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IN THE COMPETITION

APPEAL TRIBUNAL

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

Victoria House,
Bloomsbury Place,
London WC1A 2EB

14 October 2011

Before:

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

Sitting as a Tribunal in England and Wales

BETWEEN:

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

CO-OPERATIVE GROUP LIMITED

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

WM MORRISON SUPERMARKET PLC

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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HEARING (DAY 14)

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 Friday, 14 October 2011
 2 (10.00 am)
 3 Further opening submissions by MR HOWARD (continued)
 4 **THE CHAIRMAN:** Yes, good morning.
 5 **MR HOWARD:** Good morning. What I am going to do this
 6 morning is I am going to first look at this question as
 7 to whether the differentials in the Morrisons agreements
 8 or arrangements were maxima or fixed, then I am going to
 9 look at the different scenarios which need to be
 10 considered, namely Imperial price increases, Gallaher
 11 price increases and Imperial decreases and Gallaher
 12 decreases.
 13 In doing so I also will come back, when I am dealing
 14 with the Gallaher price decreases, to a point raised by
 15 the Chairman yesterday evening, just to explain why
 16 I think what you described as the issue we say is not
 17 actually really the issue. It's better if I come back
 18 to it once we have looked at the documents.
 19 So maxima against fixed. We have partly covered
 20 this already. In the two agreements, agreement number 1
 21 at tab 4 and agreement number 2 at tab 85, it is clear
 22 beyond argument that agreement number 2 is expressed in
 23 what we are calling maxima. The language is slightly
 24 awkward. By "maxima" we mean at least this difference.
 25 Agreement number 1, that is also true, except in those

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1 cases where it says "level with on", that's at tab 4,
 2 page 5.
 3 Now, the evidence on both sides of the parties to
 4 the arrangements is that this was always understood that
 5 that meant at least and no worse than level. You will
 6 hear the evidence of Mr Eastwood and Mr Matthews.
 7 Now, common sense also tells you that is the case.
 8 When I say common sense, I mean common sense in its
 9 normal parlance, but I also mean common commercial
 10 sense.
 11 What is the OFT's position on this? They look at
 12 certain correspondence, which we are going to look at in
 13 a moment. In relation to the second agreement they say:
 14 well, although that says on its face what Imperial and
 15 Morrisons say, they say that because a prior draft --
 16 which you have amongst other places at tab 72 -- was
 17 expressed in different terms, then that must be what the
 18 parties intended.
 19 Well, obviously the short answer to that, firstly,
 20 is the parties intended what they put into the agreement
 21 which is actually ultimately signed, but even leaving
 22 that on one side, of course we say in any event, even if
 23 the agreement had been expressed in those terms, the
 24 parties still actually always understand that these are
 25 maxima, and if you can do better, then so much the

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1 better, so it doesn't actually make any difference.
 2 Now, if we turn to the some of the correspondence
 3 that has been cited both in writing and orally, if you
 4 would turn first to tab 16, {D17/16}, this is a letter
 5 that the OFT cited both in its skeleton at paragraph 253
 6 and Mr Lasok cited it orally.
 7 Now, one of the things that was interesting about
 8 Mr Lasok's oral submissions -- of course this is
 9 a common thing that counsel do, is to set up a straw man
 10 to knock down. So Mr Lasok, when he referred to this
 11 letter, said that this letter, because it refers to
 12 price increases, shows that -- this is his words -- he
 13 says:
 14 "ITL is not an inveterate price cutter. ITL does
 15 not have that as its policy".
 16 So he seems to be saying "Well, if I can show you
 17 something in the documents where ITL is putting up
 18 prices, that somehow must show that the OFT's case is
 19 right".
 20 Now, the fact that a manufacturer puts up prices is
 21 something that happens day in, day out, there is nothing
 22 anticompetitive about manufacturers putting up their
 23 prices. What is in fact happening in this letter, if we
 24 look at it a bit more closely, and it's actually a very
 25 clear letter, the second paragraph:

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1 "You are aware that the broad marketplace has moved
 2 [it's about Richmond] from 3.29/3.30 to 3.34/3.35 on
 3 Dorchester and Dorchester Superkings. You may remember
 4 from my presentation on the Richmond repositioning,
 5 launch of Richmond, that our strategy is parity with
 6 Dorchester. In light of this, we are moving Richmond
 7 and Richmond Superkings up to 3.34/3.35. In order to
 8 maintain your cash margin position, the bonus levels at
 9 3.34/3.35 should be as follows."
 10 Just stopping there for a moment, what has happened
 11 is that Imperial has previously reacted to Dorchester's
 12 price, and has paid an increased bonus to get the price
 13 down, and so at 3.29 they were paying an additional
 14 bonus, if you look at the figures -- I am going to say
 15 what they are, because it's quite frankly difficult to
 16 make any sense of this if you don't -- the additional
 17 bonus was £4.31. You can see that.
 18 At a new shelf price of 3.34, the additional bonus
 19 is 2.18. At these levels, the margin is in cash terms
 20 exactly the same. It of course changes in percentage
 21 terms, because that's just a function of mathematics,
 22 but what you can see is happening is Imperial pays £4.31
 23 originally per whatever it is -- I suppose that's per
 24 thousand or something, I think. Yes, per thousand -- in
 25 order to get the price down. Now they are saying "Well,

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1 I no longer want to have the price down at that level,
2 so I am prepared to pay you £2.18 and that, Morrisons,
3 will give you the same margin of 0.1672p", slightly
4 different in percentage terms.

5 No-one is saying to Morrisons -- and Morrisons never
6 understand this -- that you can't keep the price down if
7 you want, but of course if Morrisons keep the price
8 down, for instance at £3.29, Imperial would be
9 delighted, but then Morrisons per thousand cigarettes
10 would be, you can see on these figures fairly clearly
11 they would be making a loss, because per thousand
12 cigarettes they will be subsidising the price by over
13 £2, the difference between £4.31 and £2.18.

14 So this letter, which is said to be --

15 **THE CHAIRMAN:** That margin figure of 0.1672, is that ...

16 **MR HOWARD:** That's Morrisons margin.

17 **THE CHAIRMAN:** Yes, but is that per pack, or per thousand,
18 or ...

19 **DR SCOTT:** I think it's on the shelf price, because if you
20 look, it's 16p and the shelf price is about 3 quid, and
21 it's about 5 per cent so it's --

22 **MR HOWARD:** It's definitely the shelf price, I think
23 the Chairman's question was whether it was per single
24 pack or per ten packs. I think it's per single pack.

25 **DR SCOTT:** And as we understand it, provided they were

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1 competitive with their chosen rival, they were concerned
2 about the margin, so that they would need to take the
3 price up to sustain the margin.

4 **MR HOWARD:** Of course, Morrisons have a concern -- everybody
5 has different concerns. One of the things that's very
6 dangerous is to think that there is only one concern.
7 Morrison's concern is to be competitive with Tesco,
8 I think, here. But whoever it is they are benchmarking,
9 Morrisons want to be the cheapest, essentially. They
10 also want to make their margin. So this -- and the
11 calculation that's being made here is Imperial
12 understand what the margin is that they previously had.
13 They have paid them a bonus to get the price down, and
14 to allow them to maintain their margin, and that's
15 because it's part of Imperial's strategy there to reduce
16 the price. Morrisons might independently consider that
17 they need to take a cut in this margin, but that
18 doesn't -- I don't know whether that arose in this
19 instance or not, sometimes it did. But in this
20 instance, all this -- why are we looking at this
21 document? It's because this document is relied on by
22 the OFT as part of showing that the differentials are
23 required to be fixed. It isn't actually showing that at
24 all, because it's about something different.

25 It is in the context of Imperial's strategy that

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1 they want Richmond to be priced, here it says that their
2 strategy is parity, and that is at least parity, but
3 it's not saying it -- this is the important point, it's
4 not saying to Morrisons that "we have a requirement that
5 you must, as it were, independently do this". What it's
6 saying is -- it's actually a fairly simple example. "We
7 see that Dorchester has moved up, we previously had paid
8 you a bonus, so that we could match them, we don't need
9 to do that any more, and it's costing us" -- you have to
10 remember this costs Imperial a lot of money. You can
11 see that, I don't know, I can't tell you at the moment
12 the precise figure, but if they are paying £4.31 per
13 thousand cigarettes, and this is a big brand, if they
14 don't any longer need to do that from their commercial
15 judgment because moving the price up to match
16 Dorchester's meets their strategy in the sense that they
17 believe -- that's the thing, their commercial judgment
18 was right about this -- that Richmond at the same price
19 is a better seller. And they have been proved right.
20 Their judgment was vindicated.

21 **DR SCOTT:** So just to correct what you said just now, you
22 said their strategy was to reduce the price. This
23 strategy is to take the price up, as is explained in the
24 last sentence of the second paragraph.

25 **MR HOWARD:** I don't think I -- then I must not have made

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1 myself clear. Mr Lasok, I was commenting on what he
2 said, said this shows that Imperial are not inveterate
3 price cutters. I'm saying that's a straw man to knock
4 down. It's not a necessary part of Imperial's case,
5 that what they are always trying to do is to cut price,
6 and one only has to apply a ha'peth of common sense to
7 realise that if what Imperial does is always cut price,
8 Imperial will go out of business pretty quickly. Of
9 course, Imperial is trying to make money for its
10 shareholders, nobody disputes that.

11 **THE CHAIRMAN:** Yes, what the OFT point to in this letter,
12 and we will obviously have to hear what Mr Matthews
13 says, is that -- two things, is my understanding.
14 First, that when they say, "In the light of this we are
15 moving Richmond up to 3.34, 3.35", those figures are the
16 shelf price, they are not the wholesale price.

17 **MR HOWARD:** I agree.

18 **THE CHAIRMAN:** And secondly at the bottom sentence it says:
19 "Please let me know when you can move your shelf
20 prices."

21 Rather than, "Of course we would be delighted if you
22 didn't move your shelf prices, but we understand if you
23 decide that you have to".

24 So I understand what you say this letter means, and
25 that may be something different from what it says, and

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1 then -- or you may not accept that that's something
 2 different from what it says, and what we have to decide
 3 is whether it means what it says, if that's what the OFT
 4 say, or whether it means what you say they would have
 5 understood.
 6 **MR HOWARD:** No, I think this is a debate that doesn't lead
 7 anywhere, that's really my point. For instance, if you
 8 say: is there any dispute that this is talking about
 9 shelf prices? No, of course it's talking about shelf
 10 prices. The point that the OFT seeks to draw from this
 11 letter is that where the agreement says, at this stage,
 12 "level with on", that means that it's fixed and it
 13 cannot be less. Now, all I am saying is you can't --
 14 this agreement is not addressing, as it were,
 15 a requirement to say it must be at this and no more.
 16 I'll come to that last paragraph in a moment. What
 17 you can see before you get there, all it's saying is "we
 18 are no longer going to pay you the same level of bonus
 19 because we now no longer need to. This is the
 20 consequence."
 21 The last paragraph is actually:
 22 "Please let me know when you move your shelf prices
 23 ... (... listing, multipack reductions may be a good
 24 time?) [your shelf prices] so Stephen Carroll and I can
 25 issue a new schedule of costs, et cetera."

1 What that is saying is that is to calculate the
 2 bonus because -- and again it goes back to this debate
 3 and the tension with the retailers that the retailers,
 4 when they haven't moved -- if my learned friends here,
 5 Morrisons, they may say, "Well, we see what you have
 6 said in this letter, but the thing is, we actually have
 7 all these cigarettes in our stores at this price, the
 8 original price, and therefore we expect that bonus
 9 arrangement to continue, we are not changing it". So
 10 what he is talking about in the last letter, is "tell me
 11 when you are going to do this so that I can then give
 12 you a new schedule which will reflect this". It doesn't
 13 mean that Morrisons is precluded from saying "Actually
 14 we are happy with the bonus at £2.18 per thousand,
 15 but --" Imperial is not saying "You can't price at
 16 £3.29. The reality is they recognise that it is
 17 unlikely, unless Morrisons have some special reason why
 18 they are going to promote Richmond or going to, or there
 19 is some competitive position with Tesco or somebody else
 20 that requires them to do that. The reality is they are
 21 likely to put the price at £3.34, because that's the
 22 price that will give them this margin.
 23 **DR SCOTT:** You are talking about the cigarettes already
 24 having been purchased, but as we understand it, the
 25 bonuses envisaged to pay in retrospect.

1 **MR HOWARD:** These ones are paid off-invoice, in Morrisons,
 2 all of this is paid off-invoice.
 3 **DR SCOTT:** All of this is paid off-invoice?
 4 **MR HOWARD:** Yes.
 5 **DR SCOTT:** So what they need to know implicit in this
 6 letter, then, is when are you going to change the prices
 7 so that we know when to change what we invoice.
 8 **MR HOWARD:** Yes.
 9 **DR SCOTT:** And their expectation from this letter is that
 10 they will change the prices to 3.34, 3.35.
 11 **MR HOWARD:** Yes.
 12 **DR SCOTT:** Now, what's not envisaged in this letter is some
 13 change other than that, so that it doesn't say, "In
 14 order to maintain your cash margin, bonus levels of
 15 3.34, 3.35 should be as follows, but let us know if you
 16 change the prices to something else". It's expecting
 17 them to move to 3.34, 3.35.
 18 **MR HOWARD:** It is expecting that they are going to move to
 19 that, but it's their decision ultimately whether they
 20 do. If they want to get -- if they are happy with less
 21 margin, then there is absolutely nothing to stop them
 22 saying "Actually, we are going to price below". It's
 23 all about, you have to remember, calculating the bonus.
 24 This is a price reduction. Even at the enhanced price
 25 it's still a price reduction --

1 **DR SCOTT:** From the RRP?
 2 **MR HOWARD:** Yes. It's more than from the RRP -- well, if
 3 you want, just taking it from the RRP. And it's paying
 4 them to have a low price. The difference is it's not as
 5 low a price as it originally was. So in other words,
 6 all it's saying is "I originally paid you this amount to
 7 get the price down to £3.29, I now will pay you this
 8 amount to get it down to 3.34. It's not saying you
 9 can't price below 3.34, it's just that's the amount I am
 10 paying you, that's my target, 3.34, but I am not in any
 11 way inhibiting you if you want to go any lower, it is
 12 just I am not going to pay for it".
 13 You have to see why people are writing these
 14 letters, it's to calculate how much money is to be paid.
 15 So when one says: oh, well, why didn't Mr Matthews write
 16 saying "And by the way if you want, you can carry on
 17 pricing at 3.29, but you will suffer a loss of £2". In
 18 a commercial setting there is absolutely no reason for
 19 him to say that. What he is actually interested in
 20 defining is how much he is prepared to pay, and that's
 21 what you extract from the letter. What you can't
 22 extract from the letter is that there is a requirement
 23 to keep in a fixed relationship Dorchester and Richmond.
 24 In fact, it shows quite the opposite, because the
 25 fact that Dorchester was moving up, Morrisons were in

1 fact perfectly entitled, if you hadn't written to them,
 2 to say, "We want to keep earning the bonus and we are
 3 going to keep Richmond at £3.29". They were perfectly
 4 entitled to do that, and still expect the bonus. "What
 5 it's making clear is we no longer have a need, because
 6 it's costing us a fortune and because we are trying to
 7 keep a competitive position, our competitive position is
 8 satisfied at 3.34."
 9 **DR SCOTT:** We can put this to Mr Matthews, but it would have
 10 been more straightforward to say, "We are intending to
 11 reduce the additional bonus, we would like to agree
 12 a date for doing it, and this is the terms". Instead,
 13 he puts it in rather different terms, which is
 14 "expecting a move to 3.34, 3.35".
 15 **MR HOWARD:** And to which the answer is: so what, frankly?
 16 All that he is saying is -- that's the point -- is
 17 "I expect you are going to move the price up because
 18 that's your margin, and that's the bonus I am paying".
 19 It's just recognising what Morrisons are trying to
 20 achieve. It's not, we would say, dictating to Morrisons
 21 what they must do, it's simply showing -- it's coming
 22 from the other end -- what we are prepared to do and
 23 what the consequence is.
 24 **THE CHAIRMAN:** Let's save any further debate on this,
 25 I think, until what we have heard what Mr Matthews says.

13

1 **MR HOWARD:** Yes.
 2 The point is that the context of this type of letter
 3 is that the reference to specific price points makes
 4 perfect commercial sense because it's in the context of
 5 what the level of bonus is going to be. What one has to
 6 get clear is what it's not. You have to remember, why
 7 are we actually having this debate about fixed and
 8 maxima? I think it's quite important to come back to:
 9 where does it fit in? It fits into the case in two
 10 respects, and when you look at this correspondence it is
 11 entirely contrary to what the OFT wants to say.
 12 The argument about fixed is that where Imperial puts
 13 up its price, then there is an obligation on the
 14 retailer to put up the price of Gallaher in order to
 15 maintain that fixed relationship. Sorry, I've got it
 16 wrong, it's Gallaher putting up the price, and the
 17 reason they want to say it's fixed is because if it's
 18 maxima, if Gallaher put up their price, that has no --
 19 there would be no obligation, on their case, for the
 20 retailer to act. Equally, when Imperial puts the price
 21 down, they want to say there is an obligation to put
 22 Gallaher's price down.
 23 So that is why you are looking at this. It's in
 24 order to support those arguments, the fixed point, that
 25 it feeds through to that element.

14

1 **DR SCOTT:** If you read this paragraph, it starts with:
 2 "You are probably aware that the broad marketplace
 3 has moved from 3.28, 3.29 to 3.34, 3.35 on Dorchester
 4 Kingsize and Dorchester Superkings."
 5 In other words, Gallaher are going up.
 6 "Our strategy is parity with Dorchester. In the
 7 light of this we are moving Richmond and Richmond
 8 Superkings up".
 9 **MR HOWARD:** Yes.
 10 **DR SCOTT:** That seems to be an expectation on the part of
 11 ITL that to keep their strategy at parity with
 12 Dorchester, they want the prices to go up, and therefore
 13 to pay less in bonus.
 14 **MR HOWARD:** You are putting it round a particular way, to
 15 say that whereas the -- it's actually ignoring the
 16 commercial position of what's going on, that they
 17 want -- their competitive position is parity or better.
 18 But they, at this stage, have been paying a ton of money
 19 to get the price down to meet where Dorchester was.
 20 They no longer need to pay so much money, and therefore
 21 that's what is happening, they are altering the level of
 22 the bonus to seek to match Dorchester at a different
 23 level.
 24 **DR SCOTT:** But what they appear to believe is that in order
 25 to get that bonus down, the reality of the situation is

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1 that the retailer wants to retain the margin of 0.1672p,
 2 and that therefore the price needs to be at parity,
 3 reflecting their strategy.
 4 **MR HOWARD:** Yes, exactly. That's exactly what I have been
 5 saying. I am not sure ...
 6 **THE CHAIRMAN:** Let's try and make a bit more progress on the
 7 correspondence.
 8 **MR HOWARD:** You have to remember that, just to conclude,
 9 there is a confusion, I think, in the discussion we are
 10 having between what Imperial -- what is it that Imperial
 11 is expecting to happen, and what is it paying for. The
 12 OFT's case is that where Dorchester's price moved up,
 13 there was an expectation, indeed a requirement, that
 14 Imperial's price moved up. They say that's (a) because
 15 there was a fixed relationship from the agreement and
 16 (b) because the agreement imposed the requirement.
 17 Now, if there was -- if one just thinks about it for
 18 a moment, if that were right, that there was
 19 a requirement, then the price would be moving anyway,
 20 you wouldn't need any of this correspondence about
 21 things going up or down, it would all just be something
 22 that the retailer would be doing.
 23 The next document, 17 and the one after that, 18,
 24 they are further examples. What you see here is he
 25 says:

16

1 "The following changes have been made. Please find
 2 attached a new schedule of costs, bonuses and margins.
 3 The following changes have been made."
 4 So if we take the first one:
 5 "Embassy and Regal: multipack bonuses returned to
 6 ongoing levels from Monday, 15 January. This is in
 7 response to our closest competitor's decision to end the
 8 1999 [whatever it is] price points on B&H Silk Cut from
 9 this date."
 10 Then you have a schedule. Again, all that they are
 11 doing is responding to a situation where they no longer
 12 need to be providing such large bonuses.
 13 An example of a situation that we have in the papers
 14 is at tab 75(a) where Morrisons seek to reduce the price
 15 and to extract a bonus, with you where Imperial don't
 16 feel it's incumbent on them. So at tab 75(a), you
 17 should have an email from Paul Giles to Paul Matthews,
 18 where he says:
 19 "The following prices have been keyed effective
 20 6 January. Please let me have a new cost schedule back
 21 with improved costs maintaining our profit at these
 22 levels."
 23 So you can see prices for Golden Virginia.
 24 "This will take us to a level equal to where the
 25 market seems to be. As you can guess, Old Holborn is

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1 going to the same prices on the same date. There are
 2 some changes on cigarettes but not on any of yours."
 3 At the bottom, in the bolder manuscript, it says:
 4 "Why I will not pay. It's Morrisons' decision to
 5 move, not mine. I want to keep profit in roll-your-own,
 6 but especially in Golden Virginia. The only reason we
 7 are spending money on Drum is because Amber Leaf seems
 8 determined to take value out of the market. I am/we are
 9 not supporting Golden Virginia elsewhere. If there is
 10 a market rate, your competitors are funding it. I don't
 11 just allow Morrison to dictate my investment. I have
 12 been generous."
 13 So there you have an example of where Morrisons are
 14 trying to extract money because they want to reduce the
 15 price, and the response is: well, we paid you enough
 16 already, we don't think we want to pay you any more.
 17 And they reduced the price because that suited their
 18 commercial position in the light of their benchmark.
 19 Now, can we turn to the position of an Imperial
 20 price increase. As you remember, Imperial price
 21 increase is what has been described as the central plank
 22 in the OFT's case. For this purpose, the fixed/maxima
 23 debate doesn't matter, because they say in either case
 24 compliance would require Morrisons to move the Gallaher
 25 price up where Imperial is moving its price up.

18

1 Now, it's clear, we say, from the agreements and the
 2 practice that Imperial did not require Morrisons and
 3 Morrisons did not understand there any requirement to
 4 increase the price of a Gallaher brand following
 5 an increase in the wholesale price of ITL.
 6 Now, let's just have -- you will hear the
 7 witnesses -- a look at some of the correspondence that
 8 is in the file. If you would, please turn to tab 19.
 9 This is a letter where it says:
 10 "You may remember that in my recent note [it's after
 11 the MPI] about Richmond I said that Richmond brands were
 12 not going up in the MPI. This is not strictly true as
 13 the cost prices are going up, however I do want to hold
 14 the shelf prices of all Richmond packings in their
 15 current levels."
 16 So they pay an increased margin, that's what is
 17 happening, they were at a current shelf price of 3.34
 18 and the bonus goes up as a result of holding this. You
 19 see that at the bottom:
 20 "An additional MPI and a bonus of £2.13 should be
 21 claimed against the above packings. Could you let me
 22 know on what date you are proposing to increase your
 23 shelf prices."
 24 That's, I think, relating to other products. It
 25 doesn't really matter. The point is: why is this letter

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1 being written if the position is you can have an MPI and
 2 you can be satisfied that the retailer is required to
 3 put up the price of the competitor? The reason you are
 4 spending a small fortune holding Richmond down is
 5 because Gallaher are holding down Dorchester and you
 6 need to respond.
 7 Tab 26, an example of a Budget increase. A new
 8 schedule of costs. The document is effective from
 9 19 March. The date you have decided to implement the
 10 Chancellor's Budget increase supersedes the last
 11 schedule. Then explains:
 12 "Richmond is going to be hold necessitating an
 13 increased bonus."
 14 That's at paragraphs 1 and 2. The third paragraph:
 15 "Drum ... to be at parity with Amber Leaf: a shelf
 16 prices of 196p. This represents a 10p reduction per
 17 SKU, necessitating an additional bonus of [redacted] per
 18 outer", and then also trying to get parity on other
 19 things paying for that.
 20 So again come back to what we are focusing on, they
 21 have a Budget causing price increases, but their
 22 competitor activity we see, it's not explicitly stated
 23 about Dorchester but that's clearly what's happening,
 24 and we can see that about Amber Leaf, is causing them to
 25 spend a lot of money to say "Well, I won't pass on the

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1 increase to you, I'll pass you a bonus" and the purpose
 2 of that is to feed through to lower prices, so entirely
 3 inconsistent with the OFT's case.
 4 Tab 41, {D17/41}, again it's very clear you can see
 5 what's happened, that they are having to respond to
 6 Gallaher, so they have an MPI. Then they say in the
 7 second paragraph:
 8 "We are looking to hold all Superkings brands at
 9 their current prices through the MPI. We are looking at
 10 holding them. Of course, if the market price for
 11 Sterling moves up, we would wish to do the same.
 12 However, with Sterling only just about to be launched
 13 into your business, you believe it's unlikely there
 14 would be any upward move so soon."
 15 So at this stage they are regarding Sterling as
 16 their competitor and because Sterling's price is being
 17 kept down, they are having to pay large sums of money to
 18 keep their brands down.
 19 Then the rest of it is dealing with forward
 20 purchasing, which I don't think is probably particularly
 21 important.
 22 Tab 43, {D17/43}, again this is an interesting
 23 letter showing actually what happens in these
 24 relationships, on 13 August you can see in the second
 25 paragraph:

21

1 "Morrisons have joined [I am not sure, I am afraid
 2 what the MRG chorus is, I don't know if anyone else
 3 knows] and are looking to reduce their costs through
 4 increased supplier contribution."
 5 So in other words, they are trying to get the
 6 supplier to cough up. Typically they have been quite
 7 upfront, they are expecting a pragmatic response. The
 8 bottom line is they want an additional [redacted]
 9 investment in pricing -- sorry, I won't read it out, and
 10 a further so much on the trading agreement.
 11 **THE CHAIRMAN:** Sorry, what are you reading?
 12 **MR HOWARD:** Sorry, 42.
 13 Perhaps you can read it. I was just reading the
 14 first bit. What you also see here a bit further on
 15 after the middle box in the paragraphs 1 and 2 is that
 16 in paragraph 1, see what they are saying:
 17 "An additional sum of money on all Superkings brands
 18 which are", I'll just summarise it. Those are very
 19 important because they want to break Gallaher's
 20 stranglehold on space and position; in other words, on
 21 that particular brand, this is a competitive war.
 22 Similarly, the next paragraph, the very last
 23 paragraph, you can see questioning whether there is any
 24 money left in the trade marketing pot.
 25 Then if you go to tab 57, {D17/57}, absolutely

22

1 clear, they publish our post Budget price lists. The
 2 first paragraph, they set out the increases in tax and
 3 what those literally mean. Then they say:
 4 "To reflect these, we have increased all of our
 5 brands", and so on. "The only exceptions in response to
 6 competitor activity and existing price marked packs are
 7 as follows."
 8 You then see they are going to hold down the price
 9 of Richmond and Superkings and Drum and so on, and pay
 10 bonuses. In other words, Imperial are going to absorb
 11 all or part of the cost of the tax increase in order to
 12 achieve a competitive position. Of course, all of this
 13 is completely nonsensical if what you have is
 14 an arrangement whereby your competitor's brands, because
 15 you have put up your price, are required to be put up.
 16 Tab 63 {D17/63} is an interesting one, because what
 17 happened here -- this is August 2002 -- there was
 18 a Gallaher MPI on 25 June, initially we know that
 19 Imperial decided not to have an MPI, then they had one
 20 on 2 September. But what they decide to do when they
 21 actually introduce their MPI is that they are going to
 22 change the differentials; in other words, they have
 23 an MPI of a different amount so that the effect of this
 24 is you have, in the summer of 2002, MPIs at quite
 25 different times and of different amounts. So you see on

23

1 page 134 at the bottom:
 2 "As you will see from our new price list, the RSP
 3 [recommended selling price] differentials have narrowed,
 4 specifically Embassy from minus 3 to minus 2", and so
 5 on.
 6 Of course, there is absolutely no need to do this on
 7 the OFT's case, because whenever you put up your price,
 8 the Gallaher price has to be put up. What's the point
 9 of this? You will notice that the OFT, this sort of
 10 correspondence, is just ignored. No doubt Mr Matthews
 11 will be asked questions about it, and so will
 12 Mr Eastwood, and some light will be shed on how this is
 13 supposed to support the case.
 14 Tab 68 {D17/68} is a letter which is particularly
 15 relied on by the Office of Fair Trading, by Mr Lasok in
 16 his submissions, it's 4 October 2002. You can see he
 17 says:
 18 "As per yesterday's conversation [it's a message for
 19 Paul Giles of Morrisons from Paul Matthews].
 20 "It looks like there is going to be some upward
 21 movement at the bottom end of the market at last.
 22 "I would be grateful if you could make the following
 23 moves: Richmond from 3.54 to 3.59 which will mean
 24 a 213p/thousand reduction in our contribution."
 25 A similar point for other Richmond brands.

