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IN THE COMPETITION

APPEAL TRIBUNAL

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

Victoria House,
Bloomsbury Place,
London WC1A 2EB

22 September 2011

Before:

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

Sitting as a Tribunal in England and Wales

BETWEEN:

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

CO-OPERATIVE GROUP LIMITED

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

WM MORRISON SUPERMARKET PLC

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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HEARING (DAY 2)

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 Thursday, 22 September 2011
 2 (10.00 am)
 3 Opening submissions by MR HOWARD (continued)
 4 **DR SCOTT:** Mr Howard, yesterday I realised some deficiencies
 5 in my cross-referencing from the evidence to the
 6 bundles, and there were two particular areas. The first
 7 comes up in transcript 40, lines 1 to 7, where you
 8 referred to certain public documents when you were
 9 talking about transparency, and it would be helpful --
 10 not immediately but at some stage -- to know whereabouts
 11 in the bundles we might find those.
 12 **MR HOWARD:** Yes. I don't have the transcript to hand. In
 13 due course?
 14 **DR SCOTT:** Yes, in due course, it's not urgent.
 15 The other is in transcript 55, lines 2 and 3, where
 16 you referred to the publicly available wholesale price
 17 lists.
 18 Again, although I can recall references to them and
 19 to the non-bespoke discounts as distinguished from the
 20 bespoke discounts you mentioned shortly afterwards,
 21 again I couldn't immediately remember whereabouts in the
 22 bundle we would find those.
 23 **MR HOWARD:** I don't think that they are in the bundles.
 24 **DR SCOTT:** Right.
 25 **MR HOWARD:** We will check. I'll check.

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1 **DR SCOTT:** I would think there are examples, but insofar as
 2 you are talking about transparency, both those areas may
 3 become relevant when we get to examining the witnesses.
 4 **MR HOWARD:** Yes.
 5 I think, just on that, it's just important to be
 6 clear. The RRP's are obviously public documents, and
 7 intended to be public documents. The RRP's are important
 8 to the manufacturers in that the manufacturers have to
 9 determine what the average selling price will be, and
 10 they have to account for the tax to the Revenue on that
 11 basis. Obviously, they are in effect acting as
 12 a revenue collecting agent in the same way as anybody
 13 does, say, collecting VAT. But obviously if they, for
 14 instance, pitched the RRP too high, then they will end
 15 up accounting for tax which actually they will have to
 16 bear out of their own pocket.
 17 So one has to realise and remember it's a very
 18 important exercise setting the RRP, that you can't just,
 19 as it were, say, "Well, what I am going to do is sell
 20 low, pitch the RRP high, then knowing actually that the
 21 retailers, because I've assumed a 25 per cent margin for
 22 the purpose of the RRP's, will sell at a 5 per cent
 23 margin, and so it will, as it were, wrong-foot my
 24 rival." In theory one could see that you could do that,
 25 but the net effect would be that you were accounting for

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1 an enormous amount of tax. So it's a very important
 2 exercise.
 3 I think the discussion we had yesterday, there is
 4 a danger of misunderstanding how things work. From the
 5 RRP at that stage, you can reasonably infer -- I don't
 6 say you can precisely infer -- the wholesale price,
 7 because each of the manufacturers, in order to determine
 8 the RRP, has to have a view which he will have gained
 9 from experience from dealing with the retailers over the
 10 years, what the margin requirements are. So there is,
 11 as it were, a lot of intelligence about how this works
 12 just from market understanding.
 13 Equally you will know what are the volume discounts,
 14 and you will also know, for instance, that the
 15 supermarkets expect to sell below RRP and that (a) they
 16 obviously get a volume discount which enables them to do
 17 that, but they are also pitching for the manufacturers
 18 to support them in doing that. But again, market
 19 intelligence will allow you to know where they are.
 20 Insofar as you get wrongfooted at one stage so that
 21 you believe, for instance, that Sainsbury's and its like
 22 are aiming to be 10p below RRP, and that they get there
 23 through volume discounts and through each of the
 24 manufacturers supporting them in that, when you then see
 25 that a brand which you were expecting to be at

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1 a particular price is way below, you can infer from that
 2 the reason it is below where you are expecting is
 3 because it's from price support. In other words, from
 4 a further discount.
 5 So that is why you can work out that essentially
 6 a special price discount is being offered, and there is
 7 a fair amount just through -- obviously you will want to
 8 ask the witnesses about it, and I am really just
 9 speaking from my reading the papers, but if one just
 10 thinks about it for a moment, there is an awful lot you
 11 can deduce.
 12 If one says: could you be absolutely certain, the
 13 answer is no. But of course that's where all these
 14 arrangements allow the supermarkets or the retailer to
 15 play people off against each other, and that's what
 16 Tesco's evidence actually was, for instance. If they
 17 say, "Well, when somebody comes along and sees that we
 18 have Benson & Hedges at a low price, that may actually
 19 be because they are just trying it on, so that they can
 20 then say to Imperial: well, if you want Imperial below
 21 that, you will have to pay me, leading to the inference
 22 that I have been paid by Gallaher", when they may not
 23 have been. The thing is you don't actually know, and
 24 that's of course how competition works in any discussion
 25 between supplier and retailer, and that's how it should

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1 work.

2 **THE CHAIRMAN:** I think all we are saying is that if it's

3 part of your case that people reverse engineer from the

4 RRP certain other facts, then it might be helpful for us

5 to know how the RRP is arrived at in order to see what

6 you can reasonably reverse engineer.

7 **MR HOWARD:** We will certainly look at that, but I think the

8 point I am making to you is all I am saying actually is

9 something which is really a matter of common sense.

10 It's actually not something that's absolutely peculiar

11 to -- the peculiarity of the tobacco industry of course

12 is that you have these published RRPs for everything.

13 One would imagine in any product where you are selling X

14 to Tesco and you know your rival is selling their

15 competing product, and you see what price it is in

16 Tesco's store, you try to infer from what's going on

17 what the wholesale price was in order that you can try

18 and undercut it. That's what a manufacturer will try

19 and do.

20 Of course, it may be that the wholesale price of one

21 product is no greater or no less than the other and it's

22 the difference in margin, but that's all part -- what we

23 are looking at is what Imperial's understanding is, and

24 Imperial's understanding generally would be that where

25 they have managed to set their RRP lower, it's because

5

1 they correspondingly have a lower wholesale price.

2 Again, the margins are not necessarily the same

3 across the board for the products, I am sure you

4 understand that, because the reason you will have

5 a different margin, it depends on the nature -- the

6 retailer has a different margin -- of the product. So

7 the products that sell more, there may be a lower

8 margin, whereas the old type of cigarettes which are no

9 longer so popular today which you have seen are not

10 particularly promoted, the ones with high tar, without

11 filters and so on, those presumably have a higher margin

12 because if you are going to give them shelf space, you

13 sell less of them and you need a higher margin.

14 Those are points really for the evidence.

15 **DR SCOTT:** Indeed. Thank you.

16 **MR HOWARD:** I hope that's helpful.

17 If we can go back to what we were looking at on the

18 theory of harm. If I can not recap but remind you, what

19 we are examining at the moment is the basis of the

20 theory of harm and the theory of harm and the main way

21 in which the case is put by the OFT is this lock-step

22 mechanism. We then see how they seek to relax that.

23 But it's very important to understand that the theory of

24 harm in the model is based on this, because what we say

25 is once you relax it, you are actually talking about

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1 a totally different type of relationship, and we say you

2 can't apply the theory of harm and just say "Oh, well,

3 it somehow still applies to what is a very different

4 arrangement".

5 If you would kindly take core 6, and I am going to

6 refrain from reading out chunks of the report, because

7 of time, but an important passage in Professor Shaffer's

8 report at tab 65 -- this is his 2010 report -- is at

9 paragraphs 91 to 92. This is actually the key to

10 Professor Shaffer's theory of harm. {C6/65/91}

11 Just before I invite you to read that and remind

12 yourselves of it, if I can remind you what we are

13 dealing with at the moment, in this part of the

14 analysis, is the OFT's case that there are fixed

15 differentials. So their case on fixed differentials is

16 that whenever one manufacturer puts up his price, there

17 has to be a corresponding increase in the price of the

18 other manufacturer's product, and conversely whenever

19 one manufacturer puts down his price, there has to be

20 a corresponding decrease. In other words, the rigidity

21 assumption.

22 There is then, their case, they say well, even if

23 it's maxima, they then say the rigidity point still

24 applies but it's only relevant in two instances subject

25 to the parallel and symmetrical point where they say

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1 that effectively gets you back to the fixed point. But

2 in order not to confuse things, I am focusing on the

3 fixed point at the moment, but the critical point really

4 is not for present purposes the distinction between

5 fixed and maxima, but the rigidity assumption.

6 So if you would just remind yourselves of

7 paragraphs 91 and 92.

8 (Pause)

9 This is Professor Shaffer setting out his lock-step

10 mechanism, everything goes up and down in an absolutely

11 fixed relationship, and therefore the theory is there is

12 no point ever reducing prices if you are Gallaher

13 because you won't get the market share gain that you are

14 looking for, and there is every incentive to increase

15 price because it won't create any greater loss to you

16 than you currently face, and equally from Imperial's

17 point of view, you can put up the price confident that

18 you won't thereby be out of line with Gallaher because

19 they will go up correspondingly.

20 So this theory of harm relies -- and he describes

21 it, as you can see, as co-ordination -- on the existence

22 of a mechanism under which vertical relations between

23 manufacturers and retailers perform the task of

24 co-ordinating interbrand price competition.

25 Now, if we just see what the OFT says, where there

8

1 are maxima, just to pick up on that, it's dealt with at
 2 paragraphs 6.232 to 237 of the decision. Again, I won't
 3 read out a chunk of it, but what essentially it is
 4 saying is, at the last sentence of 232:
 5 "A maximum differential requirement imposes as
 6 a corollary a minimum retail price on brand Y relative
 7 to the retail price of brand X.
 8 "So by analogy with the scenarios above, a maximum
 9 differential requirement is capable of giving rise to
 10 significantly increased certainty. When the retail
 11 price of brand X is priced at the relative price ceiling
 12 in relation to the retail price of brand Y, any increase
 13 in the retail price of brand X would be matched by
 14 a corresponding increase in the price of brand Y."
 15 They therefore explain their case on the effect of
 16 incentives. Again, this is looking at a rigid
 17 relationship and the assumption is that the RMSs require
 18 this to happen.
 19 Going back to Professor Shaffer for a moment, and he
 20 too considers this alternative version, namely that
 21 there are maxima, and at paragraph 120, it starts at
 22 paragraph 117, where he considers maximum differential
 23 requirements, and at 120, {C6/65 paragraph 120} we see
 24 he says:
 25 "The analysis in this case proceeds along similar

1 lines of the corresponding one with parity and fixed
 2 differential requirements with one key difference.
 3 Unlike in this case, with maximum differential
 4 requirements ... retail prices need not move in
 5 lock-step, instead [they] would have the effect of
 6 constraining retailer Z's independent pricing of each of
 7 its products in only one direction."
 8 Then if you go to 123:
 9 "It follows that there are effectively only two
 10 constraints on the retailer's ability to set retail
 11 prices that need to be considered in this case. One
 12 constraint is that at initially equal prices, retailer Z
 13 cannot increase the price of product A1 at its stores
 14 without also increasing the price it sets on product B1.
 15 With an equal increase in the prices of both products,
 16 consumers who would have switched to product B1 if only
 17 product A1's price had increased now will not switch.
 18 Sales of product A1 would thus be higher as a result of
 19 the maximum differential requirement on retailer Z than
 20 they would have been otherwise.
 21 "The other constraint to consider is that, at
 22 initially equal prices, retailer Z cannot decrease the
 23 price of product B1 without also decreasing the price of
 24 product A1."
 25 So then he sets out his implications for the

1 requirements of manufacturers.
 2 Now, again, it's absolutely clear what
 3 Professor Shaffer is saying is that where there is
 4 a fixed differential, fixed in parity, that's what he
 5 calls lock-step. Where you have maxima, it is in effect
 6 a lock-step but operating only in two of the situations
 7 rather than all four, and his theory is all based upon
 8 the effect on manufacturers.
 9 So the question then, having seen that, before we
 10 come to consider the variants, is: what is the basis for
 11 this assumption of rigidity? Because if that goes, then
 12 a large part of this theory of harm goes.
 13 Now, of course one of -- not the only, but one of --
 14 the major reasons that you see completely diametrically
 15 opposed views by the experts is because of their
 16 different understanding of these facts, and indeed the
 17 OFT says the real issue in dispute is whether or not
 18 they had established the existence of the infringing
 19 agreements. That way of putting it of course rather
 20 begs the question, not least because they call them the
 21 infringing agreements, and the critical aspect is
 22 actually: what is it that you are saying is the aspect
 23 of the infringing agreements? At this stage it's
 24 perfectly clear it's the rigidity which is the key
 25 aspect.

