measure it
18 against RSPs, the recommended selling prices. So the
19 suggestion that the P&D arrangements alleged to exist by
20 the OFT increased compliance with the manufacturer P&D
21 aspirations is just not one which is borne out.

22 Our evidence also shows that the manufacturers'
23 desired differentials were really contingent on the
24 wholesale pricing changes and not the other way around.

25 We analysed this in annexes 3 and 4 of the reply, by

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1 reference to the brand pairs identified by the OFT in
2 the decision, and that analysis shows examples of
3 differentials being widened by Imperial rather than
4 following a Gallaher price rise itself, as Mr Howard
5 said on our first day I think, and more generally that
6 the adjustments to the differentials followed
7 adjustments to the wholesale prices, not the other way
8 around.

9 I think this may be similar to the floating point
10 that Co-op make. We don't make it in the same way, but
11 we just say observedly the changes to differentials
12 follow the reality of pricing in the market rather than
13 the other way around.

14 So any theory of rigid or automatic adherence to
15 P&Ds isn't borne out on the facts, and the OFT accepts
16 that, and tries to deal with that by finessing the
17 meaning of its parallel and symmetrical language, and
18 making points about compliance which I will come to.
19 Approaching the evidence that is given by the OFT in
20 relation to relationships between Asda and each of the
21 manufacturers, can I just make four preliminary points
22 and then I'll come to each manufacturer.

23 Firstly, the way the OFT has put this consistently,
24 actually, its forensic case has five pillars, which are
25 set out in paragraph (ii) of its skeleton, and are based

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1 on a similar categorisation which you will have seen in
2 its approach 1.8, I think, the introductory part of the
3 decision, and 6.15 which is when they get into the
4 description. Those five pillars are: firstly the
5 manufacturers' strategies; secondly written trading
6 agreements; thirdly contacts, which are mainly in the
7 form of email between the manufacturer and the retailer
8 concerned about prices of that manufacturer's product,
9 retail prices of competing manufacturers' brands, and
10 the retail prices of the retailers' competitors, so that
11 sort of breakdown.

12 The fourth point is the payment and withdrawal of
13 bonuses, the tactical bonuses, to incentivise the
14 retailer to follow the manufacturer's strategy. The
15 fifth one is monitoring by the manufacturer, and in
16 certain cases, realignment of the retailer's price.

17 Now, the OFT says not all of those have to be
18 present in each case, not all of them are present in
19 each case, and it generalises across the retailers in
20 that fashion, builds up a mosaic, if you like.

21 We say it's pretty clear that the core pillars are
22 the middle three, because manufacturers can have
23 whatever strategy they like, but unless it's bought into
24 by the retailer then that remains a unilateral
25 aspiration, and the OFT recognises that in paragraph 111

12

1 of its skeleton.
 2 Likewise, monitoring. You can only have a concern
 3 with monitoring if you are monitoring something, and
 4 that must be, on the OFT's case, an agreement to fix and
 5 maintain parities and differentials in the way that they
 6 describe. So it's those three central pillars that
 7 really matter, the end ones are just looking as if they
 8 are holding up the edifice, but they are not really.

9 The second point I want to make is -- and I'll try
 10 not to bang on about this too much -- Asda has tried to
 11 deal comprehensively with the evidence put forward by
 12 the OFT in the decision, so in our notice of appeal we
 13 went through every document relating to Asda, and
 14 likewise our witnesses. You will find that, if the
 15 references would assist, in our notice of appeal. As
 16 regards Imperial, it's 144 to 155 of our notice of
 17 appeal, and as regards Gallaher, it's 163 to 165 because
 18 there are very few Gallaher documents. At the end of
 19 each of our witness statements there is a document by
 20 document review of the documents to which those
 21 witnesses can speak.

22 The defence doesn't engage with that review of the
 23 documents, and the OFT puts forward a few new documents
 24 that are not mentioned in the decision. In the reply we
 25 dealt with each of those new documents, and if the

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1 references would assist, for Imperial it's 116 to 134
 2 and for Gallaher it's 135 to 141.

3 We will probably mention some of those in the course
 4 of the morning, but without going into too much detail.

5 In the defence, it's worth noting just a few things.
 6 Over half of those documents pre-date the infringement
 7 period. It's not just a technical point, it's just
 8 surprising that that's the best evidence the OFT can
 9 muster. Certainly where the OFT says in its defence
 10 that it relies particularly on the correspondence during
 11 the infringement period, that's not true in the case of
 12 Asda.

13 Again, most of the documents simply concern
 14 statements by the manufacturers about their own pricing,
 15 and therefore the OFT has a burden of showing that what
 16 you would take to be legitimate manufacturer interest in
 17 its own absolute price level in fact refers to
 18 an unstated relative price of a competitor brand, and
 19 also what relativity the manufacturer was seeking.

20 Thirdly, there are lots of examples of Asda
 21 resisting the manufacturers' overture. Again, in the
 22 skeleton, the OFT doesn't respond on a point by point
 23 basis, as we had invited it to do; it refers to a few
 24 additional documents, some of which are not mentioned in
 25 either the decision or the defence. We will have to

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1 work through those. I am not proposing to do that now.
 2 I suppose perhaps the mini opening may be a more
 3 appropriate time to deal with that.

4 Asda has sought to engage and the OFT has resisted
 5 that. We say it's not appropriate, really for the
 6 reasons I have already given, for the OFT to say: well,
 7 we rely on the totality of the evidence, when you are
 8 dealing with individual bilateral agreements it at least
 9 has to show how you can read across from one
 10 relationship to another. That's the importance of the
 11 vertical point. As I've already said, and I won't
 12 repeat it, it's normal. The Court of Appeal has said it
 13 is normal for pricing for manufacturers to have pricing
 14 aspirations for their own products, and you have to have
 15 a high threshold to show that those desires overstep
 16 some legal mark. It's hard to see why in principle that
 17 mark is overstepped simply because the desire may be by
 18 reference to the pricing of competing brands. Again,
 19 you know, it would be naive to think that anyone's
 20 prices are set in a vacuum.

21 I think probably enough has been said, by others, on
 22 OFT's backtracking as to the finding in the decision
 23 that the manufacturer requirements were parallel and
 24 symmetrical, and is now falling back on similar --

25 **DR SCOTT:** Sorry, are you moving on from documents?

15

1 **MR FLYNN:** I was shortly going to move on to the individual
 2 relationships and the OFT's basis for that.

3 **DR SCOTT:** If you are coming back to that, that's ...

4 **MR FLYNN:** Yes, yes, in fact that is all I am going to deal
 5 with for the rest of my time, such as that may be. As
 6 I said, on the law I don't think we have a lot now to
 7 add to what Mr Brealey has said. We may in closing
 8 submissions, but essentially we are there. You have
 9 heard a lot about the theory of harm and so forth, and
 10 I don't wish to weary the Tribunal with that. I simply
 11 want to, this morning, set out, as it were, the
 12 distinctive stall of Asda, so that you know where we are
 13 coming from, if that's acceptable to the Tribunal.

14 So in short, we say we have, to the best of our
 15 ability, engaged with the evidence that the OFT has put
 16 forward, and we don't accept the characterisation in
 17 their recent letter to you about the approach to
 18 cross-examination, saying that the witnesses had not
 19 dealt with individual documents but more generally and
 20 by category. We have addressed individual documents,
 21 and the OFT needs to be aware of that.

22 Can I take the individual relationships between
 23 Gallaher and Imperial in turn, and I'll start with
 24 Gallaher. Bearing in mind, I'll do it by reference to
 25 the OFT's five pillars which I have already mentioned.

16

1 As regards Gallaher's strategy, we don't think that
 2 the OFT has put forward any document showing that
 3 Gallaher had a strategy for pricing specifically
 4 applying to Asda. The decision refers to an internal
 5 Gallaher document about strategy, 6.463, but there is no
 6 suggestion that that document was ever sent to Asda, and
 7 that's a pre 2000 document. None of the documents
 8 appear in the annex 4, which is the Gallaher/Asda annex.
 9 Again, as I've said, the OFT now accepts that strategy
 10 is a unilateral matter, you have to go on to show that
 11 it was accepted.

12 Written trading agreements. The position is pretty
 13 straightforward, as far as Asda is concerned, with
 14 Gallaher. There was no written trading agreement
 15 containing any references to parities and differentials
 16 or attaching a schedule. The Gallaher trading agreement
 17 with Asda is in annex 4 at tab 2A. It's an A tab
 18 because that's a document provided by Asda, it is
 19 exhibited to Mr Jolliff's witness statement. The OFT
 20 doesn't refer to it.

21 We say the fact that that trading agreement doesn't
 22 have any reference to P&Ds in it whatsoever is
 23 important, not only for that fact as regards pillar 2,
 24 no written trading agreement, but it also affects -- to
 25 pick out Mr Saini's phrase -- how sinister the

1 spectacles are when you come to look at the context. If
 2 there is no overarching framework set by a contract in
 3 relation to P&Ds, you can't just put your P&D spectacles
 4 on when you come to look at the contacts.

5 So if we look briefly at the OFT's evidence under
 6 the third pillar, as I've already said, annex 4 is
 7 a very thin file. There are only 19 documents in it.
 8 Six of those, I think, fall outside the infringement
 9 period, and that's in itself quite eloquent.

10 Actually, when you look at the decision and how it's
 11 structured, the OFT doesn't seek to advance
 12 a proposition that Gallaher instructed Asda to price
 13 Gallaher brands by reference to Imperial's, or even
 14 actually discussed those with Asda. The structure of
 15 the decision, you will see if you run through it, and
 16 bearing in mind the three subcategories in this pillar,
 17 there is no section in the Asda/Gallaher part of the
 18 decision about contacts between Gallaher and Asda
 19 regarding Asda's retail prices for Gallaher's
 20 competitors. That subheading isn't there. There is
 21 a heading about contacts concerning retail prices, but
 22 that breaks down into retail prices for Gallaher's
 23 brands and contacts regarding retail prices charged by
 24 Asda's competitors, just no reference to Imperial, and
 25 the OFT's skeleton argument is similarly structured.

1 So we say that in those circumstances the OFT has
 2 a burden to discharge to show that references to
 3 Gallaher's own prices, retail prices, in absolute terms
 4 in the correspondence are in some way implicitly
 5 references to some linkage with Imperial, and that
 6 linkage is only consistent with the infringement
 7 alleged, that there was some agreement to fix prices by
 8 reference to P&Ds, and not, for example, simply
 9 a manufacturer's interest in its own pricing not being
 10 too high relative to its rivals, which would be a lawful
 11 and normal concern. We say the OFT then just has not
 12 made out the case in respect of Gallaher and Asda.

13 Bonuses, the fourth pillar. Again, this is
 14 a defective part of the decision. The decision says at
 15 paragraph 6.500 that there are documents relating to the
 16 provision of tactical bonuses from Gallaher to Asda,
 17 examples of which are set out in the section headed --
 18 one of the sections I have just referred you to --
 19 "Contacts regarding retail prices".

20 The decision doesn't say what those documents are.
 21 We pointed that out in the notice. The OFT, at 187 of
 22 its defence, identifies some documents which, as I've
 23 already said, we dealt with in the reply.

24 We say those documents, by and large, concern
 25 tactical bonuses, promotional bonuses which were coming

1 to an end, or in Mr Summers' terms the discount was
 2 being withdrawn so that the cost price then goes up,
 3 with the result that in the ordinary case the shelf
 4 price would ordinarily increase assuming Asda wishes to
 5 maintain its margin., and that with only one exception
 6 those documents don't refer to ITL brands at all. The
 7 only exception is the one that I think you have already
 8 seen, where Gallaher is asking whether Imperial would be
 9 increasing Richmond after a Budget increase in 2001, and
 10 that's the communication of the sort which Mr Howard has
 11 shown you, which may be a cheeky attempt by
 12 a manufacturer to get some inside information, but it's
 13 not the infringement we are concerned with here.

14 So we say that withdrawing tactical bonus is not in
 15 itself objectionable and has to show some linkage to
 16 affect a parity or differential with an Imperial brand
 17 in the context within which we are currently operating,
 18 and that link isn't made.

19 The only evidence that the OFT's skeleton refers to
 20 again only concerns Gallaher changes after
 21 a manufacturer price increase without any reference to
 22 ITL brands.

23 Just for the note, it's mentioned in footnote 129 of
 24 the OFT's skeleton, and that document is addressed by
 25 Mr Mason at paragraph 48 of his witness statement.

1 So we say that the evidence shows that, you know,
2 the evidence does not show that those bonuses were given
3 or withdrawn in the case of Asda and Gallaher to affect
4 any P&Ds.

5 Monitoring, again, as I've said, this is a sort of
6 non-pillar, it's there but it's not actually holding up
7 the pediment, but again there is very little evidence
8 given about monitoring, and such monitoring as there is
9 relates only to Gallaher prices. So we say the OFT's
10 evidential case as regards Asda and Gallaher is really
11 wholly deficient as well as very short.

12 Now if I might turn to Imperial again, by reference
13 to the same five pillars. There are a few more
14 documents in the case of Imperial, but we say the case
15 is absolutely no stronger. Again, as far as strategy is
16 concerned, it's unilateral, and we say there is no
17 evidence that Asda bought into Imperial's strategy. Why
18 would it? There is plenty of evidence that it doesn't.
19 The OFT has again not responded directly to our case,
20 Mr O'Donoghue suggested it was a bit like a game of
21 "whack a mole", they ignore what we have and then they
22 put out another one which we will have to hit later.

23 This doesn't mean the OFT has lots of wonderful
24 documents that prove its case. Each one is just less
25 convincing than the others. Again they pre-date the

1 date of the infringement, they are internal to ITL,
2 there is nothing on the face to link them to P&Ds and so
3 forth.

4 We have made a particular point in our pleadings
5 that it's not an appropriate way for the OFT to carry on
6 in the decision to engage in what we have called mere
7 clerical listing. You can't simply refer to documents.
8 We know there are documents, what we need to know is
9 what conclusion the OFT draws from them, otherwise it's
10 not discharging its burden of proof and it's not
11 permitting adequate defence rights and that sort of
12 objection obviously applies with even greater force to
13 documents that are pulled out for the first time in
14 their skeleton.

15 The other point on strategy, and maybe this is the
16 time to make it, I think I have already hinted at it,
17 Asda of course has its own strategy, and there is no
18 reason to think that Asda's strategy would be the same
19 as Imperial's. I've said that the relationship was not,
20 on our evidence, a trusting one, and it verges on
21 animosity at times, and you will see examples of that.
22 Mr Mason says, essentially, "Our pricing was influenced
23 by their cost pricing and promotional funding, of course
24 it had to be, but we decided our price policy and we
25 checked it out". And the principal focus for Asda, as

1 I said, was being competitive with its chosen rivals.

2 In relation to trading agreements, now, here we have
3 three. The first one is the 2001 trading agreement.
4 The Asda/Imperial documents are in file 14. {D14} The
5 2001 trading agreement is in tab A of that file, because
6 again it's not one that the OFT refers to, there is no
7 reference to it in the relevant paragraph of the
8 decision, which is 6.399. That agreement, as you will
9 see if you glance at it, makes no reference whatsoever
10 to parities and differentials. Some of the content is,
11 I think, marked as confidential, but there is no
12 reference to parities and differentials in that
13 agreement.

14 I come back to my spectacles point, in the same way
15 as for 2000. So for 2000 and 2001 you cannot just put
16 on your P&D spectacles when you look at the context
17 between Imperial and Asda. Half the documents, this is
18 file 14, more than half, concern those periods 2000 to
19 2001 when there is no written trading agreement making
20 any reference to P&Ds.

21 Then there are two further trading agreements, and
22 those are in tabs 53 and 80 of that file. Maybe it's
23 worth just opening the first of those. If the Tribunal
24 has that, you will see at the bottom of the first page
25 that the date of signature is 5 June 2002, although the

1 period said to be covered by the agreement at the top,
2 by the side of the "confidential" box is from
3 1 January 2002.

4 Now, the decision at footnote 498 said that the OFT
5 inferred that a pricing schedule attached in fact to the
6 third trading agreement, the one at tab 80, also formed
7 part of the second trading agreement. The OFT has
8 accepted in its defence -- paragraph 76 for your note --
9 that that is an error on its part.

10 The true position is that Imperial sent price
11 differentials said to apply from 25 June on 11 June of
12 that year, and that is the document in the next tab,
13 number 54.