24

1 "Wouldn't it be good if Mayfair and Dorchester
 2 followed us?"
 3 Then something about the multipacks. And then:
 4 "In the meantime I'll ask Graham Plummer to update
 5 the current schedule."
 6 What is going on here, you have an end of the
 7 market, the ultra low price, where a price war has been
 8 going on, Imperial for its part has decided, because it
 9 believes that generally there will be upward movement,
 10 it's had enough and it's moving. In other words, it's
 11 giving up subsidising to the degree it has.
 12 It then says:
 13 "Wouldn't it be good if Mayfair and Dorchester
 14 followed us?"
 15 In other words, I'm hoping they follow us because
 16 this will get us out of the this spiral of price
 17 cutting, but I don't have a requirement on you,
 18 Mr Retailer, to do something independently. He is just
 19 saying, you know, we hope we are getting out of this
 20 trend which is where we can't make any money because we
 21 are price cutting so much, and all it's saying is, if
 22 they follow us, that will be good.
 23 Similarly at tab 69, he is confirming plans for
 24 Richmond multipack, and in the next paragraph, after the
 25 first sentence:

25

1 "From circa early November we will be moving to
 2 plain stock and in another attempt to move this critical
 3 sector of the business upward I would like you to adopt
 4 the shelf prices of [whatever it is], your cash margins
 5 will be maintained through reductions of [so much]."
 6 So what he is saying "I am no longer prepared to pay
 7 as much to keep the price down, and I hope that the
 8 market generally at this end is going to move up".
 9 I suspect if you look in the files of manufacturers
 10 of practically every single product when there are price
 11 wars where they seek to compete, they will be saying "We
 12 can't do it any more, we are moving our price up and we
 13 hope the market is going to move up. If it doesn't, you
 14 get sucked back down into the spiral. The fact that
 15 Imperial from time to time is saying "I want to get out
 16 of the spiral" is nothing, as it were, anticompetitive,
 17 that's just the reality, that they need to make money,
 18 it's not a charity that they are running.
 19 The reason I've spent a little bit of time on this
 20 is that this central plank of the case that somehow
 21 there is some requirement or expectation or anything of
 22 the sort relating to the situation where Imperial puts
 23 up its prices is entirely contradicted by what you
 24 actually see in the documents. We haven't seen a single
 25 document here where Imperial are saying "I've put up my

26

1 price, why haven't you put up the price of Gallaher?"
 2 What you see is entirely the opposite, which is they
 3 want to put up prices but they feel restrained and
 4 therefore they actually subsidise a holding of price
 5 because they are facing competition.
 6 So that's Imperial price increases. If we turn our
 7 attention to a Gallaher price increase, what's being
 8 alleged here is that Gallaher puts its wholesale price
 9 and/or the selling price either as a result of
 10 a Gallaher recommendation or retailer action and nothing
 11 is done by Imperial. What one has to consider is: what
 12 then?
 13 The OFT's case for this purpose does require you to
 14 find two things: one, that the parities were fixed,
 15 because if they were not fixed, if they are maxima, then
 16 all that happens if Gallaher's price goes up is that the
 17 differentials widen, so there is nothing wrong with
 18 that.
 19 Secondly, you have to find that the agreement
 20 operated in such a way, or there was a practice such
 21 that there was a requirement to move the price of
 22 Imperial up so as to maintain this alleged fixed
 23 differential. The OFT's case, frankly, is wrong on both
 24 counts. I've already addressed you on the fixed/maxima
 25 point. I also pointed out to you the express provision

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1 which is set out in agreement number 2 which actually
 2 contemplates movements upwards in prices where the bonus
 3 decreases.
 4 If we look at the correspondence, to see actually
 5 what that shows, again we would respectfully say it all
 6 goes the other way, and so the documents relied on by
 7 the Office of Fair Trading, the first one is the letter
 8 at tab 9, this is cited both in the decision and in the
 9 skeleton. You see:
 10 "Price Movements, L&B JPS Brands.
 11 "I understand that Mayfair brands are moving up from
 12 Monday, 2 October. I believe this is a general increase
 13 in the multiple retailers. As discussed, could you
 14 increase the shelf price of L&B and JPS from 3.60 to
 15 3.65 from that date. This will mean a removal of the
 16 additional retro bonuses used to achieve the lower shelf
 17 prices. As you are aware, your competitor's prices have
 18 been a little higher at 3.63, but they will also be
 19 moving to 3.65.
 20 "We have been funding the 100 and 200 multipack
 21 positions. If you move these up pro rata, this will
 22 also mean a removal of the additional retro bonuses used
 23 to achieve the lower shelf prices."
 24 Then he refers to Dorchester moving from 3.38 down
 25 to 3.29. Let's leave that separately. What I am

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1 focusing on is the Gallaher price increase. The price
 2 increase that has taken place in Mayfair simply provokes
 3 Imperial to then withdraw part of their margin, but what
 4 is perfectly clear from this letter is that there is no
 5 obligation on, no requirement on Morrisons to move the
 6 price of Imperial in order to achieve the parity. In
 7 other words, assume the letter is not written. Are
 8 Morrisons required to move the price up because Mayfair
 9 has moved up? Answer: self-evidently not. If you ask
 10 yourself: what would Morrisons do absent this letter?
 11 They would have actually been perfectly happy to keep
 12 the price -- well, they would have had two choices.
 13 They could have kept the price down and took the money
 14 from Imperial, or they could have put the price of
 15 Imperial up at their discretion and still took the money
 16 from Imperial. What Imperial is saying is, it goes back
 17 to the point we discussed earlier, "I do not want to
 18 carry on paying you all that money now that Mayfair has
 19 moved up with which I am trying to be competitive. I am
 20 still paying you money, it's just I don't want to pay
 21 you as much".

22 You have to come back to the case, there is
 23 a Gallaher price increase, was there some requirement
 24 under the P&D agreement, to move the price of Imperial?
 25 The answer is plainly not. This is asking them, telling

29

1 them that they are not going to get as much bonus any
 2 more and Imperial is perfectly entitled to withdraw its
 3 bonus.
 4 That's basically what is happening, a withdrawal of
 5 the bonus. You remember there has been evidence that
 6 these bonuses, one of the things that you can see from
 7 all of this, the whole context of these bonuses is
 8 complicated because there are a lot of different bonuses
 9 being paid, and you have not only the ongoing ones, you
 10 have the tactical ones. Actually, what does happen in
 11 reality is that the retailers -- I mean, there is
 12 a confrontational relationship with a lot of these
 13 retailers, and there are instances where they are
 14 claiming more than Imperial thinks they are entitled to,
 15 and so they are watching each other like hawks, and
 16 partly I think it's because the margins are so low.
 17 **THE CHAIRMAN:** Sorry, whose margins are so low?
 18 **MR HOWARD:** The margins of the retailers are low. The
 19 margins I think of the cigarette companies are also in
 20 fact low.
 21 **THE CHAIRMAN:** Well, we don't know what their margins are.
 22 **MR HOWARD:** I think there is actually evidence about it, but
 23 if I am wrong, I'll check that, but I think we actually
 24 do know that the margins -- you have to actually see it,
 25 because the tax element of -- I think it's actually in

30

1 Mr Ridyard's evidence, so I'll show you that at
 2 an appropriate time. Without even looking at that, you
 3 can actually see the margins are low, in that the amount
 4 of money that is available both to the retailers and to
 5 the cigarette manufacturers is pretty low, because so
 6 much of the price that's being sold is tax.

7 I think I am getting slightly distracted, in this
 8 sense: we will come back to the question of what are the
 9 margins for the manufacturers, but the margins for the
 10 retailers, there is a lot of evidence you have already
 11 seen, that the margins on cigarettes are low, both in
 12 actual terms and compared to other products that they
 13 are selling. I think the evidence is that for general
 14 grocery items it's something like 25 per cent, and here
 15 you are at somewhere between 5 and 10 per cent on
 16 cigarettes.

17 So what one finds is, these bonuses become,
 18 particularly these tactical bonuses, which are much more
 19 significant in money terms, that's one of the things you
 20 also have to keep in your minds, that these tactical
 21 bonuses are very large indeed in comparison with the
 22 ongoing bonuses. That's where --

23 **THE CHAIRMAN:** Per pack?

24 **MR HOWARD:** Yes, but also in cash terms, in actual what is
 25 being paid to, say, Morrisons on an annual basis

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1 under -- as a result of these -- of the bonuses, is very
 2 significant compared to what is being paid on the --
 3 under the trading agreement.

4 **DR SCOTT:** I don't know whether we are allowed to talk the
 5 actual numbers because they are in the red box, but if
 6 you take the bottom of page 43, we can see the
 7 differential between the ongoing bonus there and the
 8 additional bonus, and if we turn the page, we can see
 9 other examples of that. What you are suggesting to us
 10 is that if those amounts are over the course of a year
 11 to be more significant, then the additional bonus has to
 12 be being paid for quite a long time, because the ongoing
 13 bonus is being presumably paid on an ongoing basis
 14 through the year.

15 **MR HOWARD:** Yes.

16 **DR SCOTT:** So you are suggesting that much of the time the
 17 tactical bonus is being paid; is that right?

18 **MR HOWARD:** Yes, that's right, they are, on different things
 19 at different -- but --

20 **DR SCOTT:** No, what you said to us earlier on was that of
 21 the money being paid as bonuses, the --

22 **MR HOWARD:** Let me just show you the documents, because this
 23 really isn't controversial. It's useful it's come out
 24 because if there is any doubt about it, look at tab 23
 25 as an example. If you go to page 198, at tab 23,

32

1 {D17/23/198}. Do you have that? You see the review of
 2 the financial year, October to 30 September 01, do you
 3 see that? If you look, ongoing dealing is nearly half
 4 a million pounds. The trading agreement is just under
 5 100. If you look down at the notes, "ongoing dealing"
 6 includes all Richmond support post October 2001. Then
 7 what is the trading agreement is described as
 8 annualised. Of course the trading agreement sum is
 9 a payment, as I've already explained to you, which is
 10 actually achieved for being below RRP as well as being
 11 in relation to the differentials. This is a consistent
 12 theme, that the sums of money which are being paid to
 13 these retailers -- obviously one can look at it in each
 14 one -- are ...
 15 **DR SCOTT:** So ongoing, on page 198, has a different meaning
 16 to ongoing --
 17 **MR HOWARD:** Yes. Well, ongoing dealing there is relating to
 18 promotional activity. It's what is additional
 19 promotional activity, as I understand it.
 20 **THE CHAIRMAN:** Tactical bonuses, as we have been calling
 21 them?
 22 **MR HOWARD:** Yes. The reason the position is slightly more
 23 complicated in Morrisons is because the tactical bonuses
 24 get paid in a different way to in other retailers, in
 25 that in Morrisons it all gets wrapped up into the

1 off-invoice bonus, I don't think they separately pay it
 2 as a retro bonus, whereas elsewhere you see it
 3 separately being paid as a retro. I think that's right.
 4 No, in fact Mr Brealey points out sometimes they do
 5 set it out as a column on those price sheets as a retro
 6 bonus. So I think that is the position.
 7 But ongoing dealing you can see from the footnote
 8 what I am saying is right, that it's the Richmond --
 9 it's the support which you are providing through
 10 tactical bonuses.
 11 But the point is, that we were looking at in the
 12 letter back at tab 9, is that the OFT relies on the
 13 first paragraph that we were looking at, which is where
 14 there has been an upward movement in price, somehow to
 15 say that this shows that there is some requirement, as
 16 it were, through the P&Ds that the price should be moved
 17 up, whereas this is why you have to look at what is
 18 happening in the context of all this, the context is
 19 they have been paying a large bonus to get the price
 20 down, they see their competitors have moved up, so they
 21 are withdrawing part of their bonus.
 22 If the OFT's case were right, firstly you would
 23 never have paid the first bonus to get your price down,
 24 and secondly you would never have any need to have this
 25 letter saying "Now I am withdrawing the bonus". The

1 whole thing is in a world of unreality.
 2 Then I was going to show you an example of this
 3 situation where there is a dispute, and that's
 4 a problem. What I think I was saying to you a moment
 5 ago is these are all quite complicated, all these
 6 different financial arrangements, and you can see the
 7 retailers, they price something at 3.29, Richmond, you
 8 may say to them "after the end of May I am withdrawing
 9 my bonus so you should be going back to your previous
 10 price if you want to maintain your margin."
 11 What sometimes happens is the retailer keeps it at
 12 3.29 and says "I still want the bonus" and that gives
 13 rise obviously to differences, and you can see that at
 14 tab 61, {D17/61}, which is Imperial. Again we don't
 15 need to get stuck into the detail, but you can see
 16 Mr Matthews writes to Mr Giles saying he has some
 17 queries concerning retro summaries which he faxed
 18 through. Then you can see there has been a claim for
 19 Drum retros from 1 April to 21 April, which actually
 20 bears out that I was wrong in my explanation and
 21 Mr Brealey was right, that they do pay them retros for
 22 the promotional support. There is a dispute, you can
 23 see, about the volume split.
 24 Then Superkings, which was on promotion from
 25 22 April to 23 June, or that's their claim, and he says:

1 "I was quite sure I agreed to fund the 5p retro to
 2 achieve the shelf price of 3.99 until 13 May."
 3 So he is saying it should have been 13 May,
 4 Morrisons are claiming until 23 June, and you can see in
 5 terms of what we are talking about these can be
 6 significant sums of money, and because the margins are
 7 low, for instance for the retailers, it can make a very
 8 significant difference to their margin if they priced
 9 thinking they are entitled to a bonus when they are not.
 10 This sort of dispute also shows why it's so
 11 important and not at all surprising that in the
 12 correspondence, again that letter that we were looking
 13 at this morning, why do you refer to specific price
 14 points? Because if you don't, it gives rise to
 15 disputes. If you simply say they paid a 5p bonus to get
 16 the price down to 3.29, if you don't tell them what the
 17 consequence is of withdrawing the bonus, then there is
 18 an area, at least you can see, which is fertile ground
 19 for disputes.
 20 Then if you go to tab 58, {D17/58}, again we are
 21 focusing on what is the effect of a Gallaher price
 22 increase. This is the part of the episode where there
 23 was a Gallaher price increase but Imperial held the
 24 price. You can see that in the middle of the page:
 25 "As you are already aware, one of our competitors

1 has already announced a price increase effective
2 25 June. This means that the differentials that exist
3 naturally between our brands and our competitors' will
4 widen and I would expect to see the following examples
5 from the date you implement our competitors' price
6 increase."

7 The OFT says this letter supports its case because,
8 they say, absent this letter, the retailer would have
9 assumed that its parity and differential requirements
10 continued at the previously stated levels. The point
11 that their analysis is missing is this: Imperial's case
12 is that the differentials are maxima, they are the way
13 everybody understands them, they are at least such and
14 such.

15 Now, what Imperial was saying here, because Gallaher
16 has increased the prices and we are not, and what they
17 are saying is "we don't want you to use the cloak of
18 Gallaher's price increase as a basis to increase our
19 prices, albeit you could do it and maintain the
20 differential, so I am actually widening the
21 differential".

22 If you say: what would have happened absent this
23 letter, was there a requirement to increase Imperial's
24 price, plainly there was no requirement, but that
25 doesn't mean that the retailer might not have sought to

1 do it and still claim the bonus. So what Imperial is
2 trying to say is "I want a wider differential", and that
3 is explained by Mr Matthews as well, and you will hear
4 from him.

5 **THE CHAIRMAN:** So you are saying that there was a bonus
6 underlying this letter?

7 **DR SCOTT:** No, there didn't need to be because they hadn't
8 done an MPI.

9 **THE CHAIRMAN:** No, but I thought you just said a moment
10 ago ...

11 **MR HOWARD:** It's the ongoing bonus which is the subject of
12 the trading agreement.

13 **THE CHAIRMAN:** Oh, I see, yes.

14 **MR HOWARD:** Insofar as what they are trying to do is
15 incentivise them to have differentials, what this is
16 saying is "we want to widen the differentials", that's
17 all it's saying.

18 **DR SCOTT:** For reasons that you think are probably obscure,
19 they did bother to have a trading agreement. The other
20 side of the coin, that you are saying, you are saying
21 all this correspondence shows that there wasn't
22 a requirement in the trading agreement.

23 **MR HOWARD:** Yes.

24 **DR SCOTT:** But in fact there was a trading agreement.

25 **MR HOWARD:** Yes.

1 **DR SCOTT:** Now, the fact that there was a trading agreement,
2 whether they were fixed or maxima or P&Ds, let's not
3 worry for the moment, but there were some P&Ds around.
4 What this letter looks like in the context of there
5 being a trading agreement was: we had a schedule of
6 P&Ds, A, Gallaher have moved, we don't want to move, so
7 we have a new set of P&Ds, which if we are in the
8 trading agreement world is where we would like to be and
9 as I understand it, in strategic terms is where Imperial
10 want to be; is that right?

11 **MR HOWARD:** Yes.

12 **DR SCOTT:** So I am not quite sure why this letter counts
13 either way, really. In OFT's case they see it as
14 a natural consequence of there being a trading
15 agreement.

16 **MR HOWARD:** Yes.

17 **DR SCOTT:** In your case, you see it as a natural consequence
18 of the trading agreement not containing a requirement.

19 **MR HOWARD:** In my submission, you are entirely right, and
20 that's what I said to you in opening about the June
21 episode. The OFT relies on it to say: this shows that
22 if you hadn't written this letter, there was
23 a requirement, and that the prices of Imperial would
24 automatically go up as a result. We say that's plainly
25 not what is happening, that what -- if you don't write

1 the letter, the retailer might choose to put up your
2 price and still say, insofar as he is interested in it,
3 "I am complying with the differentials". What the
4 letter is intended to say is, as Dr Scott, you said to
5 me, it's intended to widen the differentials, but it's
6 not inconsistent with the fact that if you don't write
7 the letter, there is no requirement to put up the price.
8 What it's actually trying to do is just simply widen the
9 differentials.

10 So it doesn't -- I would agree with you -- shed
11 a great deal of light on the position other than it is
12 entirely consistent with all the correspondence I've
13 shown you as to actually the nature of the arrangements.
14 But it's the OFT in particular that say this episode --
15 it's in the decision at paragraph 6.790 -- confirms
16 their case, and it simply doesn't. If one is going to
17 analyse it, it actually is inconsistent.

18 It's just convenient at this moment to interpose, so
19 we have looked so far at the supposition of the OFT's
20 case that if Imperial puts up its price, the retailer
21 was required to put up the price of Gallaher -- I hope
22 I have demonstrated that that plainly isn't the case --
23 then looked at the situation where Gallaher puts up its
24 price and the supposition that Imperial expects its
25 price to go up; and again that's not the case.

1 You feed into that, just before we look at the other
 2 two situations: does it make any economic sense to think
 3 that the retailers were obliging themselves, because
 4 Imperial put up its price or Gallaher put up its price,
 5 to move up the price of the rival brands? Now, this is
 6 partly where the economic analysis fits in, that it
 7 doesn't make any economic sense at all, that the sums of
 8 money which the retailers are standing to make are not
 9 sufficient to compensate them for the potential losses
 10 they suffer, and if you particularly think of Morrisons,
 11 Morrisons are very concerned about benchmarking
 12 themselves against their competitors. If they are put
 13 in a position where they are obliged to move Gallaher's
 14 prices up, or Imperial's prices up, where the wholesale
 15 price of those products hasn't been moved up, then it
 16 would be obvious to them, "Hang on a minute, I will be
 17 disadvantaging myself in the market, that would not fit
 18 with my strategy". There is just no way that, for the
 19 sums of money at issue here, they would have agreed to
 20 that. That's set out in table 2 of Mr Ridyard's second
 21 report.

22 **DR SCOTT:** That seems to be so, unless, as we have seen in
 23 at least one of the letters you have shown us before,
 24 they received some comfort from ITL that their
 25 competitors were going up as well.

1 **MR HOWARD:** Yes, but you have to remember, again that's why
 2 you have to be quite careful as to -- there that's
 3 a letter, firstly, where ITL is saying "We understand
 4 that [that was, I think, talking about Gallaher's price
 5 going up] in the market they are going up and we are
 6 therefore withdrawing our bonus". But you have to
 7 remember the case that's run against by the OFT is where
 8 the Gallaher price has gone up, the retailer ipso facto
 9 moves up the price of Imperial, and -- of course he may
 10 be perfectly content to do it when he knows or believes
 11 actually that the market is moving up, but the OFT's
 12 case is he's required to do that irrespective of that
 13 position. That's the important point.

14 Now, Imperial price decreases, one can deal with
 15 that pretty shortly, and I don't think I need to turn up
 16 the documents. You will remember, for instance, the
 17 story about Richmond coming down, them spending 10p per
 18 pack of Richmond to get its price down. Just ask
 19 yourselves as a matter of common sense: did Imperial
 20 require the retailers -- when they were throwing all
 21 this money at Richmond, in order to make Richmond
 22 competitive -- to reduce the price of their competitors'
 23 brands? It's just completely nonsensical. That
 24 argument is suggesting that there is a big black hole
 25 over there where Imperial likes throwing its money.

1 The OFT's case does actually require one to apply
 2 some commercial sense to it. We have been interested,
 3 so far, in relation to a lot of the points to find that
 4 none of the witnesses so far have been asked anything to
 5 do with this, and we will see whether Mr Matthews is
 6 asked whether he was spending Imperial's money in
 7 a situation where he expected to achieve no advantage at
 8 all.

9 Now, that takes me to Gallaher's price decreases,
 10 and this is important in relation to the suggestion that
 11 Morrisons were restricted from favouring Gallaher. This
 12 is part of the point we discussed yesterday, that the
 13 trading agreements expressly envisaged that Morrisons
 14 would reduce the prices of competing products as
 15 a result of Gallaher taking action, or it could be BAT
 16 for that matter. How do we know that? Because the
 17 opportunity to respond clauses don't make any sense at
 18 all if you are not contemplating that they would do
 19 that.

20 Now, a number of the documents we can look at show
 21 this taking place. Tab 9, {D17/9}, one we looked at
 22 before, the second part of the letter, you will see that
 23 Dorchester will be moving from next Monday down from
 24 3.38 to 3.29. Mr Matthews says:

25 "You believe that it's a temporary move. Following

1 the announcement to the trade last Monday, the RRP of
 2 Richmond has been reduced by 10p. Our strategy is
 3 parity. As agreed, I am willing to maintain your cash
 4 margin at the same shelf price as Dorchester. Please
 5 reduce the brands on the same date that Dorchester goes
 6 down."

7 What you see is that they end up spending, if you go
 8 to the second page, they are already heavily bonusing at
 9 3.39, because there was an additional bonus of £3.80,
 10 and to get down to £3.29 they have to pay an additional
 11 £2. Plainly none of this makes any sense at all on the
 12 OFT's case. The OFT's case is the retailer has bound
 13 himself to reduce the price of Richmond in order to
 14 maintain parity. What's more, they are so nervous about
 15 the position and so uncertain that they also say -- you
 16 see this in the paragraph on the second page:

17 "Justin, I have assumed a shelf price of 3.29, but
 18 as you are currently 3.38 on Dorchester ... you may be
 19 selling it at 3.28 ... If this were the case ..."

20 "I want to go to that and I'll pay you even more
 21 money"; in other words "I am prepared to spend even more
 22 money to match my competitor".

23 Tab 50, {D17/50} again Imperial cuts the price. If
 24 you see the whole letter, they are cutting the price of
 25 some cigars. In other words, they are increasing the

1 bonus on them. Then Cafe Creme they say:
 2 "During our conversation we also agreed to bring
 3 down the price of Cafe Creme and Cafe Creme Mild
 4 multipacks to be in line with Hamlet with a shelf price
 5 of £13.10 and the schedule of costs has been amended in
 6 accordance with these changes."
 7 In other words "I am going to pay you more money and
 8 that's what the schedule of costs has, it's on the next
 9 page, it increases the amount of money they get.
 10 The OFT cites document 53 as somehow being
 11 supportive of their case. Again, properly read, it's
 12 entirely inconsistent. The email at the bottom is
 13 talking about the movement in the price of Amber Leaf,
 14 but you can pick it up, really, the important part, in
 15 the reply:
 16 "Ref our earlier conversation, yes, I would like to
 17 match Amber Leaf across all the SKUs. As well as the
 18 move on 12.5, I would like to move to 25 [and so on] and
 19 50. All coming down [so they are moving the price
 20 down]. This will necessitate increases in bonuses of
 21 these sums of money", considerable sums of money.
 22 So they are aware of the fact that Gallaher are
 23 heavily promoting Amber Leaf, and they reacted to it.
 24 So what you see is there is no requirement of the
 25 retailer at all, and what's more, you have a competitive

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1 position.
 2 Tab 59, {D17/59}, again it's a familiar sort of
 3 territory.
 4 "I understand one of our competitors decided to
 5 reduce the RSP of Amber Leaf. Whilst I would prefer to
 6 keep more cash in this important subcategory, I need my
 7 brands to remain competitive."
 8 Just stopping there for a moment, again there is
 9 absolutely nothing wrong with his saying "We would
 10 prefer -- in relation to I think this is roll-your-own,
 11 isn't it -- in this important category to try and make
 12 more money, but we need our brands to remain
 13 competitive, so we are going to respond and react to
 14 what they are doing by shelf price reductions and
 15 increases in bonuses"; in other words "we will fund the
 16 shelf price reduction".
 17 Again, a similar point in relation to Drum Milde and
 18 so on.
 19 Then he says he is not sure why Cafe Creme are out
 20 of line with Hamlet Miniatures, which must have been
 21 held following the Gallaher MPI. So he sees what's
 22 happened is Gallaher had an MPI but obviously unbeknown
 23 to Imperial they seek to steal a march, which of course
 24 they are entitled to do, by holding down the price of
 25 theirs, so then he says, "Uh-oh, if they are doing that,

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1 then I want to get Cafe Creme down to £12.99 and I'll
 2 pay you for it as an increase in the bonus. Again,
 3 could you move Panama 6s to 2.69 because I am going to
 4 pay you for it".
 5 What is wrong, one has to ask, with Imperial paying
 6 to get the price down?
 7 Now, what is said by the OFT about this document, is
 8 they say that this is manipulation of Morrisons' retail
 9 prices through the payment of bonuses and it's
 10 consistent with the existence of the infringing
 11 agreement. That's paragraph 6.804. It's difficult to
 12 understand what the case is that's being made. What do
 13 you mean by "consistent with the existence of
 14 an infringing agreement"? You have to first prove that
 15 there was an infringing agreement. To say manipulation
 16 of the prices, as I think you have heard, and it would
 17 be astonishing if it wasn't the case, when Unilever see
 18 the competing price of the washing liquid at
 19 a particular price, one can be absolutely sure that they
 20 are writing saying "Well, we will pay you,
 21 Mr Supermarket, to get the price of ours down in order
 22 that we can compete". To say that you are not
 23 interested in the selling prices would be very
 24 surprising.
 25 Now, this leads me back to the point that I think

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1 arose just before we broke yesterday, when Madam
 2 Chairman suggested to me that one of the issues that
 3 the Tribunal will have to decide is whether the tactical
 4 bonuses are one of the mechanisms by which the parities
 5 and differentials are maintained or enforced, or whether
 6 they are a manifestation of strong price competition and
 7 brand positioning quite apart from the P&Ds.
 8 As I said earlier this morning, we don't believe
 9 that this is really the issue in the case, in that if
 10 one just analyses it as follows: firstly, we say on the
 11 evidence none of the retailers in fact regarded
 12 themselves as obliged to apply the P&Ds, and we say nor
 13 were they, and that the payments were an incentive. But
 14 more importantly, the agreements always recognised that
 15 they would be entitled to have Gallaher price promotions
 16 or BAT price promotions.
 17 Where Morrisons chose not to follow the P&Ds, and so
 18 Imperial found itself in a less advantageous position,
 19 Imperial was free to seek to induce Morrisons to then
 20 reduce the price of Imperial's products to its
 21 advantage, and that's what you see happening, it's
 22 trying, when it finds it's out of line with where it
 23 wants its selling prices to be, it seeks to pay money to
 24 get to where it wanted to be.
 25 If you are asking the question: when Imperial sought

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1 to pay further monies to Morrisons in order to rules the
 2 shelf price, was it seeking to pursue its strategy of
 3 positioning its products in accordance with the
 4 strategy? The answer is: yes, of course it was. No-one
 5 suggests it wasn't. In other words, generally the
 6 purpose in the tactical bonuses was indeed to achieve
 7 the differential position that accorded with the
 8 strategy. There is nothing sinister or unusual in that.
 9 The fact that it's pursuant to that strategy does not
 10 mean that it is not the manifestation of strong price
 11 competition, and more importantly it doesn't mean that
 12 it is anticompetitive. Indeed, one can't think of
 13 anything that is much more competitive than what we see
 14 in these papers.