1 Now, the way in which I propose to deal with this,
 2 briefly, although we have looked at it before, is to
 3 consider the four different constraints which are said
 4 to operate. So the first circumstance is Gallaher puts
 5 up its price, a Gallaher price increase. What is being
 6 alleged is that, whenever Gallaher's price goes up,
 7 Imperial required the retailers to increase the retail
 8 price of its product, and that was something that
 9 automatically followed a wholesale price increase by
 10 Gallaher.
 11 Now, this point, just again one sometimes loses
 12 sight, only arises if the OFT is right on a prior point,
 13 which is that the differentials are fixed. It doesn't
 14 relate to maxima. It's the fixed point. That's what
 15 you just saw in Professor Shaffer.
 16 Now, we have already made the point there is
 17 absolutely nothing in the trading agreements that
 18 required this, ie a requirement that Imperial's price
 19 must go up, because they are not fixed, and -- I mean,
 20 that's actually the first key point, they are not fixed,
 21 but in any event they were incentives.
 22 As we discussed yesterday, in some cases the
 23 opposite is actually true of what is being alleged by
 24 the OFT, which is that following a wholesale price
 25 increase by Gallaher -- sorry, it's not what we were

1 discussing yesterday. The thing is, where there is
 2 a wholesale price increase by Gallaher, the trading
 3 agreements in fact provided -- no, sorry, in some
 4 cases -- an incentive to the retailers not to increase
 5 the retail price of Imperial. You remember that in the
 6 Sainsbury's and Morrisons example that the bonuses were
 7 dependent upon maintaining the shelf prices, absent
 8 a Budget increase or an MPI.
 9 So the mere fact that Gallaher puts up its price,
 10 actually, if you try, retailer, to put up your price,
 11 you will actually lose your bonus. So rather than being
 12 encouraged to put up the price, you are being
 13 discouraged. So it's the exact opposite.
 14 Even where that term wasn't present, if the retailer
 15 chooses to put up its price because -- I am sorry.
 16 **DR SCOTT:** Yes. What you are saying, this is just looking
 17 at the Imperial trading agreements, but ignoring any
 18 other trading agreements, so we are at the assumption
 19 stage that we are just looking at Imperial, we are
 20 keeping out of mind the existence of any parallel or
 21 similar arrangement now?
 22 **MR HOWARD:** At this stage, yes, absolutely.
 23 **DR SCOTT:** So we are thinking simply --
 24 **MR HOWARD:** You have to remember that the reason you should
 25 really be putting out of your mind this parallel and

1 symmetrical point, there are a whole series of reasons
 2 why, not least it is no longer essentially being argued
 3 by the OFT. They are saying "We don't say parallel and
 4 symmetrical, we say similar". Similar is very, very
 5 different in saying that gives rise to knowledge in
 6 general terms. That's not parallel and symmetrical.
 7 **THE CHAIRMAN:** Yes, but what you are saying is, just looking
 8 at this, the first of the four possible way that prices
 9 shift, this is not one of the two ways which is relevant
 10 if they are really maxima, this is one of the four ways
 11 which is relevant if they are fixed --
 12 **MR HOWARD:** If they are maxima, this is on the OFT's case
 13 irrelevant unless they establish parallel and
 14 symmetrical. Because without parallel and symmetrical,
 15 the point doesn't work.
 16 **DR SCOTT:** Well, or sufficiently similar.
 17 **THE CHAIRMAN:** Well, parallel and symmetrical is another way
 18 of making them fixed if they are not actually fixed --
 19 **MR HOWARD:** Exactly.
 20 **THE CHAIRMAN:** -- in relation to the --
 21 **MR HOWARD:** That's right.
 22 **THE CHAIRMAN:** By the terms of the Imperial agreement --
 23 **MR HOWARD:** Sufficiently similar, I am afraid I don't think
 24 does work.
 25 One has to be precise about this. Either something

1 is symmetrical or it isn't. If it isn't, it is
 2 inconsistent, it's quite difficult to really see, but
 3 even once you get to -- even if you say there is
 4 something parallel and symmetrical, you have to remember
 5 then you are actually dealing with a further
 6 complication which is you have to then establish that
 7 both the manufacturers are actually aware of what the
 8 other is doing. Of course, one of the points you will
 9 be aware of is you are not going to hear any evidence
 10 from Gallaher, the OFT, they have done a deal with
 11 Gallaher, but they are not calling any evidence, so we
 12 will not have an opportunity to examine what actually
 13 Gallaher knew.
 14 So you will be deprived, we are deprived of the
 15 opportunity to investigate that, and you simply don't
 16 know, the OFT is not seeking to call any evidence on
 17 that. So that's a further reason why the parallel and
 18 symmetrical point we say simply cannot properly arise in
 19 this case.
 20 **DR SCOTT:** And in any event what you have also just said is
 21 that the arrangements may well have been inconsistent.
 22 **MR HOWARD:** Yes, that's right. Parallel and symmetrical,
 23 you can keep saying in the decision parallel and
 24 symmetrical, but you actually have to prove it, so when
 25 they actually come to prove it, what you will see in the

1 decision is they hardly put forward anything. They make
 2 the allegation but actually they refer, I think, to some
 3 correspondence from Co-op and from Shell. They now
 4 accept there was not any parallel and symmetrical with
 5 Co-ops, so I think you have -- how many letters is it
 6 from Shell they are referring to? I can't remember, but
 7 a tiny number.
 8 So they then have sought to embroider the case in
 9 the defence, which we say in fact they are not entitled
 10 to do, but where they get to in the defence is they
 11 actually say parallel and symmetrical is not a necessary
 12 part of the finding of infringement by object. That's
 13 their defence, paragraph 277. So I think that it is
 14 fair for me to approach the case by looking at
 15 Imperial's agreements on their own terms and the
 16 relationship between Imperial and the retailers in order
 17 that you can assess whether a case by object is made
 18 out.
 19 I agree that insofar as there is something then left
 20 where, if they were seeking to bolster it, but the only
 21 way as I see it that they are seeking to bolster it, the
 22 only way that parallel and symmetrical comes into this
 23 analysis is that at this stage in relation to the
 24 Gallaher price increase if they fail on fixed, they say
 25 "Well, I can get to the same route by parallel and

1 symmetrical", but my short answer to this at this stage
 2 is: no, you can't, because you yourself are saying it's
 3 not parallel and symmetrical, it's similar, and that
 4 doesn't work. Once you acknowledge, similarity is not
 5 the same, and that's what parallel and symmetrical
 6 requires. Or at least it requires equal and opposite.
 7 If we come back to their case, we have seen the
 8 trading agreements, I've explained to you why it's
 9 actually counterintuitive to think that Imperial wanted
 10 its prices to go up when Gallaher's wanted to go up, and
 11 the only answer to that is essentially to say: well,
 12 actually, contrary to everything we see in the
 13 documents, there is a conspiracy going on here whereby,
 14 although you appear to be wanting to undercut Gallaher
 15 and to go for -- get your product at lower prices, in
 16 truth what are trying to do is to drive up prices, so
 17 whenever Gallaher's price goes up you want to put up
 18 your price.
 19 The thing is, what you have to remember, again you
 20 have to separate out different things. It may be
 21 perfectly true that when Gallaher puts up its price
 22 Imperial puts up its wholesale price, which results in
 23 the retailer putting up its price. That may be
 24 perfectly true, but that's not the complaint. The
 25 complaint is even though you are not putting up your

1 wholesale price, the retailer is putting up the price
 2 because that's what these arrangements require.
 3 It's a very, very different thing, and that's what
 4 this case a lot of the time gets confused with, not
 5 recognising that it's not at all surprising that
 6 a manufacturer, seeing his rival putting up his price,
 7 may do the same, (a) because he may be subject to the
 8 same factors, namely the budget increase, the cost of
 9 tobacco, the cost of employment; or because he himself
 10 thinks, "This is a chance for me to increase my margin
 11 if my competitor is doing the same", and that's again
 12 how markets work.
 13 **THE CHAIRMAN:** When there are only two players.
 14 **MR HOWARD:** Of course.
 15 **THE CHAIRMAN:** It's an oligopolistic market effectively and
 16 that's how it tends to work.
 17 **MR HOWARD:** That's right, but all of that is entirely
 18 different to what this case is about. Really at the
 19 heart of all of this, that's what one has to remember,
 20 there are other things, and the fact that the
 21 manufacturers may, one manufacturer puts up the price
 22 and the other one follows, that has nothing to do with
 23 the RMSs.
 24 Now, you are going to hear, and I am not going to go
 25 to it now, about the -- you have seen it in the

1 papers -- June 2002 incident, and you have both parties
 2 saying, "Look, this shows I am right about all of this".
 3 You will have to come to a view as to whether it
 4 actually makes much difference either way. What we say
 5 is it certainly does not support the idea that there is
 6 a fixed relationship which is the OFT's case; what it
 7 shows is that in that instance, what's interesting about
 8 it is where Imperial has not implemented a price
 9 increase following Gallaher, it wants the differentials
 10 to widen. So it shows that the, although very often it
 11 may, and people may think it will, that they will be
 12 increasing prices at more or less the same time, where
 13 they chose not to, what they expected was, and they told
 14 the retailers "We actually want our differentials to
 15 widen", in other words a competitive advantage.
 16 What the OFT seeks to say is "Well, you wouldn't
 17 have -- why did you write those letters?" The letters
 18 make perfect sense in the sense that what one is saying
 19 is "I want to increase my differential, widen the
 20 differential", it doesn't follow that if you, absent the
 21 letter, that there was some obligation to increase the
 22 price. They are addressing something different.
 23 Now, what is it that the OFT relies on at this stage
 24 in support of its case? I am going to take you --
 25 I accept that they rely on other documents at different

1 stages -- to the documents that they rely on in their
 2 skeleton argument, because I think it's fair to infer
 3 that they put forward that those documents represent the
 4 high water point of their case.
 5 You will see if you go to paragraph 40 of their
 6 skeleton argument, under each of the constraints they
 7 footnote various documents. You see footnotes 41, 42,
 8 43 and 44. We are currently dealing with constraint A:
 9 "If the retail price of Gallaher's brand increases,
 10 then the retail price of ITL's private brand must also
 11 increase."
 12 So for that purpose they say: See, for example, at
 13 footnote 41, this document.
 14 I think there are three documents. You see there is
 15 one, a Morrisons one, an Asda one and a TM Retail one.
 16 Could I ask you, when you look at these documents,
 17 to remember what it is we are looking at them for, and
 18 that's true of all the correspondence in this case. You
 19 have to keep in your mind at each stage: why are you
 20 showing me this, OFT, what is it supposed to support?
 21 It's supposed to support a case that there was a fixed
 22 relationship and that the retailer was obliged to move
 23 Imperial's price up when Gallaher's price had gone up,
 24 notwithstanding that Imperial hadn't changed the
 25 wholesale price of its product. So that's what they are

1 seeking to say. When you look at the correspondence,
 2 you will see it doesn't support that at all.
 3 So the first one is in SO annex 17, document 16,
 4 {D17/16} and you ought to keep open probably the
 5 skeleton, because it's in relation to a lot of these you
 6 need to -- you will just note, not necessarily a matter
 7 of criticism because obviously you can't set out
 8 everything, but the excerpts that are set out don't
 9 properly explain to you what actually the correspondence
 10 is about. So if you can see:
 11 "You are probably aware that the broad marketplace
 12 has moved from 3.29, 3.30 to 3.34, 3.35 on Dorchester,
 13 and Dorchester Superkings.
 14 "You may remember from my presentation on Richmond
 15 repositioning and the launch of Richmond Superkings that
 16 our strategy is parity with Dorchester. In the light of
 17 this, we are moving Richmond up to the price you can
 18 see. In order to maintain your cash margin position,
 19 the bonus levels at [that price] should be as follows."
 20 What is important to note in the OFT's skeleton is
 21 that they miss out that line, and then they miss out
 22 what follows. What is happening here is that Imperial
 23 is moving up its price on its product, Richmond,
 24 following the end of a Gallaher promotion on Dorchester.
 25 Imperial is ending its temporary promotion on Richmond,