14 That schedule, as the OFT's case, sets out maximum
15 differentials. In most cases it says the Imperial
16 brands are to be no more expensive than the specified
17 Gallaher brand; in certain other parts, it says the
18 pricing of the Imperial brand is X pence below the
19 Gallaher brand. We say that is also a maximum price in
20 respect of the Imperial brand and fixes no minimum price
21 for the Gallaher brand.

22 The important point as regards the OFT's case in
23 respect of Asda and Imperial is that the OFT expressly
24 says that even though Imperial communicated maximum
25 differentials, they were in fact implemented as fixed

1 differentials, and that's paragraph 6.404 of the
 2 decision.
 3 So that's an important point, going to the evidence.
 4 Sorry, madam, you are examining the agreement?
 5 **THE CHAIRMAN:** Well, just the document at tab 54 isn't
 6 worded as if it's introducing something new, it's worded
 7 as if it's a revised version of something that already
 8 exists. So is that, if we look at page 14 of tab 53,
 9 which refers to strategic pricing ...
 10 **MR FLYNN:** I believe the position -- 54 is Imperial's own
 11 statement of its strategic pricing requirements, and
 12 until June of that year there was no agreement with Asda
 13 that made any reference to such things. So he's sending
 14 the strategic pricing requirements to fit in, as it
 15 were, behind that agreement, as I understand it.
 16 **DR SCOTT:** But if one turns to the wording of the covering
 17 letter in 54, it says:
 18 "I will change the relative price positions, I am
 19 therefore taking the opportunity of enclosing a revised
 20 summary."
 21 I think our point is that --
 22 **MR FLYNN:** I understand the point. I think that --
 23 **THE CHAIRMAN:** It may be that we are falling into the same
 24 trap that we advised you not to fall into.
 25 **MR FLYNN:** Mr Hall and indeed all the account managers will

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1 have had to revise their schedules. As I think was said
 2 yesterday, one of the consequences, if you like, of the
 3 Imperial approach was that they were constantly having
 4 to do that, so he is going to have to be doing that for
 5 all his accounts. He now has an agreement with Imperial
 6 that makes reference to him, and he sends them. I think
 7 that is the force of it.
 8 **THE CHAIRMAN:** We will no doubt hear from the relevant
 9 people in due course.
 10 **MR FLYNN:** That of course can be put. Bear in mind
 11 Mr Jolliff's evidence is of course he was well aware of
 12 their pricing desires, and he would occasionally be
 13 given one of these schedules and he would put them in
 14 the bin, that's what he said.
 15 As to Asda having an agreement which even refers to
 16 them, the first example is the agreement at tab 53,
 17 which is operative from June.
 18 The point I was making which doesn't appear from
 19 this agreement, although I do wish to go back to the
 20 text for a separate point, is that the OFT's case is
 21 actually, whatever the schedules said, in Asda's case
 22 they were applied as fixed differential requirement.
 23 So we say having the trading agreement doesn't get
 24 you very far in that case, you actually have to show via
 25 the evidence that that was the arrangement as between

26

1 Asda and Imperial, and we say there is no such evidence.
 2 Now, I am coming back to that agreement. Let me
 3 just say, just for the chronology, in relation to the
 4 third agreement, which is the one at tab 80 -- maybe
 5 it's possible to keep a finger in the first. If you
 6 turn up tab 80 on the front page of it you will see that
 7 that agreement -- again if you look at the bottom -- was
 8 signed in August 2003, so after the end of the
 9 infringement period. So we say even if the OFT said,
 10 well, you know, it applied from 1 January, so there was
 11 a retroactive bonus payable, that doesn't demonstrate
 12 that anything Asda was doing before the agreement was in
 13 pursuance of or an expectation of receiving that bonus.
 14 How can you show by that that Asda had agreed to
 15 implement's Imperial's P&D strategy?
 16 The 2003 agreement also has wording in it right at
 17 the end making clear what our witnesses say was always
 18 clear, but having had contact with the OFT, Imperial
 19 wish to make it even clearer that Asda was at all times
 20 free to set its own retails for products in its stores.
 21 Again, 2003 agreement sets out maximum prices but
 22 that's not the OFT's case, which as regards Asda is that
 23 they were implemented as fixed.
 24 The point I wish to make about both those trading
 25 agreements, coming back to the one at tab 54, if you

27

1 turn to the third page of it, so number 14, the sentence
 2 under the heading "Trading Agreement Package", if
 3 the Tribunal has that, there are a couple of
 4 confidential boxes, but it says:
 5 "Subject to Imperial Tobacco's requirements on
 6 [certain matters] and strategic pricing being met, ITL
 7 will make a quarterly payment of [a certain not very
 8 large amount] per thousand [it should be sticks, no
 9 doubt] on all cigarette purchases from ITL."
 10 The point we make about that is that bonus is not in
 11 any way ventilated or weighted as between those
 12 categories of desires by Imperial.
 13 I am not quite sure why the headings are
 14 confidential, but anyway, there they are. You see what
 15 they are. You will see that that bonus is payable by
 16 reference to all those requirements, and that strategic
 17 pricing aspirations is only one of those.
 18 **THE CHAIRMAN:** Do we know whose that handwriting amendments
 19 are, or are they contemporaneous or ...
 20 **MR FLYNN:** We believe it's someone at the OFT's handwriting.
 21 That I think is the same, really, throughout this file,
 22 there is an eager commentator at work.
 23 Bear in mind that the evidence is that this bonus
 24 was simply always paid, this is the ongoing bonus which
 25 operates effectively as a cost price reduction, the

28

1 evidence is it was always paid without question,
 2 although the evidence also is that as far as the
 3 strategic pricing requirements were concerned, Asda's
 4 adherence was 40 per cent at best and there was
 5 absolutely no suggestion that the bonus was ever
 6 withdrawn for the non-compliance and there is no
 7 provision in this agreement, unlike some of the others,
 8 for any form of claw-back or reduction for partially
 9 fulfilling those requirements.

10 So we say, and we spell this out in detail in our
 11 reply, but to infer an agreement to fix the prices in
 12 line with parities and differentials from this is
 13 tenuous in the extreme.

14 **THE CHAIRMAN:** Is there anything in these agreements about
 15 pricing below the recommended retail price?

16 **MR FLYNN:** I believe not. No, there isn't. The other
 17 thing, I make the point now, there is nothing in these
 18 agreements about opportunity to respond either. So that
 19 element of linkage between the rival's price changes and
 20 anything to do with Imperial's prices is not there in
 21 Asda's case, which we say weakens the suggestion that
 22 this was a mechanism for implementing a P&D arrangement.

23 Of course, as Mr Howard rightly said, you don't have
 24 to have an opportunity to respond clause for
 25 a manufacturer to try to respond, and, as I've said, the

29

1 evidence is that if a tactical bonus is offered then
 2 Asda will take it. It's always trying to chip away at
 3 the cost prices, but that element of linkage in the
 4 structure is just not there in Asda's case.

5 The other matter perhaps just to mention is that
 6 I think others have said that these amounts vary. You
 7 see the amount specified in the trading agreement
 8 package. It is not high, it's extremely small, and it's
 9 certainly wholly insufficient to outweigh the costs of
 10 making, as it were, an unfunded change to Asda's own
 11 margin.

12 Mr Mason, should you wish to have a look at it,
 13 gives a worked example of the monthly costs of complying
 14 with, if there were to be a fixed obligation to simply
 15 pass through changes from Gallaher to Imperial, the
 16 costs simply, you know, the game would never be worth
 17 the candle as far as Asda was concerned.

18 So much for the trading agreements. In relation to
 19 contacts, much the same picture, we say, as that that
 20 I have already outlined in respect of Gallaher. A high
 21 proportion of the documents don't relate to the
 22 infringement period. Most of them refer to Imperial's
 23 views or desires as to its own retail prices, the retail
 24 prices for its own brands. No express link to anything,
 25 any competing brand of Gallaher's.

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1 We say the OFT is not entitled simply to read them
 2 as if they do make such an implicit reference. As
 3 I said, you can't just put on your P&D spectacles
 4 without more context. I've mentioned also the
 5 legitimacy of manufacturer pricing aspirations, even if
 6 that is relative to the retail prices of its rivals.

7 What you don't find in the documents is perhaps also
 8 significant. What you don't find is something from
 9 Imperial saying "But you agreed to do this, and you
 10 haven't", or "I am glad to see that you have". There is
 11 nothing like that. There is nothing to say "You are out
 12 of kilter in accordance with our agreement, please
 13 re-price". When you have re-price, that's, as others
 14 have said, by reference to your own pricing policy and
 15 the manufacturer making extremely clear to the retailer
 16 with whom, as I've said, it does not have a particularly
 17 warm and cosy relationship, making sure that it's not
 18 going to be exploited. If they are withdrawing their
 19 funding, they don't want to be on the hook for another
 20 week or month for that. So they want to be absolutely
 21 clear, "The funding is coming off and therefore, unless
 22 you have changed your own retail policy, Asda, then we
 23 assume your shelf price will go up", and they are just
 24 making it absolutely clear that they don't want any
 25 confusion about this.

31

1 You will see examples of retailers saying "Oh, we
 2 didn't know" or "We weren't sure when it was supposed to
 3 happen. Please extend the period of the bonus
 4 retroactively" and so forth, and that's a good and
 5 legitimate and we say sound reason for that sort of
 6 communication.

7 I've said that there is plenty of evidence of Asda
 8 showing its own pricing independence. I would refer,
 9 for example, in annex 14 to document 10 and also
 10 document 58. Document 10 shows Imperial saying Asda is
 11 reluctant to move two brands up. I don't know how much
 12 of this is confidential. But they are reluctant to
 13 move, given that Morrisons had continued at another
 14 price.

15 Document 58, {D14 tab 58} interesting, this is when
 16 Mr Lang comes into the job, and Imperial say:

17 "Our new man at Asda is currently refusing to
 18 accept the margin reduction on the brand. It looks
 19 likely that I will have to put some bonuses back in
 20 place to maintain [certain retail prices] to match
 21 Amber Leaf or move selling prices up ..."

22 You will see if you trace the correspondence
 23 through, that's his internal reaction to Mr Lang saying
 24 to -- what Imperial had suggested was a request to
 25 reduce the price, but at a level which would have cut

32

1 slightly into Asda's margin, and Mr Lang says in terms
 2 that if Imperial want to compete with Gallaher on the
 3 Asda pitch, as he puts it, he would expect them to fund
 4 those tactical issues.
 5 Madam, I am conscious of not wishing to weary
 6 the Tribunal with example after example.
 7 **THE CHAIRMAN:** These are important, but I am assuming that
 8 we will become more familiar with them over the
 9 coming weeks.
 10 **MR FLYNN:** Yes. I think I have given you the general
 11 picture. We have tried to engage with the evidence in
 12 the decision, we don't think that has been responded to,
 13 we have tried to respond to the further matters put
 14 forward in the defence, we will try to deal with that
 15 that comes forward in the skeleton. Perhaps I just
 16 conclude with a couple of references to documents which
 17 are put forward in the skeleton in relation to Asda.
 18 The references -- and these are all on contact between
 19 Imperial and Asda -- are paragraph 126 of the skeleton,
 20 the OFT refers to its document 28 in the Asda/Imperial
 21 annex number 14, saying that these are instructions that
 22 are explicit, that their purpose was to maintain a P&D
 23 or otherwise explicitly linked to the retail price of
 24 competing product.
 25 If you have a look at document 28, either now or at

33

1 some other point, you will see that it's simply an ITL
 2 document talking about its pricing intentions, and
 3 adopting a wait and see approach to see whether Gallaher
 4 is going to go ahead, and effectively saying that any
 5 price rise is not going to exceed that made by Gallaher.
 6 The phrase, you know, "we would be looking for", is
 7 not a particularly onerous phrase, if I can put it that
 8 way.
 9 **DR SCOTT:** Could I just check one point? You didn't talk
 10 about bonuses in relation to ITL but I understand what
 11 you are saying is that there were tactical bonuses which
 12 were brought in and withdrawn but the other bonuses, the
 13 ongoing bonuses were simply paid and not withdrawn?
 14 **MR FLYNN:** Yes, I was going to just -- as I say, these
 15 examples are on contact, I think you have the general
 16 drift and we will have to get more into the detail.
 17 Absolutely, sir, in relation to the -- and most of the
 18 evidence on contact, if I had been through it document
 19 by document I would be saying this is a tactical bonus
 20 coming to an end and precisely the sort of communication
 21 I have just described has taken place. Asda's evidence,
 22 and nobody is suggesting there is any question about
 23 that, the ongoing bonus was simply paid, and compliance,
 24 as it were, with those specified requirements just not
 25 discussed. It was a small sweetener, if you like, on

34

1 the price, in effect. So yes, in relation to bonuses as
 2 between Asda and Imperial -- the decision is 6.446 for
 3 your note -- the decision says that the evidence
 4 demonstrates that Imperial paid bonuses to Asda to
 5 ensure that its strategy was maintained, and Asda
 6 accepted them on the basis that they were paid for
 7 compliance with or to maintain the parities and
 8 differentials set by Imperial.

9 No document is cited in support of that proposition,
 10 and, as we have said, once again they don't engage with
 11 the evidence, most of which goes to what you would
 12 consider to be ordinary competitive reactions to price
 13 changes of the rival brand.

14 I think probably for present purposes, madam, unless
 15 the Tribunal has further questions at this point, I can
 16 leave it there.

17 **THE CHAIRMAN:** There is one point, you don't necessarily
 18 need to respond to now, but you are saying that the
 19 trading agreements were different from some of the other
 20 trading agreements, and the contacts were more limited,
 21 or related only to the respective manufacturers' brands.
 22 What I am wondering is whether that may reflect ITL or
 23 Gallaher's expectations of how Asda was likely to
 24 respond to a reduction in wholesale price or an increase
 25 in wholesale price, given its well publicised overall

35

1 pricing policy that they could perhaps be more
 2 confident, without needing to say anything, that Asda
 3 would price below MRP and would pass through any
 4 tactical bonuses, whereas with some of the other
 5 retailers who we heard from who have tiered pricing or
 6 who don't price according to that same policy, they may
 7 need to have had other terms and requirements or other
 8 incentives.

9 **MR FLYNN:** Yes. I see the point, madam, if I don't --
 10 I don't mean any disrespect by saying it's a somewhat
 11 Machiavellian approach to the world. There is no
 12 evidence, shall we say, that "Oh, we can rely on Asda,
 13 we don't have to try and pin them down." I think it
 14 actually works the other way. The differences in the
 15 agreements would suggest that the manufacturers had less
 16 expectation of being able to tell Asda what to do, and
 17 after all, I think it is relevant to the OFT's analysis
 18 that Tesco didn't have trading agreements. So you might
 19 well, given Tesco's own well-known position in the
 20 market, think that they will naturally respond to cost
 21 price changes in a particular way in their own retail
 22 policy.

23 So that is the way of the world, but I don't think
 24 one can simply infer, you know, from these agreements,
 25 that Asda is a more trusty co-operator.

36

1 **THE CHAIRMAN:** I wasn't thinking it was a point against you,
 2 rather I was thinking it was a point that you might want
 3 to make that one can't assume that the same incentives
 4 or constraints or requirements or whatever need to be
 5 set or imposed on each retailer, simply because the
 6 manufacturer has an overall strategy which it would like
 7 to see implemented by each retailer, it depends on their
 8 assessment of how the retailer is going to respond.

9 I agree one aspect of that response may well be that
 10 they know that Asda's not going to be incentivised or
 11 not going to comply with any such requirement. The
 12 differentiation between the pricing policies of the
 13 different retailers may have an effect on how the
 14 manufacturers' relationship with them develops.

15 **MR FLYNN:** Yes, I think that's right, and I think one has to
 16 look at each individual relationship, and that's what's
 17 required here, that each manufacturer/retailer pairing
 18 has to be looked at, as it were, on its own merits.

19 Indeed, I think as you said, those who have a lower
 20 price policy in the market are going to take more
 21 persuasion if they can be persuaded to go along with
 22 things which are against their interest. Asda's
 23 position on that is really very clear, and express on
 24 the face of some of these documents.

25 **THE CHAIRMAN:** Yes. Thank you.

1 **MR FLYNN:** So unless I can help further at this stage --

2 **THE CHAIRMAN:** No, thank you very much, Mr Flynn.

3 **MR FLYNN:** -- those are my submissions.

4 **THE CHAIRMAN:** That's probably a good point for us to take
 5 a short break before we hear from Mr Lasok. We will
 6 come back at 5 to 12.