15 In other words, there is no dichotomy between
 16 seeking to achieve or maintain the price differentials
 17 and normal competition. Moreover, the payment of the
 18 promotional bonuses is not evidence of some -- and this
 19 is what you have to keep coming back to -- restriction
 20 on Morrisons here to prevent them favouring Gallaher.
 21 You can just test that very simply.

22 The fact that Imperial pays a promotional bonus in
 23 order to achieve a pricing position of its product,
 24 whether at a specific or maximum price it doesn't
 25 matter, which accords with its strategy, doesn't stop

1 the retailer then favouring Gallaher. It just means
 2 that Gallaher, if it then wants to get into a more
 3 favourable position, has to come along and say
 4 "Mr Retailer, take some more money from me". In other
 5 words, competition in action.

6 Now, if Gallaher wants to do that, then it will do
 7 it. If Gallaher decides it's not worth it, it won't.
 8 And the same you see with Imperial. Sometimes it
 9 decides to try and meet Dorchester and sometimes it says
 10 "The game is not worth the candle and I am going to
 11 withdraw my bonus".

12 So the fact that Imperial has a strategy which is to
 13 get its cigarettes competitively priced vis-a-vis
 14 Gallaher is not in contrast to a strong price
 15 competition, it's a manifestation of strong price
 16 competition, and indeed we would suggest when you look
 17 at price promotions you can see the following things.

18 Firstly, it's obvious when Imperial leads a price
 19 promotion, it does not intend the retailer itself to
 20 reduce the price of Gallaher's product, otherwise what's
 21 the point? It of course has the risk that Gallaher will
 22 seek to match it, but that's the risk in any competition
 23 situation, that's what competition is all about. So
 24 when Imperial pays a tactical bonus, it's taking
 25 a competitive position.

1 Secondly, when Gallaher leads, firstly Gallaher
 2 obviously does not intend the retailer, when it puts --
 3 we are not going to hear any evidence from Gallaher, one
 4 can infer Gallaher did not intend when it put down the
 5 price of Dorchester that the retailer would put down the
 6 price of Richmond just because Gallaher had done so. It
 7 knew presumably there was a risk that Imperial would
 8 respond. It no doubt crossed its fingers and said
 9 "I hope they don't", but it always knew there was
 10 a risk.

11 Secondly, Imperial, as you have seen from the
 12 correspondence, obviously did not understand the
 13 retailer must put down its price because Gallaher has
 14 put down its price, otherwise why is it spending a small
 15 fortune on trying to get its prices down? So Imperial
 16 is just responding to a competitive position, and the
 17 tactical promotions are just classic examples of price
 18 competition.

19 What's actually interesting in all of this is that
 20 because the retailers actually know what Imperial's
 21 strategy is, they can actually use that, and they did,
 22 to what Professor Shaffer calls parlaying the prices
 23 down. You have seen it before in his 2007 report,
 24 paragraph 53. Because, as it were, they know the
 25 vulnerability of the manufacturers, they can use it to

1 say "Well, Dorchester is down, that may be something
 2 that they themselves have done, but you know Imperial,
 3 if you want to be competitive, you are going to have to
 4 cough up", and again all of this is things that are
 5 pointing to prices coming down as you would expect in
 6 any price war of the type that we see.

7 It's also clear in the case of these tactical
 8 promotions that what Imperial is seeking to do is to
 9 pass through from the bonus, ie a lower wholesale price,
 10 to a lower selling price. That's the purpose of
 11 actually the way the bonuses are structured. That is
 12 revealing because it's precisely in fact also what the
 13 purpose is from Imperial's perspective of the P&Ds.
 14 They are seeking to incentivise what they perceive to be
 15 the position, which is lower wholesale prices being
 16 reflected in lower selling prices. They know that if in
 17 fact their wholesale prices are not lower, then they
 18 won't actually incentivise through these agreements and
 19 they will have to pay more money, and that's what
 20 happens with the promotional bonuses. When they find
 21 that the retailer is choosing to price them at
 22 a disadvantageous level, their response is: Mr Retailer,
 23 I'll give you some more money.

24 The very fact that Imperial needed to pay tactical
 25 bonuses to remain competitive with Gallaher, we suggest

1 entirely undermines the theory of harm put forward by
 2 the Office of Fair Trading, because if the agreements or
 3 practices that operated in the way that the Office of
 4 Fair Trading suggests, you just never see any of this
 5 correspondence, because the case that the OFT makes is
 6 that the retailer, here Morrisons, is precluded from
 7 favouring Gallaher.
 8 We do suggest that -- and it is really quite
 9 important, this -- the Office of Fair Trading does not
 10 really have an answer to this point. It is interesting,
 11 and again to contrast what Mr Lasok said when he opened
 12 the case with what he actually suggests at any stage to
 13 any of the witnesses what he seeks to extract from the
 14 documents. If you look at Day 5 of the hearing, at
 15 pages 32 to 34, it might be just worth turning that up.
 16 **THE CHAIRMAN:** Is this really a point in the opening of the
 17 Morrisons case? This seems to be rather getting into
 18 more general submissions on the case.
 19 **MR HOWARD:** It is in this sense, we don't need to turn up
 20 that point, but what -- the point that Mr Lasok made was
 21 that the commercial reality, he says, is that -- what he
 22 was looking at was how the opportunity to respond clause
 23 is working, and he says, well, the retailer -- these
 24 were his words, it's likely to be a little bit sticky,
 25 you remember this expression he used, and he may not

1 want to move the price, and somehow the fact that you
 2 are then paying them, somehow they say this fits in.
 3 The point is, the issue that needs to be put to the
 4 witnesses is whether that is actually the case at all,
 5 whether when the bonuses here are being paid to
 6 Mr Eastwood, was it the position where he was a bit
 7 sticky that he was being expected to move the price and
 8 he wasn't prepared to do it unless some money came his
 9 way? When you look at this correspondence, actually
 10 there is not a hint of that sort of situation.
 11 To conclude, I started yesterday by saying what
 12 actually happened in this account, and I took you to
 13 tabs 1 and 96. If you remember, what those show is
 14 a growth in Imperial's market share in Morrisons, and to
 15 respond to the point that Dr Scott asked me, was that,
 16 as it were, like for like growth or was it as a result
 17 of acquisitions? During the period that we are talking
 18 about, there were some acquisitions but they have
 19 nothing to do with the UK market, I think there was some
 20 acquisitions of businesses which are outside. Insofar
 21 as the Philip Morris position was acquired by Imperial,
 22 you can see at tab 96 {D17/96} that the effect of
 23 Philip Morris is broken out, so you can see that the
 24 point I was making is on the like for like basis, the
 25 Philip Morris position takes it even higher.

1 So the fundamental point is that you see what is
 2 actually happening here, which is through what is
 3 actually largely a very keen competitive position as to
 4 price, particularly in this ultra low price area, which
 5 was a particular feature of Morrisons, that Imperial was
 6 able to grow its market share.
 7 The only other point I would remember to refer you
 8 to is the variability data again is entirely
 9 inconsistent with the OFT's case.
 10 **THE CHAIRMAN:** Yes, thank you very much. We will take
 11 a break now and come back at ten to 12.
 12 (11.40 am)
 13 (A short break)
 14 (11.50 am)
 15 **THE CHAIRMAN:** Yes.
 16 **MR HOWARD:** Yes, we call Mr Matthews.
 17 **THE CHAIRMAN:** Yes.
 18 MR PAUL MATTHEWS (sworn)
 19 Examination-in-chief by MR HOWARD
 20 **MR HOWARD:** Mr Matthews, could you just please tell us for
 21 the record your name and address?
 22 **A.** My name is Paul Matthews, my address is [redacted].
 23 **Q.** Thank you. Could you now be, if it's not on the table
 24 in front of you, given core bundle 3, and turn to
 25 tab 42, please. {C3/42}. At tab 42, is that your

1 statement?
 2 **A.** Yes, that is my statement.
 3 **Q.** Are the contents of that true?
 4 **A.** Yes.
 5 **MR HOWARD:** Thank you very much.
 6 **THE CHAIRMAN:** Yes, Mr Williams.
 7 Cross-examination by MR WILLIAMS
 8 **MR WILLIAMS:** Good morning, Mr Matthews.
 9 **A.** Good morning.
 10 **Q.** Have you read the transcript of any of these proceedings
 11 so far, the day-to-day transcript?
 12 **A.** I was given some notes last week for one day, which
 13 I glanced at, yes.
 14 **Q.** Do you remember what day that was or what happened on
 15 that day?
 16 **A.** I think that that was the day that an ex-colleague of
 17 mine, Roger Batty, was at the Tribunal, so I think it
 18 would have been at the beginning of last week, perhaps.
 19 **Q.** You have your statement in front of you?
 20 **A.** I do.
 21 **Q.** Could you also be given annex 17, which is -- do you
 22 know what annex 17 is?
 23 **A.** Erm --
 24 **Q.** It's a file of documents compiled by the OFT in relation
 25 to Morrisons and ITL.

1 A. Yes, yes.
 2 Q. I think it would be useful for you to have both your
 3 statement and that file open.
 4 A. Okay.
 5 Q. Could you turn to tab 85, please. {D17/85}. You are
 6 familiar with this document, I think, it's the
 7 ITL/Morrison's trading agreement which applied from
 8 August 2002?
 9 A. I am familiar with this.
 10 Q. You took over the Morrison's account in September 2000?
 11 A. Yes, that's correct.
 12 Q. So you managed the Morrison's account for the whole
 13 period we are looking at here, more or less?
 14 A. Yes.
 15 Q. You worked with Morrison's both under this trading
 16 agreement and under the previous one?
 17 A. That's correct.
 18 Q. I have been working on the basis that you wrote this
 19 document, effectively.
 20 A. Yes, I did write this document.
 21 Q. We see over the page, actually, that you didn't sign it
 22 at the time, but I don't think there is any significance
 23 in that, I just note that for the Tribunal.
 24 A. I think I did sign it.
 25 Q. Did you?

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1 A. Yes, that's my signature there, signed on behalf of
 2 Imperial Tobacco --
 3 Q. I am sorry, I had not separated that from the other
 4 signature.
 5 A. -- Limited. It doesn't look like a signature, but I can
 6 promise you that is my signature.
 7 Q. So just looking at the first page of the document, we
 8 see under the heading "Payments", there is a certain sum
 9 of money that ITL agreed to pay Morrison's per annum for
 10 the two years of the trading agreement?
 11 A. Yes.
 12 Q. If we turn over the page, you will appreciate I am just
 13 going to focus on the section about pricing at the
 14 moment, do you want to read to yourself just to refresh
 15 your memory the first two paragraphs under "Pricing".
 16 (Pause)
 17 I am just going to break this down into its various
 18 elements at the moment, hopefully in terms which are
 19 uncontroversial. ITL has a pricing strategy which has
 20 two aspects, first the achievement of certain
 21 differentials between ITL and Gallaher brands; and
 22 secondly, the achievement of certain absolute price
 23 levels.
 24 A. Yes.
 25 Q. Under this agreement, you say you are investing in

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1 Morrison's which means you are paying them a bonus to
 2 achieve that strategy, and that's the bonus we have just
 3 seen or some part of it?
 4 A. I am not sure if I am permitted to say this, and
 5 I understand that the pricing element is important, but
 6 I would like to say that the agreement should be
 7 considered in a holistic way in that it covers more than
 8 just pricing. I think I might be wrong, but those
 9 monies we referred to just a moment ago do cover more
 10 than that.
 11 Q. They do, yes.
 12 A. Quite a lot more than that.
 13 Q. Yes, but just to go back to the question I asked you,
 14 and really I was just reading the words under the
 15 heading "Pricing" --
 16 A. Yes.
 17 Q. You have a strategy in relation to pricing and you are
 18 investing in Morrison's, that is paying them a bonus to
 19 achieve your pricing strategy?
 20 A. Yes, there is a pricing strategy, yeah, and there is
 21 a payment for that.
 22 Q. In your witness statement, you talk about ongoing
 23 bonuses and tactical bonuses?
 24 A. Yes.
 25 Q. In that terminology, the bonus paid for these two

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1 elements of the strategy would be ongoing bonuses?
 2 A. I think it's probably worth just -- perhaps you could
 3 ask me that question again, so I am sure.
 4 Q. In your witness statement you talk about ongoing bonuses
 5 and tactical bonuses?
 6 A. Yes.
 7 Q. All I was saying is that I think in that terminology the
 8 bonus that you are paying here would be an ongoing
 9 bonus?
 10 A. Well, it's both, because it covers two different things.
 11 They are two quite separate things, ongoing and tactical
 12 bonuses.
 13 Q. That's right, but I am just saying that when you talk
 14 about an investment in Morrison's --
 15 A. Yeah.
 16 Q. -- I really don't think this is controversial but you
 17 can tell me if I am wrong, I am just trying to get the
 18 terminology right, when in your statement you talk about
 19 ongoing bonuses and tactical bonuses, I am just saying
 20 the investment you are talking about in these two
 21 paragraphs would be an ongoing bonus rather than
 22 a tactical bonus, but please do tell me if that's not
 23 right?
 24 A. (Pause). I mean, the ongoing schedule of costs, bonuses
 25 and margins document could, from time to time, include

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1 the provision of both ongoing and tactical bonuses.
 2 Perhaps I am misreading or misunderstanding the
 3 question.
 4 **Q.** We will come to that in a minute.
 5 **A.** Okay.
 6 **Q.** I think you are right about that. Just focusing on the
 7 bonus paid to maintain differentials, would you describe
 8 that as an ongoing bonus?
 9 **A.** It could be either.
 10 **Q.** We will look at the detail of this in due course. So
 11 focusing on the absolute levels of prices for a minute,
 12 what the agreement says is that you will pay a bonus as
 13 long as Morrisons puts its shelf prices at the levels
 14 stated in the ongoing schedule?
 15 **A.** I think that, again I hope I don't dwell on this point
 16 for too long, but the payment of absolute bonuses or
 17 ongoing bonuses I should say was to reflect the fact
 18 that Morrisons, like many other supermarkets, were
 19 selling tobacco products very cheaply. In the spectrum
 20 of prices, they were towards the bottom, and these
 21 payments were made to recognise and reflect the fact
 22 that Morrisons and other supermarkets made investment in
 23 our brands, and that we too should contribute to that
 24 whilst they continued to remain retailers that offered
 25 our brands at an attractive price.

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1 **Q.** Can we just come back to what the agreement says, I'm
 2 focusing at the moment on the second paragraph, it says:
 3 "Based on the continued achievement of [skip out
 4 differentials for the minute] the shelf prices
 5 highlighted in the ongoing schedule of costs, bonuses
 6 and margins, Imperial will pay all of these bonus
 7 off-invoice subject to the following conditions."
 8 **A.** Right.
 9 **Q.** You can see two points, really. First of all, there is
 10 a reference to off-invoice, which is why I thought this
 11 was a reference to ongoing bonuses rather than tactical
 12 bonuses.
 13 **A.** Right.
 14 **Q.** But the specific point I was making was just that the
 15 words here say that based on continued achievement of
 16 the shelf prices highlighted in the ongoing schedule,
 17 you will pay them a bonus?
 18 **A.** But those shelf prices highlighted in that or any
 19 schedule could be subject to both ongoing and tactical
 20 bonuses because in order to reflect those differentials,
 21 it might require more than an ongoing payment, and I do
 22 think that it's important to separate those two for that
 23 reason.
 24 **Q.** I think we are separating them. At the moment I am just
 25 talking about one of them. I am talking about the

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1 provision this agreement makes for one of them.
 2 **A.** Right.
 3 **Q.** Again, I don't think it's controversial, but you can
 4 tell me if I am wrong. The agreement says:
 5 Based on continued achievement of the shelf prices
 6 highlighted in the ongoing schedule [you] will pay them
 7 a bonus."
 8 So you are paying them a bonus to price at the
 9 levels in the schedule?
 10 **A.** We are paying them the ongoing bonuses for two things,
 11 for firstly -- sorry if I repeat myself again, but for
 12 two things. Firstly, to reflect those prices were below
 13 RRP and secondary to that, to achieve those
 14 differentials. Sorry to dwell on the point, I just
 15 thought it was worth making.
 16 **Q.** But that's really the point I am making to you, that
 17 this agreement doesn't talk about pricing below RRP, it
 18 talks about pricing in accordance with the schedules?
 19 **A.** You are absolutely right about that, and I think that
 20 that's an interesting point because these agreements in
 21 general terms were written by national account managers
 22 and buyers, I hope this isn't the wrong thing to say but
 23 they weren't supposed to be legally binding, they were
 24 framework documents that couldn't be written given every
 25 possible eventuality, but implicit within the trading

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1 relationship as well as the trading agreement was that
 2 Morrisons would continue to support our brands by
 3 selling them beneath RRP.
 4 Whilst it doesn't say that specifically, that was
 5 very much the understanding between ourselves and
 6 between Morrisons.
 7 **Q.** You could have written an agreement saying "We will pay
 8 you a bonus as long as you price below RRP", couldn't
 9 you?
 10 **A.** I could have done that, yes.
 11 **Q.** But you chose not to. You have provided for them to pay
 12 on the basis of the schedule?
 13 **A.** Well, I chose not to do it, I suppose I did choose not
 14 to do it, because at the time of writing it, I think it
 15 was fairly plain to both parties that one of the only
 16 reasons that Morrisons like many other supermarkets was
 17 in the tobacco business was that they were able to
 18 provide cigarette brands cheaply, and I think it would
 19 have been unnecessary to say so, because that was their
 20 raison d'être within the category. If they had sold
 21 brands expensively, there would have been no reason for
 22 people to tear themselves away from their local
 23 newsagent and visit Morrison to buy tobacco products.
 24 **Q.** So why would you pay them a bonus to price below RRP,
 25 then?

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1 **A.** Because in the UK the market structure dictates that
 2 margins are relatively slim and they were made slimmer
 3 still by Morrison, or indeed any of the supermarkets,
 4 electing to sell their brands quite cheaply. So they
 5 might well find themselves working on margins of 1 or
 6 2 per cent, particularly on the cheaper brands. We
 7 recognised that that was within our interests, and
 8 within the interests of our consumers, and we wanted to
 9 recognise and reward that, hence the continued payment
 10 of ongoing bonuses which were quite separate and quite
 11 different from tactical bonuses.
 12 **DR SCOTT:** Just to be clear, then, the margin that you just
 13 mentioned of 1 or 2 per cent is the margin before the
 14 application of your margin support; is that right?
 15 **A.** I'll be very careful what I say, because my memory isn't
 16 as good as it used to be, but even including bonuses on
 17 the cheaper brands, they might well -- some of the
 18 supermarkets worked after payments on 1, 2, 3 per cent,
 19 that wasn't unheard of.
 20 **DR SCOTT:** We will no doubt come to what the margins were in
 21 the documents, but it's getting clear whether, when you
 22 are talking about these margins, you are talking about
 23 the net price including all the bonuses or the price
 24 which is on the invoice distinct from the off-invoice
 25 bonusing?

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1 **A.** I think I would be on safer ground if I was to say that
 2 if an RRP was £5, that a supermarket would want to be
 3 well below that, which mathematically would mean they
 4 would make a much smaller margin, dependent on brand,
 5 and because of that and our recognition of that we would
 6 make investments to support it. So effectively those
 7 ongoing monies were there in margin support, margin
 8 enhancement, and I think that was very much the
 9 understanding, and because of that and because Morrisons
 10 were in the category to provide cheap products, writing
 11 "because you are selling beneath RRP" was just
 12 unnecessary.
 13 **THE CHAIRMAN:** So you are saying that because of how
 14 Morrisons saw themselves in the market they wanted to
 15 price below RRP and in recognition of the fact that that
 16 was also in ITL's interests, you gave them a better
 17 wholesale price?
 18 **A.** That's a much more succinct way than I put it. Exactly
 19 right, yes.
 20 **MR WILLIAMS:** I think what I am putting to you is that you
 21 didn't need to pay Morrisons a bonus to price under RRP
 22 and so you didn't, but you chose to pay them a bonus for
 23 something else, which was pricing in accordance with the
 24 schedules, which is what this says.
 25 **A.** I am afraid I can't agree with that.

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1 **Q.** Moving on to the differentials, what this says is that
 2 the payment of the bonus for that is based on continued
 3 achievement of the differentials. So they have to
 4 achieve the differentials to get the bonus?
 5 **A.** That is definitely the aspiration.
 6 **Q.** We have covered this already to some extent, but ITL
 7 also paid Morrisons tactical bonuses to bring about
 8 compliance with differentials?
 9 **A.** We paid tactical bonuses to reflect a period of time in
 10 the industry when there was a huge battle for market
 11 share. This period here was hallmarked by the end of
 12 traditional advertising, and when price became the major
 13 weapon in our artillery. So during this period we would
 14 make tactical bonuses to try and compete with brands
 15 that we saw as competitor brands so those bonuses were
 16 paid for that reason.
 17 **Q.** Sorry, I didn't mean to say anything controversial,
 18 I was just summarising the first sentence of
 19 paragraph 124 of your witness statement. Do you want to
 20 have a look at that?
 21 **A.** 124?
 22 **Q.** Yes.
 23 **A.** Okay.
 24 **Q.** This is a point you make in the context of a specific
 25 example, which we will look at in a minute, but if you

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1 just read that to yourself.
 2 (Pause)
 3 You can read the paragraph, but it's only the first
 4 sentence I was focusing on.
 5 **A.** 124, perhaps I am looking in the wrong place, this is
 6 a reference --
 7 **Q.** Paragraph 124, "My email to Morrisons"?
 8 **A.** I see, I am in the right place.
 9 **Q.** You say:
 10 "[This email] provides an example of ITL increasing
 11 margin support [which I think is a tactical bonus] to
 12 reduce the shelf price of an ITL product to maintain the
 13 differential with a competing product."
 14 **A.** Yes.
 15 **Q.** So all I was saying was that you would pay a tactical
 16 bonus in order to maintain a differential?
 17 **A.** We would do.
 18 **Q.** This is contemplated in the agreement in the first
 19 bullet point underneath the two paragraphs we have just
 20 been looking at. Do you want to just read that to
 21 yourself?
 22 **A.** Yes. I've read it.
 23 **Q.** Okay. So this is what we have called the opportunity to
 24 respond clause, I don't know if that terminology is
 25 familiar to you?

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1 A. Yes.
 2 Q. The opportunity to respond clause is explained in this
 3 agreement as a mechanism for enabling ITL to realign the
 4 differential that it wanted to see if Gallaher reduced
 5 its prices?
 6 A. Yes.
 7 Q. Just to put this in the context of the pricing strategy
 8 that's described in the first two paragraphs, ITL has
 9 a strategy to achieve certain differentials, a price
 10 reduction by Gallaher might disturb those differentials,
 11 and this clause or this mechanism gives you
 12 an opportunity to realign the differentials by paying
 13 a tactical bonus?
 14 A. Well, I think that's absolutely right. We wanted the
 15 right to respond, because we knew that those
 16 differentials might change from time to time, because of
 17 the competitive nature of the market.
 18 Q. But is that the differential changing? Sorry, that's
 19 the differential in the shelf price changing rather than
 20 the differential, for example the price list
 21 differential? In that situation the price list
 22 differential wouldn't necessarily change; what's changed
 23 is the differential in the shelf prices?
 24 A. It could be for a lot of reasons, and some of them
 25 aren't completely explored there, but should our

1 competitors choose to reduce the price of a product
 2 because they felt it would give them advantage, or
 3 perhaps the supermarket themselves might decide that
 4 they wanted to make a product they felt was important
 5 cheaper, and I think this was a sort of catch-all to say
 6 "Look, we have aspirations in pricing, but you know, we
 7 don't live in a perfect world and should there be
 8 opportunities for us to correct those through
 9 investment, we would like that opportunity".
 10 Q. It's interesting you say that, because what the clause
 11 says is "Should our competitors reduce their shelf
 12 prices", so you contemplate that Gallaher will reduce
 13 their shelf -- Gallaher amongst others, I should say?
 14 A. Yes.
 15 THE CHAIRMAN: Let's just check, because there are two
 16 parties to this agreement, Morrisons and ITL and their
 17 competitors, is that the competitors of ITL or the
 18 competitors of Morrisons?
 19 A. Well, I think that the only thing I knew was that from
 20 time to time my competitors, the manufacturers would
 21 want to attack my brands, but clearly I wouldn't have
 22 known the strategy of the supermarket with their
 23 competitors, which is, you know, why that wouldn't have
 24 been included in there, but that eventuality would be
 25 part of a tactical bonus.

1 MR WILLIAMS: So you are saying that you might pay
 2 a tactical bonus -- and we will come back to exactly
 3 what that means mechanically in a bit -- in order to
 4 fund a supermarket's desire to compete with its own
 5 competitors; you would pay money to enable them to do
 6 what they wanted to do?
 7 A. It was a source of tension. There would be the Monday
 8 morning phone call from Tesco "I have just been to Asda
 9 and I've seen that they are selling Lambert & Butler at
 10 3.89, I want to do the same, where is the money? You
 11 have until Friday afternoon to respond". So that became
 12 quite a frequent piece of conversation, and clearly
 13 Morrison as a competitive retailer would have a similar
 14 view, maybe they thought that they ought to be at the
 15 same price as Asda and they would frequently ask for
 16 investment. Sometimes you would make it, if you felt
 17 you could get something else. Other times perhaps you
 18 wouldn't be able to match what they required.
 19 Q. Can I just probe that because if they came to you and
 20 said "Tesco are having a promotion, we don't know
 21 whether there is any bonus on that but as far as we are
 22 concerned, it's just something they have done on their
 23 own, they decided to reduce prices, it's a Tesco driven
 24 promotion, and we want to match that, so can you pay us
 25 a tactical bonus", if they put it to you in those terms

1 would you be minded to pay them a tactical bonus to
 2 allow them to compete with their competitor?
 3 A. That was part of the game. A good buyer would persuade
 4 you to make that investment for a range of reasons, and
 5 there would be supposition, bluffing, brinkmanship in
 6 all of it. You would be less inclined to want to make
 7 that investment, but they were made from time to time.
 8 I have made similar investments.
 9 THE CHAIRMAN: Less inclined to make that kind of investment
 10 than you would be inclined to make an investment when
 11 the reduction reflected a Gallaher investment?
 12 A. Yes, I think that would be correct.
 13 MR WILLIAMS: Are you really saying that if a retailer came
 14 to you and said "Look, Tesco is doing its own thing, we
 15 want to compete with Tesco but we don't want to take
 16 that out of our own margin, we want you to take that out
 17 of your own margin, so can you do that please", that's
 18 a proposition you would entertain?
 19 A. It's certainly one that would be considered. I hope
 20 I am not overstepping the mark by saying that that is
 21 how the buyer and seller relationship works in
 22 supermarkets generally.
 23 Q. That is not a situation of bluff, I am not talking about
 24 a situation of bluff, I am talking about a situation
 25 where what's being proposed is that you fund a retailer

1 driven promotion.
 2 **MR HOWARD:** How is it suggested that anybody knows when
 3 Tesco reduces its own price whether Tesco is doing that
 4 of its own accord or whether its being funded by the
 5 manufacturer? Perhaps that could be made clear in the
 6 questions.
 7 **MR WILLIAMS:** I am just responding to something Mr Matthews
 8 said, which was that if the supermarket wanted to do
 9 a promotion of its own, that's something we might pay
 10 a tactical bonus for, so I am just asking questions
 11 about the evidence that Mr Matthews has given.
 12 **THE CHAIRMAN:** Yes. Mr Matthews is saying they don't need
 13 to know the answer to that question before they consider
 14 whether to respond.
 15 **MR HOWARD:** I think Mr Williams' question was on the premise
 16 that Morrisons will come along and say "Tesco is funding
 17 out of its own pocket a reduction", and I would ask him
 18 to make clear on what basis Morrisons would ever know
 19 the basis on which Tesco was 2p lower. The answer is
 20 they would never know. So all they can come along and
 21 say is "Tesco are lower". That's a fair question, what
 22 do you do there.
 23 **THE CHAIRMAN:** Let him ask the question.
 24 **MR WILLIAMS:** I think all I am trying to get at,
 25 Mr Matthews, is whether you would entertain a request

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1 for tactical funding for something which you knew or
 2 believed to be a promotion which the retailer was
 3 choosing to engage in?
 4 **A.** I have made investments like that within Morrison, yeah.
 5 **Q.** We will come back to an example of a situation a bit
 6 like this in due course, but we will leave that there
 7 for the minute.
 8 Coming back to the opportunity to respond clause,
 9 I think we had agreed on some of the mechanics and
 10 what's broadly going on there. What I want to come back
 11 to is the context for this, really, which is that
 12 margin, retail margins on tobacco products are thin, if
 13 you want to reduce shelf prices in order to compete with
 14 Gallaher, you don't expect Morrisons to take a hit on
 15 its margin and so you pay a bonus which means that it
 16 doesn't lose margin by reducing prices to whatever level
 17 it needs to be set in order to achieve parity?
 18 **A.** Yes.
 19 **Q.** Sorry, the question was a bit longer than I intended,
 20 but I think we got there.
 21 **A.** I understand.
 22 **Q.** When you talk about paying a bonus here, it's really
 23 a contingent reduction in the wholesale price, isn't it?
 24 You are not actually paying them money?
 25 **A.** A contingent reduction in the wholesale price?