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1 so that what you have here are price and bonus figures
 2 showing that prices are going up because the tactical
 3 bonus is being withdrawn. In other words, this is not
 4 evidence that Gallaher's price increase must per se also
 5 result in a price increase of Imperial's product; this
 6 is Imperial simply saying "We are withdrawing now the
 7 bonus, the tactical bonus because we no longer wish to
 8 be supporting, providing a tactical bonus to try and
 9 meet what Gallaher are doing, because Gallaher are no
 10 longer price cutting on their brand, Dorchester".
 11 **DR SCOTT:** Sorry to interrupt you, it's just so that we know
 12 this for the future when we read back, just before we
 13 went to this document you were talking about June 2002,
 14 and I realise that we are now in November 2000.
 15 **MR HOWARD:** Sorry, I was talking about June 2002 in what
 16 context?
 17 **DR SCOTT:** You talked about "the June 2002 incident".
 18 **MR HOWARD:** No, that is a different incident --
 19 **DR SCOTT:** It is just so that we get into the transcript
 20 that we are now in November 2000.
 21 **MR HOWARD:** Thank you, sir, I apologise. There is a danger,
 22 obviously I am slightly tight for time, and if
 23 I misspeak or take things too quickly, I apologise.
 24 The June 2002 episode I was referring to in very
 25 short terms because there is a debate about what that

22

1 shows. We are now on paragraph 40 of the Office of Fair
 2 Trading's written skeleton, and the documents that they
 3 refer you to as examples to support their case that
 4 there was a fixed relationship with a requirement that
 5 if Gallaher's price went up, Imperial's price had to go
 6 up.
 7 This letter is the first one they refer to, and when
 8 properly analysed, indeed when you set out the full text
 9 of the letter, it's actually perfectly clear that it is
 10 not dealing with any obligation to put up the price
 11 because Gallaher has put up the price, it's withdrawal
 12 of a price promotion as a result of which the retail
 13 price is expected to go up.
 14 The words that are important in the letter are:
 15 "In order to maintain your cash margin position."
 16 In other words, it is understood you are seeking to
 17 earn this margin, in order to earn the margin that we
 18 understand -- and of course this is the price that you
 19 will need to price at, because you have got your bonus,
 20 the ongoing bonus, but what we were previously paying
 21 you has gone, and so this is what you will need to do in
 22 order to maintain your margins.
 23 The thing is, what the letter is not saying is, when
 24 viewed correctly, because Gallaher's price has gone up,
 25 you must independently put up our price. What it's

23

1 actually saying is effectively we are putting up our
 2 price because we are withdrawing our bonus, and
 3 therefore in order for you to maintain your cash margin,
 4 this is the price you will now need to charge.
 5 That's that one. That's the first letter. The
 6 second one is in SO annex 14, it's the Asda annex,
 7 document 30 {D14/30}:
 8 "Again, following yesterday's increase in the retail
 9 price of Amber Leaf, I would like to increase the retail
 10 prices of ITL's range as follows."
 11 **THE CHAIRMAN:** Just remind us who the author of this is?
 12 **MR HOWARD:** So this is Martin Downham of ITL. You can see
 13 it at the top left-hand corner. Amber Leaf is
 14 a Gallaher product, and it's a roll-your-own, in the
 15 vernacular, and one sees:
 16 "I would like to increase the retail prices of ITL's
 17 roll-your-own range as follows."
 18 So they are saying they want to increase the retail
 19 price of Drum and Golden Virginia.
 20 "These prices will be achieved by withdrawing the
 21 bonus support", and of course you will see that ...
 22 (Pause).
 23 In the skeleton, they seem to quote from another
 24 letter. They quote from that letter, and they appear to
 25 quote from another one. I am not sure which one that

24

1 is.
 2 Taking this letter, it's perfectly clear, on the
 3 face of the letter, on the face of the email, what is
 4 happening, which is withdrawal of bonus support. So
 5 what they are saying is -- and that's because there have
 6 been promotions on Amber Leaf, and they were promoting
 7 Drum and Golden Virginia to try and match Gallaher's
 8 promotion, having seen the Gallaher's promotion came to
 9 an end, they decided to withdraw their promotion, so
 10 were saying this is the effect.

11 Again, you have to remember, it has nothing to do
 12 with what is being alleged. That's the thing. They are
 13 alleging -- I can't say this too often -- that there was
 14 an obligation on the retailer where the Gallaher price
 15 went up to move the Imperial price. Well, one of the
 16 things: if there was, why are you writing the letter?
 17 Self-evidently there wasn't. What they are saying is
 18 now I am withdrawing my bonus support, that will result
 19 in the price being changed because that's again, based
 20 upon what they understand are the margins in this case
 21 that Asda are seeking.

22 This email is dealt with by John Jolliff, the
 23 witness for Asda, whose statement is at core 10 --
 24 I don't think we need to get it out -- tab 109 at
 25 paragraph 91 {C10/109 paragraph 91} and indeed he there

1 said that it was an email confirming the end of a period
 2 of promotional funding on roll-your-own tobacco, and he
 3 explains that the effect of the bonus support being
 4 withdrawn had the effect of increasing his net cost
 5 price, and so he would have to move the prices to those
 6 indicated in order to maintain his margin.

7 **MR SUMMERS:** Mr Howard, I am sorry. The prices shown here,
 8 are they simply restoring the price levels to those
 9 which existed before the promotion started, or are these
 10 setting new higher levels of prices and not reverting to
 11 the previous prices?

12 **MR HOWARD:** My understanding is that they are reverting to
 13 the previous price before the promotion.

14 **DR SCOTT:** Just one other question, Mr Howard, about the
 15 status of this document. On the face of the document,
 16 this is a draft, which is faxed to somebody, and
 17 contains that "Please check this will fill the gap
 18 before I send it". Is it accepted that it was ever
 19 sent?

20 **MR HOWARD:** Yes.

21 **DR SCOTT:** That's the next tab? Okay.

22 **MR HOWARD:** Yes. It is accepted. Just to answer that
 23 point, we will obviously have to check, my understanding
 24 is firstly that it is going back to the previous price,
 25 but secondly, even if it's not, it doesn't actually

1 affect the analysis, in the sense that what -- well,
 2 again what one is looking for is evidence that the
 3 retailers were required because Gallaher has put up its
 4 price to move the price of Imperial, and that being as
 5 a result of the RMS arrangements. What this is showing
 6 is simply, we are withdrawing the bonus support, and
 7 this is the price in the light of that, and which the
 8 witnesses explained, Mr Jolliff explains, that this is
 9 in order for him to get the margin that he is looking
 10 for. As I say, my understanding is it is in fact going
 11 back to the prior price.

12 **MR SUMMERS:** But it could go to the point you were making
 13 that price increases may occur where there is not
 14 necessarily a manufacturer price increase.

15 **MR HOWARD:** This is a manufacturer's price increase in the
 16 sense that when --

17 **MR SUMMERS:** It's a withdrawal of bonus, isn't it?

18 **MR HOWARD:** I think to answer your question, a withdrawal of
 19 a bonus is in fact a price increase, firstly, in the
 20 sense that when you -- I mean, the problem is we are
 21 just playing with words. When you provide a bonus, what
 22 you are actually doing is reducing the wholesale price.
 23 When you withdraw it, you are putting it back up again.
 24 It may be that it's back to where it was before. But
 25 equally what I can't tell you at the moment, we can look

1 into it, whether Gallaher at this time was both
 2 withdrawing the bonus and putting up the price. In
 3 other words, you can have both and therefore if the
 4 price is higher than it was before, that's because in
 5 fact there has been a manufacturing price increase as
 6 well as the withdrawal of the bonus. I don't think
 7 that's what was happening but I am just saying that the
 8 two can happen at the same time.

9 As I say, what on its face the document is saying
 10 and what the evidence of the witness is saying,
 11 Mr Jolliff, who received this, is it's exactly as
 12 I described it. What is it you might think is very,
 13 very curious in the OFT's case, they continue to assert
 14 that this is evidence of this arrangement
 15 notwithstanding that. It's actually quite difficult to
 16 understand. What is their case on that? They have not,
 17 as I understand it, interviewed Mr Jolliff to ask him
 18 about that. One would have thought you would have done,
 19 to find out.

20 But in any event, on the face of the document, it
 21 doesn't support what they are saying.

22 Now, the final document that they put forward in
 23 support of this part of their case you will find in SO
 24 annex 22. {D22}

25 The bit that is relied on is under the first

1 paragraph which is headed "Richmond SA, Kingsize and
 2 Superkings 20s":
 3 "From 8 November we agreed to raise the retail price
 4 of Richmond Kingsize ... by 10p per pack. This applies
 5 to all tiers, and I will update the promotional schedule
 6 adjusting the selling price and bonus rates and forward
 7 a copy. I understand this move in price will be in line
 8 with competing brands. Please let me know should this
 9 position change."
 10 So what one has here is an email which relates to
 11 the end of short-term promotion whereby ITL, Imperial,
 12 had been funding lower prices for its Richmond brands,
 13 following a manufacturing price increase which had taken
 14 place on 3 September of that year, so a month or so
 15 prior.
 16 The context is actually set out in an earlier letter
 17 in this bundle at tab 14, which was, you can see,
 18 providing for a promotion.
 19 Document 16 confirms that the promotion supporting
 20 the flat price of £3.39, and £3.40, which you can see on
 21 page 87, tab 14, was to end from 8 November, and
 22 therefore if TM Retail didn't wish to continue to fund
 23 the promotion itself, it would need to increase the
 24 prices to the levels identified. It's not saying
 25 because Gallaher have put up the price, you must do

1 this. What they actually are saying is they understand
 2 that Gallaher is ending a price promotion of its own,
 3 and therefore this price will be in line with competing
 4 brands, let me know if this position should change.
 5 There is no expectation that because Gallaher is
 6 putting up its price you must put up ours. They are
 7 ending a promotion because they don't think it's
 8 necessary, but actually if they find they are out of
 9 line, then they might put the promotion back in. Again,
 10 it has absolutely nothing to do with the so-called rigid
 11 requirement of putting up prices.
 12 So that's dealing with those three examples. Then
 13 I am going to deal with the examples -- because again
 14 these are dependent upon the fixed relationship -- in C:
 15 "If the retail price of ITL's brand decreases, then
 16 the retail price of Gallaher's rival price must also
 17 decrease."
 18 Again, I should have reminded you on the first, in
 19 relation to the fixed point, of course there is the
 20 empirical evidence which I showed you yesterday which
 21 shows there isn't this fixed relationship, also of
 22 course the evidence that there is no requirement in the
 23 way that the OFT has put it. But it is again bizarre to
 24 suggest that if ITL -- just think about it for
 25 a moment -- puts down its price, that ITL wants the

1 retailer independent of what Gallaher does to put down
 2 Gallaher's price. I mean, I don't know what competition
 3 world those in the OFT who thought of this have come
 4 from, but it just does not make any sense at all. Why
 5 ever would a manufacturer want to cut its price and
 6 expect the retailer independently to put down the price
 7 of its rival's product? What he actually does when he
 8 cuts his price, he holds his breath and crosses his
 9 fingers and hopes that the other manufacturer won't
 10 follow them so he can gain market share. His irritation
 11 is when the other manufacturer decides to try and match
 12 him, but that's how competition works. So it's
 13 a nonsensical case.
 14 Now, what are the documents that they rely on in
 15 support of this? There are two at this stage. They are
 16 a Safeway document and a T&S Stores document. The
 17 Safeway document is in annex 28, and it's at tab 38.
 18 {D28/38} Take this one quite quickly. Again, you see
 19 this is selective quotation from a document, so you
 20 don't correctly understand it. What you can see is the
 21 introduction about pricing:
 22 "Following our meeting this week, I set out below
 23 the prices in Safeway which are wrong or require further
 24 investigation."
 25 What the OFT has quoted is the last, the penultimate

1 paragraph:
 2 "There should be one price for all cigars and noting
 3 your main competitors, I suggest the following levels."
 4 It has nothing to do with an Imperial price
 5 decrease, it is in fact, as Safeway have explained, and
 6 they are probably the best people to deal with it, that
 7 in the Safeway stores -- basically what was going on was
 8 that Safeway, were not, as it was perceived, correctly
 9 pricing the products in accordance with their own
 10 pricing strategy. In other words, there was
 11 incompetence within Safeway, and Imperial spotted this
 12 and were reporting to them that the Safeway pricing
 13 policy was not being implemented properly, as they
 14 understood it, and that's what they were telling them.
 15 That's why it says:
 16 "I set out below the prices in Safeway which are
 17 wrong or require further investigation."
 18 If Imperial understand that they are intending to
 19 have one price for all cigars, and they have got
 20 different prices, there is nothing wrong with pointing
 21 that out to them. But whether or not one thinks
 22 otherwise, and I would suggest there isn't any basis to
 23 think otherwise, this has nothing whatsoever to do with
 24 what we are addressing, which is again it's said because
 25 Imperial decreased its price, there was an obligation to

1 decrease the price of the competitor's product,
 2 notwithstanding that the competitor was not doing so.
 3 Completely nonsensical allegation and a document that
 4 doesn't support it.
 5 Then you come to the final one, T&S Stores, which
 6 you will have in annex 29 at document 19. {D29/19}.