7 (11.45 am)

8 (A short break)

9 (11.55 am)

10 Opening submissions by MR LASOK

11 **THE CHAIRMAN:** Yes, Mr Lasok.

12 **MR LASOK:** In many respects the starting point in these
 13 appeals is that each of Gallaher and ITL agreed or
 14 concerted with the retailers, the application by the
 15 retailers of the manufacturers' retail pricing
 16 strategies which were oriented around a horizontal
 17 linking of specified brands of one manufacturer with
 18 specified brands of another manufacturer sold on the
 19 retailer's premises. It wasn't a linking of every
 20 single brand, and when we look at the evidence we will
 21 see, for example, things like -- and this is quite
 22 a good example -- a linking of Richmond and Dorchester,
 23 which were at parity for most of the period and
 24 a 5 pence differential between Richmond and Sterling.
 25 But in some of the retailers they didn't sell Sterling

1 so for them we only see a parity between Richmond and
 2 Dorchester. We see Sterling popping up when you have
 3 a retailer who is selling all three brands.

4 Now, I've said in many respects that's the starting
 5 point. A number of the appellant retailers dispute the
 6 fact that they have an agreement with Gallaher, that's
 7 Morrisons, or that they have at least a written
 8 agreement, that's Safeway and ITL, and you have the
 9 submission on behalf of Asda that you have just heard.
 10 Those qualifications apart, and I pause to say that it's
 11 not entirely clear that ITL's view of the retailers that
 12 it had agreements with is exactly the same as those
 13 retailers who contest having an ITL agreement, but
 14 anyway.

15 That apart, the real dispute isn't about the
 16 existence of agreements or concerted practices, it's
 17 rather about what was agreed or what was concerted.
 18 That's particularly the case so far as ITL is concerned
 19 because it definitely had a policy of signing up
 20 retailers to this horizontal linking of specified
 21 brands, and so from ITL's perspective one of the most
 22 important aspects of the case is figuring out what
 23 exactly it was that ITL was seeking to do and did
 24 achieve in relation to the retailers. So it's more
 25 about what was agreed or concerted rather than whether

1 or not there was an agreement or a concertation.

2 It's also right to say that one of the issues that
 3 we will also be looking at is the why: why was the
 4 strategy of ITL and Gallaher exemplified in these
 5 arrangements with particular retailers to have this
 6 horizontal linking of particular brands?

7 Now, in opening, what I am going to do actually is
 8 to go to the facts and the evidence in some detail, and
 9 I am going to make some submissions on the theory of
 10 harm, but I am not going to do the law very much,
 11 because the law on one view has been done to death
 12 already in the written pleadings and the skeleton
 13 arguments, but I am going to make five points in
 14 response to the submissions made yesterday on behalf of
 15 ITL concerning the nature of object infringements.

16 The five points are these: the first is we submit
 17 that when deciding whether or not something is an object
 18 infringement, you examine the arrangement -- and I am
 19 using the word "arrangement" as a neutral term -- you
 20 examine the arrangement in its legal and economic
 21 context and you ask whether or not its nature is
 22 anticompetitive.

23 The second point concerns more particularly
 24 a refrain in ITL's submissions yesterday about
 25 experience. Mr Brealey did not dissent from the view

1 that object infringements are not limited to those which
2 experience shows to be anticompetitive. The reference
3 is to the transcript, Day 3, page 1, line 21, down to
4 page 2, line 3. So a large part of his later
5 submissions yesterday in which he relied on the absence
6 of previous competition analysis of what I'll call P&D
7 requirements is, in our submission, irrelevant.

8 Thirdly, he cited the European Night Services, or
9 ENS, case as authority for the proposition that object
10 infringements are obvious cases. That appears in the
11 transcript, Day 3, page 4, lines 21 to 25.

12 Now, it may be useful just to look at the passage he
13 cited in ENS, and that's in the authorities bundle
14 number 2 at tab 31 {A2 tab 31}. So it's authorities
15 bundle 2, tab 31, and he was looking at paragraph 136,
16 which is on page 22 of 38.

17 If you have that page, you will see that the phrase
18 or core clause of the sentence that he was focusing on
19 was towards the bottom of the paragraph after citations
20 of cases like Delimitis and Gottrup-Klim, and it's the
21 phrase beginning with the word "unless" and leading to
22 the citation of the Trefilunion case.

23 Now, Trefilunion is a very curious case to cite,
24 particularly paragraph 109 of the Trefilunion, if the
25 proposition being advanced is one that concerns the

1 nature of an object infringement. Because paragraph 109
2 of Trefilunion isn't about that at all. Paragraph 109
3 of Trefilunion is authority for the proposition that the
4 rule of reason does not apply to clear infringements of
5 competition law.

6 What you can say about paragraph 136 of the judgment
7 in ENS is that it sets out a methodology for assessing
8 agreements or arrangements that, in our jurisdiction,
9 are chapter 1 infringements, and it divides them into
10 two parts. You have the generality, for which the
11 methodology is set out in that part of the
12 paragraph that leads up to the citation of Delimitis and
13 Gottrup-Klim, and then after that, you have a reference
14 to a subset of what are, in our jurisdiction, chapter 1
15 infringements. These are obvious ones for which the
16 methodology in the first part of the paragraph need not
17 be applied.

18 So if you have price-fixing, you actually don't need
19 to bother too much about such things as context and
20 market structure.

21 But this is not, in our submission, a description of
22 an object infringement, or I should say the clause
23 leading up to the citation of Trefilunion is not
24 a description of an object infringement, it's the
25 identification of a subset of anticompetitive

1 arrangements for which the methodology is much simpler.
2 Much simpler than the norm.

3 So we can put away ENS, and I'll turn now to my
4 fourth point about the object submissions. This
5 concerns the word "capable".

6 ITL made a number of submissions directed to the use
7 by the OFT in the decision of the word "capable", but in
8 our submission this rather misses the point, because
9 when you are analysing an arrangement in its legal and
10 economic context and you are asking a question about its
11 nature, you are not directing your investigation at its
12 actual effects, because that of course is the
13 alternative effects analysis that you get in the chapter
14 1 infringement.

15 So when you are looking at nature, you are looking
16 at something else, and actually in short the nature of
17 an arrangement is its capability to do something.

18 At one point I thought that the submissions made on
19 behalf of ITL were getting into theological areas and it
20 seemed extremely familiar to anybody who has read deeply
21 into debates in the early Christian church about the
22 nature of Christ, and in our respectful submission,
23 these issues, which in many respects are linguistic
24 ones, ought to be put on one side. All we have, and
25 this goes back to my first point, is a relatively simple

1 approach. It may be onerous to apply it in reality, but
2 the methodology is basically simple, it's that you look
3 at the arrangement and you analyse it in the light of
4 its legal and economic context for the purpose of
5 identifying its nature.

6 That leads me to my last point on object, and this
7 is a mantra -- again religion seems to pervade the
8 approach of the appellants, because we now have mantras
9 as well, spells and incantations -- and this is the one
10 that the OFT abandoned an effects based case and
11 therefore an objects based case must be flawed.

12 This never looks one of the reasons why you have
13 an objects approach as an alternative to an effects
14 approach. Without going into inordinate detail about
15 the policy behind the object and effect dichotomy in the
16 chapter 1 prohibition, it is a trite observation to
17 point out that when you are looking back into the past
18 in order to, as it were, recreate what happened, you may
19 be faced with a situation in which you have incomplete
20 evidence, which is what we have here, and you may also
21 be faced with a situation in which there is a lot of
22 what I will call noise interference, so that when you
23 are carrying out this ex post facto analysis, the
24 conclusions that you draw may not be reliable because of
25 the fact that you are looking back into the past, using

1 an imperfect set of information, and you have to screen
2 out certain things, certain facts. In some instances
3 it's the absence of evidence that relate to other
4 matters that may be concealing the truth of what was
5 actually going on.

6 So the problem with an effects approach, if one
7 limited competition law to an effects approach, it would
8 pose significant difficulties for those who wish to
9 enforce respect for the Competition Rules if in every
10 case it was necessary to use an effects type of
11 analysis.

12 In our submission, that's one of the reasons, one of
13 the policy reasons why one can use an object approach.
14 So in the present case, the fact that the OFT was not
15 confident that an effects analysis would be sustainable
16 is actually neither here nor there, it's simply
17 an illustration of the problems that a body seeking to
18 enforce the Competition Rules faces when it is trying to
19 reconstruct what happened in the past.

20 In those circumstances it's perfectly legitimate for
21 it to have recourse to the object approach, and if it
22 does that, then its decision has to be tested by
23 reference to the criteria that concern that approach,
24 the objects approach, and not by reference to what
25 amounts to nothing more than speculation about what

45

1 might have happened so far as the effects of the
2 arrangement are concerned.

3 We all know that there are a whole range of reasons
4 why the effects analysis or the effects based approach
5 would be defective and that one of the most famous of
6 course is that of the cartel in which a significant
7 number of members of the cartel cheat on it.

8 So in our submission, there is nothing in these
9 points about object infringement, and I am going to pass
10 now to -- sorry.

11 **DR SCOTT:** Sorry, just on your fourth point, at 5/16 in
12 today's transcript Mr Flynn was addressing mere
13 capability, and T-Mobile, in which capability is writ
14 large.

15 **MR LASOK:** Yes.

16 **DR SCOTT:** He was characterising your position as T-Mobile
17 being a step change towards mere capability. It may be
18 helpful if you clarify how you take T-Mobile.

19 **MR LASOK:** Well, in our submission, T-Mobile is
20 an expression of a theme that runs through the case law
21 concerning the nature of object infringements.

22 **THE CHAIRMAN:** If this point about capability simply refers
23 to the question of what the nature of something, are you
24 then saying that the way you use the word "capability"
25 has nothing to do with a threshold of likelihood of

46

1 an anticompetitive effect resulting from the agreement?
2 And what is your response to the points that are made by
3 the appellants as to what threshold of likelihood of
4 a resulting anticompetitive effect is necessary or
5 appropriate before a particular kind of restraint is
6 characterised as an object infringement?

7 **MR LASOK:** Well, our submission to that is that that is
8 an academic debate in the present case, because in the
9 present case, what we are dealing with here are
10 arrangements that are, by their nature, anticompetitive.

11 I am not trying to avoid the question, it simply is
12 that when you look at this type of arrangement and
13 analyse it, as has been done both by the OFT and by
14 Professor Shaffer, it's quite clear that it's
15 anticompetitive and that is its nature.

16 Now, if you are asking, then, a slightly different,
17 rather more academic point about degrees of likelihood
18 that may be relevant to a case that is not this case,
19 our submission would simply be that when you are looking
20 at the nature of something, you must be looking at its
21 inherent properties, which include necessarily its
22 capabilities to do something, because whatever else is
23 its nature?

24 If you then ask a separate question, which is the
25 likelihood, you need in our respectful submission to be

47

1 a bit precise about what likelihood you are talking
2 about. For example, are you talking about a likelihood
3 that in given circumstances something is going to
4 happen? Because that gets you into an effects problem,
5 and I can illustrate it in this way: let's suppose you
6 have the proverbial price-fixing cartel. Now, by its
7 nature, it is anticompetitive. Its capability
8 necessarily is to prevent, restrict or distort
9 competition.

10 If you said or changed the question to: what is the
11 likelihood of it doing so?, you would have to take into
12 account factors such as the propensity of particular
13 members of the cartel to engage in cheating. That then
14 gets you into an exercise that carries you out of
15 an analysis of the arrangement by reference to its legal
16 and economic context.

17 It is -- I would suppose, but I say this only on the
18 basis of anecdotal evidence -- a fact of life that when
19 you have a cartel, at some point in the career of the
20 cartel somebody is going to start cheating, and you do
21 have situations in which, over a period of time, cartels
22 simply dissolve because the degree of cheating gets too
23 much.

24 So if you are asking the question of likelihood,
25 what you are doing is bringing into the analysis a whole

48

1 load of things that, in our respectful submission, don't
 2 go to the question of the nature, the intrinsic nature
 3 of what it is that has been done.
 4 **DR SCOTT:** Capability tends to be about "could", if we are
 5 going right to way through to effect, then we would be
 6 at "would", and in the middle I suppose it's "would be
 7 expected" as distinct from "could be expected", if you
 8 see a spectrum of things. Are you saying that you think
 9 the analysis goes to "could be expected" rather than
 10 "would be expected"; in other words, a slightly lower
 11 threshold?
 12 **MR LASOK:** Well, if you simply ask what its nature is, you
 13 are expecting that certain consequences are going to
 14 follow. If you say "could" or "would", you are
 15 beginning to get into a linguistic difference that in
 16 our respectful submission is a bit too refined.
 17 I was going to say it's a bit too refined or too
 18 crude, because I suppose it reverts back to the point
 19 I've just made, that it's beginning to move away from
 20 what it is you are examining, because you are examining
 21 the arrangement in question by reference to what I have
 22 called its innate properties in the context, the legal
 23 and economic context, in which it is going to operate,
 24 and you are drawing a conclusion.
 25 The conclusion necessarily implies an expectation

1 that consequences will follow as a result of the innate
 2 properties or the nature of the arrangement.
 3 But if you then start going further than that and
 4 saying, "Shall we use the word 'could', shall we use the
 5 word 'would'," in our respectful submission you are
 6 going to -- when I say "you", I should be using the word
 7 "one" -- one is beginning to get distracted and moving
 8 off into something else.
 9 As I say, in order to answer things like "could" or
 10 "would", you may have to start looking at things that
 11 are extraneous to the arrangement itself and what
 12 exactly is the legal and economic context in which it's
 13 operating.
 14 Again, let's take this example of the price-fixing
 15 cartel, because everybody knows that one or a number of
 16 members of a price-fixing cartel may be cheating at one
 17 time or another, but you wouldn't draw from that
 18 conclusion the fact that a price-fixing cartel was not
 19 by its nature anticompetitive. It might be
 20 unsuccessful, but it wouldn't be anticompetitive.
 21 **MR SUMMERS:** Mr Lasok, obviously we have read and heard
 22 a great deal about the length of time that the
 23 investigation took, and that there is a sense in the
 24 reading that it was a disappointment that you couldn't
 25 pursue an effects case. Would you have preferred this

1 to have been an effects case?
 2 **MR LASOK:** I assume that the "you" in this instance is the
 3 OFT?
 4 **MR SUMMERS:** Yes.
 5 **MR LASOK:** Somebody will pass me up an answer to that
 6 question. If I cast my mind back through my knowledge
 7 of the OFT's position, I am afraid that I don't recall
 8 what the OFT's position is. But if you look at it from
 9 the perspective of a regulator, a regulator, I would
 10 hypothesise, would be perfectly happy to run an object
 11 and an effects case if it was able to do so. If,
 12 however, it came to the conclusion that there was too
 13 much noise and an incomplete set of evidence to run
 14 an effects case, then it would with regret fall back on
 15 an object case.
 16 I am sure that somebody behind me will be possibly
 17 contacting somebody to find out what the factual
 18 position actually was at some time in the dim and
 19 distant past.
 20 **THE CHAIRMAN:** Have you gone through your five points or are
 21 we still waiting ...
 22 **MR LASOK:** I have gone through my five object points and
 23 I was now going to turn to the facts.
 24 So, what I was going to start off with was the
 25 manufacturers' pricing strategies and the origins of

1 these P&D arrangements. I think that we could actually
 2 start profitably with looking at Gallaher's response to
 3 the 2005 section 26 notice, which is in bundle 3 at
 4 tab 17. That's the SO bundle 3. {D3}
 5 Tab 17, and I think you have seen this before, but
 6 if you go past the covering letter and onto the first
 7 page of the response, and go down to paragraph 1.5, this
 8 is under the heading "How did Gallaher come to have
 9 a written parities and differentials clause?"
 10 Paragraphs 1.5 and 1.6 are quite interesting, I'll
 11 read them out:
 12 "It seems that at some stage one head of channel
 13 began introducing a parities and differentials
 14 clause into written trading agreements. The driver for
 15 this is not clear but it seems that the thinking was
 16 that it would do no harm."
 17 Then in the next paragraph it says:
 18 "The general view within Gallaher, however, was that
 19 a requirement for or agreement with retailers to observe
 20 parities and differentials served little purpose (as it
 21 did no more than reflect what would be retailer practice
 22 in any event)."
 23 Now, it's right to say that in paragraph 1.10 on the
 24 next page Gallaher said, and I am reading now from the
 25 end of the first line:

1 "Its intended effect was to encourage retailers not
 2 to price Gallaher's brands too high relative to key
 3 competitor brands in any one particular outlet."
 4 They then explain why, in their view, it wasn't RPM,
 5 Resale Price Maintenance.
 6 There is a slight problem here, because in
 7 paragraphs 1.5, 1.6 and 1.10 we now have three different
 8 explanations of Gallaher's apparent thinking. One is,
 9 in 1.5, that -- well, the explanation in 1.5 is that
 10 they have no idea. 1.6 simply says what their general
 11 view was, which was that it served little purpose and
 12 1.10 speculates as to a an intended effect and therefore
 13 1.10 isn't entirely consistent with 1.5 and 1.6.
 14 What is particularly useful, however, is 1.8, which
 15 explains what the parities and differentials clause in
 16 the Gallaher agreements was. You will see that it was
 17 a requirement to maintain the differential between
 18 a Gallaher brand and a competitor brand in the same
 19 price segment, and they give an example, and you will
 20 see that what they are talking about is fixed price
 21 points, either a parity or a specified differential.
 22 Now, in our submission, Gallaher's admission was
 23 clearly the outcome of a searching review of its
 24 position. For example, 1.5 and 1.6 indicate quite
 25 clearly that enquiries have been made internally and one

1 can infer that they not only talked to people, but also
 2 looked at internal documents, and then they came to
 3 a conclusion as to what they should do in relation to
 4 the OFT's investigation.
 5 There is no suggestion -- I don't think anybody in
 6 fact has suggested -- that Gallaher's position was the
 7 result of a decision that it made lightly or without
 8 consideration, serious consideration, of its position on
 9 the evidence. There is no suggestion that what Gallaher
 10 is saying here is something that was motivated by
 11 commercial reasons or something of that nature.
 12 **THE CHAIRMAN:** Could you just remind me of how the timing of
 13 this letter fits in with the early resolution
 14 agreements? Was Gallaher an applicant for leniency?
 15 **MR LASOK:** I think that was in 2008. So the early
 16 resolution agreements were made in 2008. I think you
 17 have seen the Gallaher letter which was signed. That
 18 was in one of the annexes to the decision. It was
 19 July 2008 I think.
 20 **THE CHAIRMAN:** But at the time of this 17 March 2005
 21 response, of course we don't know what was going on
 22 within Gallaher at that time, as to what their attitude
 23 was going to be to the investigation, but there is no
 24 reason to suppose that they thought that they were
 25 anything other than one of a number of recipients of

1 this request for information.
 2 **MR LASOK:** Quite so, but our submission is that there is no
 3 reason to doubt the credibility of these statements.
 4 **THE CHAIRMAN:** No, and did their position develop at the
 5 later stage before the early resolution agreement?
 6 **MR LASOK:** So far as I am aware, it did not in any relevant
 7 respect, but somebody will correct me if I am wrong on
 8 that. If we don't have an answer immediately, we will
 9 try and find one.
 10 Now, in fact the way Gallaher puts it in
 11 paragraph 1.8 is entirely consistent with the Gallaher
 12 documents that we have. One example is in the same
 13 bundle, tab 4, and the first page of this, or the first
 14 few pages of this is entitled "Promotional Policy" and
 15 it's dated to March 2001, and if you look at the bottom
 16 of that page, you see a heading "Pricing Objectives",
 17 and you see that the pricing objectives are expressed in
 18 fixed terms, parity or particular price relationships
 19 like X pence above or whatever.
 20 C is part of the section of the document dealing
 21 with cigarettes. On the next page, in the middle, you
 22 have the next section dealing with cigars. In A(i) you
 23 have another reference here to parity; B(i) is a parity;
 24 B(ii) is a specific differential; B(iii), rather like
 25 A(ii), is expressed as an "at least".

1 If you go on to the next page, and go, for example,
 2 to B on that page, I don't think that all this is
 3 confidential, at least B isn't, it deals with
 4 Sobranie Cuban range, and you have specific pences above
 5 and below.
 6 There are other documents of that nature, 3.9 is
 7 an example, but I don't think we need to elaborate
 8 further on that.
 9 Perhaps now if we could turn to consider ITL, and we
 10 could start usefully at ITL's October 2003 response to
 11 the 2003 section 26 notice which is in bundle 13 at
 12 tab 1.
 13 **DR SCOTT:** Just while we are looking at that, what you have
 14 said is entirely consistent with the economics of the
 15 elasticities, with a low general elasticity and a higher
 16 cross-elasticity.
 17 **MR LASOK:** In this particular document, the relevant passage
 18 I would like to look at is paragraph 4.33 which in the
 19 document, the internal document page number is 16.
 20 4.33 is under the heading "How price
 21 differences/parities arose" and it says:
 22 "The policy of adopting price differential/parities
 23 relative to competing brands arose out of the situation
 24 which occurred in 1990. In June of that year, ITL
 25 announced its MPI, which came several months before

1 Gallaher announced its own MPI. In that period, the
 2 on-shelf retail prices of ITL products were out of line
 3 relative to Gallaher brands, and ITL lost a significant
 4 amount of market share. At that time ..."
 5 I interpolate to say that seems to date it to either
 6 June of 1990 or maybe a few weeks or a couple of months
 7 later:
 8 "... ITL decided to benchmark its on-shelf retail
 9 prices against certain competitor brands to ensure that
 10 ITL did not suffer any future similar loss of market
 11 share as a result of its brands being priced
 12 uncompetitively relative to competing brands."
 13 So the explanation given here, and this of course is
 14 ITL's position in October 2003, which is the date of the
 15 document, as one can see from its first page, is that
 16 the P&Ds occurred because when ITL announced its MPI it
 17 pushed up the retail prices and, since Gallaher didn't
 18 react until several months later, there was a period in
 19 which, as they put it, the ITL on-shelf retail prices
 20 were out of line relative to Gallaher. So it was
 21 a problem that resulted from their MPI.
 22 Now, in bundle 13 --
 23 **MR HOWARD:** While you have that document open, you might
 24 like to just read paragraphs 4.36 and 4.37.
 25 (Pause)

1 **MR LASOK:** In bundle 13, we have from ITL a miscellaneous
 2 collection of documents dating back to 1986, which
 3 include trade reports. I am not going to go to them,
 4 but I'll just mention where they are. The trade report
 5 for June 1990 is in this bundle 13 at tab 29, and the
 6 trade report for December 1990 is bundle 13 at tab 20.
 7 These trade reports don't refer to this incident in
 8 June 1990.
 9 The next explanation that ITL has given of the price
 10 differential strategy occurs in Mr Good's first witness
 11 statement. Maybe it's sufficient if I just give you the
 12 reference rather than go to it. It's core bundle 3,
 13 tab 36, {C3 tab 36} and it's paragraphs 3 to 16 of the
 14 witness statement, which gives you his entire
 15 description of the position.
 16 What he says is that the pricing differential
 17 strategy was included into trading agreements with
 18 retailers at some stage in the 1990s, but he gives
 19 a wholly inconsistent explanation of the reason for the
 20 adoption of this strategy, because he says -- and this
 21 is more particularly paragraphs 7 to 8 of that witness
 22 statement -- that the mischief addressed by the strategy
 23 was that retailers were not passing on to customers
 24 reductions made by ITL in the wholesale price.
 25 Now, that is something for which ITL has been unable

1 to produce any supporting documentation. There is no
 2 contemporary evidence that there was a pass-through
 3 problem at that time, and so far as I can see, the
 4 appellant retailers don't support ITL on that point.
 5 For example, and I think from memory it's Mr Lang,
 6 one of the Asda witnesses, who was mentioned this
 7 morning, paragraph 9 of his witness statement he makes
 8 it quite clear that, at least in the case of Asda, there
 9 would be pass-through. So we have a bit of a mystery.
 10 The other aspect of ITL's case is that its pricing
 11 policy was based on relative maximum prices with the
 12 retailers being free to price below the maximum. We see
 13 that in the paragraphs in the ITL reply to the
 14 section 26 notice that my learned friend asked you to
 15 look at a moment ago. It also appears in the witness
 16 statements. However, no contemporary document appears
 17 to substantiate the claim that the retailers were free
 18 to price below the P&Ds. I say there is no contemporary
 19 document; we do have the trading agreements, which I'll
 20 come to, but to anticipate slightly what I am going to
 21 say about the trading agreements, when you look at the
 22 trading agreements in their factual context, you can see
 23 that the policy actually was that the retailer should
 24 price at a fixed point which reflected the parity or the
 25 differential for the ITL product in question.

1 Now, another oddity is this: Mr Good, in the witness
 2 statement that I referred to a moment ago, which is the
 3 one at core bundle 3, tab 36, in paragraph 14 of that
 4 witness statement he says that the ITL board did such
 5 things as setting the RRP for Embassy No 1.
 6 Now, if the ITL board was involved in deciding
 7 matters apparently of detail of that nature, one would
 8 have expected it to have approved a pricing differential
 9 strategy and for the nature of that strategy to be
 10 recorded. But that apparently is not the case.
 11 It is, however, worth underlining the point that
 12 a matter of apparent detail like setting the retail
 13 price of one particular brand at one penny less than the
 14 price of the competing Gallaher product, that was
 15 regarded as a matter of sufficient importance to involve
 16 the ITL board.
 17 Mr Good says in his witness statement that that was
 18 done, and I quote from his witness statement:
 19 "... in order to encourage people to switch away
 20 from the Gallaher product."
 21 There is only one way of understanding that comment,
 22 and it is that the one penny difference between the
 23 Gallaher and ITL brands in question was the policy that
 24 the ITL board had decided at the time of that decision,
 25 whenever it was it was made, should be followed at

1 a level of shelf prices, because if a one penny
 2 difference is set out only in the RRP's, and it's not
 3 carried through into shelf prices, it's difficult to see
 4 how people would be encouraged to switch away from the
 5 Gallaher product. So we have a bit of a curiosity here.
 6 Now, there are a number of aspects of what ITL
 7 claims to have been its attitude towards pricing that
 8 are just assertion. For example, we heard a lot in
 9 ITL's opening about ITL's strategic intention, if you
 10 like, to price below Gallaher. Certainly those who
 11 drafted the ITL skeleton believed that, if the retail
 12 price of Gallaher's product went up, ITL would prefer
 13 the retail price of its product, its competing brand, to
 14 remain the same as before so that it could take
 15 advantage of the consequential shift in demand away from
 16 the Gallaher product and towards the competing ITL
 17 brand. Because that's what they actually say in, for
 18 example, paragraph 14 of the ITL skeleton.
 19 Now, one can well see that that is an assumption
 20 that people who are not addressing their minds to the
 21 facts of the given case might well come to as a general
 22 assumption about how a company may behave in terms of
 23 where it sets its pricing. But not all companies behave
 24 in that way, there may be a good reason why they behave
 25 in a different way. So one has to ask the question:

61

1 what evidence is there that sheds light on the real
 2 nature of ITL's pricing strategy? Here we get again to
 3 Mr Good, and I'll just give you the reference because
 4 I don't think we need to spend the time turning up the
 5 document, it's once again his witness statement at core
 6 bundle 3, tab 36, and this time it's paragraph 23 where
 7 he refers to natural relativities reflected in RRP's.
 8 Now, obviously the RRP's were fixed by the
 9 manufacturers and they didn't sort of emerge through
 10 some natural process, it's not like a plant that pushes
 11 a tendril up through the earth in order to feed on the
 12 light and gradually grow, if tended and properly
 13 watered. The natural relativities reflected in RRP's are
 14 the decisions of the manufacturers.
 15 This interest, if you like, on the part of ITL, in
 16 these relativities, which were set out in the RRP,
 17 obviously we find time and time again in the written
 18 trading agreements and the contemporaneous documents.
 19 So to take as an example of a contemporary document,
 20 if we look at bundle 17, tab 23, this document dates
 21 back to March 2001, and it's a national account business
 22 development plan drawn up by an ITL employee called
 23 Mr Matthews.
 24 **THE CHAIRMAN:** It seems to be in a confidential box in my
 25 copy.

62

1 **MR LASOK:** Thank you very much. I think what I have just
 2 said isn't confidential.
 3 **THE CHAIRMAN:** No.
 4 **MR LASOK:** It relates to Morrison. If you go to the
 5 penultimate page the bit that I am going to read out
 6 is -- the penultimate page, by the way, is the one which
 7 in the bottom right-hand corner at least in my copy is
 8 marked with a number 200, and the heading of that page
 9 I think is not confidential, and that is "The strategy
 10 for the financial year, 1 October 2001 to
 11 30 September 2002".
 12 In point 1 you have, in the first three lines,
 13 something that I will not read out. But the bit that,
 14 around about the first holepunch, I am now going to read
 15 out is not confidential, as I understand it, at least
 16 I am told that it's not confidential, and it is as
 17 follows:
 18 "... that Morrison accept Imperial's pricing
 19 strategy of reflecting current price list differentials
 20 between the manufacturers' brands and that levels of
 21 ongoing and tactical support are also based on absolute
 22 shelf prices."
 23 So here we see one of the contemporary documents
 24 indicating the strategy of reflecting the current price
 25 list differentials between the manufacturers' brands and

63

1 that of course is reflected in the shelf prices of the
 2 retailer.
 3 **THE CHAIRMAN:** Is this document an ITL document or
 4 a Morrisons document?
 5 **MR LASOK:** Well, this is a document brought into existence
 6 by ITL. I would imagine that the source of it is also
 7 ITL, but --
 8 **THE CHAIRMAN:** No, well, that was what I was asking. So
 9 what this is saying is that ITL's aim for this year or
 10 one of its aims is to get Morrison to accept its pricing
 11 strategy?
 12 **MR LASOK:** Yes, and you will see that the pricing strategy
 13 is described as reflecting the price list differentials.
 14 Later on we will come to the ITL/Morrisons trading
 15 agreement, but at this point I wanted to look at the --
 16 **THE CHAIRMAN:** Do you draw from that reflecting current
 17 price lists something on the point about whether these
 18 were fixed or maximum?
 19 **MR LASOK:** Yes, because it goes back to the point about
 20 reflecting RRP's and things like that, because RRP's, the
 21 price list differentials, these are all fixed. An RRP
 22 is a figure. An RRP is not expressed as no more than or
 23 X pence less than, or something like that. It's a fixed
 24 figure.
 25 So if you are telling people that you want them in

64

1 their shelf prices to reflect a particular price
2 relationship and you say "You can see that relationship
3 expressed in our RRP's" and of course the price lists
4 will set out the RRP's as well as the other factors, but
5 if you are telling them that, you are pointing their
6 attention towards not a maximum figure but a specific
7 figure.

8 When we look at the documents later on, we see that
9 that is indeed what they actually did.

10 Now, the next document I was going to look at was
11 the ITL/Sainsbury trading agreement for April 2002, but
12 I see that the time is reaching the magic hour.

13 **THE CHAIRMAN:** Yes.

14 **MR LASOK:** For me, if I deal with ITL/Sainsbury, it will
15 probably take me a little bit.

16 **THE CHAIRMAN:** Well, let's break there then. We will come
17 back at 2 o'clock.

18 I should also just mention that this afternoon we
19 need to finish absolutely no later than 4.30 because of
20 various commitments that we have. So I am afraid even
21 if you are in mid-sentence, Mr Lasok, we will have to
22 pull down the shutters at that point.

23 Thank you, we will come back at 2 o'clock.
24 (1.00 pm)
25 (The short adjournment)

1 (2.00 pm)
2 **MR LASOK:** Madam, I was dealing with ITL's pricing strategy,
3 and I was trying to make the point that the strategy was
4 orientated around maintaining the so-called natural
5 relativities, and I had stated that that was supported
6 by contemporary documents and written trading
7 agreements. I have given you one contemporary document.
8 The written trading agreement that I wanted to look at
9 was the ITL/Sainsbury trading agreement which started in
10 April 2002, and that's in bundle 18 at tab 61. {D18 tab
11 61}

12 I am not going to go through all these trading
13 agreements one after the other, but really only focusing
14 on certain of the trading agreements largely in order to
15 illustrate particular points, but I think I will try and
16 cover all the trading agreements that have been
17 commented on by the appellants in their openings.

18 So for these purposes --

19 **THE CHAIRMAN:** Yes, just bear in mind for everyone's future
20 reference it's actually annex 18, I think, that you
21 mean. The bundle numbers and the annex numbers are not
22 the same, because some bundles have more than one annex
23 in. So just for future reference, it's annex 18, not
24 actually bundle 18.