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1 **Q.** So you have a particular wholesale price and you apply
 2 a retro bonus to the wholesale price which effectively
 3 brings the wholesale price down on the basis that they
 4 price at the level you want them to price at, you are
 5 not positively paying them money, it results in
 6 a reduction in the wholesale price?
 7 **A.** Well, their landed price, their net price would be what
 8 they bought from either direct or through a third party,
 9 I think Morrison at the time were buying directly, and
 10 I am not sure I appreciate the point completely, I mean,
 11 how the Budgets and the Treasury piece worked I am not
 12 sure, but we would pay money, it would cost us money to
 13 make these investments.
 14 **THE CHAIRMAN:** In some instances with other retailers we
 15 have seen that a separate invoice was raised for the
 16 payment of this bonus --
 17 **A.** I see.
 18 **THE CHAIRMAN:** -- whereas what's been put to you is that
 19 that's not the mechanism, the mechanism in this retailer
 20 was a reduction in the wholesale price?
 21 **A.** It was. There was a time when the payments weren't made
 22 off-invoices and they were raised separately, but one
 23 way or another it had the net result of reducing their
 24 buying price.
 25 **MR WILLIAMS:** In the situation that we have just been

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1 describing where you want to react to a reduction in
 2 price by Gallaher, is it right to say that there is no
 3 obvious reason why Morrisons would turn down the bonus
 4 that you are proposing?
 5 **A.** They might, and if you ask me specific to Morrison, it's
 6 unlikely, but I can think of times when they played hard
 7 to get.
 8 **Q.** Broadly speaking, you could expect to be able to restore
 9 the differential by offering a tactical bonus?
 10 **A.** As long as you were able to maintain cash margins,
 11 I think it was pretty likely that from time to time
 12 a buyer would say "Look, you know, how low do you want
 13 to go? You are taking cash out of the till, so turnover
 14 is being affected". So dependent on how they were
 15 feeling on that morning they might negotiate a bit
 16 harder than they needed to.
 17 **Q.** I am not sure, was that a "broadly yes, but"?
 18 **A.** "Broadly yes, but", but it's not black and white.
 19 **Q.** The second sentence of this bullet point about the
 20 opportunity to respond clause says:
 21 "Should any additional funding be agreed to support
 22 a response to the competitor activity, it should be
 23 removed once that activity has ended."
 24 Applying the same sort of "broadly" approach,
 25 broadly speaking would you accept Morrison's shelf price

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1 to come back up to the unfunded level when you reduced
 2 the tactical bonus?
 3 **A.** You would hope that it would, but again that isn't black
 4 and white either because a buyer might say "I forgot to
 5 change the pricing last week, I can only do it every
 6 week, it's gone another week, is that okay, Paul?"
 7 So even within the negotiation there would be
 8 negotiation, so you would hope that it would, broadly,
 9 yes.
 10 **Q.** Would that be a negotiation about the date on which the
 11 bonus finishes, or would that be a negotiation about
 12 whether they reduced prices when you reduced the bonus?
 13 **THE CHAIRMAN:** Whether they would increase prices --
 14 **MR WILLIAMS:** Thank you madam.
 15 **A.** It would be the former, I think.
 16 **Q.** So once you turned the bonus off, you would broadly
 17 expect them to come back to the unfunded level?
 18 **A.** You would expect that to happen.
 19 **Q.** Given that it was your strategy to maintain certain
 20 differentials, as we have seen recorded in the
 21 agreement, would you agree that it was usual for you to
 22 offer a bonus to maintain the differential in any given
 23 case falling within the strategy?
 24 **A.** I would say it was usual but it wasn't binary in that
 25 there were examples where we didn't want to -- we

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1 couldn't afford or didn't want to follow price
 2 reductions.
 3 **Q.** We are going to look at an example of this now, but
 4 before we do that can we just look at the right-hand
 5 side of the agreement.
 6 **A.** Yes.
 7 **Q.** In the middle of the page you have "Drum SKUs no more
 8 expensive than Amber Leaf SKUs"?
 9 **A.** Yes.
 10 **Q.** While we are there we might as well also have a quick
 11 look above that, immediately above that, it says:
 12 "Drum SKUs not more than 5p more expensive than
 13 Sterling, no more expensive than Dorchester."
 14 **A.** Right.
 15 **Q.** We will look at some documents about those brands too,
 16 but could you turn to tab 53, {D17/53}, please.
 17 **A.** Do you want me to keep this tab open?
 18 **Q.** You don't need to at the moment, no, we will come back
 19 there before very long. Do you want to just read that
 20 to yourself. Obviously start at the bottom.
 21 (Pause)
 22 **A.** Okay.
 23 **Q.** So this is a situation where you want Drum to be at
 24 parity with Amber Leaf, you notice that Amber Leaf has
 25 reduced in price, and that means that, if you want to

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1 achieve parity, you have to reduce the price of Drum
 2 too?
 3 **A.** Yes.
 4 **Q.** You say that you want a parity position and therefore
 5 you offer a tactical bonus?
 6 **A.** Yes.
 7 **Q.** To fund that, for want of a better way of putting it?
 8 **A.** Yes.
 9 **Q.** When you fund that level of price at 2.09, is it fair to
 10 say that you expect them to go to 2.09 rather than
 11 a lower price, assuming they take up the offer.
 12 **A.** I would expect them to -- can you just say that again?
 13 **Q.** Go to 2.09 rather than a lower price than 2.09?
 14 **A.** I think that what I am suggesting here is that I am
 15 prepared to make an investment on this brand which means
 16 that if you want to maintain cash margin, you would be
 17 at 2.09.
 18 **Q.** Well, I think what you actually say is "could you reduce
 19 the shelf price from 2.12 to 2.09"?
 20 **A.** Yes.
 21 **Q.** So I think what you actually do is ask them to reduce
 22 the shelf price --
 23 **A.** Yes.
 24 **Q.** -- rather than say "If you want to maintain your
 25 margin", that's because you want to match Amber Leaf,

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1 isn't it?
 2 **A.** Yes.
 3 **Q.** But my question was on a slightly different point was:
 4 when you pay a bonus which maintains the margin at 2.09
 5 but not a lower level than 2.09, would you expect them
 6 to go to 2.09 rather than a lower level than 2.09?
 7 **A.** I would expect them to do that but it is not unheard of
 8 for adventurous buyers to declare their own independent
 9 thoughts on it, and sometimes prices would be lower than
 10 that. But you would expect that, because if they
 11 weren't to do that, they would reduce their cash margin.
 12 They might make a call and say "I am going to reduce it
 13 further, I am prepared to take less cash margin, he has
 14 given me some support, I'll put some more in as well",
 15 so that could happen.
 16 **Q.** You weren't funding a better position than 2.09?
 17 **A.** No. No.
 18 **Q.** You don't say "Can you go to 2.09 or lower", you say
 19 "can you go to 2.09?"
 20 **A.** I do say that.
 21 **Q.** Is that because that's what you meant?
 22 **A.** That's what I was suggesting I wanted, yes.
 23 **Q.** Mr Batty, I think you said you have looked at some of
 24 his evidence?
 25 **A.** Yes.

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1 Q. But I won't expect you to remember all of it.
 2 A. No.
 3 Q. He said something along the lines of "Imperial would
 4 tend to be reactive in this sort of situation", they
 5 would react to what the competitors were doing, but the
 6 implication was that Imperial would tend to follow
 7 Gallaher in this sort of situation rather than vice
 8 versa. Would you agree with that?
 9 A. To a point. I don't think, again, it's black or white.
 10 We could be reactive but I like to think that our market
 11 share over this period increased dramatically because we
 12 took the lead, and in fact we were more aggressive than
 13 they were, particularly on Richmond, where we made huge
 14 investments.
 15 Q. So when you say "our market share increased", what are
 16 you talking about there?
 17 A. Well, our market share during this period was on
 18 a growth path because we were --
 19 Q. Sorry, what market share --
 20 A. The cigarette market share.
 21 Q. The whole cigarette market share.
 22 A. Yes.
 23 Q. So this is actually roll-your-own, isn't it?
 24 A. You mean -- are you saying were we reactive in RYO?
 25 Were you being specific to RYO?

1 Q. I wasn't being specific, Mr Batty wasn't being specific.
 2 A. Oh, I see.
 3 Q. As I say, I just wanted to understand what your answer
 4 related to.
 5 A. Okay.
 6 Q. The bottom email focuses on 12.5 gram packs. If you
 7 look at the top email, this expands the discussion to
 8 all stock keeping units. What seems to have happened is
 9 you had a conversation with Paul Giles in which he asked
 10 you if you wanted to match Amber Leaf on all SKUs, not
 11 just 12.5, and you followed up with an email saying
 12 "Yes"?
 13 A. That looks as exactly that happened, yes.
 14 Q. This is an example of him proactively giving you
 15 an opportunity to respond on the other stock keeping
 16 units?
 17 A. Yes.
 18 Q. I think we can see again that you wanted to match
 19 Amber Leaf rather than wanting a price better than that?
 20 A. Yes.
 21 Q. Could we now just turn back to 17/4, which is the other
 22 trading agreement. This is a slightly more basic form
 23 of agreement. I think I can say that, because I don't
 24 think you wrote this one. Is it fair to say that your
 25 dealings with Morrisons in relation to P&Ds at the time

1 of this agreement worked in essentially the same way --
 2 **THE CHAIRMAN:** Mr Matthews, it's tab 4 of the bundle.
 3 {D17/4}
 4 **MR WILLIAMS:** Sorry, I am speaking in code, am I?
 5 A. No, my hearing isn't quite as good as it used to be, and
 6 I should have been listening better, my apologies.
 7 Q. When I say 17 something, you can ignore the 17, because
 8 you have 17.
 9 A. I am there now, I have it in front of me.
 10 Q. This is the first trading agreement in the period we are
 11 looking at. It's slightly more basic, but you didn't
 12 write this one, so I can say that.
 13 Your dealings with Morrisons, is it fair to say that
 14 your dealings with Morrisons in relation to parities and
 15 differentials at the time of this agreement worked in
 16 essentially the same way as the trading agreement we
 17 were just looking at?
 18 A. I think that the aspirations would have been very
 19 similar.
 20 Q. In terms of the agreement, I think one point we will
 21 come to in a minute is that the bonus is actually worked
 22 out in a different way here, it's an off-invoice bonus
 23 which you can see on page 4, but in terms of what
 24 happened day-to-day, did things work in broadly the same
 25 way under the two agreements?

1 A. Yeah.
 2 Q. In this agreement, you will see the first sentence, and
 3 it says:
 4 "Provided ITL prices are in line with our current
 5 strategy."
 6 If you flip to appendix 2, which is actually page 5,
 7 and appendix 2 is rather unhelpfully bottom right, this
 8 is the ITL strategy pricing sheet, and this is all about
 9 differentials, isn't it?
 10 A. Mm.
 11 Q. So just going back to page 2, when it says "ITL agreed
 12 to maintain levels of off-invoice bonuses provided
 13 prices are in line with the current strategy", what you
 14 are paying them for is the differential strategy and
 15 this doesn't deal with absolute prices?
 16 A. I can't agree with that, I am afraid, and at the risk of
 17 repeating what I said earlier, the off-invoice bonus per
 18 outer would have been paid in relation to recognising
 19 and rewarding Morrisons selling tobacco products
 20 cheaply, below RRP, bargain basement, as well as them
 21 rewarding us by reflecting those price list
 22 differentials, so all those bonuses on that page 4 from
 23 the top to the bottom would be in reflection of both
 24 those points.
 25 **DR SCOTT:** Mr Matthews, just pausing on that point for

1 a moment, if Morrisons were pricing below the
 2 recommended retail prices but if they were favouring
 3 Gallaher's in relation to selling below recommended
 4 retail prices, what would have been the impact on ITL?
 5 **A.** I think that that would have been not a good outcome,
 6 because whilst they continued to provide economically
 7 attractive brands or products, that we would have felt
 8 that we were disadvantaged on a comparative basis.
 9 **DR SCOTT:** So that in making a trading agreement, you would
 10 have been concerned to ensure that ITL was not so
 11 disadvantaged?
 12 **A.** That would certainly be our aspiration, but we did know
 13 that from time to time there was the danger of that
 14 happening.
 15 **DR SCOTT:** Yes, and that's when you went into the
 16 negotiations on the tactical bonusing, as we heard?
 17 **A.** Yes.
 18 **DR SCOTT:** Thank you.
 19 **MR WILLIAMS:** So I think what you said, although I might
 20 have misheard you, is that every bonus on page 2 is paid
 21 in respect of, I think, amongst other things, possibly,
 22 pricing below RRP; is that what you said?
 23 **A.** I think that these bonuses are paid for, for two
 24 things --
 25 **Q.** What do you mean by "these bonuses", sorry, that was the

1 first question I was asking you?
 2 **A.** The ones, unless I am misreading it, page 4, for example
 3 Embassy No 1 Kingsize --
 4 **Q.** Sorry, I understand what you are saying, I had page 2
 5 open, and you said all of these bonuses from the top to
 6 the bottom of the page, and that includes --
 7 **A.** I beg your pardon.
 8 **Q.** No, that's my misunderstanding.
 9 So you are saying that the off-invoice bonuses are
 10 paid in respect of --
 11 **A.** Yes.
 12 **Q.** -- matters including RRP. We had a discussion about
 13 RRP pricing in relation to the second trading agreement,
 14 but that was in the context of a provision which did
 15 actually at least talk about absolute price levels?
 16 **A.** It did.
 17 **Q.** This agreement doesn't talk about absolute price levels
 18 at all?
 19 **A.** It doesn't.
 20 **Q.** So I think all I am putting to you is that this
 21 agreement provides for you to pay an off-invoice bonus
 22 in relation to pricing for pricing in accordance with
 23 the differentials --
 24 **A.** I -- sorry, were you going to continue there?
 25 **Q.** I can stop there. That's the point. That's what the

1 agreement provides for?
 2 **A.** I think that -- and again my apologies for repeating the
 3 point -- you said yourself that this agreement wasn't
 4 written perhaps as clearly as the one that I had written
 5 later on, and they were largely down to the personal
 6 idiom of the individual national account manager, and as
 7 I said before, they weren't supposed to be legally
 8 binding, didn't cover every eventuality, but largely
 9 were there to reflect the custom and practice of dealing
 10 with supermarkets, which was very much, in this case,
 11 an unwritten understanding that they would price their
 12 brands cheaply, we would understand that and reward them
 13 for doing so. But at the same time to, what we would
 14 expect from the quid pro quo is that we would have those
 15 differentials that we desired.
 16 **Q.** I am not disagreeing with you about that, it's just the
 17 fact that this doesn't talk about absolute prices or
 18 RRP, and I am just saying really what it says on the
 19 page, which is that the off-invoice bonuses paid under
 20 this agreement didn't relate to below RRP pricing.
 21 **A.** Again, my apologies if I am going off subject here, but
 22 if I look at the merchandising part of the agreement, it
 23 says "ITL products achieving position and space in line
 24 with market performance", that's a pretty broad
 25 spectrum. I think that, you know, these agreements

1 would have been 15 pages long if we had considered every
 2 eventuality. You are absolutely right, it doesn't
 3 mention it there, but that would be because of the
 4 person writing it and the implicit understanding that's
 5 what Morrisons did. They advertised on television "we
 6 sell products cheaply" and we would have expected them
 7 to continue doing that.
 8 **Q.** I am just a bit confused because Morrisons sell prices
 9 cheaply just because that's what they do, in a sense you
 10 don't need to pay them to do that. I am just a bit
 11 confused about why you would include a bonus to pay them
 12 to do something that you had absolute confidence they
 13 were going to do anyway?
 14 **A.** I am not sure we had that complete confidence and, you
 15 know, maybe you are right, maybe we shouldn't have paid
 16 all this money, but it was a case of paying it because
 17 of custom and practice and the expectations of the
 18 supermarkets. They very much felt, and perhaps it's
 19 wrong of me to talk on their behalf, this was the cost
 20 of doing business with Morrison. We are the retailers,
 21 we know the right prices, you pay us the money and we
 22 will look after you. This is how supermarkets do sell
 23 their products cheaply, because they have suppliers who
 24 are investors that help them do it, and without the
 25 support of big suppliers liked Imperial Tobacco, they

1 wouldn't have been able to maintain their market
 2 position across most of their products.
 3 **Q.** I think when we were talking about TA2, the second
 4 trading agreement, you said that you paid or offered
 5 them a bonus because it was your aspiration that they
 6 would price in accordance with your strategy?
 7 **A.** Yes.
 8 **Q.** I think a moment ago you have just used the expression
 9 "the cost of doing business with Morrisons"?
 10 **A.** That's what Morrisons would have thought.
 11 **Q.** But from your point of view the bonus was paid for
 12 achievement of your strategy?
 13 **A.** No. My apologies for repeating it again, but I paid
 14 bonuses based on two quite clear criteria, the fact that
 15 they were prepared to stump up cash and reduce marked
 16 pack or sell products at lower margins and that my
 17 investment was based on that and that I would also get
 18 my price list differentials.
 19 **Q.** I don't think we are disagreeing, Mr Matthews, I just
 20 said that from your point of view you paid them bonuses
 21 because you wanted them to achieve your strategy, now
 22 that strategy might have different strands, but from
 23 your point of view, this wasn't the cost of doing
 24 business with Morrisons, this was a bonus paid for
 25 a purpose?

1 **A.** No, it was the cost of doing business with Morrisons,
 2 because if I had taken the money away I would have had
 3 a very difficult trading relationship, like all
 4 relationships with big companies.
 5 **Q.** Moving down this agreement, further down we see that
 6 Morrisons is to tell you if there is a promotional
 7 activity which affects differentials?
 8 **A.** Yes.
 9 **Q.** It goes on to say:
 10 "Should ITL agree to maintain bonus levels in line
 11 with appendix 1, should we elect not to respond to other
 12 manufacturers' pricing initiatives", so that's what this
 13 is about, it's about other manufacturers' pricing
 14 initiatives?
 15 **A.** That's one possibility, yes.
 16 **Q.** That's what this is about, though?
 17 **A.** When you say this is what this is about, sorry, I am
 18 losing the thread --
 19 **Q.** The paragraph that starts:
 20 "WM Morrison to confirm instore promotional
 21 activities", up to the words at the end " ... other
 22 manufacturers' pricing initiatives".
 23 **A.** Right.
 24 **Q.** I was just putting to you that that paragraph seemed to
 25 be about promotional activities that were the result of

1 other manufacturers' pricing initiatives?
 2 **A.** Yes, that would be the right to respond, I think you
 3 called it earlier.
 4 **Q.** If we could turn to page 5, we see that some of the
 5 requirements are expressed simply in terms of parity and
 6 others are in terms of "not more than" or "at least",
 7 I am not going to have a debate with you about that, but
 8 I am just noting it while we are here. While we are
 9 here, just to pick up, there are differentials between
 10 Embassy and -- sorry, different permutations of Embassy
 11 and B&H, and that's a minus 3 on a pack of 20, and Regal
 12 B&H, minus 5 on a pack of 20?
 13 **A.** Yes.
 14 **Q.** We also see further down Cafe Creme, Small Classic, are
 15 linked to Hamlet Miniatures. I am just noting these
 16 because we will go to some documents in due course.
 17 **A.** Okay.
 18 **Q.** Can we go to tab 85, {D17/85}, and back to the second
 19 page with the heading "Pricing". Just focusing really
 20 on the first bit of the first paragraph under "Pricing":
 21 "Morrisons agree to continue supporting Imperial
 22 Tobacco's pricing strategy."
 23 We have seen that that includes the differentials.
 24 It goes on underneath in the next paragraph:
 25 "Based on continued achievement of those

1 differentials as well as the shelf prices in the
 2 schedule."
 3 Then top right, on the next page -- sorry, is your
 4 bundle top right? It's page 464.
 5 **A.** Yes.
 6 **Q.** "At the time of writing, the following price list
 7 differentials should be reflected in Morrison's shelf
 8 prices."
 9 **A.** Yes.
 10 **Q.** So the agreement records that first of all Morrisons it
 11 had been supporting your pricing strategy, as in the
 12 words "continue supporting", so they had been supporting
 13 your pricing strategy?
 14 **A.** I hope I don't sound as though I am being obtuse,
 15 I promise I don't mean to be obtuse, but sometimes the
 16 commercial language of these agreements is a little bit
 17 flowery. So when you say "The continued support", you
 18 know, that doesn't mean that there is a sort of
 19 cast-iron guarantee, it means that generally speaking
 20 Morrisons have been supportive of Imperial, and
 21 generally speaking Imperial Tobacco has been supportive
 22 of Morrisons, it doesn't mean that there wasn't a fairly
 23 testy commercial relationship between the two. I just
 24 wanted to make that point.
 25 **Q.** You have made that point now. As I say, the idea here

1 is that there has been achievement of the differentials,
 2 and they are now agreeing to continue to support the
 3 strategy of pricing in accordance with the
 4 differentials. That's just what this says?
 5 **A.** It's what it says, and that's the aspiration and the
 6 intention, and Morrisons might or might not have seen it
 7 differently. Again, my apologies for drawing this out,
 8 but these agreements were the basis for negotiation very
 9 often.
 10 **Q.** I thought it was the outcome of a negotiation?
 11 **A.** Ah, well, a negotiation is something that is -- doesn't
 12 end, it keeps going and going and going, and the signing
 13 of this agreement -- and it covers much more than
 14 pricing, in fact you could argue some of the other
 15 issues are far more important -- but this was a point in
 16 time, and there was far more negotiation between the two
 17 agreements than there was negotiating agreement to be
 18 signed.
 19 **Q.** We can ask Morrisons what their perspective on all of
 20 this was, but from your point of view you had secured
 21 their agreement to support your differential pricing
 22 strategy?
 23 **A.** I felt that I had gained their confidence to understand
 24 what I wanted and, within a commercial relationship,
 25 subject to an immense amount of fluctuation and change

1 I could achieve it, but it wouldn't be based just on
 2 this agreement.
 3 **Q.** I am not exactly sure whether that answered the question
 4 or not. I think all I was putting to you is that what
 5 this records is that you thought you had secured their
 6 agreement to your strategy?
 7 **A.** Except that there were very specific references for
 8 when -- or remedies for when that was out of line, and
 9 there would be lots of them, hence my wording on the
 10 pricing piece.
 11 **Q.** Language like "the following price list differentials
 12 should be reflected in Morrison's shelf prices", you
 13 basically had formed an expectation this agreement gave
 14 you the basis for an expectation that they would price
 15 in accordance with the differentials?
 16 **A.** An expectation.
 17 **Q.** Would you agree with language like "continued
 18 achievement of those differentials" that Morrisons got
 19 the differentials consistently right?
 20 **A.** They didn't.
 21 **Q.** Could we turn to tab 96, please. {D17/96}. This is
 22 a national accounts customer plan. It's at tab 96
 23 because the date is slightly unknown, I think, but
 24 I think we can put it at the back end of 2002, possibly
 25 in advance of the beginning of 2003. Does that look

1 about right?
 2 **A.** Yeah, I would say so.
 3 **Q.** Could we turn over the page, there is a lot of material
 4 in this document that is in theory confidential, I am
 5 not sure if it really is confidential. It would be very
 6 helpful to be able to talk openly about what's said.
 7 The paragraph I am interested in is on page 225. You
 8 will appreciate these page numbers aren't logical, but
 9 I'll use them anyway. The paragraph that starts,
 10 "However, as testimony ..." which is I think four
 11 paragraphs down, could you read that?
 12 **A.** Do you want me to read it out loud?
 13 **Q.** No, I don't.
 14 (Pause)
 15 In terms of, I can't actually work out what's
 16 confidential and what's not on my copy, because it's
 17 quite confusing, but I think the words that aren't
 18 confidential are "pricing differentials consistently
 19 right", and I don't think the words after that are
 20 confidential, are they? Does ITL have a view about
 21 that? No.
 22 **THE CHAIRMAN:** You don't have a view or they are not
 23 confidential?
 24 **MR HOWARD:** I don't have a view and I don't think they are
 25 confidential.

1 **MR WILLIAMS:** In that order.
 2 Both quick to respond and co-operative. So this is
 3 an internal ITL document, isn't it?
 4 **A.** Yes.
 5 **Q.** This is not a document where you are massaging
 6 Morrisons' ego. Am I right in thinking that what this
 7 is recording is that the differentials we have just been
 8 looking at in the trading agreements were consistently
 9 right?
 10 **A.** It might not have been massaging Morrisons' ego but it
 11 is an internal document, sometimes one speaks bravely in
 12 internal documents. I am not sure which is sensitive or
 13 not, but it does include quite a few other areas
 14 I think --
 15 **Q.** We will come to those others, if that helps, but
 16 "focusing on pricing differentials consistently right",
 17 was that an accurate reflection of the position on the
 18 account that you were relaying to your superiors or was
 19 it not accurate?
 20 **A.** I am not sure how you would measure accuracy in this
 21 instance. I would say that largely Morrison wanted to
 22 work with us, but like all buyers and like all
 23 supermarkets, they had their difficulties. I mean, it
 24 wasn't an easy relationship from time to time.
 25 **Q.** But at the time you were dealing with Morrisons, you

1 took the view that they were basically implementing your
 2 differentials?
 3 **A.** I felt that more often than not, I could negotiate
 4 a settlement with them.
 5 **DR SCOTT:** Just to get the picture of Morrisons just
 6 briefly, you were sending out multiple trade
 7 representatives visiting the stores?
 8 **A.** Yes.
 9 **DR SCOTT:** Were their stores pretty disciplined about
 10 following Morrisons' pricing or were they indisciplined?
 11 **A.** There were far fewer Morrisons than other supermarkets
 12 so they generally got things right and they were
 13 regional, so again they had less management tiers but
 14 there were notable exceptions down to poor store
 15 discipline, but they were quite good.
 16 **DR SCOTT:** Thank you.
 17 **MR WILLIAMS:** Can you keep that page open and go back to
 18 paragraph 113 of your witness statement.
 19 **A.** Yes.
 20 **Q.** Just read that to yourself. Can ITL's legal
 21 representatives tell me whether what's said to be
 22 confidential in here is really confidential?
 23 **MR HOWARD:** Sorry, which bit?
 24 **MR WILLIAMS:** In 113 of Mr Matthews' statement.
 25 (Pause)

1 **MR HOWARD:** We waive any confidentiality.
 2 **MR WILLIAMS:** I am grateful.
 3 (Pause)
 4 So this talks about problems making sure that new
 5 products were adopted, and if we just go back to 17/96,
 6 {D17/96} in the paragraph we were looking at it says:
 7 [REDACTED]
 8 [REDACTED]
 9 [REDACTED]
 10 That's new product development, is it?
 11 **A.** Yes.
 12 **Q.** So am I right in thinking that what you are saying there
 13 is that Morrisons were good when it came to listing and
 14 not only were they good in terms of coverage, they were
 15 actually quick to respond as well?
 16 **A.** On listing products, are you asking me?
 17 **Q.** That is what I am asking you, yes.
 18 **A.** Yeah, they were, they got better, definitely.
 19 **Q.** So when you say in your statement "it was a constant
 20 struggle" --
 21 **A.** Yes.
 22 **Q.** -- "to make sure that new products were adopted", is
 23 that not quite right?
 24 **A.** I may be reading the wrong document. It says here:
 25 "It was a constant struggle in the account to make

1 sure our products were prominently displayed ..."
 2 **Q.** "... and that new products were adopted."
 3 **A.** Sorry, can you just repeat the question again?
 4 **Q.** The question was really just based on what we see in the
 5 document at 96 which says:
 6 [REDACTED]
 7 Whereas the witness statement says it was a constant
 8 struggle to make sure that new products were adopted?
 9 **A.** Right.
 10 **Q.** Do you think the witness statement puts it a bit high?
 11 Because what 17/96 tells us is that they were quick to
 12 respond to NPD, new product development, and that there
 13 were few gaps in listing?
 14 **A.** I mean, I can't remember the context of when this
 15 internal document was written, I can recall that having
 16 inherited the account in 2000, that after that it did
 17 become easier to get new products on the shelf.
 18 Definitely.
 19 **Q.** So at the very least the word "constant" is not quite
 20 right?
 21 **A.** "Constant" might not be completely right, as I said it
 22 was an internal document and sometimes you become brave
 23 by talking brave.
 24 **Q.** I am just going to ask you to read something else now,
 25 it's paragraph 47 of the statement. There's a reason

1 for asking you to read this given the way in which you
 2 hesitated over paragraph 113.
 3 **A.** Witness statement 47?
 4 **Q.** Paragraph 47, that's right.
 5 **A.** Okay.
 6 **Q.** Apart from the words "Sainsbury" and "Morrison" those
 7 paragraphs are absolutely identical, and I wanted to ask
 8 you: is it the case that your relationships with
 9 Sainsbury's and Morrisons were identical, or has just
 10 something gone wrong in the drafting here?
 11 **A.** I think that every account was very different and
 12 I would say I thought I had good trading relationships
 13 but I would say that there was definitely a difference
 14 in all the supermarkets because of the styles of the
 15 people you dealt with.
 16 **Q.** I can fully understand that, the reason for asking you
 17 the question is just that paragraphs 47 and 113 are
 18 identical, so really going back to 113 --
 19 **A.** Yes.
 20 **Q.** -- does this accurately describe your relationship with
 21 Morrisons or is it cut and pasted from Sainsbury's or
 22 vice versa?
 23 **A.** I think they are both reflective, I mean Morrison and
 24 Sainsbury had some similarities, they were broadly
 25 positive commercial relationships with both.