7 This one is in the decision, and the footnote
 8 cross-refers to paragraph 6.1521 of the decision. It's
 9 very important to actually see what it's about, which is
 10 Day & Nite stores.

11 This is all explained in the witness statement of
 12 Mr Culham, who explains that what had happened was T&S
 13 had purchased Day & Nite stores in the year 2000, and
 14 they were intending to bring those stores within their
 15 pricing structure, within their pricing tiers, and that
 16 pricing structure had tiers and a strategy setting shelf
 17 price levels at certain levels below or above RRP, and
 18 T&S had discussed that with Imperial, as they wanted to
 19 make sure that they could get the same bonus
 20 arrangements on Day & Nite as on their T&S stores, and
 21 what in an earlier letter Mr Culham had done was to
 22 indicate the funding which would be available, and in
 23 this letter, all he was doing was working out the
 24 bonuses that were available.

25 Probably because of the time available, it's best to

1 leave you to read what Mr Culham says in core 3, tab 35
 2 at paragraphs 122 to 124, {C3/35 paragraph 122} but you
 3 can see from this letter that it is a fairly detailed
 4 letter, and once one understands the background, it has
 5 absolutely nothing whatsoever to do with the allegation
 6 that's being made.

7 **DR SCOTT:** It does employ the word "differential":
 8 "From the visit we have now noticed the following
 9 differential errors."

10 **MR HOWARD:** Exactly, but the differential errors that are
 11 being referred to here -- you have to remember, again
 12 you have to be clear what it is that's being alleged.
 13 This is a letter which is supposed to support a case
 14 that whenever there is an Imperial price reduction there
 15 is required to be a Gallaher price reduction. So it's
 16 not actually about that at all. So yes, what was
 17 happening was Imperial monitor the stores. Here the
 18 particular background was looking, investigating the
 19 extent to which Day & Nite stores were pricing in
 20 accordance with what Imperial understood T&S were trying
 21 to do, i.e. their retail strategy, including their
 22 retail strategy of intending to earn the bonus which was
 23 on offer. So yes, there is a reference to the
 24 differentials, and asking them to correct them. Because
 25 their understanding is that T&S are intending to have

1 the differentials.
 2 Again, as I say, I can't underemphasise the
 3 importance of actually keeping in one's mind what it is
 4 that the correspondence doesn't show, which is in
 5 relation to the case.
 6 So the whole basis of there being -- these are the
 7 best examples in relation to constraints A and C, one
 8 has to wonder really why we are all here.
 9 Now, one then comes to the other two constraints,
 10 which are where, as you can see:
 11 "If the retail price of ITL's brand increases then
 12 the retail price of Gallaher's brand must increase, and
 13 if the retail price of Gallaher's brand decreases, then
 14 the retail price of ITL's brand must decrease."
 15 Our position is that the RMSs were designed to
 16 incentivise on the basis of maxima. Accordingly, they
 17 could not impose restrictions -- we say they didn't
 18 impose restrictions, but they certainly couldn't do it
 19 where Imperial decreased price or Gallaher increased
 20 price. Such restrictions would be contrary to the
 21 stated objective of trying to win market share.
 22 Now, if we consider these two constraints now,
 23 **constraint B:** according to the OFT, constraint B is the
 24 central part of its case. That's what they say. Could
 25 I ask you to take core 4, which is where we will find

1 their defence, at tab 46, if you see at page 166 of the
 2 bundle, paragraph 35, {C4/46/166} second sentence they
 3 say:
 4 "ITL ignores the central part of the OFT's
 5 explanation of the anticompetitive nature of the
 6 infringing agreements."
 7 So it's the central part, and that's
 8 a cross-reference then to paragraph 6.216, and the
 9 central part of the case. Therefore, it is worth
 10 looking at that:
 11 "If manufacturer A has a requirement that
 12 a retailer's price for brand X is linked to the retail
 13 price of competing brand Y, by virtue of the required
 14 parity or fixed differential, that requirement is
 15 capable of giving rise to a significant degree of
 16 uncertainty that competing linked brands will move in
 17 parallel, and the loss of sales that you would normally
 18 expect to suffer by increasing your price is
 19 significantly reduced. As a result, manufacturer A
 20 would enjoy the gain in revenue from increasing its
 21 wholesale price without suffering the loss of sales that
 22 would normally result."
 23 So that's the central part, and at paragraph 38, you
 24 can see about five lines down, that's described as the
 25 central component of the OFT's theory of harm, and also

1 they cross-refer here, over at paragraphs 36 and 38, to
2 Professor Shaffer's report. So no question that they
3 are pinning their colours to the mast as established by
4 Professor Shaffer.

5 Now, if one then considers this for a moment, we
6 have already looked at two of the trading agreements.
7 None of the trading agreements provide for, were
8 Imperial putting up the price, that there is
9 a requirement to put up the price of Gallaher's product.
10 None of them in terms contain such an obligation.

11 What you have to distinguish in relation to this is,
12 one, if Imperial puts up the price that Gallaher puts up
13 its price, that's one thing, and the retailer then
14 putting up the price of Gallaher because Gallaher's
15 wholesale price has gone up. That's not what we are
16 talking about. The other is the retailer putting up the
17 price of Gallaher, even though Gallaher is not putting
18 up its price, and that's what this theory of harm is,
19 because it's the manufacturer can put up -- here
20 Imperial -- the price of its product in the knowledge
21 that the price of Gallaher's product goes up, whether or
22 not Gallaher is itself seeking to put up the price.

23 Now, as I say, and you have to distinguish these two
24 different things.

25 If Imperial put up the price, and Gallaher chose not

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1 to respond with its own wholesale price increase, all
2 that would then happen is that the RMS differentials in
3 the trading agreements would simply adjust as a result.
4 The retailers would still be entitled to qualify for the
5 RMS incentive payments, but on the basis of altered
6 differentials.

7 **DR SCOTT:** Sorry, you have me a little confused there. Are
8 you saying that the differentials in the prices would
9 change, which I understand, or that the differentials in
10 the agreement would change? Because we recognise that
11 sometimes, you know, a fresh schedule might be issued.

12 **MR HOWARD:** If you issue a fresh schedule, then that's the
13 thing, you can always issue a fresh schedule, so if you
14 put -- but what we are looking at is a situation where
15 you have not expressly issued a schedule, what actually
16 then was expected to happen.

17 Part of the problem with this is that we are
18 debating something which doesn't have any relationship
19 to real life, because in real life, what actually
20 happened was that when Imperial put up its wholesale
21 prices, not necessarily the same day, but within a short
22 period, usually Gallaher would do the same. That has
23 nothing to do with the RMSs, it's simply that when one
24 manufacturer was observing what the other was doing, it
25 might react. Occasionally, for instance we saw when

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1 Imperial chose to hold prices, that didn't happen. But
2 generally that did.

3 What one doesn't have is instances of the
4 manufacturer, here Imperial, putting up its price and it
5 requiring -- and that's what is being said in
6 evidence -- the retailer and saying to the retailer "We
7 have put up our price, why haven't you put up Gallaher's
8 price?"

9 We will see what correspondence is relied on for
10 this, but before we look at the correspondence, the
11 trading agreements don't on their face say that and this
12 is where the whole thing about this being contrary to
13 the interests of the retailers come in, because it's one
14 thing if the retailer says "Well, okay, Imperial,
15 I can't stop you, you are putting up your wholesale
16 price, the result of that is I will need to, want to
17 sell your products for more", but it would make no sense
18 at all for the retailer to say "As a result of that,
19 I am going to put up the price independently of
20 Gallaher", although you can say: ah, wouldn't the
21 retailer be obliged to do that? He might try and do
22 that because it's in his interest, but he won't want to
23 be obliged to do it. Why? Because he may then find
24 himself out of kilter with Tesco or whoever else it is.
25 He could only enter into such an arrangement if he has

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1 complete confidence that the whole of the market is
2 going to do exactly the same. Since we know it is the
3 case that the party with a market share in the
4 supermarket sector of in excess of 30 per cent was not
5 said to be party to this, it's rather difficult to see
6 how this would work.

7 None of the witness evidence supports the case, and
8 indeed the OFT, you remember they are only calling one
9 witness, that witness says the opposite to what the
10 OFT's case is. So it is again necessary to look at what
11 she says. It's in core 6, tab 69, pages 438 to 439,
12 {C6/69/438} paragraph 55 is entirely contrary to the
13 OFT's case.

14 She says:

15 "The Price Relatives/Differentials.

16 "It was their ideal strategy to have price
17 relativities probably for 99% of the time those
18 relativities were in place, but there would be the odd
19 couple of weeks between MPIs where they would be out of
20 parity. If, say, Imperial had an MPI and they were the
21 first one to go and they put Marlboro up 5p, I would not
22 stick Benson & Hedges up 5p if Gallaher had not
23 announced a price increase, even though Imperial's
24 strategy was to have parity between Marlboro and Benson
25 & Hedges. It was Imperial's decision to go first and

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1 they would expect somebody to follow them .
 2 "They would not come to me and say 'Gallaher have
 3 not had a price increase but we expect you to increase
 4 all their shelf prices'. If Gallaher or Rothmans did
 5 not follow Imperial 's MPI, imperial would have to
 6 reduce its own prices to realign the price
 7 differential -- but it would be up to Imperial to do
 8 so."
 9 In other words exactly the opposite of what the
 10 Office of Fair Trading's case is. It's if one
 11 manufacturer puts up its price, it hopes that it won't
 12 find itself out of line, it hopes that Gallaher will
 13 follow suit. If that hope proves to be frustrated
 14 because Gallaher is taking a robust approach to whatever
 15 it was that motivated the price increase, then it has
 16 to, with its tail between its legs, come back and
 17 reverse the thing.
 18 Actually what then happens in fact which supports
 19 all of this is -- and I won't take you to it now but
 20 I would refer you to the correspondence that we have set
 21 out at section 3 of our skeleton argument -- what you
 22 find is numerous examples where Imperial announce
 23 a price increase but then say to the retailer "Please
 24 hold the price of a particular brand" because they are
 25 waiting to see what Gallaher do. In other words,

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1 although they announce a price increase, they say don't
 2 implement it. So in other words the fact there is
 3 a price increase may filter into the market, but what
 4 they want to see is whether or not Gallaher is also
 5 increasing. If Gallaher doesn't and hasn't for the
 6 moment, they don't want to put themselves at
 7 a competitive disadvantage. All of that would be
 8 completely nonsensical if it were correct, as the OFT
 9 asserts, that there was some obligation or anything
 10 approaching an obligation that the retailer,
 11 independently, should put up the price of the Gallaher
 12 product.
 13 So just before we look at what the OFT puts forward
 14 in support of this part of the case, one says it's not
 15 supported by the terms of the trading agreement, not
 16 supported by any economic interest of the retailers, it
 17 would be entirely contrary to their interest, not
 18 supported by what we have shown happened. So that one
 19 then sees in their skeleton they cite, I think,
 20 altogether four communications at footnote 42. So this
 21 is the central part of the case. Let's see what they
 22 have there. So we have First Quench, which is in SO
 23 annex 16, and for this purpose we are looking at
 24 a letter from Mr Byas, which is at document tab 15.
 25 {D16/15} The paragraph of the letter that the Office of

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1 Fair Trading relies on is at the foot of the page:
 2 "With regard to Dorchester and Richmond, we would
 3 like to move Richmond up in price to £3.45 as soon as
 4 possible. Other accounts are moving in a similar
 5 direction, and if you are speaking with Gallaher in the
 6 next few days, I should be grateful if you would
 7 encourage them to move Dorchester to £3.45 on, say, 18
 8 or 26 June."
 9 What one sees is, in the text, Imperial asking
 10 First Quench to encourage Gallaher to change the price
 11 of Dorchester. Now, it is plainly not reflecting there
 12 being some pre-existing requirement upon the retailer
 13 independently to move the price. What it actually shows
 14 is that Imperial was uncertain what Gallaher would do.
 15 Indeed, if Imperial had a requirement that its price
 16 increase should be followed by the retailer putting up
 17 the price of Gallaher, one wouldn't need to write this.
 18 Nor, if you had an expectation that the retailer would
 19 move the price independently of Gallaher, would you
 20 write that.
 21 It is fair to say that it's questionable whether
 22 Mr Byas of Imperial should have been writing to
 23 First Quench in these terms. But that is not what the
 24 case is about, again. The allegation of illegitimate
 25 indirect contact, in other words the hub and spoke case,

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1 has been withdrawn. The thing is, if you were running
 2 a hub and spoke case, you would need to show that this
 3 information, firstly that there was inappropriate price
 4 information being passed on to -- well, it's not
 5 inappropriate price information being passed from
 6 Imperial, it's that Imperial is expecting and requiring
 7 price information to be passed on to Gallaher. So
 8 that's the first thing you would have to test. Then you
 9 would have to show that it was in fact passed on, and
 10 then you would have to show that it was in fact acted
 11 on. In other words, those are the links in the hub and
 12 spoke, which, as I understand it, have been established
 13 by the Court of Appeal in *Argos v JJB*. I'm displaying
 14 that I'm not the specialist, as everybody knows, in this
 15 field, but I have sufficient familiarity with that at
 16 least.