25 **MR LASOK:** Annex 18. At any rate it is tab 61, at least

1 I got that one right.
2 So the first page, of course, gives you the date and
3 the period of the trading agreements, and in the third
4 paragraph on page 1 you have the reference to the
5 payment which was subject to the following criteria, and
6 on page 2 in the middle of the page you have the
7 pricing. I think that the pricing section is not
8 confidential, so you see that it starts off by saying
9 that Sainsbury were accepting that ITL makes:
10 "... investments in their brands based on two
11 fundamental criteria: shelf price relativities and the
12 absolute levels of those shelf prices. ITL's pricing
13 strategy is to replicate the differentials that exist
14 naturally between our brands and those of our
15 competitors."

16 Then there is a cross-reference to appendix 5 for
17 the price list differentials. Appendix 5 is, in my copy
18 at any rate, the last page of the tab. If you go to
19 that page, you see that the differentials are expressed
20 as fixed, Marlboro for example is parity, and then you
21 have various other fixed relativities, 3 pence below,
22 6 pence below and so forth.

23 In the middle of the page, as a matter of interest,
24 you will see the relationship between Richmond on the
25 one hand and Sterling and Dorchester on the other.

1 Richmond is to be 5 pence above Sterling, and parity
2 with Dorchester.
3 You will also have observed that there are two
4 Richmonds, there is Richmond KS, which is Kingsize, and
5 Richmond Superkings, SKS. The two were commonly priced
6 differently. Superkings tended to be more expensive
7 than Kingsize but there were some variations over time.
8 If you go back to the second page, to the point at
9 which I broke off, just before the second holepunch, you
10 have this bit:

11 "Based on SSL's current shelf prices and the
12 achievement of the price list differentials detailed in
13 appendix 5, ITL will continue to pay those bonuses
14 framed in the example price file in appendix 3."

15 Then there is a reference to the two elements, and
16 in the paragraph following on from that we have
17 an explanation of so-called ongoing bonuses, and it
18 says:

19 "Ongoing bonuses will be paid, based on SSL's shelf
20 prices remaining at their current levels and should be
21 reduced in line with any upward movements (excluding MPI
22 or Budget increases); tactical bonuses are paid to
23 reflect additional investment usually in response to
24 temporary or sustained competitor activity, and should
25 also be reduced once that activity has ended."

1 Then you get the opportunity to respond provision,
2 in respect of which, as I understand it, the appellants
3 take differing views, because Asda seems to think that
4 the existence of an opportunity to respond clause
5 supports the OFT's case and its absence weakens the
6 OFT's case, and ITL's position is the reverse, as
7 I understand it.

8 This here, the clause says:

9 "From time to time, ITL's competitors may reduce the
10 shelf price of their brands. SSL should allow ITL the
11 opportunity to respond, in order to realign with the
12 differentials highlighted in appendix 5. Should ITL
13 choose not to respond, those differentials may widen."

14 You will observe that the opportunity to respond
15 clause is specifically tied in with the differentials in
16 appendix 5. So their movements, what's envisaged is
17 a competing manufacturer initiated reduction in a shelf
18 price, and that generates the operation of the
19 opportunity to respond clause.

20 This clause does not apply when you have a retailer
21 initiated price movement, and that's, as far as I can
22 recall, fairly common.

23 **THE CHAIRMAN:** What's fairly common?

24 **MR LASOK:** The fact that the opportunity to respond clause
25 applies only where there is a competing manufacturer

69

1 initiated price movement, a downward movement. It
2 doesn't apply where the movement is a retailer initiated
3 movement.

4 **DR SCOTT:** One of the interesting things about the way in
5 which it is expressed is it implies ITL's understanding
6 that a manufacturer could initiate a change in a shelf
7 price.

8 **MR LASOK:** Yes. This goes to a fact that one sees very
9 often in the documents where a manufacturer will write
10 down in an email "I" or "we are moving the prices". One
11 of the features of this case is that, to put it in
12 a slightly coloured way, the retailer isn't a player,
13 the retailer is an instrument used by the manufacturer
14 so that the manufacturer can effect an alteration to
15 retail prices.

16 What I am going to do is to go back a little bit
17 further up this page. Round about the second holepunch,
18 you have the reference to SSL's current shelf prices,
19 and that looks like a reference to the absolute level of
20 shelf prices which appears in the first paragraph under
21 the heading "Pricing", but also that sentence in the
22 paragraph commencing "Based on SSL's current shelf
23 prices", we have another thing mentioned, and that is:

24 "The achievement of the price list differentials

25 detailed in appendix 5."

70

1 What you will observe here is that essentially
2 Sainsbury's commits itself to achieving the price list
3 differentials and on the basis of that it's got the
4 inducement in the form of the continued payment of the
5 bonuses.

6 Now, that commitment concerns whatever the retailer
7 does, in other words it was the retailer who was to
8 respect the price list differentials, and there were two
9 possible price movements that might be relevant,
10 a retailer initiated price movement or a wholesaler
11 initiated price movement. These clauses that refer to
12 the retailer committing itself in some way to the price
13 list differentials in the ITL agreement or the Gallaher
14 agreement apply just as much to retailer initiated price
15 movements as it did to wholesaler initiated price
16 movements.

17 The opportunity to respond clause is the clause that
18 is limited in its scope to wholesaler -- sorry,
19 manufacturer initiated price movements.

20 If you look further down the page at the paragraph
21 beginning "Ongoing bonuses", you have already read the
22 bit which refers to SSL's shelf prices remaining their
23 current levels and the reduction of the bonuses in line
24 with upward movements, with the bit in brackets,
25 "(excluding MPI or Budget increases)".

71

1 Now, there is no basis for believing that the bit in
2 brackets "(excluding MPI or Budget increases)" was
3 intended to refer only to ITL initiated MPIs or
4 movements.

5 The reference to "SSL's shelf prices remaining their
6 current levels" appears to be a reference to the concern
7 to maintain absolute levels of shelf prices.

8 Shelf price relativities, which is the other matter
9 that was of concern to ITL, would necessarily be
10 affected by MPI or Budget increases.

11 The main point about this document is that it's
12 indicative, and it's a good indication of the
13 communication by ITL to retailers of ITL's pricing
14 strategy, the strategy being to replicate the
15 differentials that exist naturally between its brands
16 and those of its competitors.

17 What you don't see here -- sorry.

18 **THE CHAIRMAN:** Are you saying that those are made apparent
19 by the manufacturers' retail price lists?

20 **MR LASOK:** In this particular instance --

21 **THE CHAIRMAN:** Or by the appendix 5?

22 **MR LASOK:** Here it's the appendix 5, because as Mr Thompson
23 submitted yesterday, the style of the ITL agreements
24 tended to be to append to the agreements a schedule
25 setting out the parities and differentials. So in

72

1 contrast to, for example, I think it was the
 2 Gallaher/Co-op agreement which directed the reader's
 3 attention directly to the RRP's, here the retailer's
 4 attention is directed to appendix 5.
 5 **DR SCOTT:** And as a matter of fact, do we know whether these
 6 do in practice replicate the RRP differentials?
 7 **MR LASOK:** I haven't checked every single one of them, but
 8 the ones that I have checked do reflect the RRP's. For
 9 example, the Richmond/Dorchester/Sterling triad was
 10 reflected in the RRP's, or was derived from the RRP's.
 11 There is evidence in relation to some of the
 12 manufacturers -- and again it concerns ITL -- that when
 13 RRP's changed it did send round a schedule which altered,
 14 that replaced the preceding schedule, and the intention
 15 was to reflect the RRP's as they stood at the time when
 16 the amended schedule was sent round.
 17 For example, from memory, that occurred in something
 18 like June 2002, which is one of the incidents, I think,
 19 that is the subject of some discussion in the pleadings
 20 and probably we will come to, because that's
 21 an illustration of ITL sending round a replacement
 22 schedule or a replacement instruction which effectively
 23 countermanded the previous differential that had
 24 featured here attached to some of these agreements,
 25 because Gallaher had moved its RRP's upwards, but at that

1 stage ITL did not want to follow immediately.
 2 I was about to say that one of the oddities about,
 3 at least so far as ITL's case is concerned, is one
 4 doesn't find in these agreements a description of ITL's
 5 pricing strategy that bears any resemblance to the
 6 description that has been given by ITL to the Tribunal.
 7 Now, on the face of it, on the face of documents
 8 like this, where the strategy is described and in
 9 particular it's described for the benefit of retailers
 10 by reference to the replication or the maintenance of
 11 these differentials, ITL must have regarded it as being
 12 in its commercial interest to maintain differentials
 13 and, on the face of it, would wish the retail price of
 14 its brands to increase commensurately, for example, with
 15 an increase in the retail price of the linked Gallaher
 16 brand, because that is the ordinary and natural reading
 17 of the words used in these agreements, these
 18 communications whereby ITL informs the retailer of its
 19 intentions and in these agreements we have of course the
 20 retailer signing the agreement and committing itself to
 21 the agreement.
 22 The clear intention, we submit, on a fair reading of
 23 these documents, is that the retailer committed itself
 24 to the implementation of the pricing strategy
 25 communicated to it by ITL.

1 Now, this idea that the pricing strategy was focused
 2 on the maintenance or replication of these differentials
 3 is not only borne out by the contemporary exchanges that
 4 took place, and which we will come to, but it is after
 5 all what follows from other things like the ITL board's
 6 decision regarding the relationship between Embassy No 1
 7 and the competing brand which I mentioned before lunch.
 8 Because if you had the ITL board deciding that the
 9 difference between Embassy No 1 and the relevant
 10 Gallaher brand shall be 1 pence, Embassy 1 pence below,
 11 and if it is done, as Mr Good says, in order to
 12 influence the decisions of buyers, that's to say the
 13 consumers, the retail purchasers, the ordinary and
 14 natural inference is that what is going to happen is
 15 that the ITL personnel are going to set about ensuring
 16 that retailers keep that price relationship, the price
 17 relationship that the board has decided. So the
 18 ordinary and natural conclusion to be drawn from the
 19 material that we have is that we are going to see the
 20 retailers being signed up by ITL to give effect to this
 21 relationship of these pricing relativities that ITL had
 22 decided at some point in time was the right way to go
 23 ahead.

24 Again, pursuing these submissions concerning ITL's
 25 pricing strategy, I want to look at another aspect of

1 it, which is the suggestion that the purpose of the
 2 strategy was to reduce prices, be competitive on price
 3 with Gallaher.
 4 Now, the fact is that ITL welcomed opportunities to
 5 increase prices. For example, if you go to annex 17,
 6 tab 68, {D17 tab 68} this is in the Morrisons file, and
 7 it's an email from ITL, Mr Matthews, to Mr Eastwood, in
 8 the subject line you see that it's a message for
 9 a Paul Giles about Richmond pricing. Just the figures
 10 are confidential.
 11 **THE CHAIRMAN:** A message for Paul.
 12 **MR LASOK:** From Paul Matthews to Mr Eastwood of Morrison.
 13 It's actually for Paul Giles, and it starts off:
 14 "Paul, as per yesterday's conversation. It looks
 15 like there is going to be some upward movement at the
 16 bottom end of the market: at last!!"
 17 Then there is a request to Morrison to increase the
 18 price of Richmond from October 14. Now, there is
 19 a suggestion from another document that the move was
 20 deferred to 21 October, at least in the case of Asda.
 21 I ought to interpolate here to say that in all these
 22 files we don't have complete sets of documents, and in
 23 some files we have some documents that -- this is
 24 an example, the Asda file we have a document where there
 25 is a similar communication to Asda about increasing the

1 price of Richmond. But it then seems that there is
 2 a later email that defers the price increase from
 3 14 October to 21 October, and we don't have a similar
 4 communication in the Morrisons file.
 5 But the point here is this is ITL taking advantage
 6 of an opportunity that it perceived to increase prices.
 7 This dates to October 2002, but it's the point in time
 8 when ITL secured a 10 to 11 pence rise in the price of
 9 its Richmond brand and the related Gallaher brand across
 10 the market, not just in one retailer, and it did it in
 11 two stages, taking effect in September and October.
 12 So for example, if you put away 17 and go to --
 13 **THE CHAIRMAN:** What does that mean: "which will mean
 14 a [something] pence per thousand reduction"? Oh, "in
 15 our contribution".
 16 **MR LASOK:** Yes, that's a reduction in bonus.
 17 So if you go to annex 28, this is Safeway, and you
 18 go to tab 65, {D28 tab 65} this is actually August 2002,
 19 and here we have Imperial writing to Safeway about
 20 an MPI taking place on 2 September, and the writer
 21 highlights some of the main changes and implications.
 22 If you go to paragraph 9, that says -- and I think this
 23 is not confidential:
 24 "The individual brand price changes are shown on the
 25 price list but please note the following ..."

1 You then have a reference to Embassy and Regal going
 2 up 7 pence and there is a reference to the change in the
 3 differential vis-a-vis Benson & Hedges. Richmond
 4 Superkings go up 6 pence, and in the next line, Lambert
 5 & Butler, JPS and Richmond Kingsize go up 4 pence. No
 6 change in GV, which is Golden Virginia. Then it says:
 7 "At the MPI we wish to move the market up on
 8 Richmond brands and bring greater profitability to this
 9 end of the market. Therefore on 2 September please
 10 increase Richmond brands by 4 pence for Kingsize and
 11 6 pence for Superkings. We would encourage you to
 12 follow on Sterling and Dorchester and as a guideline
 13 across the trade, anticipate shelf prices as
 14 follows ..."
 15 They then anticipate a price for Sterling, which is
 16 of course 5 pence below the anticipated price for
 17 Richmond and Dorchester, which are at parity. Then
 18 there is a reference to the tilt stores. Sterling and
 19 Dorchester of course are Gallaher brands. The tilt
 20 stores is the reference to the fact that Safeway had
 21 a tiered pricing system and there were some stores that
 22 were more expensive than others.
 23 After the reference to tilt stores, we have this:
 24 "You may also price higher than shown above but the
 25 differentials should be the same, ie Sterling is minus

1 5p, and Richmond and Dorchester at parity."
 2 Then the next page, which is tab 66, is a 4 October
 3 communication, a fax on the face of it, from Imperial to
 4 Safeway, and this confirmed discussion with Safeway
 5 regarding pricing, and it says:
 6 "Richmond Kingsize/Superkings will move up
 7 [will move up] 5 pence to its natural position of
 8 £3.59/£3.63 ..."
 9 I interpolate to say that that is the difference in
 10 price between Richmond Kingsize and Richmond Superkings.
 11 Then I read on:
 12 "... from 14 October and the tactical bonusing will
 13 discontinue from this point."
 14 That was the next stage of the move. Overall, in
 15 the period of a few weeks, ITL was engineering
 16 a significant increase in the price of those brands.
 17 You can see, however, in particular from 28/65, ITL's
 18 concern is as much with maintaining the relativity
 19 between its brand and the two Gallaher brands with which
 20 its brand was linked, the two Gallaher brands being
 21 Dorchester at parity and Sterling 5 pence below. So
 22 that's why in 28/65, the first document in this annex
 23 I took you to, they don't mind if the price goes higher,
 24 as long as the differential is observed.
 25 But in our submission that knocks a serious hole

1 below the waterline in a case that is being advanced on
 2 the basis that ITL is an inveterate price cutter which
 3 wants always to be below Gallaher, because that, in our
 4 submission, was not ITL's pricing strategy. Gallaher of
 5 course was moving up at the same time. And as the
 6 letter states, I think this is 28/65, the whole market
 7 was going up.
 8 The idea that ITL was concerned only to keep its
 9 prices at competitive levels vis-a-vis Gallaher simply
 10 isn't borne out by the documents, another example of
 11 which is in annex 20 at tab 9, {D20 tab 9} and if you
 12 have tab 9, the bit that I wanted to draw your attention
 13 to is just beyond midway down the page, and it's under
 14 the heading "Somersetfield". This letter is addressed to
 15 Somersetfield stores, but you can see it concerns the two,
 16 as it were, manifestations or fascias, as I believe they
 17 are called, of the Somersetfield group, which was
 18 Somersetfield and Kwik Save. Somersetfield and Kwik Save were
 19 pitched at different sectors of the market. In relation
 20 to Somersetfield it says:
 21 "I note that you have reduced the selling prices for
 22 Cafe Creme and Small Classic to £2.52 from 1 November.
 23 Our strategy on miniature cigars is normally to match
 24 Hamlet Miniatures which appear to be unchanged at
 25 £2.62."