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1 Q. Broadly positive as opposed to constant struggle?
 2 A. Well, that's just one part of the relationship.
 3 Q. But it is the part that you have chosen to describe in
 4 setting up your relationship with Morrisons in the first
 5 paragraph of this section of your witness statement.
 6 A. But the internal document talks about more than just
 7 listing products.
 8 Q. I agree with that, it's just that your witness statement
 9 talks about listing products.
 10 A. Right. Yeah, there is a disparity in that internal
 11 document and what is said there.
 12 Q. I think you also talk in this paragraph about "constant
 13 struggle in relation to the obtaining of space on the
 14 shelves". Could you turn over to 229.
 15 A. Yes.
 16 Q. You see, about the middle of the page, it says "Specific
 17 account strategy"?
 18 A. Yes.
 19 Q. Could you read the two paragraphs of point 1, please.
 20 (Pause)
 21 A. Yes.
 22 Q. At this stage, you seem to think you have reached
 23 agreement with Morrison on significantly increased share
 24 of space on the planogram; is that right?
 25 A. That's the account strategy and I felt I was close to

1 that.
 2 Q. So you have increased your share of space significantly
 3 from -- well, from one number to another number, I don't
 4 think we need to worry about reading out those
 5 percentages.
 6 A. Okay.
 7 Q. So it seems that any struggle you had in relation to
 8 display yielded fruit in a better outcome for ITL there?
 9 A. That looks as though I definitely was breaking through
 10 there, yes.
 11 Q. If you go back up the page, right in the middle of the
 12 page, it says "our relationship with the buyer"?
 13 A. Yes.
 14 Q. It's a short sentence. So the buyer there is Mr Giles?
 15 A. Yes.
 16 Q. And the manager is Mr Eastwood?
 17 A. Yes.
 18 Q. And your relationship is sound and has greater
 19 continuity than relationships with other manufacturers?
 20 A. I thought so, yes. I mean, again difficult to measure.
 21 Morrison had quite a few different people in the role,
 22 and with this particular gentleman it was a positive
 23 relationship.
 24 Q. So would you agree that paragraph 113 of your statement
 25 paints an unnecessarily gloomy picture of the

1 relationship you had with Morrisons?
 2 A. I think -- I am not sure about gloomy. Perhaps it's
 3 a bit more realistic than the internal document.
 4 I mean, they are both different context.
 5 Q. While we are jumping around your witness statement,
 6 could you go back to paragraphs 10 and 11 and just read
 7 those to yourself.
 8 (Pause)
 9 A. I am lost again here, I am terribly sorry.
 10 Q. In your witness statement, page 552 is the bottom right.
 11 THE CHAIRMAN: Tab 42.
 12 MR WILLIAMS: Sorry, I thought you had your witness
 13 statement open, I beg your pardon.
 14 A. No. And 11?
 15 Q. 10 and 11 please, yes.
 16 (Pause)
 17 A. Okay.
 18 Q. I am sorry to do this, but could you turn back in that
 19 witness statement file to tab 33, and go to
 20 paragraphs 3.1 and 3.3 of Mr Batty's witness statement,
 21 which you will find at tab 33, and just read those to
 22 yourself.
 23 A. I am terribly sorry, I got my 10 and 11 --
 24 Q. I am sorry, we have been jumping around in these files
 25 for weeks now and we know what we're doing. It's tab 33

1 in the witness statement file.
 2 A. Okay.
 3 Q. Internal page 329.
 4 A. Yes.
 5 Q. Just read paragraphs 3.1 and 3.3. There is obviously
 6 3.2 in the middle but I think you will be able to make
 7 sense of it.
 8 A. Right. Okay.
 9 Q. Do you want to read 3.1 and 3.3 of Mr Batty's statement?
 10 A. Yes, I am reading it. (Pause).
 11 Q. So I think apart from a few drafting changes, the odd
 12 word here and there, these paragraphs are identical to
 13 paragraphs 10 and 11 of your witness statement. I just
 14 wanted to ask you who drafted these paragraphs?
 15 A. Which, the Roger Batty?
 16 Q. Well, no, I can't ask you who drafted Roger Batty's
 17 statement, but paragraphs 10 and 11 of your statement.
 18 A. Well, this would have been done in conjunction with our
 19 legal team.
 20 MR WILLIAMS: I don't know if that's a convenient moment,
 21 madam.
 22 THE CHAIRMAN: Yes, thank you. We are now going to take
 23 a lunch break, Mr Matthews. Now, because you are in the
 24 middle of giving your evidence, that means you mustn't
 25 talk to anybody about the case over the lunch

1 adjournment, so I am afraid you will have to be
 2 antisocial with the rest of your team because your
 3 evidence mustn't be discussed with anybody else.
 4 **A.** I understand.
 5 **THE CHAIRMAN:** Thank you. We will come back at 2 o'clock.
 6 (1.05 pm)
 7 (The short adjournment)
 8 (2.00 pm)
 9 **THE CHAIRMAN:** Yes, Mr Williams.
 10 **MR WILLIAMS:** Good afternoon, Mr Matthews.
 11 **A.** Good afternoon.
 12 **Q.** Before lunch we were looking at, amongst other things,
 13 the trading agreement. You don't need to turn it up now
 14 but we looked at the provisions which said that
 15 Morrisons agreed to support your pricing strategy in
 16 return for payment of bonuses, and the agreement also
 17 said that prices should be in line with the
 18 differentials.
 19 Having signed Morrisons up to that agreement,
 20 I don't suppose you thought that Morrisons were free to
 21 disregard the differentials if they wanted to?
 22 **A.** No. I think that wasn't the intent, but we did also
 23 recognise that as part of the weave and weft of
 24 a commercial relationship that there would be times when
 25 they could put pressure on that, hence our need to from

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1 time to time increase our investments.
 2 **Q.** So from your point of view you thought the agreement put
 3 a constraint on how Morrisons was going to price its
 4 products?
 5 **A.** I felt it was a good basis for negotiation on a whole
 6 range of things.
 7 **Q.** I think as we explored before lunch obviously there
 8 would be negotiations after that, but it was also the
 9 outcome of a negotiation, it was agreement?
 10 **A.** Of one part of a negotiation, yes.
 11 **Q.** So having decided to invest in their business under that
 12 agreement, you expected Morrisons to price in accordance
 13 with the agreement?
 14 **A.** That was certainly what we hoped for, yes.
 15 **Q.** Could we look at document 59 in the Morrisons file,
 16 please. So this is an email. Do you want to read it
 17 through?
 18 **A.** If I could have a couple of minutes.
 19 **Q.** Of course, yes.
 20 (Pause)
 21 **A.** Okay.
 22 **Q.** So basically you want to align Drum and Amber Leaf,
 23 Amber Leaf has come down, and so you offer a tactical
 24 bonus and say that you want them to bring Drum into
 25 alignment with Amber Leaf?

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1 **A.** Yeah, I mean, I think this is quite a good example of
 2 what you were alluding to before that, having signed
 3 an agreement, we had aspirations for pricing positions,
 4 but clearly within the period of the agreement this
 5 would be a very good example of where we had to operate
 6 outside the confines of that to do exactly as you say.
 7 **Q.** Is this outside the agreement, though? Because they
 8 have reduced the price of Amber Leaf and you are
 9 responding.
 10 **A.** But the agreement, as we were talking earlier, contained
 11 both ongoing and tactical bonuses.
 12 **Q.** Yes.
 13 **A.** And under this scenario, we would want to make more
 14 investment than we had suggested in the initial
 15 agreement.
 16 **Q.** Yes, so I rather saw this as an example of you applying
 17 the opportunity to respond clause?
 18 **A.** Yes, but it's part of the fluidity of our investment.
 19 **Q.** What you say is you want prices to be aligned, you don't
 20 say aligned or better, so really you were looking for
 21 the same price rather than a better price?
 22 **A.** Yes, I wanted to limit my investment and remain
 23 competitive against a comparable brand.
 24 **Q.** There is a similar exchange a bit further down in
 25 relation to Hamlet Miniatures and Cafe Creme?

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1 **A.** Yes.
 2 **Q.** If we turn over to tab 60, you can see there is two
 3 pages here, the second page is the same email or some of
 4 the same email. If you go back to the first page, at
 5 the bottom it says:
 6 "Prices are keyed down, I await new schedule"
 7 **A.** That's on 59. Which was the one that you --
 8 **Q.** Are we at tab 60? You can see at the second page of
 9 tab 60 it's the same email?
 10 **A.** I beg your pardon, yes.
 11 **Q.** Back on the first page of tab 60, it says "Prices are
 12 keyed down" --
 13 **A.** Yes. I understand.
 14 **Q.** -- so Morrisons agreed to do that for you.
 15 Can we now turn back to tab 2, please. You can tell
 16 me whether you have seen this document before. It's
 17 a Morrisons supplier meeting notes. I think it
 18 pre-dates your involvement with Morrisons?
 19 **A.** It does.
 20 **Q.** Do tell me if you don't want to answer questions about
 21 it.
 22 **A.** I'll do my best.
 23 **Q.** Did you have meetings with Morrisons where they sort of
 24 filled in forms like this?
 25 **A.** From time to time but they were an informal organisation

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1 and I can't remember many of these.
 2 **Q.** You can see this is a meeting, Colin Wragg and
 3 Justin Addison attended. This is a previous generation
 4 of the relationship. Down at point 3 it says:
 5 "Justin Addison to realign HR [I believe that's
 6 handrolling tobacco] retails. Action: JA."
 7 **A.** Yeah.
 8 **Q.** So you may not feel able to comment on this because
 9 obviously you weren't at the meeting, but my reading of
 10 that is that this is an arising from the meeting, so
 11 Imperial have probably raised at the meeting the need to
 12 realign hand rolling tobacco retails and that's
 13 an action that Morrisons had taken away something they
 14 are going to do. That would be my reading of the
 15 document.
 16 **A.** It would be mine too, although realign, I mean, it's
 17 obviously shorthand, which I suppose is testimony to
 18 their informality. I can't comment on how that, what it
 19 exactly meant.
 20 **Q.** Thank you. Could you now look at something slightly
 21 different, which is Mr Eastwood's witness statement.
 22 **A.** Right.
 23 **Q.** You know who Mr Eastwood is?
 24 **A.** I do.
 25 **Q.** It's in file 8, is it? Core bundle 8. I think it might

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1 be at the back of this file, tab 94. {C8/85/436}
 2 **A.** Mine only goes up to 85.
 3 **Q.** Maybe you have the wrong file. It's file 8 rather than
 4 7 I think we want.
 5 **A.** Ah, that would be 7.
 6 **Q.** Could you read paragraph 15 of that, which is on
 7 internal page 436.
 8 **A.** Paragraph?
 9 **Q.** Paragraph 15 on page 436.
 10 (Pause)
 11 So the point I take from that is that Mr Eastwood
 12 considered that entering into the agreements with ITL to
 13 be in Morrison's commercial interests?
 14 **A.** Yes.
 15 **Q.** I am sorry for showing you a series of slightly random
 16 documents, because I wanted to then just turn back to
 17 something you say in your witness statement at
 18 paragraph 129.
 19 **THE CHAIRMAN:** Can we put Mr Eastwood away for the moment?
 20 **MR WILLIAMS:** We can put Mr Eastwood away, yes.
 21 I think the bit I wanted to focus on first is it is
 22 absurd of the OFT to suggest that a FTSE 100 company
 23 would meekly be told what to do with their prices by
 24 ITL.
 25 Really what I wanted to put to you is that these

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1 comments are attacking a bit of a straw man really,
 2 because the OFT's case isn't that ITL told Morrisons
 3 what to do, it's that Morrisons chose to enter into
 4 an agreement with ITL to support its strategy in return
 5 for bonus payments, and that's what happened, that's
 6 what we have seen, isn't it?
 7 **A.** You are going to have to break that down for me.
 8 **Q.** The thrust of this paragraph is a criticism of the OFT,
 9 saying that the OFT's case is based on ITL bossing
 10 Morrisons around telling them what to do, and I am
 11 saying that's not really what the OFT's found, the OFT
 12 has found that there was an agreement or
 13 an understanding between Morrisons and ITL that
 14 Morrisons would support your strategy and that you would
 15 pay them bonuses to do so. We have seen the agreement
 16 and I've just shown you a couple of documents where it
 17 appears that Morrisons were happy to do that. So the
 18 point I am putting to you is that the comment in 129 is
 19 not really engaging with the case that your evidence is
 20 concerned with?
 21 **A.** I am probably confusing -- I mean, I stand by the fact
 22 that it is absurd to suggest that a large retailer would
 23 do what they were told by Imperial Tobacco, I think
 24 I feel that quite strongly, but I am not sure the
 25 relationship between what I've said there or what's

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1 written there and what you are suggesting, I am sorry,
 2 I am a bit slow, I am just not really picking up on
 3 that.
 4 **Q.** Putting it shortly, Mr Eastwood has just said that he
 5 regarded the trading agreement as in Morrison's
 6 commercial interests; you saw that, I showed you that?
 7 **A.** Yes.
 8 **Q.** So I am just saying that your comment is not really
 9 dealing with the case. The case is that there was
 10 an agreement or understanding which Morrisons entered
 11 into for its own reasons and under which it was going to
 12 be paid bonuses and in return for which it would do
 13 certain things for ITL?
 14 **A.** Yeah, I think that's fair enough, it was an agreement
 15 that did just that.
 16 **Q.** I think you say that Morrisons was at all times free to
 17 decide its own retail prices, but I think you have
 18 already agreed that the purpose of the agreement from
 19 your point of view was to constrain their freedom so
 20 that they would price on the basis of your strategy?
 21 **A.** I can't agree that I agreed with that.
 22 **Q.** We will have a look at the transcript in due course.
 23 Could you go into file 17 again, please, and turn to
 24 document 23. {D17/23/193}.
 25 **MR HOWARD:** I would have thought, rather than having

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1 a debate about the transcript, surely if there is
 2 a point which is sought to be put, a challenge to the
 3 witness, it ought to be put fair and square so he
 4 understands what it is. It's not a question of trying
 5 to see whether you have got him to say yes to something
 6 where he is saying he doesn't understand he said yes to
 7 that. In fact, the question was, I think: was there
 8 a constraint? The constraint hasn't been identified,
 9 that remains the case throughout. If it admit to be
 10 said that this witness is agreeing there was
 11 a particular constraint on Morrisons, one really ought
 12 to identify what the constraint was.
 13 **THE CHAIRMAN:** Well, I think the question was being put to
 14 him that he had said in his witness statement that, even
 15 though they had signed the agreement, Morrisons remained
 16 entirely free to price as they saw fit. The question
 17 I understood was being asked of Mr Matthews -- perhaps
 18 I can ask it -- is: do you agree that, in signing up to
 19 the agreement or in entering into this agreement, the
 20 parties expected or hoped or intended that it would
 21 influence Morrisons as regards the setting of their
 22 retail prices?
 23 **A.** No.
 24 **THE CHAIRMAN:** Well, what were you paying them the money
 25 for, then?

1 **A.** We were paying them to reflect the fact they sold prices
 2 at lower than RRP and from time to time we invested
 3 money to react and respond to moves in the market. Now,
 4 that might, from time to time, as we have seen in some
 5 of these documents, be a request for Morrison to respond
 6 to something and the output was that there was a price
 7 we were hoping to achieve. Hopefully I am not treading
 8 on the wrong territory, that seems different to me than
 9 telling them what prices to sell at, generally speaking.
 10 **THE CHAIRMAN:** We are not talking about telling them what
 11 prices to sell at, we are focusing on the differentials
 12 between the Imperial products and the Gallaher products,
 13 whether by attaching that schedule that we have seen of
 14 the "not more than 3p or not more than 5p" and offering
 15 them ongoing bonuses, part of which was supposed to
 16 reflect their agreement to do that, whether you then
 17 expected them to do that, subject to these times when
 18 manufacturer intervention caused things to go out of
 19 kilter?
 20 **A.** Yes.
 21 **THE CHAIRMAN:** Right.
 22 **MR WILLIAMS:** Do you have document 23 there?
 23 **A.** I do.
 24 **Q.** What I am going to do now is start to look at what was
 25 the strategy that Morrisons had agreed to support. Just

1 looking, first of all, at page 193, a slight detour: do
 2 you see there is a heading "Morrisons and Tobacco"?
 3 **A.** Yes.
 4 **Q.** Underneath the first paragraph there is a single line
 5 paragraph?
 6 **A.** Yes.
 7 **Q.** So Morrison's strategy was clear to you in relation to
 8 tobacco?
 9 **A.** Yes.
 10 **Q.** At page 200 of this document, {D17/23/200}, if you just
 11 turn over, and obviously I should have said but we all
 12 understand this is a document you drafted, I think,
 13 isn't it?
 14 **A.** It is a document I drafted, yes.
 15 **Q.** We see at 200 you start to deal with your strategy for
 16 the financial year.
 17 **A.** Right.
 18 **Q.** So it's an obvious point, when you were designing this
 19 strategy, you had in mind Morrison's strategy?
 20 **A.** Yes.
 21 **Q.** The two were designed to work together as best they
 22 could?
 23 **A.** Yes.
 24 **Q.** If you look at the first point, there are two
 25 introductory paragraphs which end with a colon?

1 **A.** Yes.
 2 **Q.** You have read those, have you?
 3 **A.** Yes.
 4 **Q.** Then seventh paragraph down, it may be the paragraph
 5 between two boxes on your copy, I don't know if it is?
 6 **A.** Yes.
 7 **Q.** There is a description of what your pricing strategy was
 8 in recommendation to pricing differentials?
 9 **A.** Yes.
 10 **Q.** It says:
 11 "The strategy is to reflect current list price
 12 differentials."
 13 And "reflect" here as in the shelf prices?
 14 **A.** Yes.
 15 **Q.** So the way this works is you have the RRP for an ITL
 16 brand?
 17 **A.** Yes.
 18 **Q.** You have the RRP for a Gallaher brand, you identify them
 19 as a pair, and you work out the difference between them,
 20 and that gives you a number, let's say it's 3p?
 21 **A.** Yes.
 22 **Q.** Your strategy is that shelf prices should reflect that
 23 3p differential?
 24 **A.** Yes, or better.
 25 **Q.** Well, you say that, but that's not how the strategy is

1 described here. It says you should reflect the
 2 differential, and the differential is not a maximum or
 3 a minimum number, it's just a differential?
 4 **A.** But it would be better, wouldn't it, if it was better
 5 than that differential? So, for example, if we had
 6 an aspiration that Richmond and Mayfair should be the
 7 same price, if we were cheaper, I mean, that would be
 8 a good thing, and any opportunity that we could -- to
 9 try and, even for a limited time, achieve that, would be
 10 a good thing. That would be better, much better.
 11 **Q.** Could you turn to tab 16, please. Do you want to read
 12 that to yourself?
 13 **A.** This is Richmond Kingsize and Superkings.
 14 **Q.** Sorry, it's 15 November 2000, that's right, yes.
 15 **A.** Okay. (Pause). Okay.
 16 **Q.** So, first of all, just looking at the language of this
 17 document where you say "We are moving" -- sorry, do you
 18 have that, "in the light of this we are moving Richmond
 19 Kingsize up to 224/225"?
 20 And then right at the bottom:
 21 "Please let me know when you can move your shelf
 22 prices."
 23 So this is an instance where you did expect
 24 Morrisons to price at 3.34 when you removed the bonus?
 25 **A.** Well, that's their call. I think what I am trying to

1 highlight here, I am afraid that some of these documents
 2 are rather turgid because they were largely -- in many
 3 ways they were part of an audit trail, and I am going
 4 off-piste here a little bit, but the sums of money
 5 involved were very often [REDACTED],
 6 particularly in the larger supermarkets and I was
 7 relatively young at the time, I always felt I should
 8 keep very clear records of what was being paid for what,
 9 and this document shows to Morrison the natural
 10 commercial outcome of that move. Morrison could argue
 11 with it, they could say "I want to keep it on the shelf
 12 for longer", they could say "I want to keep the price
 13 down, would you support some of it?" They could do what
 14 they wanted. This is a record of the commercial outcome
 15 of what would happen if they chose to follow this
 16 strategy.
 17 **Q.** I think what you have done there is really repeat
 18 an account of these sorts of documents you give in your
 19 witness statement, but it didn't really answer the
 20 question I asked you which was about something a bit
 21 different, which was, just looking at the language "we
 22 are moving" and "please let me know when", I was just
 23 saying it does look as though this is a good example of
 24 you assuming that when you take the bonus away, they
 25 will move to 3.34?

1 **A.** Well, I think that assumption would be based on the fact
 2 that if they weren't to do that, it would have
 3 a suboptimal impact on their margin, particularly their
 4 cash margin, and I am just laying that out as plainly as
 5 I can in this communication.
 6 **Q.** This document tells us that when you say you have
 7 a strategy of parity, that doesn't mean no more
 8 expensive than, because Richmond was no more expensive
 9 than Dorchester, and yet you were asking Morrisons to
 10 increase the price?
 11 **A.** Right, asking them, yes.
 12 **Q.** Do you agree with that?
 13 **A.** I am suggesting that, yeah.
 14 **Q.** But you are asking them to increase the price?
 15 **A.** I'm saying in order to maintain your cash margin the
 16 bonus level should be as follows, so I suppose implicit
 17 in that, if they didn't want to maintain their cash
 18 margin, they would make a different call.
 19 **Q.** Can we look at the order of the points in this document,
 20 because you are talking about the bonus and the cash
 21 margin, but actually really where this starts is the
 22 paragraph:
 23 "You are probably aware that the broad marketplace
 24 has moved from 3.39, 3.40 to 3.34, 3.35 on Dorchester
 25 Kingsize and Dorchester Superkings. You may remember

1 from my presentation on the Richmond repositioning and
 2 the launch of Richmond Superkings that our strategy is
 3 parity with Dorchester."
 4 **A.** Yes.
 5 **Q.** "In light of this".
 6 So do you agree that the "in light of this" is that
 7 the strategy is parity with Dorchester?
 8 **A.** That's certainly our strategy, yes.
 9 **Q.** And it is in light of the strategy that you are "moving
 10 Richmond Kingsize and Superkings up to 3.34, 3.35"?
 11 **A.** Right.
 12 **Q.** Do you agree with that?
 13 **A.** I do.
 14 **Q.** So that tells us that you wanted to see the price of
 15 3.34, 3.35 because of your strategy of parity?
 16 **A.** I hope I don't sound argumentative, and perhaps it's
 17 a urbane point or an arcane point -- and I know I am
 18 repeating myself -- but this is setting out the maths of
 19 the situation. I want to reduce my investment, my brand
 20 I have been investing in heavily, and when I do so, this
 21 is what would happen if you increased the shelf price.
 22 But that is all it does. My strategy might not be the
 23 same as Morrison's, and Morrison might, for example --
 24 and I do not want to bring other accounts but other
 25 grocers might not want to follow this, and they might

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1 not have wanted to follow this.
 2 **Q.** I am focus at the moment on what your strategy was, what
 3 you were seeking to achieve.
 4 **A.** Yes.
 5 **Q.** I think the point I am putting to you is that, just
 6 reading the word on the page --
 7 **A.** Yes.
 8 **THE CHAIRMAN:** There is perhaps a prior point. Where it
 9 says "We are moving Richmond Kingsize and Richmond
 10 Superkings", was that we, Imperial?
 11 **A.** I think it's probably we, me, and what I probably ought
 12 to have said is that I would like to do this.
 13 **THE CHAIRMAN:** Right. It's not "we", you and I?
 14 **A.** No, I understand the point now.
 15 **THE CHAIRMAN:** Not "we", Mr Addison.
 16 **A.** I can't -- I suspect that it's not you and I, it's more
 17 we --
 18 **THE CHAIRMAN:** The royal "we"?
 19 **A.** Exactly, I think it's Imperial want to reduce our
 20 investment and want to move up.
 21 **MR WILLIAMS:** I read it in that way because you say "our"
 22 strategy just before and the "our" is plainly Imperial.
 23 So where had we got to? I think I was putting to
 24 you that the "we are moving", just as the Chairman
 25 identified, is talking about Imperial wants to see, it

1 wants to see a price of 3.34, and then what the document
 2 goes on to do is set out what is the bonus associated
 3 with the shelf price of 3.34?
 4 **A.** In order to maintain the cash margin. Now, by saying
 5 that, in order to maintain your cash margin, yes, you
 6 are absolutely right, we have been investing heavily in
 7 Richmond, we saw an opportunity to take the foot off the
 8 gas, in other words reduce our investment in that brand,
 9 and I am saying to Justin in this instance "there is
 10 a movement in the market, you have told me, we have had
 11 a phone conversation about it, I would like to reduce my
 12 investment. If I do that, and you move to 3.34, this is
 13 going to be your cash margin", so if they want to
 14 maintain their cash margin, this is what the commercial
 15 equation looks like.
 16 **Q.** That's a letter you could have written, obviously, isn't
 17 it? You could have written a letter saying: Dorchester
 18 was being promoted, it's not being promoted any more, we
 19 have been funding a lower shelf price, we obviously
 20 don't want to fund a lower shelf price if the rival
 21 product has gone up, as a result of which we are not
 22 paying a bonus any more. If you want to maintain your
 23 margin you can move it up to 3.34 but just to let you
 24 know we are not paying the bonus any more at 3.29
 25 levels, that is just a different letter?

1 **A.** I suspect that happened and that conversation was part
 2 of the telephone conversation that I referred to.
 3 **Q.** The impression I got was that this letter was
 4 a reflection of the telephone conversation rather than
 5 the two were in different terms?
 6 **A.** In its perfunctory form, yes, but part of the
 7 conversation, and of course life as a national account
 8 manager is very much based on the telephone, I did try
 9 and keep these letters as short and sweet as possible,
 10 but preceding the letter, there would have been quite
 11 a long conversation about this, depending on how
 12 bellicose the buyer felt at the time.
 13 **Q.** I don't think the letter I suggested would have been any
 14 longer, it just would have been different?
 15 **A.** It might well have been different.
 16 **Q.** On a different note, you have discussed this, as you
 17 said a minute ago, with Morrisons, and you then write to
 18 them, so it looks as though this letter is confirming
 19 what's been discussed and there was no particular
 20 difficulty about this?
 21 **A.** It certainly confirms what was being discussed, whether
 22 or not there was difficulty in it I can't remember
 23 because these weren't, they weren't straight lines,
 24 a good buyer would not have accepted this, a good buyer
 25 would have argued for a very long time about this.