17 This letter, so what one sees is it encouraging
 18 Gallaher to do something, as I say, it does not support
 19 the case which the OFT is seeking to make out, and you
 20 always have to look at it and ask: how does it fit?

21 The next one is at annex 28, and it's again the
 22 Safeway story, not properly looked at in its context.
 23 So you see at tab 34 {D28/34}:

24 "There is still an error in the pricing of both
 25 Mayfair and Sovereign in all Safeway stores. The

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1 difference between Lambert & Butler and John Player
 2 Special should be minus 16 and minus 9 respectively.
 3 Currently the differentials are minus 18 and minus 11.
 4 Can you please increase the prices of both Mayfair and
 5 Sovereign by plus 2p, and then the increase will then
 6 make their prices in stores as follows.
 7 "Many thanks, George Byas."
 8 The RRP differentials at that time indicated that
 9 ITL's brands were intended to be not more expensive than
 10 plus 16p on Lambert & Butler and 9p on JPS, which were
 11 the Gallaher competing brands. ITL was saying in the
 12 letter that its retail prices were too expensive, as it
 13 saw it, in the Safeway stores, relative to Gallaher's
 14 competing brands.
 15 The fact that the prices that were so could have
 16 been due to an administrative error on the part of
 17 Safeway in implementing what they call the tilt in their
 18 stores, or it could have been as a result of
 19 a deliberate policy on the part of Safeway, or as
 20 a result of a Gallaher promotion. What was understood
 21 by Imperial, as you can see here, is that they thought
 22 there was an error going on, and so in fact the
 23 position -- and Safeway deal with this in
 24 paragraph 34(a) of their skeleton as well as the places
 25 we deal with it -- Safeway did not alter its prices as

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1 a result of this, and you can see that at documents 35
 2 to 39, where the correspondence continues.
 3 That in fact reinforces the point that they were
 4 free to set prices as they choose, and that they were
 5 pursuing their own pricing policy. The prices for the
 6 Gallaher brand remained the same some two months later.
 7 So all one gets out of this is Imperial thought
 8 there was a mistake in the way that brands were priced,
 9 Safeway, there obviously wasn't, and Safeway therefore
 10 continued to price them as they had before. Nothing
 11 sinister about it. They thought that the differentials
 12 were higher than Safeway was intending, and in fact it
 13 appeared that the differentials were what Safeway
 14 intended. So again, you have to bear in mind what it is
 15 we are addressing, which is it's supposed to be
 16 an obligation when Imperial increases its price, then
 17 Gallaher's price must be increased. It has nothing to
 18 do with that at all.
 19 I think the next two are in annex 22. So we have
 20 a document at 16. {D22/16} Actually, we have basically
 21 I think seen this before. It's that paragraph under --
 22 you have probably already marked it -- "Richmond
 23 Kingsize", and the emphasis seems to be on those words:
 24 "I understand this move in price would be in line
 25 with competing brands."

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1 I have already explained what it related to, the end
 2 of a short-term promotion. What it shows is in fact,
 3 contrary entirely to the OFT's case, uncertainty
 4 regarding the pricing of Dorchester, and inconsistent
 5 with any idea of there being an obligation to move the
 6 price of Gallaher's product. It's because they
 7 anticipate Gallaher has withdrawn its funding,
 8 anticipate that therefore the retail price of Gallaher
 9 is going up, they are withdrawing their funding for
 10 Dorchester and therefore the Dorchester price they
 11 anticipate will go up.
 12 **DR SCOTT:** Just in passing, it's a reference to the future,
 13 so this isn't an observation of a price change
 14 suggesting that Gallaher have moved, it's a suggestion
 15 that they know that Gallaher are moving and there will
 16 be a change.
 17 **MR HOWARD:** Let's just backtrack a little bit, we need to be
 18 careful. It has nothing to do with moving Gallaher's
 19 price, firstly. You have to remember, that's what we
 20 are talking about.
 21 **DR SCOTT:** No, I understand what you are saying. Yes.
 22 **MR HOWARD:** Now, secondly, it's saying "We believe, we
 23 understand that Gallaher is doing this, therefore we are
 24 doing this, but let me know if I am not right". Now,
 25 Imperial, we are talking about a vast market, and of

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1 course they are watching avidly, through general market
 2 intelligence they learn or believe that Gallaher's
 3 ending a price promotion. That's what we are saying,
 4 that's what we understand is happening, and that's why
 5 we are doing this. We may be right, we may be wrong,
 6 and they are saying "Let us know if we are wrong".
 7 There is nothing untoward in that, that one manufacturer
 8 says: this is what I believe is happening.
 9 Again, whether one says "I wonder whether they are
 10 privy to some information that they shouldn't have",
 11 it's not this case, that's the thing. The OFT has
 12 dropped that, obviously they investigated and came to
 13 the conclusion that the evidence didn't stack up, so
 14 simply saying, well, you know, there we are, this looks
 15 like possibly that they have learnt something, query
 16 should they have done, you don't need to worry about
 17 that, we need to focus on what it is that the thing is
 18 supposed to support, which is a different allegation.
 19 The next one is tab 24, {D22/24} and again the bit
 20 that is quoted is the line, penultimate line:
 21 "Superkings, Berkeley, Raffles, B&H, Superkings in
 22 tiers 1, 2 and 3 need moving up."
 23 What this is actually about is these people
 24 TM Retail have a rather complicated structure and they
 25 have various tiers, and basically -- there is no secret

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1 about it, you will see it in the documents -- they have
 2 a strategy for pricing at different levels in those
 3 tiers, and what is being said here is that they appear
 4 not to have got the pricing strategy right in that the
 5 prices in tiers 1, 2 and 3, of both Imperial and
 6 Gallaher brands, don't seem to be correct, is what they
 7 are saying in that line.
 8 I think they had 11 tiers, no less, and this is just
 9 relating to three tiers, and it's also after the Budget.
 10 So you have people who have a very complicated tiered
 11 structure, you have whoever was the Chancellor then
 12 seeking to gain a bit more money -- I think that was
 13 probably Mr Brown, wasn't it? -- fleecing the smokers,
 14 and then you have a retailer who is not correctly
 15 pricing things, and you have evidence that the
 16 manufacturers had a heavy involvement in checking that
 17 they were doing it properly, and telling them that you
 18 actually seem to have it wrong in your bottom three
 19 tiers. Whether it was bottom three or top three doesn't
 20 matter, I think it was the bottom three. That's all
 21 that this letter is.
 22 **THE CHAIRMAN:** Is that a convenient moment? Are we now
 23 going to move to D?
 24 **MR HOWARD:** I was going to move to D. That is a convenient
 25 moment. Can I say, I am conscious of time. I suspect

1 you won't be surprised to know that I am a little bit
 2 behind. I would ask for your indulgence, and there is
 3 a little bit more that I want to say, and then it will
 4 be Mr Brealey's turn, but I suspect that it is quite
 5 important that I should, on behalf of Imperial,
 6 particularly then go on to deal with some further points
 7 on the theory of harm. Although, therefore, time may
 8 get a bit squeezed, but I suspect it is quite important
 9 for the Tribunal and certainly for my clients that
 10 I should have the opportunity. So can we see where we
 11 get to? But I am conscious that I may be eating a bit
 12 into the time.
 13 **THE CHAIRMAN:** Well, we will come back, then, at 10 to 12.
 14 (11.40 am)
 15 (A short break)
 16 (11.50 am)
 17 **MR HOWARD:** So we are now considering the constraint where
 18 if the retail price of Gallaher's brand decreases, then
 19 the allegation that the retail price of ITL's brand must
 20 also decrease, paragraph 40(d) of the OFT's skeleton.
 21 This is a point which is contradicted by the trading
 22 agreements, the witness evidence, the correspondence.
 23 The trading agreements, which we have already considered
 24 the point, actually had, in the main, the opportunity to
 25 respond clauses, there is no point in having

1 an opportunity to respond clause if there was already
 2 an obligation or requirement on the retailer to reduce
 3 the price of Imperial's product to match the reduction
 4 in Gallaher. So it's simply difficult to reconcile the
 5 two.
 6 Where there wasn't an opportunity to respond clause,
 7 the relationship was in fact no different.
 8 Now, the witness evidence called by the OFT, in the
 9 form of Ms Fiona Bayley -- core 6 again -- contradicts
 10 the case. It's {core 6, tab 69}. Two references,
 11 absolutely explicit. Paragraph 7:
 12 "None of the tobacco companies had any say about the
 13 level at which I sold other brands. They all had
 14 competitor brands against which they sought to benchmark
 15 themselves."
 16 So that's the evidence of the OFT, on behalf of the
 17 OFT, none of the tobacco companies had any say.
 18 Then paragraph 78 -- we have seen that yesterday --
 19 where she makes it clear that if she implemented
 20 a tactical move for a competitor, Imperial would see
 21 this and want an opportunity to respond. I wouldn't
 22 initiate it. And then she explains it was up to them
 23 whether or not they would respond.
 24 So the evidence that the OFT calls is contrary to
 25 their own case.

1 Then there is again a large amount of correspondence
 2 which we have cited in section 3 of our written skeleton
 3 where Imperial, one sees funding price reductions to
 4 match Gallaher price reductions, in fact spending vast
 5 sums of money to do that. If there was already
 6 a requirement on the retailer to reduce Imperial's price
 7 because Gallaher had reduced its price, why was Imperial
 8 spending all this money? Doesn't make any sense at all.
 9 Then to turn to the documents, there are loads of
 10 documents that we have cited, I am not going to take you
 11 to, I am going to take you now to what the OFT obviously
 12 sees as the high water mark of its case in two
 13 documents, one in the Morrisons SO, annex 17 at tab 60.
 14 {D17/60}
 15 Again, very important to see selective quotation
 16 from a letter, when you look at the letter properly it
 17 is actually saying the opposite to what the OFT is
 18 alleging.
 19 What the OFT does is, tab 60, it's the second page,
 20 and it's an email from Paul Matthews of ITL to
 21 Grant Eastwood of Morrisons, and he says:
 22 "I understand that one of our competitors has
 23 decided to reduce the retail selling price of
 24 Amber Leaf. Whilst I would prefer to keep more cash in
 25 this important subcategory, I need my brands to remain

1 competitive. To this end, I would be grateful if you
 2 would bring all Drum SKUs into alignment with all
 3 Amber Leaf SKUs."
 4 The OFT stops their quotation at footnote 44 there.
 5 So they infer something sinister going on. Therefore
 6 you have to read on:
 7 "This will necessitate the following shelf price
 8 reductions and increases in bonuses" which are then set
 9 out.
 10 So in other words, what that text there makes clear
 11 is that what Imperial is doing is responding to a price
 12 move by Gallaher, Gallaher has cut the price, Imperial
 13 are then paying money to cut the price of their product.
 14 So it's the opportunity to respond, whether it's
 15 actually not being done by specific reference to
 16 a clause, but it's responding to a price cut by your
 17 competitor by cutting your own price.
 18 **DR SCOTT:** Just to be clear about the language here, the RSP
 19 is the retail shelf price, so we assume they have left
 20 the RRP where it is, they are just reducing the shelf
 21 price?
 22 **MR HOWARD:** I think that's probably right, in the sense
 23 that -- I'll have to check. There are two
 24 possibilities, one is that RSP and RRP are being used
 25 interchangeably. The other is that because it's

1 a short-term promotion, they have not formally changed
 2 the RRP because it has tax consequences, and therefore
 3 they are talking about what is the actual shelf price at
 4 this time. I am not sure which it is. But it doesn't
 5 really matter. The important point of the letter is
 6 that what -- the detail, in other words. Obviously we
 7 will be able to ask the witnesses and we can look at the
 8 detail but that isn't, with respect, what is important.
 9 What is important is what you see happening is
 10 competition in action. Gallaher have cut the price.
 11 The chap is actually saying "We don't really want to do
 12 this, but we have to remain competitive, we would rather
 13 not spend the money on this, but those dirty dogs
 14 Gallaher are putting us in the position and so if we
 15 don't do it we are going to lose too many sales".
 16 That's how the market works. Poor old Imperial had to
 17 spend money, hopefully it worked. It's very difficult,
 18 you know, one has to remember what it is that's being
 19 alleged. It's being said because Gallaher decreases its
 20 price, the retailer a fortiori automatically is under
 21 a requirement to reduce the price of Imperial. It's
 22 self-evident on this letter that isn't at all either
 23 a requirement or an expectation or anything of the sort,
 24 it's simply a competitive response by one manufacturer.
 25 So all of that is again borne out by the evidence.