1 So that was a reminder to Somerfield that to conform
2 to ITL's strategy, they had to secure parity with
3 Hamlet Miniatures. Again, the verb is "match", "match
4 Hamlet Miniatures". So the communication to the
5 retailer is not expressed in terms of "You must not go
6 higher than". The instruction or the communication to
7 the retailer is to ensure that the prices match.

8 This is a situation in which effectively the
9 Gallaher brand is more expensive, but instead of saying
10 "That is good news, keep on the good work, this is
11 consistent with our pricing strategy to be lower than
12 Gallaher", we see an altogether different message being
13 sent to the retailer.

14 **DR SCOTT:** This, as I understand it, is the copy taken from
15 Imperial's files, judging by the annotation "James" at
16 the top right.

17 **MR LASOK:** Yes.

18 **DR SCOTT:** Which also reflects not in fact increasing JPS
19 and multipack, but it should have.

20 **MR LASOK:** But they should have done, yes, and the note goes
21 on:

22 "... and have [REDACTED]" --

23 **THE CHAIRMAN:** Where are you?

24 **MR LASOK:** That's -- I am terribly sorry.

25 **DR SCOTT:** I was deliberately not going on. Anyway, there

1 is something in a box.

2 **MR LASOK:** I was going to move from there to another
3 document also in annex 20, but in my version I have two
4 lever-arch files and it's in the second one, because
5 it's 20/70. This is, tab 70, in fact two emails. As we
6 are all used to, the first email is the last. It starts
7 off, just below the first holepunch, and it refers to
8 the acquisition by Tesco of Supercigs.

9 The email is from a Martin Thomas of Somerfield, and
10 it goes to Mr Alan Hutcheon at Rothmans, Chris Halford
11 of Gallaher and Graham Hall, and he was an ITL man, and
12 the subject was, as you can see from the "Subject" line:

13 "Supercigs versus Kwik Save pricing."

14 The query raised by Somerfield was about the
15 breakdown of the Supercigs pricing structure, the query
16 being whether or not the Kwik Save/Supercigs tier was
17 still relevant.

18 The answer comes back from Mr Hall of Imperial at
19 the top of the page, and he refers about what's going on
20 in the Supercigs estate and the fact that they were
21 running a deep discount tier to compete with Kwik Save
22 but then says:

23 "If there were a will to end this battle on the part
24 of Kwik Save, I am sure that Supercigs could be
25 persuaded to move up in price."

1 That carries with it the implication that ITL would
2 not resist the role of assisting in persuading Supercigs
3 to move up. But again, although that's a document that
4 is concerned with competition between retailers, it
5 shows once again that ITL is not an inveterate price
6 cutter. ITL does not have that as its policy.

7 The last document in connection with this subject
8 that I want to look at is 17/6, that's annex 17 --
9 sorry, it's 17/16, annex 17, tab 16. {D17 tab 16}

10 This particular document, which I think we have seen
11 before, can be associated in the documentation with
12 a Gallaher move with effect from 29 October 2000, but in
13 order to make the connection you would have to do
14 a cross-reference to annex 14. It's really if you go to
15 annex 14, tab 9 and 10, you will see it starting off.
16 If you actually wanted the entire sequence from the
17 Gallaher initiative down to this letter, which is dated
18 15 November, so far as one can piece it together from
19 the documents that we have, the sequence runs something
20 like: annex 14, tab 9; annex 14, tab 10; annex 26,
21 tab 11; annex 28, tab 21; annex 8, tab 5; and then you
22 get to annex 17, tab 16.

23 Then this document, 17, tab 16, is 15 November 2000
24 from Imperial to Morrison, and in the second paragraph
25 by the first holepunch it says:

1 "You are probably aware that the broad marketplace
2 has moved from £3.29/£3.30."

3 I interpolate to say that that again refers to the
4 difference between Kingsize and Superkings, and I resume
5 reading:

6 "... to £3.34/£3.35 on Dorchester Kingsize and
7 Dorchester Superkings and you may remember from my
8 presentation on the Richmond repositioning (and launch
9 of Richmond Superkings) that our strategy is parity with
10 Dorchester. In light of this, we are moving Richmond
11 Kingsize and Richmond Superkings up to £3.34/£3.35. In
12 order to maintain your cash margin position the bonus
13 levels at [a certain level] should be as follows."

14 Then at the end of the letter, the recipient is
15 asked to let Imperial know when Somerfield can move the
16 shelf prices, and Imperial will then issue a new
17 schedule of costs.

18 The schedule in tab 17 has the new prices. I think
19 this is one of the communications that is said in the
20 ITL witness evidence to be written in commercial
21 shorthand. The background perhaps ought to be
22 explained. This is November 2000. What had happened
23 was that earlier in 2000 both Gallaher and ITL had
24 a policy of parity between Richmond and Mayfair, and
25 then in I think it was the autumn of 2000, ITL

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ITL

1 repositioned Richmond and introduced at that point the
 2 parity with Dorchester. So this is reflecting the
 3 repositioning of Richmond with Dorchester instead of
 4 Mayfair. But you see again the tone of the
 5 communication with the retailer and of course the
 6 retailer in our submission would read this just as we
 7 read it, because it's written in ordinary English, and
 8 in our submission again what we see is that ITL's
 9 strategy, its pricing policy, is not as it has submitted
 10 to the Tribunal, it is rather instead a policy that is
 11 focused on maintaining, in this instance, a parity with
 12 a selected Gallaher brand.

13 **THE CHAIRMAN:** So when they say "We are moving Richmond
 14 Kingsize and Richmond Superkings up to 3.34/3.35", the
 15 3.34/3.35, that is the MRP, not the wholesale price?

16 **MR LASOK:** That's the shelf price.

17 **THE CHAIRMAN:** That's the shelf price.

18 **MR LASOK:** If you go to tab 17, and this in fact is a letter
 19 that attaches a new schedule of costs, bonuses and
 20 margins which was effective from Monday,
 21 15 January 2001, and it records that it supersedes the
 22 last schedule which ran from 4 December 2000. We don't
 23 have the last schedule, but if you go to the next page
 24 and look at the middle of the page, you have --
 25 I understand that the whole of this page is

1 confidential. What you actually see is --

2 **THE CHAIRMAN:** Actually I think the column that we are
 3 interested in isn't, which is the selling price column.

4 **MR LASOK:** Yes. It's the second from the right.

5 **THE CHAIRMAN:** Yes.

6 **MR LASOK:** You have the figures. The larger figures are for
 7 100s, but what we are looking at is the figures for 20s.

8 **THE CHAIRMAN:** Yes. That's where you get the ...

9 **MR HOWARD:** I think if you go back to tab 16 it actually has
 10 very clearly on it what the new and old shelf prices
 11 are, and you can actually see the adjustment in the
 12 tactical bonus, that's what actually set out.

13 **THE CHAIRMAN:** That was going to be my question.

14 **MR HOWARD:** It's set out on page 53. If you look, you will
 15 see the variants in the additional bonus, and you can
 16 see it comes down, and that's what --

17 **THE CHAIRMAN:** Yes, that's what I was just going to go on to
 18 ask. So there is the 3.34/3.35 is the shelf price, is
 19 moving up, and that is accompanied by, to use a neutral
 20 phrase, or achieved by a reduction in the bonus which
 21 equates to an increase in the wholesale price.

22 **MR LASOK:** Yes, because they are keeping the margins the
 23 same. The important thing for present purposes is that
 24 this is an illustration of ITL moving the retail price,
 25 the shelf price, upwards from the purpose of maintaining

1 its parity with Dorchester, because that was what its
 2 strategy was.

3 **DR SCOTT:** If we go to the very helpful table that we have
 4 which tells us the MPIs, what we discover is that the
 5 Gallaher MPI in August of that year left Dorchester
 6 Kingsize and Dorchester Superkings unchanged, and that's
 7 followed by the ITL MPI a few days, which leaves
 8 Richmond unchanged. So here we see the wholesale price
 9 was unchanged, though there appears to be a bonus change
 10 taking place behind the scenes.

11 **MR LASOK:** Yes.

12 So in our submission the upshot is that the
 13 contemporary documents are inconsistent with the picture
 14 painted by ITL in its pleadings and in its opening.
 15 It's worth emphasising that the infringing agreements as
 16 construed by the appellants didn't constrain in any way
 17 price increases. The P&D requirements were really
 18 incapable of encouraging retailers not to price above
 19 a certain level, and they weren't directed at that. As
 20 we can see from these documents dealing with movements
 21 upwards, and for example it's 28/65 where they say "We
 22 want you to move the price upwards to this level, you
 23 can go higher as long as you maintain the parity or the
 24 differential", I can't remember what we said in that
 25 letter.

1 So the structure of these arrangements was such that
 2 they weren't directed at encouraging retailers not to
 3 price above a certain level. What they secured was
 4 confidence that there would be parallelism in price
 5 movements as between the linked brands in accordance
 6 with the desires of the manufacturers, and confidence
 7 that by and large the retailers wouldn't go off-message.

8 Now, obviously there is the phenomenon of poor shelf
 9 price controls, but essentially, in our submission, what
 10 we see in these exchanges is the manufacturers relating
 11 with the retailers, building up a trading relationship
 12 under which the retailers subscribed to the parity and
 13 differential strategy that is being used by the
 14 manufacturer in order to determine retail prices, the
 15 shelf prices.

16 Now, I want to turn now to a distinct topic, and
 17 that is the question of the manufacturers' knowledge of
 18 each others' parity and differential strategies. In the
 19 decision, the OFT inferred from the evidence taken as
 20 a whole that the manufacturers must have known of each
 21 others' P&D requirements. Just for the Tribunal's
 22 reference, in the decision you have paragraph 1.15, and
 23 paragraph 6.204. The latter refers to the evidence in
 24 6.154 to 6.178.

25 The inference made by the OFT, in our submission, is

1 just a common sense conclusion. The evidence is that
 2 the P&Ds were derived from the published RRP. Whether
 3 they were expressed by direct reference to the RRP,
 4 such as in the Gallaher/Co-op agreement, or whether, as
 5 it were, they were derived indirectly, as in the ITL
 6 agreements where you have a strategic pricing
 7 requirement attached to the agreement and updated
 8 periodically doesn't really matter, because that
 9 document was itself derived from the RRP.

10 But the upshot was that when you bear in mind the
 11 serious effort that both Gallaher and ITL put into the
 12 monitoring of actual shelf prices, it wouldn't take them
 13 too long to figure out what was going on, even if they
 14 had no other information. When I put it in that way,
 15 and relating to monitoring, I do bear in mind the highly
 16 sophisticated analysis that has been carried out by the
 17 appellants' experts and also by Mr Walker in relation to
 18 the adherence evidence that exists. But we must bear in
 19 mind that at the material time the manufacturers were
 20 not employing these experts to go around monitoring
 21 shelf prices. They used a different method of
 22 monitoring the shelf prices, and that method in the
 23 material that we have gave them results that they felt
 24 confident in accepting because they feature in such
 25 things as the ITL reports on their trading relationship

89

1 with a particular retailer in which very often there is
 2 a line or a paragraph that talks about levels of
 3 adherence.
 4 Also, we have the evidence of payments that are made
 5 pursuant to these trading agreements. From the
 6 contemporary evidence we don't see the kind of
 7 non-adherence that is suggested by the experts, and that
 8 probably reflects the fact that at the material time the
 9 experts were not being used. They had been used for
 10 forensic purposes, for the purposes of this hearing. At
 11 the material time, the manufacturers had people who went
 12 around the stores and actually monitored, and they
 13 relied on the reports that these people provided. So at
 14 the material time, it appears that the manufacturers had
 15 information in which they placed confidence.

16 The reason why it wouldn't take too long to figure
 17 out what was going on, even if you had no information at
 18 all apart from the information that you derived from
 19 monitoring shelf prices is that if, for example, you had
 20 two brands, an ITL brand or a Gallaher brand, and the
 21 RRP was the same, let's say £4, and you looked around
 22 what a particular retailer was doing, and you saw that
 23 a particular retailer was selling the ITL brand at,
 24 let's say, £3.71, but you then observed that the
 25 retailer, the same retailer was selling the Gallaher

90

1 brand at £3.71, that would send you a signal because it
 2 looks a bit odd that both would be priced in exactly the
 3 same way. In other words, the relativity matches the
 4 RRP.

5 So really it wouldn't take you too long to figure
 6 out what was going on, and that presupposes that you
 7 have no other sources of information. The reality is
 8 that the evidence suggests that there were other sources
 9 of information. For example, if you go to annex --

10 **THE CHAIRMAN:** What are you saying that they would infer
 11 from that, if they saw that the RRP for two brands was
 12 4, and the one retailer was selling both those competing
 13 brands at £3.71, could you spell out a bit more what you
 14 say the signal being sent by that is?

15 **MR LASOK:** Why £3.71 for both of them?

16 **THE CHAIRMAN:** Well, you have asked the question rather than
 17 answering it --

18 **MR LASOK:** It's a rhetorical question.

19 **THE CHAIRMAN:** So tell me what you think the answer is. Are
 20 you saying that the wholesale price must be the same and
 21 they are applying the same margin to it, or --

22 **MR LASOK:** No. I don't think you can infer anything --

23 **THE CHAIRMAN:** Well, that's why I am asking what you infer
 24 from that.

25 **MR LASOK:** In our submission, on the basis of that

91

1 information, you wouldn't be able to infer what the
 2 actual wholesale price was. What you are observing is
 3 the fact that one brand has a particular price, it
 4 doesn't obviously relate to the £4 RRP, because in my
 5 example it's £3.71, which is 29 pence off the RRP. But
 6 the significant thing is that, curiously enough, both
 7 brands are at the same odd price. Odd in the sense that
 8 there is no particular reason, if you have no
 9 information other than the shelf prices, why either of
 10 them should be at £3.71 as opposed to £3.72 or £3.73 or
 11 £3.74 or, for that matter, £3.70. But you find both of
 12 them at the same price.

13 **THE CHAIRMAN:** But I would infer from that that the retailer
 14 must have decided that they are going to price at
 15 29 pence off the RRP, or that they are actually buying
 16 the products at the same price and they have put
 17 whatever percentage margin on, same for the two brands,
 18 and they are then arriving at a retail price. I still
 19 don't think you have spelled out what you say is the
 20 inference that one would draw from seeing that pricing
 21 pattern.

22 **MR LASOK:** There is no particular reason why the two brands
 23 ought to be priced at the same.

24 **THE CHAIRMAN:** What are you inferring then?

25 **MR LASOK:** What you do is you look and say "that's

92

1 interesting".

2 **THE CHAIRMAN:** Yes.

3 **MR LASOK:** It's curious.

4 **THE CHAIRMAN:** It's curious and interesting, and what do we

5 learn from it?

6 **MR LASOK:** Well, what you then do is you say, "I will keep

7 a look on this and see what happens", and if you see

8 that when changes take place, you have the same pattern

9 replicating itself, you could draw an inference.

10 **THE CHAIRMAN:** Which is?

11 **MR LASOK:** Which is that the two brands are being tracked.

12 By whom is the question. Is it being done by the

13 retailer or is it being done by the manufacturer?

14 That's a question that you would then ask.

15 **THE CHAIRMAN:** I see.

16 **MR LASOK:** The thing is that what I have done is I have

17 taken an extreme instance of a situation in which the

18 only information in the entire world that you have is

19 that the recommended retail prices of the two brands is

20 the same, the second piece of information is that the

21 shelf price for each of those brands is not the

22 recommended retail price but some other price, and the

23 third piece of information is that for both of those

24 brands it happens to be the same shelf price.

25 **THE CHAIRMAN:** So you would say that you infer from that

93

1 that somebody must be linking the price of those two?

2 **MR LASOK:** No, because my inference is that there is

3 something that you need to keep an eye on, because it

4 looks too good to be true, too much of a coincidence

5 that they are the same. So what you would do is you

6 would --

7 **THE CHAIRMAN:** "You" being who in this instance?

8 **MR LASOK:** If you were the other manufacturer.

9 **THE CHAIRMAN:** Right.

10 **MR LASOK:** So the reality is that it wouldn't work like this

11 in the real world because --

12 **THE CHAIRMAN:** Well, you set up this example, Mr Lasok, and

13 I'm still trying to understand what signal is being

14 sent, what alarm bells are being rung by somebody,

15 whether sent by the manufacturer or by the retailer or

16 by the OFT, to the shop and seeing those things, what

17 inferences they could draw.