1 **Q.** We know that they did move the price to 3.34, we get
 2 that from 17/19, I don't think we need to turn it up,
 3 I am just giving that for the Tribunal's reference.
 4 Could you look at a document in annex 18, please,
 5 which we haven't got at the moment. It's the
 6 Sainsbury's annex. It's at tab 22. {D18/22}.
 7 **A.** That's a document about Sainsbury.
 8 **Q.** It will be about Sainsbury, yes. It is tab 22. This is
 9 more or less the same letter as sent to Sainsbury's on,
 10 I think, the same date. The only reason for going to it
 11 is because there is one slight difference from the
 12 letter you wrote to Morrisons. Do you see in the second
 13 paragraph, it says:
 14 "In light of this and not to hold the market up ..."
 15 Do you see those words?
 16 **A.** I'm looking for them.
 17 **Q.** The second paragraph "You may remember"?
 18 **A.** All right. (Pause). Yes.
 19 **Q.** You say "not to hold the market up". So as I read it,
 20 that's saying that you don't want to deter retail price
 21 increases across the market, ie by you and Gallaher and
 22 that's why or partly why you are raising prices?
 23 **A.** I think that's part of the language that you use with
 24 buyers. I doubt if she would have been moved by that,
 25 but it was to try and put some impetus behind the fact

1 that I wanted to claw some of my investment back because
 2 at the time we were dangerously close to being
 3 underwater on that brand.
 4 **THE CHAIRMAN:** Could you just explain again what is meant by
 5 "and not to hold the market up and not to delay the
 6 upward movement in the price?"
 7 **A.** "Let's get the price up, Fiona, you can take more cash
 8 in the till, I can recoup some of my investment, it
 9 seems to be happening, why wait".
 10 **THE CHAIRMAN:** How would they make more cash in the till?
 11 **A.** Well, they would take more cash. It was, to be quite
 12 frank, a spurious argument, whether 5p or 6p on a packet
 13 of cigarettes would have a massive effect, but it was
 14 one I tried to use that they wanted to take as much
 15 turnover through the till as possible, so by putting the
 16 price up you get some inflation and some additional
 17 turnover.
 18 **MR WILLIAMS:** Could you turn to paragraph 56 of your witness
 19 statement there, please, which deals with this letter.
 20 It's quite a long description, and you deal with some of
 21 the issues that you have covered already in your
 22 evidence in relation to Morrisons. On page 20 --
 23 **A.** 56 in the witness statement?
 24 **Q.** Paragraph 56. That paragraph spans two pages.
 25 **A.** I have the wrong 56 then.

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1 **Q.** Sorry, it's your witness statement. I am so sorry.
 2 **A.** No, no, it's me, I am not up to speed with these files
 3 as much as --
 4 **Q.** So you are at tab 42.
 5 **A.** Right, okay.
 6 **Q.** You might still have been in Mr Batty's statement.
 7 **A.** I was in somebody else's business there. What number is
 8 it?
 9 **Q.** It's paragraph 56, page 20. Paragraph 56 runs onto
 10 a second page.
 11 You can read the whole paragraph if it's helpful,
 12 but it really says some of the same things you said
 13 about the Morrisons document. The bit I wanted to focus
 14 on was, do you see at the top of page 20, about three
 15 lines down:
 16 "I also say that I do not want to hold the market
 17 up."
 18 **A.** I hope I am on the right page. This is 56?
 19 **Q.** The top of page 20?
 20 **THE CHAIRMAN:** Paragraph 56.
 21 **MR WILLIAMS:** It says:
 22 "... would have been the case if our bonus had
 23 continued."
 24 **A.** Yes.
 25 **Q.** Then three lines down "I also say"; do you see that?

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1 **A.** Right. Yes, I do see it.
 2 **Q.** This is said to be confidential, but I don't know
 3 whether it really is or not. No? So you say:
 4 "This was not actually true, but I was trying to
 5 persuade Sainsbury to accept the ending of the bonus
 6 which was being withdrawn across the market generally."
 7 I don't think that's exactly what you said a few
 8 moments ago, is it?
 9 **A.** I don't think it's dissimilar. [REDACTED]
 10 [REDACTED]
 11 **Q.** When you say:
 12 "I was trying to persuade Sainsbury to accept the
 13 ending of the bonus", I am not sure I understand that,
 14 because you say in paragraph 18 of your statement that
 15 decisions about the level of promotional funding were
 16 made by the ITL management team. Do you want to look at
 17 that? It's a fairly straightforward point. It's
 18 exactly what you would expect, ITL offers bonuses and it
 19 decides whether to withdraw them?
 20 **A.** I think there was a little bit more play in it than
 21 that, largely because the relationships with these
 22 senior accounts wasn't one in which anything was black
 23 and white, and from time to time you could get
 24 additional investment and hang on to investment longer,
 25 but in this particular case with Sainsbury and with --

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1 I mean, I've also said there, mentioned or referenced
 2 Tesco, you know, if you were trying to money back on
 3 a brand, in other words hand reduce investment on it,
 4 you would pretty much try your hardest to do that, and
 5 sometimes, you know, there would be times in
 6 a relationship [REDACTED]
 7 [REDACTED]
 8 [REDACTED]
 9 **Q.** All I am really saying to you is that you offered them
 10 a bonus and you could take it away; there was nothing to
 11 persuade them about?
 12 **A.** I am not sure that -- I think that's too black and
 13 white. I mean, it's not as simple as that. If it was
 14 as simple as that it would have been done by computer.
 15 There was persuasion required, and there was negotiation
 16 involved.
 17 **Q.** Persuasion required for you to withdraw a bonus?
 18 **A.** Yeah.
 19 **Q.** Have you still got annex 18 open?
 20 **A.** I think so.
 21 **Q.** While we have it open, could you turn to tab 20, please,
 22 and just read it to yourself. {D18/20}. I am not going
 23 to ask you any questions about it, I am just asking you
 24 to read it because it provides some useful background to
 25 a Morrisons document we are about to look at. You only

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1 need to read down to the word "concept".
 2 (Pause)
 3 A. Okay.
 4 Q. Just so that we pull out the point, this is an email on
 5 26 September, Mayfair is moving up from 3.44 to 3.49 on
 6 2 October, and you basically say you are going to change
 7 the level of the bonus which will give rise to a shelf
 8 price of 3.65 which brings L&B and JPS into line with
 9 a 16p price list differential?
 10 A. Yeah.
 11 Q. I am only showing you that because that document spells
 12 out a bit more background than the document in the
 13 Morrisons file that we are about to look at. Could you
 14 turn to document 9 in the Morrisons file, please, 17.
 15 You can put Sainsbury's away now, actually, I don't
 16 think we need that again.
 17 A. Which document was it?
 18 Q. It's number 9 in the Morrisons file. Do you want to
 19 read the section with "The pricing movements L&B JPS
 20 brands"?
 21 A. Yes. (Pause). Okay.
 22 MR WILLIAMS: Do you have it, Madam, sorry?
 23 (Pause)
 24 This is the same date as the email we saw in the
 25 Sainsbury file and it covers basically the same ground

1 in Morrisons but it just explains in a little bit
 2 more -- sorry, the Sainsbury's document explains what's
 3 happening behind the scenes, and this relates to the end
 4 of a period during which you paid retro bonuses on L&B
 5 and JPS to maintain a lower price against Mayfair.
 6 Now, do you have your witness statement there? You
 7 deal with this in your witness statement at 142 and 143.
 8 It's 143 I was really interested in at the moment.
 9 (Pause)
 10 A. Okay.
 11 Q. One of the things you say in this paragraph is that
 12 Gallaher was having an MPI on 2 October, and I think on
 13 that basis you say, well, Morrisons as a Gallaher
 14 customer would have known about the forthcoming MPI in
 15 any case and increasing the cost of Mayfair. Actually
 16 Gallaher wasn't having an MPI at this stage. This is
 17 just a scenario where levels of bonuses are being moved
 18 around on products between manufacturers' price
 19 increases. So what this looks like is not so much
 20 a scenario where there is a price list floating around
 21 and everyone knows what is happening on the Gallaher
 22 brands, it looks like a situation where you have picked
 23 up some intelligence about what's happening on the
 24 Gallaher brand from some of your other customers and you
 25 have passed it on to Morrisons?

1 A. I am not sure. I mean, that could have been as a result
 2 of what Justin told me at Morrison.
 3 Q. One of you seemed to be passing intelligence to the
 4 other?
 5 A. I don't know. I mean, I've written in the letter
 6 "Following our meeting on Friday, the issues we
 7 discussed, I understand", so that could quite well mean
 8 that I have had some intelligence directly from Justin,
 9 it might be supposition, it could be a whole range of
 10 things.
 11 Q. A bit further down you say:
 12 "As you are aware, your competitors' shelf prices
 13 have been a little higher but they would also be moving
 14 to 3.65."
 15 That does appear to be you giving Morrisons some
 16 intelligence about what's happening in its competitors,
 17 doesn't it?
 18 A. I am not sure. Again, that could have been part of the
 19 conversation we had at the meeting.
 20 Q. I think it probably was part of the conversation you had
 21 at the meeting, but I am just saying that you are going
 22 to have a better idea what's happening to your brands in
 23 Morrison' competitors than Morrisons, I am saying it
 24 looks like it's coming from you?
 25 A. No, I don't agree with that. It wouldn't have been

1 something I would have discussed with Justin. He may
 2 have mentioned it to me, it may have been a conversation
 3 between he and I.
 4 Q. He mentioned to you that ITL's brands were going up in
 5 his competitors? It just looks like something which
 6 would have come from you rather than the other way
 7 around.
 8 A. Can you just explain again what you are trying to say,
 9 because I am not sure that I follow it necessarily.
 10 Q. Okay. The paragraph as discussed, the last sentence of
 11 that says:
 12 "As you are aware, your competitors' shelf
 13 prices~..."
 14 And this is talking about L&B and JPS?
 15 A. Yes.
 16 Q. "... have been a little higher at 3.63" and we actually
 17 saw that in the Sainsbury's document a few moments ago.
 18 But they would also be moving to 3.65. So it looks as
 19 though you are giving him reassurance that his
 20 competitors are going to be moving to 3.65 as well.
 21 A. I don't recall that particular piece of intelligence,
 22 but I suspect it was like all intelligence, it could
 23 have come from various sources but it might well be as
 24 a result of that conversation I had with Justin on that
 25 Friday.

1 Q. Sorry, I do not understand, in what direction are you
 2 saying the intelligence went?
 3 A. Well, he could have told me.
 4 Q. He could have told you that your brands were going up in
 5 his competitors?
 6 A. I am sorry, I am confused. Right. Your competitors.
 7 Q. So the "your" is Morrisons?
 8 A. Right, I thought you were referring to Gallaher. Right.
 9 So --
 10 Q. Sorry, perhaps I should have broken it down.
 11 **THE CHAIRMAN:** Well, perhaps I can help. What this looks
 12 like it's doing is anticipating an argument from
 13 Morrison to the effect, "Well, we don't want to go up to
 14 3.65 as you are asking us because our competitors are at
 15 3.63" and it seems that you are saying to him, "Well,
 16 don't worry about that, although they are currently at
 17 3.63, they will be moving to 3.65 in the same way as we
 18 are asking you to move to 3.65".
 19 A. I see. I understand, I understand.
 20 **THE CHAIRMAN:** It looks as if you are giving him that bit of
 21 information to head off at the pass an argument from him
 22 as to why he might not want to put his price up to 3.65.
 23 Is that a fair summary?
 24 **MR WILLIAMS:** It is, Madam, yes, I didn't think that was
 25 a deeply controversial thing.

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1 **THE CHAIRMAN:** Let's find out. Does that help you recall
 2 whether actually that is what you were saying, or where
 3 did that information come from?
 4 A. It seems as though that's what I was saying. Whether
 5 I knew it to be the truth or not, I don't know, I can't
 6 remember, I mean, there were a lot of conversations
 7 where you would insinuate something without actually
 8 knowing it, to try and do exactly as you say, to sort of
 9 chivvy them up, or reassure them that they weren't going
 10 to be out of kilter in the marketplace, that particular
 11 instance I don't remember it exactly.
 12 **DR SCOTT:** Just remind us, which relationships were you
 13 dealing with at this time?
 14 A. In 2000 I suspect that would have been Tesco, maybe not
 15 Tesco. Well, obviously Morrison, Sainsbury and Tesco,
 16 I think.
 17 **MR WILLIAMS:** In your statement you say 1997 to 2004
 18 Sainsbury, September 2000 to May 2004 Morrisons and the
 19 same for Tesco.
 20 A. Yes, so Tesco, Morrison and Sainsbury.
 21 **DR SCOTT:** So in the sense that you were in touch with Tesco
 22 and Sainsbury and you had colleagues who were in touch
 23 with others --
 24 A. Yes.
 25 **DR SCOTT:** -- you might well have been in a position to

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1 know that parallel letters might be emanating to other
 2 retailers suggesting parallel moves?
 3 A. Yeah, I mean, that could be where the intelligence --
 4 not necessarily from letters but conversations.
 5 **DR SCOTT:** Communications?
 6 A. Communication.
 7 **MR WILLIAMS:** You do say in your statement at 142, "This was
 8 speculation on my part and I didn't know what the other
 9 retailers' prices were actually going to do." Obviously
 10 you didn't have a crystal ball.
 11 A. No.
 12 Q. But presumably you believed this to be correct, useful
 13 information; you wouldn't have damaged your relationship
 14 with Morrisons by giving them misinformation?
 15 A. I wouldn't knowingly want to lie to them, but I might
 16 suggest something that would be to my commercial
 17 advantage that wasn't strictly true.
 18 Q. We have just seen that you wrote to Sainsbury on the
 19 same day about the same thing. In the letter, reading
 20 this letter in conjunction with the Sainsbury's letter
 21 which we have just put away, I think what we can deduce
 22 is that the move from 3.60 to 3.65 is designed to
 23 restore a 16p differential. Do you remember that from
 24 the --
 25 A. I do remember that from that letter, yes.

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1 Q. With Mayfair at 3.49?
 2 A. Yes.
 3 Q. This is just for the Tribunal: when Mr Goodall was
 4 cross-examined, I think a question was asked about
 5 whether 3.65 was a post promotional price. I wasn't
 6 going to go through all the documents with Mr Matthews,
 7 but what we see in the period prior to this, L&B and JPS
 8 were around 3.59 to 3.61 and then there was an MPI in
 9 August, so it looks as though what might have happened
 10 is that the MPI was held on L&B and JPS. If you want
 11 the references for that, they are 17/3, 17/6 and 17/8.
 12 That gives you a picture of what's happening at that
 13 time.
 14 What you say about this document in your statement
 15 in paragraph 144, do you want to just read the last
 16 sentence of 144.
 17 (Pause)
 18 You say you would have had no objection if they had
 19 kept the price down, but what the letter says is, "Can
 20 you increase the shelf price from 3.60 to 3.65?" It
 21 doesn't say, "We are reducing the bonus and no longer
 22 funding a price below 3.65", it says, "Could you
 23 increase the shelf price". So it doesn't look as though
 24 you would have had no objection if they had kept the
 25 price low. It looks as though you wanted them to price

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1 at 3.65.
 2 **A.** But why would I have objected?
 3 **Q.** The reason you would have objected is because you had
 4 a strategy of pricing at parity, pricing these brands at
 5 parity or at fixed differentials?
 6 **A.** If it was better, I would get more share.
 7 **Q.** Well, I am not going to debate the economics of this
 8 with you, Mr Matthews, I am just putting to you what the
 9 facts show. The facts show that you are asking, in this
 10 instance Morrisons, to increase their price up to 3.65
 11 in order to restore the 16p differential?
 12 **A.** But again I would say perhaps at the point of repeating
 13 myself that -- two things: firstly, that this just is
 14 showing the natural mathematical outcome of them doing
 15 that. They could say no. They could make a point "we
 16 don't want to go up yet" and very often you would have
 17 periods where they would use anything they could in
 18 their armoury to prevent it from happening.
 19 **Q.** They didn't say that, they actually did put the price up
 20 in due course, but that's not really the point I am
 21 getting at. The point I am getting at is: what were you
 22 seeking to achieve?
 23 **A.** I was seeking to reduce my investment.
 24 **Q.** I am just putting it to you that this document says:
 25 "Could you increase the shelf price. This will mean

1 a removal of the additional retro bonus."
 2 So the document says that the price point to restore
 3 the differential comes first and the reduction of the
 4 bonus is a means to that end?
 5 **A.** I would say it's the other way round, that my -- you
 6 asked me what my strategy was, and my intention, it was
 7 to produce my investment.
 8 **Q.** You would accept it's not the other way round in the
 9 letter?
 10 **A.** I am not sure. I think that a lot of these letters are
 11 written knowing that that is probably going to be the
 12 outcome because the supermarket isn't want to going to
 13 then sacrifice cash margin, but that doesn't mean that
 14 they wouldn't be free to do so. And that would happen.
 15 On this instance, as you say, that didn't happen but I
 16 can think of quite a few -- a lot of instances, I am not
 17 going to reference them directly, but other large
 18 supermarkets where that wasn't the case, and there were
 19 huge arguments that went on for weeks about investment,
 20 not only did they want to maintain the shelf price but
 21 they wanted the investment as well, and sometimes you
 22 would end up paying for it.
 23 **DR SCOTT:** Your witness statement emphasises, I think on
 24 more than one occasion, that they were very focused on
 25 margins.

1 **A.** Yeah.
 2 **DR SCOTT:** And I understand that you are focused here on
 3 reducing your investment, and so I do see that there is
 4 a chicken and egg, but what's being put to you is that
 5 the way the letter is written is "you put up the price,
 6 and you will retain your margin even though we are going
 7 to reduce the investment"?
 8 **A.** Yes.
 9 **DR SCOTT:** Looked at from your point of view, you could be
 10 saying "I need to save some money, they need to retain
 11 their margin, therefore they must put the price up".
 12 Now, what's actually happening here is you have done the
 13 mathematics very carefully so that the price matched by
 14 your reduction investment is that particular price that
 15 you mentioned in the letter.
 16 **A.** Yes.
 17 **DR SCOTT:** And your expectation of what's going to happen,
 18 because they are very worried about the margin, is that
 19 they will actually do what you suggest.
 20 **A.** Yes, you are right, with every material particular, but
 21 there were lots of instances where it didn't happen.
 22 Perhaps that isn't relevant to the question, but --
 23 **THE CHAIRMAN:** Where what didn't happen?
 24 **A.** Where they wouldn't have put their prices up.
 25 **MR WILLIAMS:** We did see this morning that the differentials

1 were consistently right.
 2 **A.** I am talking in general multiple supermarkets now and
 3 from time to time Morrison. Maybe it was a timing issue
 4 rather than an absolute one, but yeah, I mean, they were
 5 as keen to maintain their cash margin as I was, as you
 6 say, to reduce my investment. So I suppose there was
 7 a sort of a symbiotic relationship there.
 8 **Q.** Do you want to then just look at the section of the
 9 letter that starts "Price movements Richmond", do you
 10 see that in the middle of the first page?
 11 **A.** I do.
 12 **Q.** If you read down to the middle of the next page where it
 13 starts to talk about 100 multipacks, you can stop there.
 14 (Pause)
 15 **A.** Stop at that point?
 16 **Q.** You don't need to read about the 100s.
 17 (Pause)
 18 **A.** Okay.
 19 **Q.** So the only point I wanted to put to you is that here,
 20 if Dorchester is at 3.28, you want to be at 3.28, if
 21 it's at 3.29 you want to be at 3.29, and in both cases
 22 you are asking them to price at that specific price
 23 rather than that price or a lower price?
 24 **A.** Well, I've said I've assumed a shelf price and that
 25 assumption is, I suppose, based on the conversation

1 piece with the gentleman that, you know, I assume he
 2 wanted to meant or save his cash margin and I wanted to
 3 decrease my investment. So I've made that assumption to
 4 illustrate -- sorry to interrupt -- again that sort of
 5 maths of the situation, which you are absolutely right
 6 were fairly fine-tuned.
 7 **Q.** So if they were at 3.29 you want to be at 3.29, if they
 8 are at 3.28 you want to be at 3.28?
 9 **A.** I am not sure that's what I am saying. I am not sure
 10 that's what I am saying. What I am saying is that
 11 I want to reduce my investment and I want to reduce it
 12 by that much. If I reduce it by that much and you want
 13 to maintain your cash margin and I make the assumption
 14 that's where your price will be.
 15 **Q.** I do understand that all of the bonuses are designed to
 16 maintain margins depending on where the price is, I do
 17 understand that.
 18 **A.** It's quite an important point that they were, because
 19 the supermarkets largely worked on cash margins, so
 20 I was always -- and you know, many of these letters are
 21 drafted with that in mind, because that's what drove
 22 their business.
 23 **Q.** So the bonus you pay depends on what is a factor of the
 24 shelf price?
 25 **A.** Yes.

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1 **Q.** And here if they are at 3.29 you will pay a bonus that
 2 will maintain their margin at 3.29 and you say, "Please
 3 reduce these brands to 3.29" and if they are at 3.28,
 4 you will say, "I would like to be at 3.28 necessitating
 5 a further increase to maintain cash margin". So you
 6 will pay the bonus to achieve the price you need to
 7 achieve to achieve parity?
 8 **A.** Certainly in this instance we seem to want to be at that
 9 price.
 10 **Q.** At that price?
 11 **A.** Yeah, because that differential was very important, they
 12 were both very key brands at the time.
 13 **Q.** We know that this price change happened because we have
 14 already seen the next document in the sequence where
 15 prices went from 3.29 to 3.34?
 16 **A.** Yeah, I mean, in an instance where you are offering
 17 a supermarket the ability to reduce the cost of their
 18 products to their consumers, it's very rare for them to
 19 argue with that.
 20 **Q.** The next document in this sequence I want to go to is
 21 28, but before we go there, can I just ask you some
 22 questions about the schedules on varying costs, bonuses
 23 and margins.
 24 You deal with this in your statement, or these
 25 documents, at 131. Do you want to read that to

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1 yourself?
 2 **A.** I will. (Pause). Okay.
 3 **Q.** So you say in here, amongst other things, that the
 4 prices in the schedules were set by the retailer?
 5 **A.** Yes.
 6 **Q.** I understand the idea that the price was ultimately set
 7 by the retailer?
 8 **A.** Yes.
 9 **Q.** But we saw earlier under the second trading agreement
 10 that you paid Morrisons a bonus to price in accordance
 11 with the schedule?
 12 **A.** Right.
 13 **Q.** So I was just wondering whether it can be right to say
 14 that these are just the retailer's prices, because if
 15 they were just the retailer's prices, presumably you
 16 wouldn't have been paying them a bonus to price in
 17 accordance with them?
 18 **A.** Can you say that last piece again, please?
 19 **Q.** I can. We saw earlier on that under the second trading
 20 agreement, you paid Morrison a bonus to price in
 21 accordance with the schedules, and what you are saying
 22 in 131 is that this was the price set by the retailer,
 23 and I am just asking: well, they can't just be the
 24 retailer's choice of price, otherwise you wouldn't pay
 25 them a bonus under the second trading agreement in order

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1 to do it?
 2 **A.** I go back to what I was saying earlier today that two,
 3 I think important points, the first is that those
 4 schedules reflected both ongoing and tactical bonuses,
 5 and the ongoing element was in part for prices below
 6 RRP, and secondly that those schedules were largely
 7 audit trails and that the prices keyed into them were
 8 the prices that we found having walked through the doors
 9 of the store. So they weren't dictations. I do not
 10 believe that. I believe that those were the prices the
 11 retailer chose that we were paying for beneath RRP and
 12 from time to time tactical bonuses, that is my
 13 understanding of what those schedules represented.
 14 **Q.** I am sorry to press you on this, I don't understand the
 15 answer you have just given. All I was saying is that
 16 they can't simply be prices that are the retailer's
 17 choice of price, because if that were right it would
 18 make no sense that in the second trading agreement, you
 19 say "We will pay you a bonus to price in accordance with
 20 the schedule"?
 21 **THE CHAIRMAN:** Are you talking about two different schedules
 22 here?
 23 **MR WILLIAMS:** I don't think so. Sorry. Pricing schedules
 24 such as the one sent on 9 January 2001. Perhaps we
 25 ought to look at it to make sure we are talking about

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1 the same thing, and that's at tab 17, that schedule. If
 2 you just look at the first line, we don't need to get
 3 into the detail of this for the minute.
 4 **A.** In the schedule?
 5 **Q.** No, in the cover letter. If you look at the first line
 6 and then read down to the end of the first point.
 7 **A.** Sorry, this is the "please find attached a new schedule
 8 of costs bonuses"?
 9 **Q.** That's right, yes.
 10 **A.** Right, I've read that.
 11 **Q.** Have you read to the end of point 1?
 12 **A.** (Pause) right.
 13 **Q.** So I think the way I read "the following changes have
 14 been made", you have made some changes to the schedule
 15 and what we see in point 1 is that the changes are
 16 designed to restore a pricing relationship, it looks
 17 like a differential --
 18 **A.** Right.
 19 **Q.** -- between Embassy and Regal on the one hand and B&H
 20 Silk Cut on the other?
 21 **A.** Yes.
 22 **Q.** So you have changed the schedule there to include
 23 a price which will restore a differential?
 24 **A.** But isn't there a point before that, and isn't this the
 25 point, the difference between ongoing and -- I've

1 forgotten the word now -- ongoing and tactical bonuses.
 2 To get to the tactical price there has to be a price
 3 established by the retailer for that brand. So for
 4 example using this product as an example, Embassy and
 5 Regal 100s and 200s, the retailer, for reasons best
 6 known to themselves, has decided to sell this product
 7 at, I don't know, £20 or £18, and we had paid a bonus
 8 based on the price that they had established.
 9 **Q.** That's the tactical bonus, I do understand that.
 10 **A.** Yes.
 11 **Q.** We are now --
 12 **A.** In danger of agreeing --
 13 **Q.** Mixing up a number of different points.
 14 **A.** Okay, right.
 15 **Q.** I understand the context of all of this is a reduction
 16 in tactical bonus and an apparent move in a Gallaher
 17 brand, that's the background. Just in terms of the
 18 mechanics, what's happening here is you are changing the
 19 schedule, you are changing it to include the price that
 20 you want to see to restore the differentials.
 21 **A.** No, I am changing the schedule to make sure it reflects
 22 the investments that I want to make, so when somebody
 23 turns round to me three months later and says "Why did
 24 you pay this against this volume" I would be able to say
 25 "This is why I did it and this is my audit trail".

1 **Q.** Okay, but what you say in the statement about this
 2 document is:
 3 "ITL then recorded the selling price or retail price
 4 which was set by the retailer."
 5 **A.** Yes.
 6 **Q.** I am just saying that this is not an instance of you
 7 including a selling price which has been set by the
 8 retailer, it's including a selling price together with
 9 a package of bonuses and all the rest of it that are
 10 designed to achieve a particular shelf price that's
 11 designed to restore a differential.
 12 **A.** I hope I am not making a fool of myself when I say --
 13 maybe I am just not listening properly or I don't
 14 understand the question, but at that retail price we
 15 talk about is at some stage before any retro bonus has
 16 been applied surely based on the price that the retailer
 17 has decided to sell at and that the ongoing bonus on top
 18 affects that. It's not me setting the price. The
 19 retailer set the price. I've paid a tactical bonus to
 20 achieve something, and it's reflected in the schedule.
 21 Perhaps -- am I getting confused here?
 22 **DR SCOTT:** I think if you go back, if you remember what we
 23 saw in Mr Eastwood's statement --
 24 **A.** Yes.
 25 **DR SCOTT:** -- he seems relatively content because what's

1 happening is they expect to be below RRP, they expect to
 2 make a certain margin, and their experience is that
 3 since you want differentials associated with RRP's, and
 4 you are prepared to support a certain margin, then their
 5 normal experience is that they can retain their margin
 6 because you will support that at a level normally
 7 related to the RRP's and then if there is a bonus
 8 situation they will move and they will keep their margin
 9 because you will put in the relevant support. When you
 10 take the support away, then they move the price back up
 11 and retain their margin. I think that in mathematical
 12 terms in the Morrison case, it seems relatively
 13 straightforward.
 14 Now, what's going on is how do we interpret that in
 15 terms of the trading agreement, but in mathematical
 16 terms, in Morrison's case, it seems relatively
 17 straightforward. They, from your evidence, seem
 18 unlikely to set a maverick price unless they make
 19 a mistake, because they are pretty clear about margins.
 20 That's what your evidence says. Is that right?
 21 **A.** Yes.
 22 **THE CHAIRMAN:** Is this the case: looking at the page which
 23 is stamped 58, the column that says "Selling Price", is
 24 it your evidence that that is the selling price that
 25 Morrisons have told you somehow that they want to sell

1 the product at --
 2 **A.** Yes.
 3 **THE CHAIRMAN:** -- and in relation to those items amongst
 4 the items on this page, where you are paying them
 5 a tactical bonus, you have altered that figure to show
 6 them that you intend that, because of the tactical
 7 bonus, the price they previously told you they would be
 8 selling at will now be a lower price because they have
 9 accepted the bonus?
 10 **A.** Exactly. Absolutely.
 11 **THE CHAIRMAN:** Before you have done your changes, in 123 on
 12 page 57, how did you get hold of the prices that are in
 13 that selling price column?
 14 **A.** By going into the store and collecting them.
 15 **THE CHAIRMAN:** I see.
 16 **A.** So, as I think has been mentioned today, we had a team
 17 of tactical merchandisers, I think that's what they were
 18 called, and they would call every six or eight weeks in
 19 stores and that information would be downloaded into our
 20 computers. And these prices sort of developed over
 21 years. Sometimes there would be maverick changes, but
 22 largely this was a result of years of negotiation, of
 23 changes in various tactical and non-tactical bonuses.
 24 **THE CHAIRMAN:** You gleaned what these prices that are in
 25 that column are from your market research, as it were,

1 and then you sent them this to say "Well, we are paying
 2 you these bonuses, these extra bonuses in relation to
 3 these things, and we have taken the liberty of
 4 reflecting that in changes on those items" --
 5 **A.** Yes, that's what I was trying to say, very ham-fistedly,
 6 but exactly that.
 7 **MR WILLIAMS:** I think where we had got to there is that the
 8 price we see in the schedule is the price that you have
 9 put in there in order to restore the differential,
 10 making adjustments from the base price?
 11 **A.** I think that's what I am saying, yes.
 12 **Q.** So --
 13 **A.** The base price being set by the retailer.
 14 **Q.** Could we turn to another example, at 26, please.
 15 **A.** Yes.
 16 **THE CHAIRMAN:** Sorry, could I ask one more question in
 17 follow-up just on that.
 18 The changes that you would make to the prices that
 19 were in that column gleaned from the market research,
 20 would you make a change in order to restore that price
 21 to a differential as per those trading agreement
 22 differentials, or would you only alter that price if you
 23 were giving a tactical bonus in relation to that
 24 product?
 25 **A.** That's a good question. What would generally happen is

1 that you would get that information from the computer
 2 and then, if there was something that looked odd, the
 3 phone call would be made and dependent on the buyer's
 4 commercial guile, there could be lots of different
 5 outcomes. But if it meant paying a bonus to change that
 6 price, that could be reflected in that schedule. It
 7 tried to -- what you would hope for is that that
 8 schedule reflected what our aspirational pricing was.
 9 If it didn't, you would have opportunities to make
 10 a move or not.
 11 **MR WILLIAMS:** Could you turn on to document 26, please?
 12 **MR HOWARD:** Sorry, could I clarify one thing arising out of
 13 your question. As I understand what was happening at
 14 tab 17 in the case of Embassy and King Edwards, the
 15 witness ought to clarify but I think what was happening
 16 was a retro bonus was being withdrawn and so it's not
 17 a case of a bonus being paid and then the price being
 18 reduced, it's the bonus being withdrawn, I think, but
 19 perhaps he ought to just clarify that and how that works
 20 in relation to the schedule.
 21 **THE CHAIRMAN:** But I was asking more generally whether
 22 changes made to the prices coming from the computer, as
 23 Mr Matthews has put it, were made only in relation to
 24 tactical bonuses or were made more generally to restore
 25 P&Ds.