1 This is what the OFT says supports its case, whereas
 2 what you actually have is the entire -- something which
 3 is entirely inconsistent and indeed quite the opposite.
 4 You have something which couldn't be, with respect,
 5 more pro competition than, when one looks at it from the
 6 point of view of the consumers, manufacturers battling
 7 it out, price cutting to try and gain sales.
 8 The next one is Somerfield in annex 20, tab 44.
 9 {D20/44} It's part of an email chain between Mr Hall of
 10 ITL and Mr Thomas of Somerfield.
 11 What's referred to is in the middle of the email on
 12 page 330, Mr Hall says:
 13 "Our strategy pricing requirements apply across all
 14 price tiers. The strategy is that Richmond Kingsize
 15 matches Dorchester and Richmond Superkings matches
 16 Dorchester Superkings. That's what I said to
 17 Stephen Clarke when he was setting up the post Budget
 18 prices."
 19 Then you can see a few lines up that Martin Thomas
 20 replies saying again this is all immediately post
 21 a Budget, and Mr Hall in his witness statement explains
 22 that Gallaher had been funding a post Budget promotion
 23 on Dorchester, and he made an offer to match the
 24 promotion for ITL's Richmond brands across all the
 25 Somerfield price tiers.

1 In other words, it's again -- in fact, sorry,
 2 I should have shown you, this is, if you go to the next
 3 page, 331, you can see that that's exactly the position
 4 that was being explained, that Gallaher were promoting
 5 Dorchester, it's what it says, and Imperial, whether
 6 reluctantly or otherwise, decided to match them.
 7 Again, nothing to do with there being some
 8 requirement, obligation, or anything of that sort, that
 9 the retailers should move the prices; it's all as
 10 a result of competition in action.
 11 So in relation to all of this, I've already made the
 12 point, how does the case that is made fit in with the
 13 retailers' independence and strategies? The OFT here
 14 misses the point. Imperial and the other appellants and
 15 their experts have said that it does not make any sense
 16 for the retailers to have entered into the type of
 17 agreement that the OFT alleges. The OFT's answer to
 18 that is to say "What's this got to do with the case?
 19 They did enter into the agreement, so whether or not it
 20 made sense for them to do so doesn't matter". But the
 21 question is, you have to decide whether they did enter
 22 into the agreements of the type alleged by the OFT. We
 23 and the retailers say they didn't, and we say it is
 24 entirely against their economic interests for them to
 25 have done so, and it is difficult to explain why it is

1 being said and the basis for saying that they entered
 2 into it if it was so much against their interests.
 3 Now, I do not want to spend a lot of time at the
 4 moment on this, but if I can just explain how this
 5 arose. In the decision, the OFT did not consider the
 6 question of whether or not the retailers had any
 7 incentive to enter into the arrangements of the type
 8 they were putting forward.
 9 Mr Ridyard, in his first report, explained that the
 10 case that was being made by the OFT was entirely
 11 contrary to the interests of the retailers and didn't
 12 make any sense for that reason. In particular, he
 13 explained that because they were benchmarking themselves
 14 in the case of the major supermarkets, particularly
 15 a number against Tesco, it doesn't make any sense for
 16 them to have curtailed their freedom to benchmark
 17 against Tesco and to put themselves into
 18 an uncompetitive position. That benchmarking point is
 19 explained by a number of the witnesses, including
 20 Mr Hall and Mr Batty, and Mr Matthews I think, and
 21 Mr Mason of Asda and Mr Eastwood of Morrisons.
 22 Now, in the context of that, there has then been
 23 a debate about retailer incentives. What has emerged is
 24 this: Professor Shaffer, in his 2007 report, which was
 25 his report which the OFT commissioned at the time when

1 they were preparing their decision, or which they used
 2 to support their decision, although it wasn't disclosed
 3 as part of the decision, he simply asked himself
 4 whether, if there was this fixed parity and differential
 5 requirement and if there was this rigid requirement,
 6 whether or not that would result, as his simplistic
 7 model was purporting to show, in higher prices.
 8 But in order to get to the conclusion that it would
 9 make sense for the retailers to enter into any such
 10 arrangement, he assumed for the purposes of his 2007
 11 report that the retailers had no bargaining power
 12 whatsoever, in other words that Imperial was able to
 13 coerce them into entering into agreements which would
 14 otherwise be entirely contrary to their interests.
 15 That, he acknowledges that he was making that assumption
 16 in his 2011 report. It might be worth just turning that
 17 up. It's in core 6, tab 66, and if you go to
 18 paragraph 4, page 3, footnote 4, {C6/66 paragraph 4} you
 19 will see he says:
 20 "Recall that manufacturers are assumed to be able to
 21 make take it or leave it offers to retailers in the
 22 model."
 23 So the economic model that he puts forward is the
 24 manufacturers have all the power and the retailers have
 25 none. One would have thought a very simple sense check

1 might have been employed to ask: hang on, do you really
 2 say that Asda has no economic power at all and is just
 3 in a position of take it or leave it? Do you really say
 4 that's true of Tesco, of Sainsbury's, of Morrisons,
 5 Somerfield and Shell? It couldn't be a more nonsensical
 6 assumption for both Professor Shaffer and the OFT to be
 7 making and to form the basis of the model.
 8 So where does one then go with all of that? What is
 9 now said, and one sees this being echoed in this
 10 footnote, is an assumption: oh, well, you should --
 11 bargaining power may be more equally split. That also
 12 appears at footnote 20 on page 14 of the report. He
 13 says:
 14 "The manufacturers are assumed to have all the
 15 bargaining power in the model contained in the appendix
 16 of my 2007 advisory report. However, even when
 17 bargaining power is more evenly distributed such that
 18 retailers would need to be compensated to accept P&D
 19 requirements from the manufacturers, it does not follow
 20 that lump sum payments will necessarily be observed as
 21 the manufacturers may have other means of transferring
 22 surplus to the retailers. The other means might include
 23 retrospective rebates as well as flatter quantity
 24 discount schedules and other things."
 25 The problem with all of this, put it very shortly,

1 you can speculate about all sorts of things, you can say
 2 "Well, if the retailers and the manufacturers were
 3 conspiring, then they might be able to find ways whereby
 4 the manufacturer, here Imperial, could pay the retailer
 5 to do something which suited him". But that isn't the
 6 evidence. There is no evidence of lump sum payments.
 7 That's where they were in the Shaffer 2010 report. Nor
 8 is there evidence of anything else. So what you are
 9 left with on the evidence is, there is no point having
 10 idle speculation as to whether there might be some means
 11 whereby retailers could be incentivised to do something
 12 which is against their interest. The question is the
 13 OFT is saying they did, there is no evidence that they
 14 were incentivised, so how do you explain that? All that
 15 the OFT actually says is "Oh, well, we say they did,
 16 therefore they must have done, therefore it doesn't
 17 matter". But you have to ask yourselves: did they?
 18 I can see it is not in their economic interests to do
 19 so, so do I find that they did something that makes no
 20 economic sense for them? In our submission, the answer
 21 to that is relatively straightforward.
 22 I have skipped over that rather quickly, there is
 23 quite a lot of material, but the final point I want to
 24 make on this is that, if one takes it in stages and just
 25 thinks about it, Professor Shaffer's original model is

1 based upon all the bargaining power being with the
 2 manufacturers. Well, anybody with any knowledge about
 3 anything to do with the UK economy knows that is
 4 nonsense. So then he speculated in the 2010 report, and
 5 said it would be possible for there to be lump sum
 6 payments. That's been shown not to be the case. It has
 7 also been shown to be the case that the incentives
 8 provided by the RMS agreements were very small indeed,
 9 and they couldn't be sufficient to compensate for the
 10 losses which Professor Shaffer accepts on his approach
 11 would be suffered. We are then left with "Oh, there
 12 could be other things". No-one on the OFT -- it is not
 13 a criticism of Professor Shaffer because he is
 14 approaching hinges as an academic economist, but the
 15 OFT, having sought to say "Well, here are the facts
 16 which show there are other means" and in fact not only
 17 have they sought to do that, Mr Ridyard in his final
 18 report has explained that if it were truly the case that
 19 other means of payment were being provided to the
 20 retailers, what you would expect to see is a step change
 21 in the relative profits of participating and
 22 non-participating retailers when the alleged
 23 infringements were terminated, but he in his report has
 24 demonstrated that is not the case.

25 But in fact before you get there, the onus was on

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1 the OFT to say "Well, here you are, this is it". They
 2 can't do that, so they are putting their heads in the
 3 sand and just saying "None of this is relevant because
 4 I simply say there is the agreement". As I say, that's
 5 because they are not approaching it correctly, asking:
 6 was there?
 7 So to pause for breath, it's clear that the theory
 8 of harm, as endorsed by Professor Shaffer, is based on
 9 his assumption of a state of affairs which is belied by
 10 the evidence and by common sense, in particular the
 11 alleged agreements particularly make no sense from the
 12 point of view of Imperial and importantly the retailers
 13 who would have suffered significant losses if they had
 14 entered into them.
 15 So that takes me to the revised theory that we are
 16 now dealing with. The OFT from time to time recognises
 17 that the evidence doesn't support the assumption of
 18 rigidity which we have been discussing. I'll have to
 19 show you one or two points where they accept that, and
 20 how they deal with it. The first place to look is in
 21 the defence at core 4, paragraph 197 page 227. {C4/227
 22 paragraph 197}. If we just track through how this
 23 paragraph works, at 197.1 they say their case is that
 24 the ITL required retailers to implement parity or fixed
 25 differential requirements.

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1 Then at 2 they are dealing with their case on lack
 2 of incentive. At subparagraph 4, it's 197.4 on page 78
 3 that one particularly needs to deal with. This is
 4 dealing with wholesale price increases. So what they
 5 say is:

6 "The OFT notes that the manufacturers generally
 7 implemented MPIs at about the same time, so that MPIs
 8 did not tend to result in any divergence from the
 9 manufacturers' parity and differential requirements."

10 Stopping there for a moment, what they are saying is
 11 in fact the manufacturers were implementing MPIs at more
 12 or less the same time. In other words, their case on
 13 the retailers being obliged to do something independent
 14 of manufacturers' price increases doesn't actually apply
 15 on the facts.

16 Then they say, notwithstanding that general point,
 17 and this is the paragraph we need to look at rather
 18 carefully, they rely on their response to paragraph A,
 19 specifically that number, thus, and this is the
 20 important thing:

21 "In a scenario in which Gallaher increased its
 22 prices before ITL, the realignment of prices with ITL's
 23 parity or differential requirement might be brought
 24 about in a number of ways. ITL might choose to respond
 25 to respond to that price increase with its own price

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1 increase and instruct the retailer accordingly. For
 2 that purpose, the retailer might have provided ITL with
 3 notification or indeed advance warning of the competing
 4 manufacturers' price changes.

5 "Alternatively, in a scenario in which ITL raised
 6 its prices before Gallaher, a realignment of ITL's
 7 parity and differential requirements might be brought
 8 about by ITL encouraging, instructing or requiring the
 9 retailer to change the price of the linked Gallaher
 10 product or by ITL asking the retailer to increase prices
 11 subject to compliance with its P&D requirements."

12 This paragraph is actually very revealing.

13 Take the first situation they are referring to, that
 14 ITL chooses to respond to a Gallaher price increase.
 15 This is simply a case where one manufacturer chooses to
 16 follow a price increase of his rival, no doubt because
 17 he has either been affected by the same factors that
 18 drive manufacturer price increases or because he sees it
 19 as an opportunity in any event to increase his price.
 20 But there is no requirement on the retailer to do
 21 anything. It is affected by here Imperial's price
 22 increase, but it's not required to put up Imperial's
 23 retail price, although it will usually do so because
 24 otherwise its margin will be reduced. But it has
 25 nothing to do with the RMS operating in some adverse

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1 way. This is just Imperial putting up its price, its
 2 wholesale price, and the retailer -- it says they
 3 instruct the retailer accordingly. It's up to the
 4 retailer whether if Imperial puts up its price they put
 5 up Imperial's retail price, but invariably they will do
 6 so, because --

7 **THE CHAIRMAN:** That's the question we have to decide, isn't
 8 it, whether that is the case that the retailer was free
 9 to respond to the ITL decrease by decreasing the shelf
 10 price?