18 Now, you say they can't draw necessarily the

19 inference that the retailer's just having an across the

20 board certain amount of pennies off the RRP, you can't

21 infer that they must be getting it, buying it at the

22 same wholesale price and adding the same margin, you say

23 the inference is that there is some linkage going on

24 between those two prices?

25 **MR LASOK:** I am saying that it's too much to be

94

1 a coincidence and what you would do is you would keep an

2 eye on the situation.

3 **THE CHAIRMAN:** Yes, it's not a coincidence, but why can't it

4 be either of those two other --

5 **MR LASOK:** The thing is it could be a coincidence, but it

6 would be a bit of an odd coincidence that it happens to

7 be the same odd price.

8 **THE CHAIRMAN:** Yes, it's clearly not a coincidence,

9 Mr Lasok, clearly prices don't arise by coincidence.

10 **MR LASOK:** So you infer this is not a coincidence --

11 **THE CHAIRMAN:** Yes, so you infer something.

12 **MR LASOK:** And then you say to yourself: if it's not

13 a coincidence, it must be something.

14 **THE CHAIRMAN:** Yes.

15 **MR LASOK:** And you keep your eye on what is going on, and

16 then you arrive at a conclusion. The thing is keeping

17 an eye on what is going on, this is where we move from

18 a theoretical construct that I advance, throw out in the

19 course of argument, to what would actually happen in the

20 real world, because in the real world probably the

21 manufacturer -- we will say it is a hypothetical

22 manufacturer for obvious reasons -- simply rings up the

23 hypothetical retailer and says "What's going on?" and

24 they get an answer, probably.

25 **DR SCOTT:** Mr Howard, on Day 1, transcript 40, lines 1 to

95

1 10, gave us an idea of what he thought ITL might infer.

2 He says, he is talking about manufacturers.

3 Manufacturers:

4 "... are not precisely the same, one may operate in

5 a more efficient way than the other, but they will know

6 just from studying public documents a fair amount about

7 each other, so that -- and will also know from the

8 public documents what the margins are that they are each

9 seeking to earn. Then you know what the RRP is.

10 "From knowledge of the way in which the industry

11 operates, I would suggest it is not actually terribly

12 complicated to infer what the likely wholesale price

13 is."

14 So what he is saying is that when you look at these

15 numbers and compare them with the RRP's, a manufacturer

16 can infer what the other manufacturer has done to

17 wholesale prices.

18 We did ask on Day 2 about the public documents and

19 when we were going to either be referred to the existing

20 bundles or be provided with the sort of public documents

21 to which ITL and Gallaher might refer as manufacturers,

22 but it may be that whereas Mr Howard can provide the ITL

23 ones we may look to your agreement on early resolution

24 with Gallaher to provide any Gallaher ones. But that's

25 the sort of inference that Mr Howard was suggesting that

96

1 you make.

2 **MR LASOK:** Well, he has a problem, then, hasn't he, because

3 that's not his evidence. His evidence is that this is

4 Mr Goodall, he didn't know.

5 **THE CHAIRMAN:** But how we got to this was your discussing

6 the manufacturers' knowledge of each others' P&D

7 requirements.

8 **MR LASOK:** Yes.

9 **THE CHAIRMAN:** So you seem to be saying that from

10 a comparison of the actual selling price of competing

11 brands in a retailer, the manufacturer can get a good

12 idea of what the other manufacturers' P&Ds are likely to

13 be.

14 **MR LASOK:** Yes. I am not talking about wholesale prices.

15 **THE CHAIRMAN:** No, no.

16 **MR LASOK:** I'm saying that if you perceive a pattern in

17 shelf prices that replicates the pattern in the RRP's,

18 you can draw a conclusion that the opposition is running

19 a parity or differential pricing strategy.

20 **THE CHAIRMAN:** Presumably only if you are not running a P&D

21 in relation to that paired brand, because if you are

22 running a P&D that requires them to have parity for

23 that, then that would explain why there is parity, so

24 that you wouldn't be able to infer anything about

25 whether the other manufacturer is also imposing parity

1 for that.

2 **MR LASOK:** That depends on the timing of price movements,

3 because if, for example you -- let's take Richmond and

4 Dorchester, if you are Gallaher and you say "Tell you

5 what we will do, we will try this one, we will increase

6 the price of Dorchester" and then you discover that

7 Richmond goes up as well, or it doesn't matter, whatever

8 the price change is, then you can infer that it's not

9 just you who has a Richmond/Dorchester parity, but it's

10 also ITL has it as well, because they are moving in

11 conjunction.

12 I am not saying that --

13 **THE CHAIRMAN:** I thought your case was that the one

14 agreement required them both to move in conjunction,

15 without there being the necessity for a parallel

16 agreement.

17 **MR LASOK:** Yes, that's true. So that if you have signed up

18 the retailer, the retailer will move its prices up and

19 down. But the thing is that if you hypothesise that you

20 haven't got -- because the first stage in the OFT's

21 analysis is a situation in which there is only one

22 manufacturer has a parity and differential strategy and

23 the other one hasn't, but if you are hypothesising that

24 both have, the OFT's position is that that's

25 an aggravating feature. But at the moment I didn't want

1 to get into the parallel and symmetrical aspect of the

2 case at this stage, I wanted to focus on the inference

3 drawn by the OFT that the manufacturers knew

4 a substantial amount at any rate of each others' P&D

5 strategies. I was pointing out that, in a hypothetical

6 case, if you were observing parallelism at shelf price

7 level that reflected what was going on at RRP level,

8 then if those were the only facts that you knew, then it

9 wouldn't take you too long to figure out that the

10 opposition, as I put it, has got a P&D requirement.

11 If you add in additional facts, well, of course the

12 analysis changes. But that was not my starting point.

13 My starting point was a rather more simplistic one in

14 which you have a limited number of facts from which you

15 can draw an inference.

16 Now, what I wanted to turn to was the documentary

17 evidence that does indicate that there was knowledge by

18 one manufacturer of the other manufacturers' P&D

19 strategies. The first one I wanted to turn to dates to

20 June 2002, and that's in annex 9 at tab 30. {D9 tab 30}

21 This is an email exchange. It actually starts on the

22 second page, with an email from Mr Daryl Barry, who was

23 a Shell employee, and he is sending here to Wes Feeney

24 of Gallaher recommended retail prices which he has put

25 together to cover what he describes as the upcoming

1 price increases, and he wants Wes's immediate thoughts.

2 Then you have the next email at the bottom of the

3 preceding page, he says:

4 "Please find the updated price increase in RRP

5 recommendations, effective 25 June, to include all three

6 manufacturers."

7 Then you get Wes Feeney's reply, and I would only

8 ask you to look at the second paragraph of the reply

9 where Feeney says:

10 "All manufacturers look to achieve price list

11 differentials between competitor brands and also their

12 own price list. If you move one product to a price

13 point and not the competitor brand also because it is

14 already at a favourable price point, then obviously

15 parities and differentials would be affected."

16 So Mr Feeney professed at that stage to know that

17 all manufacturers were pursuing the price list

18 differential policy.

19 If you go to tab 32 in the same annex, 30 is dated,

20 as I said, to June 2002. Tab 32 is dated to July 2002,

21 and again the earlier email is at the bottom of the

22 page. There is another version of this in tab 31, by

23 the way, which has an attachment.

24 If you are looking at the second half of tab 32,

25 it's a similar communication with Mr Barry sending

1 pricing proposals for comments, and he -- that's to say
 2 Mr Feeny -- says in paragraph 1:
 3 "I know you are keen to move prices up in order to
 4 optimise margin. However, the Gallaher agreement is for
 5 price list parities and differentials to be maintained."
 6 Then there is what appears to be a numbered
 7 paragraph 2, although in my copy the number has
 8 disappeared, and Mr Feeny says:
 9 "I note you are proposing to increase some ITL
 10 prices even though they are not having an MPR yet.
 11 I would think their agreement also stipulates parities
 12 and differentials to be maintained and with this in mind
 13 I have moved their prices in the attached as well as
 14 mine. Breda", that is a reference to Breda Canavan, who
 15 was Mr Feeny's equivalent on the Imperial side, and
 16 I start reading again:
 17 "... will be on the phone, I would think, if the
 18 above is not maintained."
 19 Now, on the face of it, Mr Feeny must have had
 20 a fair idea of what ITL's parity and differential
 21 strategy was in order to move the ITL prices. Now, if
 22 you go to the corresponding ITL bundle for Shell, which
 23 is annex 19, and go to tab 50, {D19 tab 50} tab 50 is
 24 the follow-on email from -- actually it was
 25 Breda Hughes.

101

1 **DR SCOTT:** She is the same lady, she changes her name
 2 several times.
 3 **MR LASOK:** So it is Breda Hughes and here she is sending
 4 an email with a price file to Daryl Barry, and she says,
 5 in the first line of her email:
 6 "As per our telephone conversation this morning,
 7 I agree with Wes' recommendations for the price files."
 8 There is a reference here in the middle of the
 9 page to maintaining the manufacturers' price
 10 differentials across the comparable brands, and there is
 11 a separate paragraph in the middle of the page saying:
 12 "Have a look and see what you think. However, as
 13 I mentioned earlier, I agree with Wes' recommendations
 14 as well."
 15 There is no expression of astonishment here, it
 16 seems to be perfectly accepted that each of them should
 17 know the others' parity and differential requirements.
 18 Tab 53 in the same annex is an instance of Shell
 19 acting as effectively an intermediary between Imperial
 20 and Gallaher. Again, if you look at the first email in
 21 the sequence, that's on the second page, and here it's
 22 Breda Hughes on 5 August 2002 sending an email to
 23 Daryl Barry, the subject line says:
 24 "ITL Price Increase, September."
 25 The body of the email refers to the fact that she is

102

1 attaching a new ITL price list, effective from
 2 2 September, and she attaches an amended price
 3 requirement sheet and asks whether Mr Barry has any
 4 queries.
 5 Then if you look above that, Mr Barry forwards this
 6 to Wes, asking him to check the proposed price points
 7 and provide any feedback. If you go to the previous
 8 page, if you take it again in reverse order and look at
 9 the email at the bottom of the page, you have an email
 10 from Wes Feeney on 9 August thanking Shell for the
 11 assistance.
 12 No, I think actually this is an internal Gallaher
 13 email.
 14 **THE CHAIRMAN:** Yes, Wes is delegating the task, I think, to
 15 Trevor.
 16 **MR LASOK:** Yes. Then at the top of the page you have Trevor
 17 to Daryl Barry, copied to Wes Feeney, and the first
 18 attachment is the Imperial price, SEP 2002, which is the
 19 attachment. In fact, the first two attachments, the
 20 second one being the price requirements, August 2002,
 21 are the two attachments which are referred to in text at
 22 the end of the first email in the middle of the
 23 following page.
 24 That ties in with tab 57. Tab 57 is an ITL
 25 document. It's the national accounts business

103

1 development plan for Shell. If you go to the fourth
 2 page, it's the first full paragraph on the fourth
 3 page -- which I think is not confidential -- and it
 4 simply describes Shell's arrangements and says:
 5 "Under the previous category manager, the price file
 6 was in a state of disrepair with many differentials out
 7 of line. Under the new category manager and with the
 8 aid of both Gallaher and ITL this has been resolved and
 9 in the main differentials between manufacturers'
 10 comparable brands are now maintained."
 11 I would like, on this topic, to go to a couple more
 12 documents, one of which is earlier in time, but, given
 13 the fact that it's 3.25, is this the appropriate moment
 14 for the usual break?
 15 **THE CHAIRMAN:** Let's have a break, yes. We will come back
 16 at 25 to 4.
 17 (3.25 pm)
 18 (A short break)
 19 (3.35 pm)
 20 **MR LASOK:** Before I move on to the question of the next
 21 document on the knowledge of the other manufacturers'
 22 parities and differentials strategy, there is a document
 23 that I can refer the Tribunal to on knowledge of
 24 wholesale prices, and that is in annex 20 at tab 45.
 25 It's tab 45, in annex 20, and it's the usual email

104

1 string. In this instance, the first email is on the
 2 second page at the top. It's a message from Graham Hall
 3 of Imperial to Liz Smith of Somerfield, in which he
 4 says:
 5 "Reference our telephone conversation in which you
 6 said that Gallaher pipe tobacco prices are correct and
 7 that they are maintaining your margin. It would be
 8 helpful if you could let me have your current margins on
 9 a couple of lines ... in both Somerfield and Kwik Save.
 10 I will then endeavour to come up with a package to match
 11 their margins."
 12 The response at the bottom of the preceding page
 13 from Liz Smith was to say that she was providing as much
 14 information as possible, and then she says at the end of
 15 the first paragraph of her email:
 16 "I am not in a position to give you the margins, but
 17 should you feel that you are in a position to match and
 18 maintain margins, then that would obviously be seen as
 19 a positive."
 20 So he didn't get the information on margins that he
 21 requested, and he comes back, just above the first
 22 holepunch -- and the figures here are confidential --
 23 but essentially he offers to reduce selling prices to
 24 give margins of a specified sort, and asks how they
 25 stacked up.

105

1 What's interesting is that in the middle of the page
 2 he says:
 3 "Whilst I appreciate the frustration you are feeling
 4 generally on pricing, our aim is merely to see our
 5 products competitively priced against our competitors'
 6 (ie maintaining our published price list
 7 differentials)."
 8 So that's just an illustration that, certainly at
 9 that stage, there is no indication that ITL was in
 10 a position to work out what margins were, because if it
 11 had been in that happy position it wouldn't have needed
 12 to make an enquiry of Somerfield.
 13 The next document is in annex 3, and if you go to
 14 tab 7A, you should have there a Gallaher document. It's
 15 "Key Issues Review" dated to 4 June 2001. If you go to,
 16 now on my copy --
 17 **THE CHAIRMAN:** Just wait one moment. The transcript seems
 18 to have stopped. (Pause). Just tell me again what we
 19 are looking at.
 20 **MR LASOK:** It's 7A, a Gallaher document, and a key issues
 21 review dated to 4 June 2001.
 22 My copy appears to have two series of page numbers
 23 on it. I was going to say "if you look at the
 24 pagination in the bottom right-hand corner", but I am
 25 now looking at a page which has two page numbers in the

106

1 bottom right-hand corner.
 2 If you went to 208, or to 116, you have a fair
 3 chance of getting to the page that I would like to go
 4 to.
 5 **DR SCOTT:** Somebody has severely redacted the black and
 6 white version.
 7 **MR LASOK:** Yes. I don't know how that -- this document got
 8 into the bundle relatively late in the day, but I don't
 9 know who did the redaction or why.
 10 The page that I wanted to go to is not redacted.
 11 I was going to page 208. In my copy I have a 208 in the
 12 bottom left-hand corner, and a 116 in the bottom
 13 right-hand corner. This appears to be probably a slide
 14 which says:
 15 "Sterling: Next steps."
 16 In the second and third bullets, it says:
 17 "Imperial, for their own ends, have pegged their
 18 Richmond price in multiple grosses to 5 pence above
 19 Sterling. Clearly this removes, in the short-term, the
 20 opportunity to proactively engineer margin enhancement
 21 for both Dorchester and Sterling.
 22 "The key task is to cajole the price of Richmond
 23 upwards, allowing enhancement of both Gallaher brands."
 24 At that time it was absolutely correct that the ITL
 25 policy was that Richmond should be 5 pence above

107

1 Sterling. Now, we don't know how Gallaher found this
 2 without, but we know that it did. In fact, it certainly
 3 knew that earlier in the year, because there is another
 4 document floating around in this annex which also refers
 5 to the fact that they knew that that was ITL's policy.
 6 The last document on this topic that I would like to
 7 turn to is annex 15, tab 11. This dates to
 8 January 2002. It's an internal ITL document.
 9 Now, in my copy I have pagination in the bottom
 10 right-hand corner which starts at 204. This is
 11 a document that concerns obviously CWS Retail and CRTG.
 12 If you could go to page 211, you see at the top of
 13 the page under the heading "General" a passage that goes
 14 as follows:
 15 "I expect CWS Retail to challenge the strategy
 16 pricing differences during this year. They believe that
 17 the manufacturers are restricting promotion and activity
 18 by demanding strategic differentials. This will affect
 19 all manufacturers over the coming year."
 20 Now, obviously CWS Retail had an idea about what the
 21 manufacturers were up to, in the plural, because it was
 22 dealing with the manufacturers. But this is an instance
 23 in which ITL is making the comment that CWS's
 24 anticipated challenge would affect all the manufacturers
 25 over the coming year, and by necessary implication this

108

1 indicates that ITL knew that other manufacturers had
 2 strategic differentials, as well as ITL.
 3 I would like now to pass to a different topic, which
 4 is the evidence concerning the existence of the
 5 infringing agreements in relation to each of the
 6 manufacturers and each of the retailers.
 7 What I am going to do is to make some general
 8 submissions before looking first at the written trading
 9 agreements and then the contemporaneous exchanges
 10 between the manufacturers and the retailers.
 11 By way of introductory observation, the OFT's case
 12 is that the written trading agreements provide
 13 a starting point for the investigation and the analysis
 14 of the facts. They provided a framework for the ongoing
 15 commercial relationship between the manufacturer and the
 16 retailer in question. That ongoing commercial
 17 relationship was worked out over time by the parties in
 18 a way that was mutually suitable. So we don't need --
 19 we don't expect to see necessarily that the same pattern
 20 of exchanges between each manufacturer and each retailer
 21 is going to be exactly the same across the board. How
 22 it was worked out over time was something that was
 23 a reflection of the particular relationships struck up
 24 between the particular manufacturer and the particular
 25 retailer.