1 **MR HOWARD:** I understood that, but your question I think was
 2 in the context of a bonus being paid and a retro --
 3 **THE CHAIRMAN:** I see, yes.
 4 **MR HOWARD:** Maybe it's obvious, it's just the other side of
 5 the coin.
 6 **THE CHAIRMAN:** It's another side of the coin.
 7 **MR HOWARD:** The particular examples we have actually are
 8 retros being withdrawn, it's not retros being added,
 9 I think.
 10 **MR WILLIAMS:** Do you have got 26?
 11 **A.** I do.
 12 **Q.** Do you want to read through. I am most interested in
 13 the third point.
 14 (Pause)
 15 **A.** Okay.
 16 **Q.** So this seems to be a different situation where you have
 17 amended the schedule without having had a discussion
 18 with Mr Eastwood in relation to the 25 gram pack,
 19 because you say a shelf price of 3.84 would give you
 20 a parity position. We can see over the page that you
 21 have the price of 3.84 in the schedule?
 22 **A.** Yes.
 23 **Q.** So you were happy to amend the schedule to include the
 24 price you wanted to see, even if it hadn't been agreed
 25 with Morrisons?

1 A. Knowing Grant as I did, he would be very quick to tell
 2 me if any assumptions I had made were wrong.
 3 Q. But you thought the assumptions you were making were
 4 probably right?
 5 A. Similar to the document we were discussing five minutes
 6 ago when I used the term "I assumed". I think in this
 7 instance when you are offering support, as I said
 8 before, to a large retailer to reduce price, they are
 9 going to be happy with them.
 10 Q. We see at point 5 --
 11 A. Yes.
 12 Q. -- "Please allow the shelf prices of L&B, JPS to
 13 increase by 7p."
 14 So here you are doing what you did in document 17,
 15 which is working out what the price will be absent any
 16 retros. I think point 3 is an example of a situation of
 17 you just adding in the bonus without having had
 18 a discussion. It's not just --
 19 A. It's an assumption that I made that I think that he
 20 would be happy to agree to.
 21 Q. That's right. Can we then turn to tab 28. {D17/28}
 22 I am afraid this letter is a bit less self-explanatory,
 23 but do you want to read it to yourself?
 24 A. Yeah. I will, and I know this document.
 25 Q. Yes.

1 A. I'll do my very best to describe what this -- is that
 2 what you are asking me to do?
 3 Q. No, I'll put to you my understanding of it.
 4 A. Okay.
 5 Q. I am focusing on the fourth period and Richmond, because
 6 Richmond is stable, I think, until the fourth period, it
 7 stays at 3.34 in the first three schedules?
 8 A. Stable?
 9 Q. The price is 3.34 in the first three schedules and then
 10 the fourth schedule says "Richmond 5p shelf increase"?
 11 A. Right.
 12 Q. Do you agree or know whether this is a price change
 13 which is designed to implement parity between Richmond
 14 and Dorchester?
 15 A. I don't know. I do know that this was a -- or I am just
 16 familiarising myself with this, it was some time ago,
 17 but I seem to remember that this was rather a tricky set
 18 of circumstances where I am covering both things that
 19 have happened and things that are going to happen as
 20 a result of an announced Chancellor's increase on tax,
 21 and it seems to me as though we are trying to implement
 22 some tactical holding against the prevailing increase
 23 that the Chancellor is levying on cigarettes, and that
 24 we are trying to hold down the cost or the shelf price
 25 of Richmond against that Budget. That's my -- I am

1 making a few assumptions that are actually very
 2 dangerous, but that's what it looks like.
 3 Q. Focusing on the fourth period, it says "Richmond 5p
 4 shelf increase". If you turn over the page, I am afraid
 5 I think the schedules are in the wrong order, Imperial
 6 can tell me if that's wrong, but if you look at the
 7 first schedule and you look at "Richmond Kingsize", you
 8 will see that the shelf price is 3.39. Then if you look
 9 at the next schedule and look at the shelf price, it's
 10 3.34. Actually it's one penny higher in Superkings,
 11 which is often what you see. 3.40 and 3.35. Okay?
 12 A. I am just trying to work out for the sake of my own
 13 sanity which, if they are in the right order because
 14 I would have expected to see post Budget costs ...
 15 Q. I think the rest of them are 3.34.
 16 A. Are they?
 17 Q. So I've assumed they are in the wrong order or at
 18 least --
 19 A. I think that's possible.
 20 Q. -- the 5p increase is from 3.34 to 3.39 because that's
 21 the only 5p increase we see.
 22 A. So what was the question, sorry, I am lost trying to
 23 work this out?
 24 Q. I was asking you whether this was a price increase that
 25 was designed to restore parity between Richmond and

1 Dorchester, and this is a letter 6 April and the fourth
 2 schedule covers the period from 9 April.
 3 Could we look at a document in annex 7, please, you
 4 should have a confidential version that you can show
 5 Mr Matthews. It might be that we --
 6 **THE CHAIRMAN:** Well, is this going to say what the
 7 Dorchester price --
 8 **MR WILLIAMS:** It does, it says -- perhaps I will get my
 9 copy --
 10 **THE CHAIRMAN:** Perhaps do we need to take him to it?
 11 **MR WILLIAMS:** There is a document 10 in annex 7. It is
 12 a fax to Grant Eastwood from Gallaher. {D7/10}.
 13 Perhaps Mr Matthews doesn't need to see this,
 14 perhaps it's enough for the Tribunal --
 15 **THE CHAIRMAN:** Well, quite. To put a schedule to a witness
 16 who's not from that company and say "It says 3-point
 17 whatever" a bit is pointless.
 18 **MR WILLIAMS:** I take your point, madam. But we see that
 19 there was at that time an increase in Dorchester from
 20 2.339 with effect from 1 April.
 21 Would you agree on that basis that what you are
 22 doing in the letter at tab 29 is communicating with
 23 Morrisons about a price increase which is going to
 24 restore parity between Richmond and Dorchester?
 25 A. I can't be sure, because I can't remember the context of

1 this. I really can't remember the context of this.
 2 **MR HOWARD:** If it helps, I don't think the context is
 3 controversial. I've shown you the documents and we
 4 actually have that schedule that was helpfully prepared
 5 by, I think, whoever it was, maybe it was the Morrisons
 6 team, which shows when the MPI came in, and what you
 7 have actually seen at tab 26 is that the price was then
 8 held. There was a 6p price increase and the price was
 9 held on Richmond by a bonus and then this seemed to be
 10 withdrawing it.
 11 **THE CHAIRMAN:** We have asked Mr Matthews whether he can
 12 remember why that was dealt with, whether it was in
 13 order to achieve parity with Dorchester, and my
 14 understanding is that that may have been the reason but
 15 you can't remember the particular context of that?
 16 **A.** I can't remember the context.
 17 **MR WILLIAMS:** I am grateful, madam, I don't know if that's
 18 a convenient moment for a short break?
 19 **THE CHAIRMAN:** Yes. We will take a break now and come back
 20 at 25 past 3.
 21 **MR HOWARD:** Could I just say, I am sorry to interrupt, that
 22 at say, 4.25, we can discuss some timetabling issues.
 23 **THE CHAIRMAN:** Yes.
 24 Mr Williams, just to remind you again not to discuss
 25 your evidence with anyone whilst we are on a break.

1 Thank you.
 2 (3.20 pm)
 3 (A short break)
 4 (3.35 pm)
 5 **MR WILLIAMS:** Mr Matthews, before the break we were looking
 6 at the document at tab 28. You deal with this at
 7 paragraph 134 of your witness statement, albeit you deal
 8 with it in a bit of a list. Do you want to have a quick
 9 look at that. The reference to this document is PM1/39
 10 in the penultimate line.
 11 (Pause). Really the reason for taking you through
 12 that in some laborious and tedious detail was simply to
 13 make the point that although you talk about this in
 14 simply mechanical terms in 134, you talk about what was
 15 happening in terms of the bonus, but really what was
 16 happening there was a price increase to restore parity
 17 between Richmond and Dorchester.
 18 You say you don't know what the Dorchester price
 19 was, but that's really what was happening there.
 20 **A.** Is that a question or a statement?
 21 **Q.** It was putting to you --
 22 **THE CHAIRMAN:** Do you remember whether --
 23 **A.** No, I don't remember.
 24 **THE CHAIRMAN:** That's where we got to.
 25 **MR WILLIAMS:** Could you turn to tab 31, please, in file 17.

1 {D17/31}. Can you turn to the second page. Feel free to
 2 cast your eye over the whole letter. (Pause).
 3 **A.** Right.
 4 **Q.** On the second page I am interested in point 2:
 5 "As per the message I left some weeks ago your
 6 current shelf prices on our cigar brands are still below
 7 those outlined in the last schedules. All brands are 6p
 8 below where they should be."
 9 You discussed this at paragraph 150 of your
 10 statement. Do you want to just refresh your memory of
 11 what you have said about it?
 12 **A.** Yes. (Pause). Okay.
 13 **Q.** You are saying the first document shows that Morrison
 14 was in charge of its own pricing and I think the point
 15 you are making was that they didn't do what you asked
 16 them to?
 17 **A.** I think what I meant by Morrison being in charge of
 18 their own pricing is that they, not Imperial Tobacco,
 19 decided what shelf prices to adopt.
 20 **Q.** But the letter says:
 21 "All brands are 6p below where they should be."
 22 So plainly you thought they should be somewhere
 23 else?
 24 **A.** I am not sure I agree with that, and the reason I say
 25 that is because the schedule served several purposes, as

1 I've said before it was an audit trail, it was also the
 2 basis from which we may or may not make tactical
 3 adjustments, but it was also what Morrison told us they
 4 were going to do, so if I was in a store and I saw that
 5 something wasn't reflected in the store that was on the
 6 schedule I felt duty bound to discuss that with the
 7 buyer. When I say in that letter "all brands are 6p
 8 below where they should be", they doesn't mean below
 9 where I think they should be, but where Morrison told me
 10 that they wished to price their products.
 11 **Q.** So a bit further down you say:
 12 "Secondly it was commonplace for ITL to check the
 13 actual shelf prices charged as huge sums were spent on
 14 bonuses?
 15 **A.** Yes.
 16 **Q.** "Morrisons claiming a bonus which was not payable would
 17 lead to ITL overpaying large sums of money."
 18 **A.** Yes.
 19 **Q.** So this letter, with the one we were looking at, has
 20 laid down a marker, you would say, should they want to
 21 claim a bonus for you. Do you want to turn to tab 32.
 22 **THE CHAIRMAN:** Can we clarify, I thought you had said
 23 earlier that the prices in this column under "Selling
 24 Price" were arrived at from the observations that were
 25 made in store.

1 A. Yes.

2 **THE CHAIRMAN:** So where did you get the point that you have

3 just made, namely that you knew that Morrisons' policy

4 was to price 6p higher than the prices that you had

5 observed in the stores?

6 A. I think there is two reasons: firstly you could have

7 stores that I had visited where that wasn't the case,

8 and in that instance the buyer would say, "Well, that's

9 the Wednesfield store, they are always getting it

10 wrong." That's possible. The second is that when the

11 key prices on a weekly basis, they could make mistakes

12 in that or change things or various things could happen

13 which means what we believed we would see in the store

14 wasn't the same as it should be, or what we saw at the

15 store was different from the schedule I should say.

16 So in this particular instance I have been in the

17 store, I've got a schedule, I think something has

18 happened. Some evidence has told me that is the case,

19 something may have changed, and I wasn't aware of it; in

20 other words, Morrisons have decided that they want to be

21 more aggressive on cigars and they wouldn't have to tell

22 me if that was the case, or I have been into a store and

23 I have seen an anomaly, or maybe one or two stores and

24 that's what I'm drawing the buyer's attention to.

25 I don't think it's meant to say where they should be,

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1 where I'm dictating the price should be, that is

2 an observation that I have made.

3 **MR WILLIAMS:** Can we look at tab 32 then, please. {D17/32}.

4 A. Yes.

5 Q. I am only interested in the bottom paragraph. This is

6 a follow-up note or memo a few weeks later:

7 "I have not looked this week but I assume you have

8 increased shelf prices as per my last two schedules."

9 A. Right.

10 Q. So you have already covered yourself against the claim

11 for a bonus with your last letter, haven't you? They

12 can't possibly say after the last letter that you have

13 left them in any doubt about where their prices ought to

14 be?

15 A. Right.

16 Q. Do you agree?

17 A. Yeah, I may be taking this out of context, I am not sure

18 if this was a brand that I was paying a bonus on or not.

19 The point I was making was perhaps more of a general

20 one, that the prices on the schedule as I have

21 established are ones that we collected data on, but from

22 time to time mistakes were made and the mistake I am

23 alluding to, whether in this case I was planning a bonus

24 or not I don't know, was that I had been in the store,

25 you have told me you are selling something at £5, it's

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1 actually at £4.95, you ought to know about it, because

2 you could be robbing yourself of a cash margin, and

3 really that's all I was trying to outline.

4 I mean, I can't remember this exact instance but

5 I do remember, even though it's more than -- ten years

6 ago, that Grant or Morrison were selling something below

7 the price they were telling me they were selling it at

8 and I just brought it to their attention. The shelf

9 prices of saying cigars, in the plural. I mean, we

10 didn't pay bonuses on cigars, I don't think and I am

11 reasonably certain that's what it relates to.

12 Q. The only point I was putting to you a moment ago was you

13 can't explain this note on the basis that you are

14 protecting yourself against some claim for a bonus

15 because your last letter was on the record. So if there

16 were any chance of them coming back to you and saying,

17 "Can you please pay us a bonus because we have been

18 pricing at whatever level" then there is a paper trail

19 on that now, isn't there, of the letter of 19 June?

20 So the letter at tab 32 is obviously doing something

21 different, and I think what I am putting to you is that

22 it's you telling them where you thought their prices

23 should be in the context of your trading agreement with

24 them?

25 A. I respectfully suggest it's me telling them that what

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1 they have told me isn't the case, but that's my --

2 I can't be sure to which brands it relates to, unless

3 I've missed the thread here.

4 Q. Do you say you were telling them that they ought to

5 increase their prices --

6 A. No.

7 Q. -- solely in their interests?

8 A. Yeah. Or -- and it could be in my interest, I don't

9 know the brand that I am talking about, but if for

10 example -- I am trying to think of a good example --

11 that they were under the impression that I was prepared

12 to pay something and I hadn't agreed to it, that would

13 put me in difficulty. Equally if they were selling

14 something beneath the price that they decided to, they

15 were making less margin. Either way, there could be

16 an issue, either I would end up paying or they would be

17 claiming money from me I hadn't agreed to, or they would

18 be making less cash margin because they would be selling

19 it at a shelf price less than they thought they were.

20 **DR SCOTT:** I thought earlier on you had said to us that

21 selling too cheaply was what you were looking for, that

22 you would rejoice, that they were free to do it and you

23 would rejoice.

24 A. I think that generally speaking, yeah, but in this

25 instance -- and again I may be very wrong -- I thought

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1 I was actually doing the buyer a favour here, and you
 2 try and use any tactic you can to try and get commercial
 3 advantage. I think generally on cigars it's less of
 4 a competitive business, but that's my recollection of
 5 it, that I was informing him, he wasn't doing something
 6 he thought he was. I don't know what else to say
 7 about --
 8 **MR WILLIAMS:** What this shows is you complaining to
 9 Morrisons that their prices are too cheap and the only
 10 reason you would do that is because you wanted your
 11 prices to be at a certain relativity to the Gallaher
 12 brands.
 13 **A.** I can't agree with that on either count I am afraid.
 14 **Q.** Can we turn on to tab 41, please. Just read that to
 15 yourself. {D17/41}.
 16 **A.** Yes. (Pause).
 17 **Q.** So this is talking about various holds at MPI time?
 18 **A.** Yes.
 19 **Q.** Just to understand what that means behind the scenes,
 20 would you agree that when you hold a brand at MPI
 21 essentially what you are doing is deferring the
 22 wholesale price increase, so you have a list price
 23 increase but you basically take it away again through
 24 a tactical bonus?
 25 **A.** We are foregoing any potential benefits from an increase

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1 in our own margins, that's the first thing that's
 2 happening if we decide to do that, so we have to balance
 3 it within our own portfolio. But effectively we are
 4 doing -- as you said, the prevailing price has gone up
 5 and I am going to continue to charge a lower price.
 6 **Q.** In the paragraph starting "We are also looking at
 7 holding Richmond Kingsize".
 8 **A.** Yes.
 9 **Q.** So the prices we have are 3.39, 3.40, so I am assuming
 10 given that you were usually 5p above Sterling, that they
 11 were at 3.34, 3.35, not that the detail matters for the
 12 purposes of this. What you say is that whilst Sterling
 13 is at whatever price it's at, you want Richmond to stay
 14 where it is, but if Sterling goes up, you want the shelf
 15 price of Richmond to go up?
 16 **A.** Well, we would certainly like to balance our investment,
 17 it's quite a big deal, if you have an increase, this is
 18 how tobacco companies make their money in the UK, they
 19 are able to leverage on price, if you have made
 20 a decision to do that and then you hold brands as big as
 21 Richmond and as Superkings, that's a big call, it's
 22 a huge investment and you take that pretty seriously, so
 23 if there is a chance of perhaps not doing it as much as
 24 you need to, you would take that. So I think what this
 25 refers to is that it's not so much a shelf price, it's

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1 an investment that I'm concerned about and the company
 2 would have been concerned about.
 3 **Q.** What it says is "of course if the market price for
 4 Sterling moves up, we would wish to do the same" --
 5 **A.** Certainly wish not to continue to overinvest in that
 6 brand.
 7 **Q.** But that isn't what it says, is it?
 8 **A.** It doesn't say that, no, I can't deny that, it says it
 9 here.
 10 **Q.** It is like all the other documents really, it says what
 11 you want is the price to go up?
 12 **A.** I think that there is an important point behind that,
 13 that it is also about the margin that we make, and the
 14 investments that we make.
 15 **Q.** I don't suppose you are going to remember what happened
 16 next in relation to particularly the price of
 17 Dorchester.
 18 **A.** I must confess I don't.
 19 **Q.** I'll just tell you, this is a letter dated 13 August, on
 20 15 November Sterling went up to 3.39, and with
 21 Superkings at 3.40, so assuming it was at 3.34, 3.35
 22 before with a 5p relativity, it looks like it's going up
 23 5p.
 24 Against that background can you turn to tab 50.
 25 {D17/50}. There is no comment on Richmond in the letter.

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1 If you turn over to the schedule, we can see that at
 2 this stage Richmond Kingsize is at 3.44 and Superkings
 3 is at 3.45.
 4 **A.** Right.
 5 **Q.** So this is 19 November, which is just a few days after
 6 Sterling went up 5p, so we see Richmond going up 5p, so
 7 5p differential reinstated. While we are in this
 8 document, if I pause on Richmond, could you turn back to
 9 the cover page?
 10 **A.** Yes.
 11 **Q.** Under Cafe Creme, Cafe Creme Mild, this records that you
 12 agreed to reduce the price of Cafe Creme to parity with
 13 Hamlet?
 14 **A.** Yeah.
 15 **Q.** Again the agreement is that it will be in line rather
 16 than at that price or a lower price?
 17 **A.** Okay.
 18 **Q.** Coming back to Richmond and Sterling, I think you are 5p
 19 above them at 3.44, 3.45. The next instalment of the
 20 story is that Sterling Superkings go up to 3.42, so up
 21 2p, and that is on 25 February, so a few months hence.
 22 Could you turn then to tab 56, and just read that to
 23 yourself.
 24 **A.** I've read that.
 25 **Q.** So the first thing we see, I think, is that you

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1 discussed the price, the increase in Sterling before it
 2 happened, because it says "Forthcoming Sterling price
 3 moves". Do you agree?
 4 **A.** It seems as though I have had a conversation and Paul
 5 has told me, yes.
 6 **Q.** You decided that you would increase the price of the
 7 Superkings by 2p as well to 3.47, so that tells us first
 8 of all that the last move to 3.45 had happened?
 9 **A.** Yes.
 10 **Q.** And you wanted to go up another 2p to reinstate the 5p
 11 differential with Sterling?
 12 **A.** That's what it says in that document.
 13 **Q.** So we have a situation where you are within 5p on
 14 Superkings, on Richmond Superkings, of Sterling
 15 Superkings, but you say that you want prices to increase
 16 anyway to exactly 5p more than Sterling?
 17 **A.** Right.
 18 **Q.** So what you were doing in these letters is communicating
 19 with Morrisons about price increases that were designed
 20 to reinstate your parity and differential requirements
 21 upwards as well as downwards, the differentials weren't
 22 ceilings, as you say in your statement, they are fixed
 23 intervals. Time after time you tell Morrisons that what
 24 you want is them to increase prices to reinstate the
 25 differential and Dorchester goes up?

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1 **A.** But they don't have to do it, though.
 2 **Q.** Well --
 3 **A.** But they don't.
 4 **THE CHAIRMAN:** That's a different point. The point is: is
 5 this email reflecting a conversation in which you and
 6 Mr Eastwood agreed that that was what would happen with
 7 Richmond Superkings?
 8 **A.** Yes, that is the point of the conversation, what
 9 happened in the conversation I don't recall. I also
 10 notice that the multipacks continue to be price marked,
 11 I am not sure, but it's possible that we would have
 12 continued on lower prices on Richmond Superkings in the
 13 multipacks.
 14 **MR WILLIAMS:** Can you turn back to --
 15 **A.** Which might have been -- sorry to progress the --
 16 **Q.** No, carry on, please.
 17 **A.** That might well have been as a result of trying to get
 18 a competitive advantage on multipacks. In fact, I think
 19 it was, at the time. Because we would have held the
 20 price on multipacks and perhaps gone up on the 20s.
 21 **Q.** Can you turn back to paragraph 134 of your witness
 22 statement. You have already looked at this in relation
 23 to document 28. You lumped this document in with 16 and
 24 28.
 25 You say you would normally discuss these bonus and

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1 price changes with Morrisons and that correspondence was
 2 just confirmation of that discussion, but actually this
 3 document is just about the shelf price, it's not about
 4 the bonus at all, it says "I've asked Graham Plummer to
 5 create a new schedule to reflect this change."
 6 **A.** Yes, but isn't that following the conversation?
 7 **Q.** It is, but the point is that you are not --
 8 **A.** The notes are perfunctory --
 9 **Q.** The point is that you are talking about shelf prices
 10 before you have even worked out what's happening in
 11 terms of the bonus?
 12 **A.** I've talked about shelf prices --
 13 **Q.** You are discussing shelf prices, what's going to happen
 14 on the shelf price before you have even worked out what
 15 is happening on the bonus, this isn't a discussion about
 16 bonuses, it's a discussion about shelf prices?
 17 **A.** But the two things are mutually inclusive.
 18 **Q.** Yes, but what you say --
 19 **A.** Aren't they?
 20 **THE CHAIRMAN:** What's being put to you is that other letters
 21 that we saw included a discussion of the bonus, the
 22 change to the bonus and how that would affect their
 23 margin, and when you were looking at those, you said
 24 "Yes, really we only pointed out to them what the shelf
 25 price would be because we were changing the bonus, we

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1 knew they wanted to retain their margin, and hence, as
 2 a matter of courtesy really, because we were withdrawing
 3 the bonus, we pointed them to the shelf price they would
 4 need to move to?"
 5 **A.** Yes.
 6 **THE CHAIRMAN:** Whereas here you are saying "We would like to
 7 move the shelf price up" and that doesn't seem to be
 8 referring to any change that you have already decided to
 9 make to the bonus, this letter doesn't refer to the
 10 bonus or the margins or anything.
 11 **A.** No.
 12 **THE CHAIRMAN:** It just seems to say you have agreed to move
 13 the price of Richmond Superkings up because Sterling
 14 prices are moving up.
 15 **A.** It's a very functional letter, but there may have been
 16 a conversation about margin and about benefit prior to
 17 this being written.
 18 **THE CHAIRMAN:** You don't recall?
 19 **A.** No, I don't.
 20 **MR WILLIAMS:** Do you accept that in this series of letters
 21 that we have been looking at, we can see that ITL's
 22 strategy of maintaining parities and differentials was
 23 a strategy that worked in both directions, you weren't
 24 just making sure that your brands stayed relatively
 25 cheaper than or no worse off than the Gallaher brand,

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1 you wanted your brands priced at a fixed relativity to
 2 the Gallaher brand, and that's what you do in these
 3 letters time after time?
 4 **A.** Sorry, can you just start the point again?
 5 **Q.** I am really just putting to you that we have seen
 6 a whole series of letters in which, from which it's
 7 clear that ITL's policy of ensuring that certain
 8 differentials were maintained between its products and
 9 Gallaher's products, that policy didn't work as a price
 10 ceiling, it worked so that the fixed interval, the fixed
 11 differential, a parity relationship, a fixed 3p
 12 relationship, whatever it was, that interval was in
 13 place at all times. That's what you are doing, that's
 14 what you are making sure happens in every one of those
 15 letters?
 16 **A.** That was the point of the trading agreements, to try and
 17 achieve those pricing relativities.
 18 **Q.** Could you turn to tab 67, please? {D17/67}
 19 **A.** Yes.
 20 **Q.** There is a letter here which attaches a draft of the
 21 trading agreement?
 22 **A.** Yes.
 23 **Q.** I just wanted to look at the bit of it that relates to
 24 differentials. So could you turn over to 445?
 25 **A.** Yes.

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1 **Q.** Just read the first three paragraphs to yourself.
 2 (Pause)
 3 **A.** Okay.
 4 **Q.** You will see the word I wanted to emphasise there is to
 5 replicate the price list differentials, then down at the
 6 bottom of the page it says "as at September"?
 7 **A.** Yes.
 8 **Q.** There is a list of price list differentials?
 9 **A.** Yes.
 10 **Q.** And they are not expressed in the same way as the
 11 ultimate draft of the second trading agreement because
 12 it doesn't say at least 2p cheaper than or whatever?
 13 **A.** Right.
 14 **Q.** It just lists them as specific intervals. I just wanted
 15 to say, do you agree that that document reflects the way
 16 in which the parities and differentials worked in
 17 practice?
 18 **A.** Which one, the final one or this one?
 19 **Q.** This one, the draft.
 20 **A.** I suppose it was a draft document and knowing that, it
 21 wasn't as full and as well written as the final one.
 22 But your question is --
 23 **Q.** What it says is "replicate the natural price list
 24 differentials" and then the differentials are expressed
 25 in a different way?