11 **MR HOWARD:** No, no, we are not talking about that, this
 12 is -- the sentence I am focusing on is Gallaher --

13 **THE CHAIRMAN:** I see, yes, within prices it is the other way
 14 round.

15 **MR HOWARD:** This is very important to focus on. This is
 16 about the central part of the case. This is about the
 17 price increase. Gallaher's price is increased. So the
 18 first example they give, they say Imperial puts up its
 19 wholesale price in response to Gallaher.

20 Just stop for a moment. Is there something that
 21 precludes Imperial doing that? The answer is
 22 self-evidently not, it's entitled to put up its price
 23 because of factors that affect it, which may include the
 24 fact that its competitor is putting up the price.

25 In other words, the first example they put is there

1 is nothing sinister about Imperial putting up its price.
 2 Imperial, when it puts up its price in response to
 3 Gallaher, doesn't have a requirement that the retailer
 4 puts up the retail price of Imperial's product. It
 5 recognises the retailer will wish to do so because it's
 6 in the retailer's interest, otherwise his margin will be
 7 cut.

8 That's all that's happening in the first example.
 9 It's not any obligation on the retailer. You have to
 10 remember, the case that's being made by
 11 Professor Shaffer is moving prices of Imperial up simply
 12 because Gallaher has moved up. This is the opposite.
 13 This is you are moving the price of Imperial up because
 14 Imperial's put up its price.

15 Now, it's not that it doesn't take their case
 16 anywhere, it's actually against their case.

17 You then have this allegation the retailer might
 18 have provided ITL with notification or advance warning.
 19 Now, again the hub and spoke allegation of inappropriate
 20 pricing information being provided and acted on, that's
 21 no longer part of the case, and in fact in relation to
 22 Gallaher price increases, you have to remember this
 23 isn't an opportunity to respond case, there is no basis
 24 for saying that there was any expectation on the
 25 retailers to tell Imperial. What actually happened

1 generally was that -- you have seen in the
 2 correspondence we have looked at -- either Imperial sees
 3 something happening on the shop floor, or through some
 4 market awareness it has, it says "I believe they are
 5 going up, I am putting up my price" but usually it's not
 6 MPIs going on that we have seen in the correspondence,
 7 it's usually withdrawing a payment of tactical bonuses.

8 The other point that is then made in the next
 9 sentence is this reference to encouraging, instructing
 10 or requiring the retailer to change the price. Well,
 11 what it is true to say is I showed you the letter they
 12 rely on where there was said "How about encouraging
 13 Gallaher", but the point is it was not encouraging the
 14 retailer independently to change the price of Gallaher,
 15 that letter; what it was saying is "Why don't you try
 16 and get Gallaher to put up their prices". As I said,
 17 that may or may not be something they should be saying,
 18 but it's not supporting the case that's being run.

19 This is a very important point: once you relax the
 20 assumption of rigidity, and the OFT in relation at this
 21 stage to price increases has to recognise that. I'll
 22 just remind you again, it's worth going back to
 23 paragraph 35 in this document. Paragraph 35 --

24 **DR SCOTT:** Sorry, which --

25 **MR HOWARD:** This document, the defence. Paragraph 35,

1 remember we looked at it before, which is the central
 2 component of their case, is that there is a requirement
 3 that the brands are linked so that if A puts up his
 4 price he can be confident that the price of B will go
 5 up. It's the central plank, and that central plank is
 6 entirely dependent upon there being this obligation on
 7 the retailer. Once you recognise there is no obligation
 8 on the retailer, no requirement, but all that happens is
 9 that sometimes Imperial itself puts up the price, where
 10 does the central plank stand? There is no theory of
 11 harm that supports the case once you take away, in
 12 relation to this price increase, the central plank,
 13 there is no theory of harm explaining why anything
 14 that's going on is anticompetitive.

15 They have an alternative theory of harm relating to
 16 price decreases, but in relation to the central plank
 17 they don't have one at all. The central plank stands or
 18 falls on whether the RMSs operated in the rigid manner.
 19 They did not, and the central plank disappears.

20 Now, leaving that on one side, once the rigid
 21 assumption disappears, let's say that they say "No, no,
 22 I'm misunderstanding it and there still is", the
 23 question is: okay, what now? The rigidity has gone,
 24 what now is the nature of the alleged agreement or
 25 practice which is said to be anticompetitive? Because

1 previously one could see there was a case there was
 2 a requirement that the retailers have to move Gallaher's
 3 price up in line with an increase in Imperial's
 4 wholesale price, and a requirement to move Imperial's
 5 retail price up in line with an increase in Gallaher's
 6 price. Once you take that away, what is the case? If
 7 there is no requirement, and we say clearly there
 8 wasn't, what is the OFT then complaining about? Because
 9 you have to remember, again, the OFT's core complaint
 10 was that the retailer was prevented from favouring
 11 Gallaher. Now, what is it that gave rise to that?
 12 Well, previously one understands it, but once you take
 13 away the requirement, take away the rigidity, it's
 14 difficult to follow what the complaint is.
 15 You then have to ask yourself: what is it you are
 16 complaining about which is any different from the way in
 17 which a market works, particularly a market where the --
 18 which is highly regulated, highly taxed, transparent
 19 and, as the Chairman has pointed out, concentrated where
 20 you have two major players, where there may be
 21 a tendency for them -- obviously for them to watch each
 22 other, and sometimes, and indeed very often as the OFT
 23 themselves say, to follow manufacturing price increases
 24 or to apply them at the same time?
 25 So in relation to the central plank, we say the case

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1 is very difficult to understand and it falls away, once
 2 you take away the rigidity.
 3 The revised theory has emerged when they have tried
 4 to deal with price decreases and the opportunity to
 5 respond. In relation to price reductions, the OFT has
 6 recognised that they cannot maintain their case that
 7 there was an automatic change at all times, and you will
 8 see that in the decision, and the particularly relevant
 9 parts are in the decision at 6/92. At 6/92, the OFT
 10 considers that:
 11 "Although the retailer may not have automatically
 12 changed the retail price in response to a change in the
 13 price of the competing linked brand in every case, the
 14 parity and differential requirements created the
 15 expectation that even the retailer would seek to be
 16 granted permission from the manufacturer to move the
 17 price of et cetera product in line with the P&D
 18 requirement or the manufacturer would instigate the
 19 price alignment itself in order to maintain its parity
 20 and differential requirements."
 21 A similar point you will see, or the point explained
 22 more, at page 124 of the decision, 6.223 and 6.224.
 23 This is the, as far as one can see, recognition in
 24 these paragraphs of the right to respond, and in the
 25 defence the right to respond specifically is referred to

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1 at paragraph 197. But what one just sees -- I ask you
 2 separately to look at paragraph 197 -- is that the OFT
 3 is recognising that the RMSs operated in the following
 4 fashion: firstly, leaving aside the question of
 5 incentives and so on, the retailers were able to reduce
 6 the price of a Gallaher brand without automatically
 7 reducing the price of the competing Imperial brand.
 8 Indeed, recognising that, although this comes in almost
 9 as a side wind in their decision, the effect of that is
 10 that practically all the work of Professor Shaffer is
 11 irrelevant, because it's based upon this rigid
 12 lock-step.
 13 The effect of that is that the differentials if
 14 Gallaher puts down its price change, then you have
 15 a situation where Imperial might respond by itself
 16 having a tactical bonus or might choose not to respond.
 17 The final position is that the retailers were free,
 18 whether to accept Imperial's response or not. There is
 19 no obligation on them to do so. Obviously, if the
 20 response is in their interest, ie Imperial saying "We
 21 are prepared to match what Tesco is doing and throw
 22 money at them", one can't see any economic reason why
 23 they would not do so.
 24 **DR SCOTT:** I suppose what I lost sight of in this account is
 25 where the bonuses are and are not being paid. Now, if

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1 I go back to the trading agreements, my recollection was
 2 that there were moments when the bonuses were not
 3 withdrawn in certain circumstances.
 4 **MR HOWARD:** Sorry, were not withdrawn? Are you asking me
 5 whether as a matter of fact the bonuses were withdrawn?
 6 **DR SCOTT:** No, I seem to remember in some of the trading
 7 agreements there was a statement that in certain
 8 circumstances the bonuses would not be withdrawn, that
 9 Imperial chose not to --
 10 **MR HOWARD:** They would not be withdrawn if Gallaher's price
 11 came down and Imperial didn't match it.
 12 **DR SCOTT:** That's right.
 13 **MR HOWARD:** In other words there is no obligation on you,
 14 retailer, to move our price down, and indeed we are
 15 going to continue to incentivise you even if we don't
 16 throw more money at you to try and meet Gallaher. In
 17 other words, it's entirely the opposite to the case
 18 that's being suggested.
 19 **DR SCOTT:** That was my recollection.
 20 **MR HOWARD:** And it's a very important point, sir, that
 21 actually the way those were operating on their face is
 22 that, far from creating some expectation that the
 23 retailer will move Imperial's retail price down, saying,
 24 "Well, we recognise that Gallaher may do significant
 25 that puts you at a competitive disadvantage, but you

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1 mustn't feel we are not going to pay you a bonus,
 2 Mr Retailer, we may try and pay special tactical bonuses
 3 in order to make ourselves more competitive in that
 4 situation, but if we don't, you will not be prejudiced,
 5 providing you stick with the position as it was before,
 6 in other words don't prejudice us beyond the degree to
 7 which Gallaher's price cut has prejudiced us, you will
 8 still get your bonus".

9 All of that is self-evidently and obviously
 10 pro-competitive. It's not in any way inhibiting by the
 11 terms of the agreements Gallaher cutting its prices.
 12 What is an entirely separate matter is the notion, which
 13 is of course something highly uncertain, which would
 14 obviously require an effects analysis, saying if you
 15 have a concentrated market and manufacturers are price
 16 cutting, after a while they may independently cease to
 17 price cut. We all know that is something that can
 18 happen. But there is absolutely no certainty, it all
 19 depends upon market dynamics, upon the interests of each
 20 trying to gain market share and things of that sort.

21 Now, the difficulty with the OFT's case, and again
 22 you have to always remember, this is a case about
 23 an object infringement, that once you move off this
 24 rigid assumption, they have then got to explain how it
 25 is -- we say they are wrong on that -- because we

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1 understand how they articulate it, once you are into
 2 this area of people being able to respond and counter
 3 respond, how you say -- firstly what it is you are
 4 actually saying is wrong with the agreement, and
 5 secondly, how that is going to create an anticompetitive
 6 situation, where what is actually designed from
 7 Imperial's point of view is to create a competitive
 8 situation.

9 Now, the way in which Professor Shaffer tries to
 10 deal with this is his concept of uncertain compliance,
 11 and you will see that -- I am not going to take you to
 12 large tracts of it, but this concept featured in his
 13 2010 report at paragraph 160, it's in core 6, tab 65.
 14 {C6/65 paragraph 160}

15 Again, one needs to look at this quite carefully and
 16 just think: what is actually being said, see how this
 17 fits in. He has previously got his absolutely rigid
 18 lock-step, and paragraph 157 makes it clear that it's
 19 rigid and there is a full 100 per cent compliance. Then
 20 he claims at 158 he was looking at it on this basis
 21 because he wanted to isolate the economic effects of the
 22 requirements. Note the important word, the
 23 requirements, when taken at face value.

24 He then at 160 says:

25 "I am going to analyse the impact on competition

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1 when compliance is not certain. A retailer may or may
 2 not realign a parity or differential after a wholesale
 3 price change by the manufacturer."

4 Now, what he says are the three possible causes for
 5 non-compliance, the first one is an error by the
 6 retailer. Now, if one just stops for a moment, an error
 7 by the retailer, and of course the world isn't perfect,
 8 and if, let's assume he is right or his assumptions were
 9 right, there were these rigid requirements, but you
 10 can't be 100 per cent certain that the world works
 11 perfectly, well, one can see that doesn't affect his
 12 theory, everybody knows that nothing works perfectly, so
 13 that's an illusory point.

14 His next point is at 162, and that's where he says
 15 that:

16 "Compliance with the requirements may also be
 17 uncertain because the retailer may sometimes choose not
 18 to comply. For example, it may comply with the
 19 requirements 80 per cent of the time and not the other
 20 20 per cent, or it may be that the retailer's trading
 21 arrangement with the rival manufacturer requires it to
 22 let the rival respond before it changes the retail price
 23 of the rival's product. The rival manufacturer may
 24 choose for whatever reason not to respond to the initial
 25 manufacturer's price change."