109

1 What does happen, however, is that -- we say, at any
 2 rate -- the trading agreements were not simply
 3 negotiated, signed, put in a drawer and forgotten; they
 4 did in fact contain provisions of commercial
 5 significance such as the provision for the payment of
 6 the money. As the Tribunal has seen from the other
 7 appellants' openings, when they refer to some of these
 8 trading agreements, the provision for money is there in
 9 the written trading agreement, and it's to be determined
 10 and paid and they expect to get it. So these trading
 11 agreements were not simply things that gathered dust in
 12 the depths of a filing cabinet.
 13 However, when one assesses the written trading
 14 agreements, in our submission you have to look at the
 15 evidence as a whole, and that does involve looking at
 16 the contemporaneous documentary exchanges between the
 17 parties and take that in conjunction with the trading
 18 agreements.
 19 In our submission, these appeals don't concern
 20 a contractual dispute; we are not looking at the
 21 agreements from the perspective of the English law of
 22 contract. The Tribunal, in our submission, applies well
 23 established rules of competition law to determine
 24 whether or not an agreement or concerted practice
 25 exists.

110

1 In that connection, Shell relied on -- on Day 2 --
 2 an entire agreement clause in the RBA, and when the
 3 phrase "entire agreement" hit the soundwaves,
 4 I certainly had a sort of sensation in which I felt that
 5 my eyes were swivelling in a rather alarming way, if
 6 observed, because of course there was passing through my
 7 mind hundreds of years of the English law of contract
 8 and ancient cases on what an entire agreement is.
 9 But, in our submission, this is completely
 10 irrelevant. An entire agreement clause is something
 11 that lawyers stick into a written agreement because they
 12 anticipate that there might at some stage be a dispute
 13 over the terms of the contract, there might be legal
 14 proceedings involving allegations of a breach of
 15 contract, and the entire agreement clause is there to
 16 enable one to look at the terms of the agreement and
 17 effectively nothing else in order to resolve a legal
 18 dispute.
 19 But the problem about an entire agreement clause, in
 20 our submission, is that it's not the kind of thing that
 21 commercial people have in the front of their minds when
 22 they are working through a commercial business
 23 relationship with another company or another partnership
 24 or firm or whatever it is.
 25 So it's interesting to be told that there is

111

1 an entire agreement clause in the RBA. In our
 2 submission, it's irrelevant for present purposes.
 3 What is similarly irrelevant, in our respectful
 4 submission, is ITL's apparent contention that the OFT's
 5 case is dependent upon there being some sort of legal
 6 obligation or contractual obligation that binds the
 7 retailer.
 8 In relation to that contention, I am going to make
 9 a rather general submission about the chapter 1
 10 prohibition: that is that, in our submission, the
 11 chapter 1 prohibition captures a spectrum of
 12 collaborative or co-operative conduct that runs from
 13 what you could describe as hard edged instances of
 14 co-operation or collaboration that take the form of
 15 a purportedly legally binding agreement written in blood
 16 or inscribed in stone. I say "purportedly legally
 17 binding" because of course the restrictive clauses or
 18 the anticompetitive clauses in it wouldn't be legally
 19 binding.
 20 The spectrum runs from that end of the spectrum
 21 through things like gentlemen's agreements to nods and
 22 winks and situations in which expectations as to the
 23 future behaviour of an undertaking are engendered by
 24 conduct of one sort or another.
 25 Therefore, in the present case, it is not an answer

112

1 to the OFT's decision to say that, for example, there is
2 no written contract which contains a clause that binds
3 the retailer to do X. At the risk of overelaborating
4 the point, I will give an illustration as follows: let's
5 suppose that you have got a manufacturer and it has
6 a trading relationship with three retailers, X, Y and Z.

7 With X it's got a written contract that binds X to
8 follow the manufacturers' parity and differential
9 requirements. I am not looking at the anticompetitive
10 nature of the parity and differential requirements, I'm
11 looking at the idea of an agreement or concerted
12 practice for the purposes of a chapter 1 prohibition,
13 and the question of what is or is not a restriction on
14 the retailer.

15 So it's got a written agreement, a written clause,
16 that binds X to price in accordance with the P&D
17 requirement, and let's say that there is a penalty for
18 non-compliance. It doesn't matter what it is. It could
19 be the withdrawal of a bonus, it could be some other
20 penalty, it could be that X's hands are chopped off. It
21 doesn't matter.

22 Now let's take a second situation, and this is the
23 trading relationship with Y. Let's suppose that the
24 trading relationship with Y is a bit closer to the
25 relationship between ITL and Sainsbury's at the outset

113

1 of the infringement period, because the agreement that
2 you will have seen, which takes the form basically of
3 slides, has in it a slide that says "This is not
4 a legally binding agreement".

5 So let's suppose that we have something between the
6 manufacturer and Y that is expressed as not being
7 a legally binding agreement, and it simply says "Y
8 promises, without being under any obligation, to
9 implement the manufacturer's parity and differential
10 requirements".

11 The third scenario is Z in the case of Z there is no
12 written trading agreement but there is a custom and
13 practice that has developed under which the manufacturer
14 every so often rings up Z and says to Z "Well, it's time
15 to move your prices to keep in line with our P&Ds", and
16 Z says "That's fine, I'll do it now", or says "Send me
17 a price file and I do it", and then adds "See you at the
18 golf course on Sunday". You have three scenarios.

19 Now, as I understand it, the appellants, or some of
20 them, appear to take the view that there is no situation
21 falling within the chapter 1 prohibition in relation to
22 Y and Z, because in the case of Y and Z there is no
23 constraint placed on either Y or Z. It is only in X's
24 case that we have a constraint because it takes the form
25 of a legally binding promise on the part of X and it's

114

1 coupled with, could be an incentive or it could be
2 a penalty, doesn't matter.

3 But, in our submission, for the purposes of the
4 chapter 1 prohibition, all these situations are the
5 same, because in each of these situations you see
6 exactly the same phenomenon, and that is that the
7 retailer, X, Y and Z -- and I will use a colloquial
8 phrase -- signs up to, accepts or goes along with,
9 however you put it, the P&D requirements of the
10 manufacturer. In our submission, that's enough.

11 So, for example, in the context of --

12 **THE CHAIRMAN:** I thought that what Mr Howard was agreeing to
13 when I raised this was that it's one of those contracts,
14 like the *Carlill v Carbolic Smoke Ball Company* case,
15 that you don't have to inhale from the smoke ball but,
16 if you do and you catch flu, then you can sue the
17 sellers of the smoke ball for the £1,000 that they say
18 they have put into a bank account as to provide
19 an incentive for people to buy and use the smoke ball;
20 so it was an unilateral contract or something. This is
21 going back some time when I studied this.

22 It's a contract whereby there is no obligation on X
23 to do the thing, but Y agrees that if X does do that
24 thing, then Y will pay X a certain amount of money.

25 So where does that come on your spectrum?

115

1 **MR LASOK:** It doesn't, because *Carlill v Carbolic Smoke Ball*
2 *Company* isn't often cited in competition cases.

3 The point essentially is that you look at the
4 evidence in the round and you ask yourself the question:
5 does the evidence indicate that what has happened is
6 that, in this particular instance, the retailer has
7 agreed or concerted something, and if so what?

8 So in the case of *Carlill v Carbolic Smoke Ball*
9 *Company*, you don't stop the terms of the written
10 agreement from a competition perspective; you look at
11 the whole situation in the round.

12 So you may start off with a contract which is of
13 that nature, but that isn't the issue, because that's
14 not the end point of your investigation. It's only the
15 starting point. In the present case, for example, we
16 have references in the decision to restriction on the
17 retailer's ability to determine its own retail prices.
18 One example is paragraphs 1.12 and 1.13 of the decision.

19 The decision goes on, when it explores or further
20 describes this restriction, it talks about or rather
21 uses the language of the retailer's understanding or its
22 acceptance of its role in the arrangements or what it
23 was going to do. So that's what we get in paragraphs
24 like, in the decision, 1.6, 1.9, 6.5 and 6.108.

25 So in the present case, rather like my illustration,

116

1 X, Y and Z, and let's focus on Z for a minute, the point
 2 about Z is Z has never signed up to any agreement at all
 3 in any written terms, it's not even a Carlill v Carbolic
 4 Smoke Ball Company case.
 5 The point is that by conduct we see that Z in my
 6 illustration has accepted that its behaviour will be in
 7 a particular way.
 8 **DR SCOTT:** Will you be taking us to instances where monies
 9 appear to have been paid without there being trading
 10 agreements?
 11 **MR LASOK:** I'll just have to check that, because in my
 12 recollection -- I can't remember now, because I think
 13 that the ones that I ... there are always tactical
 14 bonuses. I think that the general pattern is that where
 15 you see a payment for parity, which is of course one of
 16 the phrases that crops up in the documents, it's usually
 17 associated with a provision in the written trading
 18 agreement. I can't remember offhand of a situation in
 19 which there is no written trading agreement and no
 20 suggestion that there ever was a written trading
 21 agreement, and yet you still have a payment for parity.
 22 I can't remember, but I wouldn't trust my memory on that
 23 one.
 24 So the upshot, in our submission, is that it's
 25 important to draw a distinction between the question of

117

1 what has been agreed or concerted and what is the
 2 mechanism by which the agreement or concertation is put
 3 into operation.
 4 Generally speaking, when we look at the question
 5 what has been agreed or concerted, we have to look at
 6 the totality of the evidence, but sometimes the totality
 7 of the -- the mechanism shouldn't confuse us as to
 8 whether or not there is an agreement or concerted
 9 practice, or what it is.
 10 I'll give you an example of that. Again, looking at
 11 it entirely from a theoretical perspective, let's
 12 suppose you have a situation in which I have used the
 13 example of X, Y and Z, when we look at the facts, we see
 14 that there is a written contract, and let's suppose that
 15 it is inscribed in stone and it is a contract between
 16 the manufacturer and X, but when we look at the
 17 evolution of the trading relationships between the
 18 manufacturer and X, we see that there are constant
 19 communications.
 20 The manufacturer bombards X with requests to move
 21 his prices. Do we infer from that that this agreement,
 22 which was actually inscribed in stone, was non-existent
 23 or irrelevant, when we have all this bombarding going
 24 on? In my submission you can't assume that the
 25 agreement was ignored, and one of the reasons for that

118

1 is that the bombarding of X with emails asking X to make
 2 a price movement to keep in line with the P&D
 3 requirements can simply be explained as the manufacturer
 4 working out the trading relationship with X, for which
 5 there can be any number of reasons. For example, the
 6 manufacturer distrusts X; the manufacturer thinks X is
 7 lackadaisical; the manufacturer therefore believes that
 8 X needs to be egged on. The manufacturer knows that its
 9 fallback position is that it has the agreement. What it
 10 wants is performance, and that's why you get the
 11 communication building up. But that's mechanism, and it
 12 doesn't detract from the fact that there was
 13 an agreement.
 14 Equally, if you have no agreement but you still have
 15 the bombarding, then you have still got an arrangement
 16 that falls within the chapter 1 prohibition. It may, in
 17 that instance, be perhaps better described as
 18 a concerted practice rather than an agreement, but there
 19 are academics who will discuss what the true description
 20 to be attached to the conduct is. We don't need to
 21 worry about that. The thing is, it's what's going on.
 22 The what is going on is tested by the interchanges
 23 between the undertakings themselves. That's to say
 24 between the ITL, NAM, the national account manager,
 25 whatever he is called, and the buyer, the tobacco buyer

119

1 in the retailer. These are the people that we have to
 2 focus on in order to determine whether or not there is
 3 an agreement or concertation. It may not necessarily
 4 have to be the buyer because there could be other people
 5 at a superior managerial level, but we are talking about
 6 the contacts between the undertakings.
 7 There are undoubtedly performance issues which have
 8 surfaced in the debate about adherence, and which I'll
 9 come to in due course, but the performance issues
 10 operate at a lower level, and it was well known by the
 11 parties that the multistore operations had poor or
 12 variable shelf controls, so that there was
 13 an understanding that the performance of an arrangement
 14 might not be 100 per cent guaranteed. In fact, in some
 15 of the agreements there was reference to things like
 16 90 per cent performance in, for example, selected
 17 stores.
 18 But performance is not the relevant question when
 19 you are investigating the issue as to whether or not
 20 there was an agreement or concerted practice of the sort
 21 found in the decision, because there we have to look at
 22 the interchange between the undertakings themselves.
 23 **DR SCOTT:** Surely bombardment sounds unilateral, whereas
 24 agreement and concerted practice involves a conjunction
 25 of wills.

120

1 **MR LASOK:** It depends what the result of the bombardment
 2 was. If you have a bombardment and the retailer was
 3 batting it away and saying "Get lost", that's
 4 a completely different kettle of fish.
 5 In this particular case, we have got in some
 6 instances bombardments and they are bombardments of this
 7 sort, for example, it is "Move the price of Richmond
 8 from X to Y", and then after a while you get another
 9 email which says "Move the price of Richmond from Y to
 10 Z". It's not "Now you must move the price from X to Z";
 11 it's "Move it from Y to Z", and there is nothing in the
 12 documentation in which the retailer says "Hold on
 13 a minute, you have it wrong, I never moved to Y".
 14 We do, however, see instances in which that kind of
 15 thing happens. I was going to come to one of them in
 16 the context of a discussion about the nature of the
 17 trading agreements, because we do have situations in
 18 which the retailer is, as it were, getting it wrong, and
 19 there we need to know -- when the manufacturer is
 20 pointing out the error and asking the retailer to mend
 21 its ways, you need to know what the error was, and what
 22 the reaction of the retailer is.
 23 But we can clearly identify instances in which the
 24 error is a failure to respect a parity or
 25 a differential.

121

1 So, for example, there is one of these letters --
 2 I think it's in annex 28 -- in which it's spattered with
 3 things like "You must move to match, we are paying for
 4 parity". I can't remember which one it is, it's
 5 something like 28/55. But there are letters that are
 6 wholly unambiguous, and it is quite clear, when you look
 7 at a letter like that, that if there was no
 8 understanding between the manufacturer and the retailer
 9 in question as to what the retailer was to do, that
 10 letter could never have been written, and, if it was
 11 written, it would have drawn a response that would have
 12 been found in the documentation; that would have been
 13 produced by the retailer, certainly if the retailer was
 14 a party in these proceedings.
 15 Now, it's 4.15. I don't know whether now would be
 16 a convenient moment for the Tribunal?
 17 **THE CHAIRMAN:** Well, tomorrow, what do we have planned?
 18 That's for you to complete your opening?
 19 **MR LASOK:** Yes.
 20 **THE CHAIRMAN:** Is there anything else planned? No. Well,
 21 if you feel that you can comfortably finish during the
 22 course of tomorrow ...
 23 **MR LASOK:** Can I ask what time we start tomorrow?
 24 **THE CHAIRMAN:** I think we are starting at 10.
 25 **MR LASOK:** I would have thought then there is no difficulty.

122

1 **THE CHAIRMAN:** Right. Well, if that's a convenient point,
 2 then we will break there for the evening, thank you very
 3 much, and we will recommence at 10 o'clock tomorrow
 4 morning.
 5 (4.15 pm)
 6 (The court adjourned until 10.00 am on
 7 Wednesday, 28 September 2011)

123

1	INDEX	
2		PAGE
3	Opening submissions by MR FLYNN	1
4		
5	Opening submissions by MR LASOK	38
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		

124