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1 **A.** In which, in the final document?
 2 **Q.** In this document, focusing on this document, it says
 3 "Replicate rather than reflect".
 4 **A.** Yes.
 5 **Q.** You might say that is dancing on the head of a pin, but
 6 anyway.
 7 **A.** You might.
 8 **Q.** Further down, the differentials are not expressed as 2p
 9 cheaper than or whatever, it just says "minus 2p
 10 parity", and all I was asking: do you agree that this
 11 idea of replicating these differentials is actually how
 12 the trading relationship worked in practice?
 13 **A.** Replicating the differentials?
 14 **Q.** So to put it in the context of the documents we have
 15 just been looking at, if you had a differential of 5p
 16 between Richmond and Sterling, you wanted prices to move
 17 so that you were 5p more expensive than Sterling rather
 18 than at least 5p more than?
 19 **A.** Well, it would be better if we were more than 5p,
 20 wouldn't it, clearly?
 21 **Q.** That's not what I was asking you, I was asking whether
 22 this document reflects the way it worked in practice?
 23 **A.** In practice sometimes, in other times not, but ...
 24 **Q.** In practice, you wanted Morrisons to replicate the
 25 differentials and you wanted them to replicate specific

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1 differentials rather than maximum differentials?
 2 **A.** Based on the prices they chose to sell at, we would make
 3 bonuses, and we wanted commercial advantage over our
 4 rival manufacturers, and this is what we thought
 5 commercial advantage was.
 6 **Q.** You don't get a commercial advantage by making sure you
 7 are always at parity with them, you just make sure you
 8 are always at parity with them?
 9 **A.** Well, we wouldn't be commercially disadvantaged, and
 10 that's what we were trying to avoid. Because if we were
 11 worse than parity, parity is -- well, parity is parity.
 12 If we were above that, we would be commercially
 13 disadvantaged.
 14 Maybe I am dancing on the head of a pin now, but
 15 there is a big difference; if you are at parity and then
 16 you are not at parity, you are going to have a problem.
 17 if you are better than parity, clearly that could be to
 18 your advantage.
 19 **Q.** This document doesn't talk about being better than
 20 parity?
 21 **A.** It doesn't talk about it, but it's draft.
 22 **Q.** I understand that it's draft, but all that occurs to me
 23 is that you have been working on these accounts for some
 24 time, you are familiar with the way that they work, if
 25 you thought that these were price ceilings, it's hard to

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1 see how you would have written this up in the way you
 2 have written it up. You have said that you want to see
 3 the differentials replicated, and you want the specific
 4 differential, and it's hard to see why you would write
 5 up the document in this way -- in draft, in draft -- if
 6 your experience of running the account was that these
 7 were price ceilings?
 8 **A.** I would say again it's a draft document and I am sure
 9 there is quite a few loose phrasings in it, whether it
 10 relates to pricing or not. I don't think this precludes
 11 or would seek to preclude a retailer doing his own thing
 12 and giving you more advantage if he so desired to do so.
 13 I don't think we could stop that.
 14 **Q.** It does, though, doesn't it? Because replicating
 15 a differential of parity is different from saying "We
 16 would be happy if we were one penny below"?
 17 **A.** It's different in the way that it's written, but we
 18 would have advantage, wouldn't we, if we were better
 19 than that?
 20 **Q.** Well, you would have advantage but that's not really
 21 what I am getting at.
 22 **A.** Why would I want to stop us having advantage?
 23 **Q.** What I am putting to you is that what this document
 24 shows is that when you sought to write down and capture
 25 what ITL was doing, what its strategy in relation to

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1 differentials was, this is the way you saw it. You saw
 2 it in terms of replicating specific differentials?
 3 **A.** Maybe I am just re-emphasising the point too much, but
 4 anything better than that is going to be better. It
 5 doesn't mean that that wasn't -- the retailers weren't
 6 free to do that. That's what we would consider
 7 desirable, but you know, there is different degrees of
 8 desire, I guess, and when you could get commercial
 9 advantage, that would be beneficial, because then if you
 10 were better than parity or 6p not 5p, you would hope
 11 that a consumer would notice that and that you would
 12 gain for a period of time some share from competitor
 13 brands. I would be foolish to say you couldn't do that.
 14 **Q.** Do you understand the distinction I am drawing, though,
 15 between effectively differentials which give rise to
 16 price ceilings and fixed differentials?
 17 **A.** Yes.
 18 **Q.** Do you agree that the way this is written up reflects
 19 what we have just seen you doing in practice, which is
 20 making sure that specific differentials are always in
 21 place?
 22 **A.** But I go back to the point I made a few hours ago that
 23 these trading agreements were firstly a basis for
 24 negotiation, secondly, they weren't written to be
 25 legally binding, I don't think even in this case that

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1 they would have been seen by anybody but myself and
 2 maybe my immediate supervisor, and I think we recognised
 3 there was a degree of fluidity in the market and in
 4 those accounts. I mean, I know the textual analysis is
 5 important, I appreciate that and I respect that, but
 6 I would say that, you know, this was not a document that
 7 went that much further than junior management.
 8 **Q.** Do you know if there was legal comment on this document?
 9 **A.** On this particular document?
 10 **Q.** Legal input?
 11 **A.** I am almost certain to say no, but I don't recall that
 12 specifically.
 13 **DR SCOTT:** Just one question: you said this document was not
 14 seen by anybody in ITL apart from yourself and maybe
 15 your supervisor, but as we understand it, the strategic
 16 pricing requirements weren't particular to Morrisons
 17 they were being set from above, so you would receive
 18 guidance as to what ITL was looking for.
 19 **A.** Yes, absolutely right.
 20 **DR SCOTT:** Now, were you seeking to reflect that guidance in
 21 the arrangements that you were seeking to make with
 22 Morrisons in particular here? Though presumably with
 23 Sainsbury's as well in parallel.
 24 **A.** If I was able to achieve those differentials, that's
 25 good.

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1 **DR SCOTT:** So that matches the requirement of your strategic
 2 colleagues.
 3 **A.** Yes.
 4 **DR SCOTT:** Thank you.
 5 **MR WILLIAMS:** Could we just turn back to tab 85, please,
 6 which is the second trading agreement. {D17/18}.
 7 I just wanted to look at a provision that we didn't look
 8 at before. Under the heading "Pricing" again, the
 9 second bullet point "With the exception ..."
 10 **A.** Yes.
 11 **Q.** It says:
 12 "With the exception of the application of either
 13 Budget or manufacturer price increases, Imperial Tobacco
 14 investments should reduce in line with any upward
 15 movement in shelf prices."
 16 Would you agree that, bearing in mind the series of
 17 correspondence that we have just seen, you wouldn't
 18 reduce the bonus that would be paid to Morrisons if they
 19 increased prices to restore your preferred
 20 differentials?
 21 **A.** Sorry, say that again?
 22 **Q.** We have just seen a lot of documents in which you say
 23 "We want to maintain parity with Dorchester, therefore
 24 please put our prices up", and I am asking you: given
 25 that we have seen that you did that on many occasions,

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1 you wouldn't expect to take away a parity or
 2 differential bonus payment from Morrisons if they
 3 maintained the differential by increasing the price of
 4 your brands? That was something you wanted to see them
 5 do?
 6 **A.** I might be on the wrong track here, but I think that
 7 that point there is to protect against price creep
 8 towards or potentially above RRP, and there is
 9 a particular reason I use that, that was getting my
 10 fingers burned somewhere else.
 11 **Q.** Absolute prices?
 12 **A.** Yes. So what I was trying there is saying, "Look, I am
 13 paying bonuses, there is an absolute element to this.
 14 There is a sort of an agreement here that I make this
 15 much, you make that much; if you start to profiteer [if
 16 I can use that word] I would like to share some of the
 17 spoils", and that's really what that was talking about.
 18 **Q.** Thank you. Could you turn to tab 58, please. Do you
 19 want to read that to yourself. {D17/58}. I think you
 20 comment on this in your witness statement so you are
 21 probably familiar with it.
 22 **A.** This is the Philip Morris price increase note, yes.
 23 **Q.** That's right, yes, although it's not is much that bit
 24 that we are interested in, it's the bit underneath it.
 25 (Pause)

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1 **A.** Okay.
 2 **Q.** So the background here is that Gallaher has published
 3 an MPI?
 4 **A.** Yes.
 5 **Q.** And you haven't?
 6 **A.** No.
 7 **Q.** And you say that the result of this is that the
 8 differentials will widen?
 9 **A.** Yes.
 10 **Q.** If we look at the way you express them, you say "Moving
 11 from minus 3p to minus 9p" and so on?
 12 **A.** Yes.
 13 **Q.** Draft agreement we were just looking at a few minutes
 14 ago?
 15 **A.** Yes.
 16 **Q.** You expressed them in that form rather than as price
 17 dealings.
 18 You say that you expected to see prices which
 19 implemented the new differentials. I think this is
 20 consistent with the evidence you have given that you
 21 would expect to see Morrisons pricing in accordance with
 22 your differentials?
 23 **A.** I do remember this reasonably well, and you are
 24 absolutely right, this was when our arch competitor had
 25 decided to increase their prices and Philip Morris who

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1 we were supporting in the UK, we have a distribution
 2 agreement with them, had agreed to do the same.
 3 **THE CHAIRMAN:** Slow down a bit. I think the transcriber is
 4 probably struggling.
 5 **A.** So Gallaher are going up, Philip are going up, we are
 6 not, so commercial advantage, for that period of time we
 7 are going to be not just differential, we are going to
 8 be differential plus. It might be that an enterprising
 9 supermarket might try and put everybody's brands up at
 10 the same time to be avoided because if they do, we lose
 11 two things: they are effectively taking our MPI early
 12 and they are making brands, they are increasing the
 13 product's price to consumers when there is no need to.
 14 So this was -- I suppose I was getting my retaliation in
 15 first and explaining: listen, we are not going up yet,
 16 we are not going up, so make sure we don't put our
 17 prices up and it's a very long-winded way of saying
 18 that, to be quite frank.
 19 **MR WILLIAMS:** That's right. I am interested in the way you
 20 expressed it, because what you said to Morrisons was
 21 that you wanted them to implement new differentials.
 22 **A.** Well, I don't think it would be a case of implementing
 23 new differentials, it would be to make sure that they
 24 don't implement anything, that this is really a letter
 25 saying "If the status quo is allowed to continue, we

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1 will have an advantage. I would like that advantage,
 2 and please don't disadvantage me".
 3 **Q.** You are quite right, what you wanted them to do was to
 4 respect new differentials rather than implement new
 5 differentials?
 6 **A.** I just didn't want them to put our prices up.
 7 **Q.** You didn't say that, though, you said:
 8 "I would expect to see the following example
 9 disparities from the date you implement our competitor's
 10 price increase" and you express it in terms of
 11 a widening of differentials?
 12 **A.** Yes, I did, and that's what it says there, but I'll say
 13 it again just so I make it clear, "We are not going up,
 14 please don't put the products up. If you do as you are
 15 doing, this is what we will see", and that is it.
 16 **Q.** That would have been a much more straightforward letter
 17 to write, wouldn't it?
 18 **A.** It probably would.
 19 **Q.** Between two business people?
 20 **A.** It would have been a much more straightforward letter to
 21 write. I didn't. I used this particular idiom. But
 22 that is exactly what I meant.
 23 **Q.** I am suggesting that the reason you wrote the letter in
 24 these terms is because you had an agreement with
 25 Morrisons that they would respect certain pricing

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1 differentials and your concern was that if you didn't
 2 articulate new differentials, that they would proceed on
 3 the basis of the old differentials and that's not what
 4 you wanted?
 5 **A.** What I did not want is to, for a customer to profiteer
 6 from a situation that they shouldn't be and that's what
 7 this is about. Differential or no differential, there
 8 was a pool of money being shared at the time which both
 9 parties were comfortable with, and had Morrison or
 10 indeed any customer at the time decided to declare UDI
 11 and put prices up at the same time, that would be a bad
 12 outcome, and that's what I was trying to avoid, and this
 13 is why I wrote that letter.
 14 **Q.** Morrisons was benchmarking itself against its rivals,
 15 wasn't it?
 16 **A.** I think that Morrison, like the other multiple
 17 supermarkets, had a sort of favoured other retailer they
 18 would match themselves against, I think that's fairly
 19 plain, yes.
 20 **Q.** You weren't having an MPI anywhere at this stage, were
 21 you?
 22 **A.** Well, you only have one, so no.
 23 **Q.** If Morrisons had chosen to put your prices up, then they
 24 would have risked putting themselves at a competitive
 25 disadvantage against their rivals, wouldn't they?

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1 **A.** They would, and it would be a mistake all round, because
 2 they would lose out to their own rivals and it would be
 3 a no win situation. And I think in truth the chances of
 4 that happening are slim, but you just felt compelled to
 5 put something in writing, so if my boss said to me
 6 "Paul, I've just bought my prawn sandwich from Morrisons
 7 and, horror of horrors, they have gone up" at least
 8 I would have something to defend myself against those
 9 accusations with, and that's what that letter
 10 represents.
 11 **Q.** I don't know if you know what actually happened while
 12 you were writing these letters, do you remember Gallaher
 13 actually instituted a set of price holds so that
 14 effectively --
 15 **A.** I don't remember that.
 16 **Q.** -- their prices remained, and this is a bit of
 17 a simplification of a complicated situation, but their
 18 prices on a number of brands were made at the same level
 19 as yours. We don't need to go to the documents in
 20 relation to that. What you did then was I think simply
 21 to leave your prices where they were. Do you recall
 22 that?
 23 **A.** I don't recall it but it would seem -- I mean, that's
 24 what we might do from time to time if we were having
 25 a manufacturers' price increase, like the document we

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1 saw earlier with Morrison where I think we were holding
 2 Superkings and L&B and the prevailing increase we would
 3 try and hold some brands to get our margin mix to try
 4 and gain advantage. I don't know, they quite possibly
 5 could have done that, held a couple of brands.
 6 **Q.** The only thing I am getting at really is that in that
 7 situation, if they held their prices and you left yours
 8 where they were, which is what I think has actually
 9 happened, then it's not really clear that you did want
 10 to see increased differentials at all, really, is it?
 11 Actually you were just leaving your prices where they
 12 were, because you didn't then say, "Actually, we want to
 13 be 4p under, can you reduce our prices by 4p?"
 14 **A.** That's exactly what I was suggesting earlier, that we
 15 weren't going up, and if we are not going up and they
 16 are, this is what you would see, we are going to get
 17 a win from it. Can I have my win, please? That's
 18 really all I am saying here.
 19 **Q.** But you didn't get a win?
 20 **A.** Well, I don't know, because you asked me if I knew what
 21 had happened while I was writing these letters, I don't
 22 recall that specifically, if you are suggesting to me
 23 that they went up but didn't go up on a number of
 24 brands, we wouldn't have got a win on those brands, but
 25 they didn't hold on all of them, did they?

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1 **Q.** They didn't hold on all of them, no.
 2 **A.** So we would have got a win, wouldn't we?
 3 **Q.** No, but the point is that on most of the key brands, on
 4 Richmond and Dorchester and all the rest of it, what we
 5 see is a continuation of the price relationship we see
 6 before, but if you don't know what was happening on
 7 Dorchester then we can't explore that.
 8 **A.** I don't remember that specifically.
 9 **Q.** Can we then just turn over to 63, {D17/63} to complete
 10 this sequence.
 11 **A.** Okay.
 12 **Q.** Do you want to just read that to yourself?
 13 **A.** Yes. (Pause).
 14 **Q.** In fact you can stop at the end of the first page
 15 actually because it then moves on to a different topic.
 16 **A.** Okay. (Pause). Right, okay.
 17 **Q.** So now you issue your MPI, and you communicate some new
 18 differentials again, and these are again expressed as
 19 specific intervals rather than as price ceilings; you
 20 see that?
 21 **A.** I think this was, I have some recollection of this for
 22 many years we believed that the optimal pricing
 23 relationship between, for example, Embassy and
 24 Benson & Hedges was a 3p differential, somebody in the
 25 clever sums department had changed their mind, so a new

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1 price list was issued with a smaller differential, and
 2 I am pointing this out to Paul.
 3 **Q.** Yes, but the differential you describe is minus 3p,
 4 changes to minus 2p rather than --
 5 **A.** Yes, so we were prepared to live with a smaller
 6 differential.
 7 **Q.** Your prices are going up, relatively speaking?
 8 **A.** I suppose you could say that, yes.
 9 **Q.** We will come back to the second page of this letter.
 10 **A.** Okay.
 11 **Q.** One last topic I wanted to cover today, if I can, and
 12 then I think we will have a little bit more to finish
 13 off next week. This is Morrison's strategy, we have
 14 seen Morrison's strategy already, it's maintaining low
 15 prices and remaining competitive against its benchmark
 16 competitors, and we have seen that alongside that
 17 strategy Morrisons agreed to support your strategy.
 18 You are nodding. It doesn't show on the transcript.
 19 I think you need to say "Yes", that's all, if you agree.
 20 **A.** I was nodding because I was thinking about what you were
 21 saying. I didn't actually mean I agreed with it, I was
 22 just nodding.
 23 **Q.** Let's start again and see if you really do mean to nod.
 24 We have seen Morrisons' strategy in the documents we
 25 were looking at earlier on, and that's to maintain low

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1 prices and remain competitive against this benchmark,
 2 broadly speaking.
 3 We have seen that in the trading agreement,
 4 Morrisons agreed to support your strategy, and I think
 5 you said that when you formulated your strategy it was
 6 intended to work alongside Morrison's strategy?
 7 **A.** I don't think I did say that. I might have done, but --
 8 **THE CHAIRMAN:** Which part of that do you disagree with --
 9 **A.** It's the last part, that I formulated a strategy to --
 10 I can't remember the phrase that you used.
 11 **MR WILLIAMS:** Shall we go back to document 23, because
 12 that's where we talked about it.
 13 **A.** Okay.
 14 **Q.** We saw on page 193 Morrison's strategy?
 15 **A.** Yes. That's me saying Morrison's strategy is clear.
 16 **Q.** That's right, yes, but I think that's in the
 17 confidential box, I am not sure how confidential it
 18 really is, but anyway turning on to page 200, then you
 19 discuss your strategy which we have already looked at.
 20 Really all I said was you obviously had Morrison's own
 21 strategy in mind when you were formulating your
 22 strategy, and I said that the two have been designed so
 23 that they tend to work alongside one another and my
 24 recollection is that you said yes, which is the sense of
 25 this document?

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1 **A.** They must do if they were prepared to sign an agreement.
 2 I suppose the bit that I was perhaps in disagreement was
 3 as though they work in complete concert, and they
 4 weren't always.
 5 **Q.** No.
 6 **A.** It's probably just me being obtuse, I didn't mean to.
 7 **Q.** I understand.
 8 You say in your witness statement that your strategy
 9 was consistent across all the retailers you dealt with,
 10 so you were dealing with Tesco and Sainsbury, you had
 11 basically the same strategy in relation to them?
 12 **A.** We sought to reflect price list definitions and gain
 13 competitive advantage through the minimum possible
 14 investment and make the most possible money, that would
 15 have been my strategy in all of those accounts.
 16 **Q.** I think you also say in paragraph 18 that:
 17 "If ITL had a promotion it would apply across
 18 a range of retailers including those whose accounts
 19 I did not manage".
 20 Do you want to look at it for yourself?
 21 **A.** 18?
 22 **Q.** That's right, yes.
 23 (Pause)
 24 **A.** Okay.
 25 **Q.** So really I am getting at a fairly straightforward

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1 point, which was that there was a consistency in the way
 2 that ITL dealt with the retailers and specifically like
 3 retailers like Morrisons and its competitive set?
 4 **A.** I think when it came to supermarkets that was the trade
 5 sector that was the most difficult, and I do think there
 6 was a difference in the way that we dealt with the
 7 supermarkets, I think they were much more difficult to
 8 negotiate with, and because they had made this intention
 9 or had an intention to sell at lower prices they
 10 demanded more investment, and they were difficult from
 11 time to time.
 12 **Q.** But you were pursuing the same strategic objectives with
 13 all of Tesco, Morrison, Sainsbury?
 14 **A.** Are we talking about just pricing now?
 15 **Q.** I am talking about just pricing, I beg your pardon.
 16 **A.** Because there are an awful lot of other things that we
 17 did try and do. Maybe that's not for now. As far as
 18 pricing was concerned we did look to reflect those
 19 differentials, but we were also always, particularly
 20 with Tesco, I am not sure if it's worthy of mention,
 21 very, very keen to keep a close eye on that sort of
 22 joint margin pool and, I would refer back to the point
 23 I have made many times, that that relationship between
 24 absolute pricing and investment was important with all
 25 of them.

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1 **Q.** The same thing was happening with the other big
 2 supermarkets that you weren't dealing with like Asda,
 3 Co-op or perhaps you don't have direct knowledge of
 4 that?
 5 **A.** I never manage -- I was a bit of a specialist on
 6 grocers, I am afraid, so I didn't have a great deal of
 7 experience outside those. They all came with different
 8 issues and different problems.
 9 **MR WILLIAMS:** That's where we have gotten to, Madam, I know
 10 Mr Howard wanted to discuss timetable.
 11 **THE CHAIRMAN:** Yes. How much longer do you think you will
 12 need to have?
 13 **MR WILLIAMS:** I think I can finish certainly within an hour,
 14 I would have thought.
 15 **THE CHAIRMAN:** Right.
 16 Mr Saini, will you have any questions?
 17 **MR SAINI:** I think I will have about 15 minutes of questions
 18 for this witness.
 19 **THE CHAIRMAN:** Difficult to know at this stage, but any
 20 ideas as to re-examination?
 21 **MR HOWARD:** I anticipate, I am not certain, possibly an hour
 22 or so.
 23 **THE CHAIRMAN:** Well, that's all we have time for this
 24 afternoon, as they say, so I am afraid we will have to
 25 keep you from Florida a little bit longer.

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1 **A.** I knew that this would happen, despite advice.
 2 **THE CHAIRMAN:** The only thing I can say is that it looks
 3 like it's lovely weather out there, so you are not being
 4 too gravely disadvantaged by staying on this side of the
 5 Atlantic. In fact, it's Tuesday that we will re-start,
 6 because Monday is a non-sitting day, and it will
 7 probably be 10.30 although we might need to have
 8 a discussion amongst ourselves. Again, as you are in
 9 the middle of your evidence, you mustn't speak to
 10 anybody about it between now and Tuesday, except someone
 11 may need to tell you what time we are starting on
 12 Tuesday. But for the moment, you can leave the witness
 13 box and we will just discuss some logistical matters.
 14 (The witness withdrew)
 15 Discussion re timetable
 16 **THE CHAIRMAN:** On Tuesday, then, we will be completing this
 17 witness and then going on with Mr Eastwood.
 18 **MR HOWARD:** Yes.
 19 **THE CHAIRMAN:** At some point, Mr Saini, you will want to say
 20 something?
 21 **MR SAINI:** I was going to say it before Mr Eastwood gave
 22 evidence but we want Mr Eastwood to be able to leave by
 23 the end of Wednesday at the very latest, so subject to
 24 that, I did want to make a few observations.
 25 **THE CHAIRMAN:** Yes. Mr Howard.

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1 **MR HOWARD:** Sorry, I didn't realise Mr Saini was standing
 2 up. I just wanted to make some points really about the
 3 timetable in the sense that, as I see it at the moment,
 4 we are, at least on the way the current timetable is set
 5 out, about two and a half days off. Tuesday was
 6 a slightly odd day in that we didn't actually have any
 7 factual evidence, so assuming we are using that, we are
 8 about a day and a half off.
 9 If you go forward to 3 November, that's when we are
 10 due to start with expert evidence. I mentioned to
 11 Mr Lasok that one solution at the moment is that we use
 12 that day as a further fact day, and we therefore start
 13 the expert evidence the following week. The reason of
 14 course I am particularly concerned is that my experts
 15 are coming first and one of whom is coming over from the
 16 United States, so that we would like to do that. If we
 17 knock things on by one day, that means that we need to
 18 use probably or certainly 18 November, which is the
 19 reserve day. So that's really what I wanted to check,
 20 (a) whether the Tribunal was content and (b) whether at
 21 least those in court believe that is right.
 22 The other point is I think in a letter in response
 23 to the OFT's request for further time in relation to
 24 expert evidence, I think there was some question as to
 25 whether any time was going to be used in the week of

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1 21 November. Of course, if we do do that, then we may
 2 need to think about how that knocks on in terms of the
 3 subsequent timetable, and again I am looking at it
 4 particularly from my perspective in that we have to go
 5 first in oral closings and we wouldn't want to start
 6 oral closings before you and we have had sufficient at
 7 this moment to absorb the written closings.
 8 If we work on the basis that we are going to finish
 9 live evidence on the 18th and we are just going to slip
 10 by a day, I think we can stick with everything else.
 11 **THE CHAIRMAN:** Yes. As regards to the start of the oral
 12 closing submissions, there has been some mention of
 13 there being a strike on 30 November, which may force us
 14 to take an extra day with considering the written
 15 closing submissions anyway.
 16 There is a lot of time left at the end of the
 17 timetable, which gives us some flexibility. At the
 18 moment it's difficult to see how the factual evidence
 19 could be speeded up, given how it's been conducted so
 20 far.
 21 The only additional point I would make is that we
 22 all on the panel are a little concerned that the opening
 23 submissions in relation to each of the appellants have
 24 become rather more extended than we envisaged when we
 25 had the idea that those would be useful.

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1 Certainly as regards Shell and the Co-op and
 2 Morrisons, those are three rather distinct retailers --
 3 **MR HOWARD:** That's right.
 4 **THE CHAIRMAN:** -- and we were hoping that now we are moving
 5 on to counterparties who are more similar to each other,
 6 more similar to Morrisons, we might be able to shorten
 7 the opening.
 8 **MR HOWARD:** Certainly we anticipate for Safeway and Asda
 9 there is a lot less we will want to say by way of
 10 opening.
 11 **THE CHAIRMAN:** We would ask you really to focus on any
 12 points of difference in those, rather than reiterate the
 13 main case.
 14 **MR HOWARD:** I appreciate that. First Quench, T&S and
 15 TM Retail fall into a different category, so it's just
 16 maybe that one of those will require a little
 17 amplification. Somerfield has peculiarities of its own
 18 relating to the nature of the evidence.
 19 **THE CHAIRMAN:** Well, peculiarities are what we want you to
 20 focus on, rather than the more general case.
 21 **MR HOWARD:** Yes. I'm conscious that we took slightly more
 22 time on Morrisons, but the distinction was, in the case
 23 of Morrisons, we have actually taken you through the
 24 documents so it's actually meant that the
 25 cross-examination and re-examination may be slightly

1 shorter.
 2 **DR SCOTT:** I was just going to say one small thing: earlier
 3 in the day you didn't know what an MRG was; I think it's
 4 a multiple retail grocer, and that came up in a later
 5 document. That's just so that we get it in the
 6 transcript what an MRG is.
 7 **MR HOWARD:** I am grateful.
 8 **THE CHAIRMAN:** Can we start at 10.30 on Tuesday or would it
 9 be better to start at 10?
 10 Mr Saini, it's your Mr Eastwood who --
 11 **MR SAINI:** I think 10 would be safer as far as our witness
 12 is concerned.
 13 **THE CHAIRMAN:** Well, we will say 10.15, that makes things
 14 easier for some of us. Very well, thank you.
 15 Mr Howard?
 16 **MR HOWARD:** I think it's clear, but I am just being asked
 17 from behind whether we are agreed, therefore, that the
 18 economic experts will start on 8 November rather than
 19 3 November? Ie that we are slipping --
 20 **THE CHAIRMAN:** Yes, I think we will take that decision, and
 21 also say that it does look like that certainly
 22 Mr Shaffer will need to be available on 18 November as
 23 well as earlier than that.
 24 **MR HOWARD:** Yes. It also has the effect that you will have
 25 one week of appellant's experts and one week of OFT

1 experts, which may make things at least easier to manage
 2 and think about.
 3 **THE CHAIRMAN:** Yes. Thank you very much, everybody. We
 4 will meet again then at 10.15 on Tuesday.
 5 (4.35 pm)
 6 (The court adjourned until 10.15 am on
 7 Tuesday, 18 October 2011)

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