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1 All of this begs a very important question: comply
 2 with what? The premise of the error is that there is
 3 a requirement for rigid price increases and reductions,
 4 his lock-step.

5 His second example, which is the first in 162, is
 6 there is that requirement, but the retailer is just
 7 being naughty and not complying all the time; he chooses
 8 to. Of course that anticipates that the retailer
 9 actually begs the question: was he obliged to do
 10 something or was that how he was entitled to behave?

11 It takes you back to: require with what? And the
 12 requirement has to be, to make sense of this,
 13 a requirement of his lock-step. So what he is saying is
 14 there is a requirement of lock-step, but it might not
 15 always be observed because the retailer is breaching
 16 what he is required to do.

17 You have seen the evidence and I've explained to
 18 you, there simply is no requirement that the retailers
 19 have to move the prices absent wholesale price changes
 20 by one or other.

21 **DR SCOTT:** To be clear, what you appear to be saying to us
 22 is that the use of the word "error", which occurs quite
 23 a lot in the evidence, is Imperial helping the retailer
 24 by saying "You have erred from your own retailer
 25 strategy", not saying "You have erred by breaching our

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1 trading arrangement". Is that what you are saying?
 2 **MR HOWARD:** Yes.
 3 **DR SCOTT:** So although that word "error" occurs frequently,
 4 you are saying that's how it's used?
 5 **MR HOWARD:** Yes. The answer is yes, the correspondence that
 6 is referred to, one sees they are talking about
 7 an error, it's for instance in Safeway, because that's
 8 I think where it particularly featured, there is error
 9 by you, Safeway, in what we understand to be your
 10 strategy.
 11 Now, that strategy may be both as to the way they
 12 are going to price generally in their store, and it may
 13 be that they understand that Safeway are intending to
 14 implement the price differentials in order to earn the
 15 bonus. So it covers that situation, it's not saying
 16 it's simply an error. It's an error in the pricing, but
 17 what one then finds is that Safeway in those examples
 18 don't change the prices because it isn't an error, so
 19 Imperial has just got it wrong.
 20 I just want then to go back to what
 21 Professor Shaffer is saying, he is talking about
 22 something different here, it's not by reference to any
 23 of the correspondence. The first point he was making is
 24 just an obvious point, that there is a requirement that
 25 you assume his assumption, the requirement is the

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1 retailer must always do X. The fact that that is, let's
 2 say, a strict requirement, that's what the contract
 3 says; the fact they only do it in 5 per cent of the
 4 cases because they are shoddy doesn't tell you anything,
 5 it's just that that's the nature of the world, that
 6 people aren't perfect and no doubt it's very complicated
 7 setting prices in supermarkets and so on. So there is
 8 just nothing to discuss on that.
 9 It's his other two examples which are of greater
 10 importance. The first is that the retailers may
 11 sometimes choose not to comply, but there again what he
 12 is saying is there is, for the purposes of this theory,
 13 an absolute obligation, but then it's recognising that
 14 the retailers just don't perform the obligation.
 15 Now, there is either a obligation, in which case you
 16 are saying, well, even though, although it's
 17 an obligation I can't be certain the retailers will
 18 perform it, although it seems a rather odd situation,
 19 what you are actually saying is the retailers have
 20 a discretion to do what they want when it suits them; or
 21 what you are actually recognising is that there is no
 22 obligation in the first place, no requirement to which
 23 they have to adhere.
 24 The third scenario is actually what we are really
 25 dealing with, because the third scenario is where, in

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1 this throwaway line, he refers to the opportunity to
 2 respond clause. So this is a situation, he says:
 3 "It may be the retailer's trading agreement requires
 4 it to let the rival respond before it changes the retail
 5 price of the rival's product, and the rival manufacturer
 6 may choose for whatever reason not to respond to the
 7 initial manufacturer's price change."
 8 Stopping there for a moment, the way he put this is
 9 entirely of course very tendentious and not an accurate
 10 description of the opportunity to respond clause,
 11 because he is putting it round that the retailer wants
 12 to change, as it were, the price of Imperial because
 13 Gallaher has put the price down, but before he can do
 14 so, he has to let the rival manufacturer, here Imperial,
 15 decide whether it wishes to do so.
 16 Of course, what is actually happening is Gallaher
 17 cuts the price, Imperial decides whether or not it's
 18 going to cut its wholesale price by means of giving
 19 a tactical bonus or not. In other words, there is no
 20 requirement, it has nothing to do with his lock-step,
 21 it's an entirely different scenario. So what he is
 22 trying to shoehorn into his theory by his model of
 23 lock-step is something which is completely different.
 24 That's the point that has been made by the various
 25 experts for the appellants.

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1 Now, it's graphically summarised by Professor Froeb
 2 as a theory that a bad thing some of the time is still
 3 bad. But of course the point he is making is: what you
 4 actually have got to do is look at the nature of the
 5 agreement and the nature of the agreement here is wholly
 6 different to that on which the OFT's case and
 7 Professor Shaffer's theory is based.
 8 What both Professor Shaffer and the OFT have to do
 9 here is try to elide two different situations, their
 10 allegation that there is a rigid scenario with the
 11 recognition that actually that isn't the case and
 12 somehow to elide the two situations and to treat one as
 13 being a variant on the other.
 14 But again, once you take away the central plank, we
 15 have already seen that the central plank of the case
 16 falls away relating to price increases. We consider the
 17 case about price reductions: where Imperial reduces its
 18 price, there is absolutely no obligation on the retailer
 19 to reduce the price of Gallaher. That's perfectly
 20 clear, and the opportunity to respond clause has nothing
 21 to do with that. Where Gallaher reduces its price,
 22 there is no obligation on the retailer, it's all the
 23 opposite, it's simply if Imperial chooses to respond
 24 then if it cuts its price and pays a bonus on the basis
 25 that you will cut the price, then that's what happens.

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1 If you take away the rigid assumption in relation to
 2 the price reduction case, what is the aspect of the
 3 agreement that is being complained of? Again, ask
 4 yourself: what is the restriction on the retailer that
 5 prevents the retailer favouring Gallaher? What, again,
 6 you should ask yourself, in this instance, is the theory
 7 of harm and what is any empirical evidence in support of
 8 it?

9 Now, can I just at this point, just before
 10 concluding, make some points about parallel and
 11 symmetrical which I can fit in at this stage.

12 In the decision, in section 6, at the beginning and
 13 end of the retailer sections, the OFT finds that both
 14 manufacturers communicated parallel and symmetrical
 15 parity and differential requirements to the retailer and
 16 that each manufacturer must have been aware of the
 17 other's parallel and symmetrical parity and differential
 18 requirements, and that reinforced and increased the
 19 inherently restrictive nature of each infringing
 20 agreement.

21 So that's the assertion. Can I ask you to take the
 22 decision at section 6, and if you turn to page 116 of
 23 the decision, you will see that the material relied on
 24 in support of parallel and symmetrical runs from 6.154
 25 to 6.178. Basically, a handful of documents. Just

1 before I say anything more about that, I just want to
 2 clarify, which is important, particularly I think in
 3 light of some of the questions, about parallel and
 4 symmetrical. Imperial's RMS schedules are based upon
 5 its strategy which it based upon the RRP's, but its
 6 strategy was therefore, once it had set its RRP's and saw
 7 the RRP's of its competitor, for it to decide which
 8 products it wanted to promote by reference to those
 9 differentials, and also in which retailers. So in other
 10 words, Imperial had its strategy, which is brand and
 11 retailer specific.

12 Gallaher may well have a completely different
 13 strategy, both as to brands and retailers. It may have
 14 a completely different strategy, full stop. But insofar
 15 as it is seeking to incentivise retailers, it will have
 16 a different strategy, and indeed that's what the
 17 evidence shows, vis-a-vis different retailers and
 18 different brands, and that's why you don't find
 19 a complete overlap of retailers, or the same brands
 20 being matched. So in other words they have different
 21 strategies. That's a very important point to
 22 understand.

23 Now, after the decision, Mr Ridyard's report was
 24 produced, which showed that the OFT's allegation of
 25 parallel and symmetrical was not supported by the

1 evidence, in that only firstly Shell, TM Retail and
 2 TS Trading had trading agreements with both Imperial and
 3 Gallaher at the same time, and 80 per cent of the
 4 identified brand pairs in Imperial's trading agreements
 5 didn't match the brand pairs in Gallaher's trading
 6 agreements.

7 Moreover, far from being symmetrical, there were
 8 many cases where the differential provisions, even where
 9 there was that overlap, were inconsistent.

10 Where we are is that in the defence -- and it is
 11 worth pointing you to this -- at paragraph 277, we may
 12 have looked at that this morning, actually, it's Core 4,
 13 tab 45, a couple of references to pick up, paragraph 277
 14 {C4/45 paragraph 277}. The position in the decision is
 15 that:

16 "The existence of parallel and symmetrical parity
 17 and differential requirements is not a necessary part of
 18 the finding of an infringement by object."

19 They rely on:

20 "It's however relevant to the expected impact of
 21 each infringing agreement."

22 Then if you go to paragraph 282, this is what they
 23 now say:

24 "Thus the OFT's case is that there is a significant
 25 degree of similarity between the infringing agreements

1 and that similarity is material to the expected impact
 2 of the infringing agreements. This view is supported by
 3 Professor Shaffer."

4 So in other words, actual parallel and symmetrical
 5 has gone, we now have significant degree of similarity,
 6 which is material to the expected impact, and then as to
 7 knowledge, paragraph 301:

8 "The manufacturers were not privy to all of the
 9 evidence on which the OFT relies. However, assuming
 10 that is correct in its generality, ie that they weren't
 11 privy to the evidence [well, that's common ground], it
 12 doesn't follow the manufacturers were not aware of each
 13 others' infringing agreements and the existence of
 14 parallel and symmetrical requirements under those
 15 agreements."

16 Since they don't seem to be saying there were
 17 parallel and symmetrical requirements, quite difficult
 18 to follow. Then they say:

19 "The evidence shows that each manufacturer [of
 20 course we are not going to hear from Gallaher, put that
 21 to one side] was aware in general terms of the other
 22 manufacturer's pricing strategy and in some respects of
 23 the detail of the requirements under that strategy. The
 24 manufacturers could be expected to draw further
 25 inferences as to the content of each others' infringing

1 agreements based on their observation of each others'
2 prices."

3 If what is being said is Imperial can deduce what is
4 Gallaher's strategy, then the answer to that is they can
5 do that today, because they can see the extent to which
6 Gallaher price promotes particular brands and is trying
7 to undercut, they know which sector brands are falling
8 into, so they both know, for instance, that Dorchester
9 and Richmond are part of this ultra low price, so they
10 know that if Gallaher is promoting its brand that what
11 they are trying to do is to gain market share in the
12 ultra low price sector of which -- whichever, I can't
13 remember which it is -- Imperial's Richmond is part.
14 That's nothing to do with the RMSs.

15 Now, it is fair to point out that the OFT has
16 sought, in annex 14 to the defence, to remedy the
17 evidential deficiencies in the decision by putting
18 forward additional schedules. That we have replied to,
19 and we say it doesn't show anything at all. But there
20 is a prior point as to whether or not the OFT should, by
21 its defence, be entitled to put in this new annex. We
22 suggest that that is embroidering, which it is not
23 entitled to do.

24 In any event, similarity, awareness in general terms
25 is not sufficient for the OFT's purposes, whether you

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1 are looking at their theory of the lock-step mechanism
2 or the uncertain compliance.

3 Now, I see the time. I have probably about another
4 half an hour. I understand that my learned friend
5 Ms Rose is in difficulties. We realise that we have
6 taken slightly beyond our allotted time, but the way in
7 which we hope we could deal with things is if I could
8 take until 2.30, if Shell could then open their case
9 until 4.30, and then on Monday morning we could complete
10 with Mr Brealey making some observations on object, and
11 possibly on exclusion and exemption, and then hopefully
12 catch up in the course of next week. I apologise, but
13 obviously I have the lion's share of opening.

14 **THE CHAIRMAN:** It's partly our fault for interrupting you,
15 but it's useful to clarify these things at the start.

16 **MR HOWARD:** And I welcome intervention from the Tribunal,
17 because they are important for clarification.

18 **THE CHAIRMAN:** Well, we will come back, then, at five past 2
19 and continue with you and then hear from Ms Rose and
20 then Mr Brealey on Monday morning.

21 **MR HOWARD:** I am grateful.

22 (1.05 pm)

23 (The short adjournment)

24 (2.05 pm)

25 **MR HOWARD:** So, we had been looking at the basis of the

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1 theory of harm. If we go back a stage, what we are
2 looking at is the price reduction scenario, if you want
3 to go back on price increase. Imperial's desire to
4 undercut one of its rivals here, Gallaher, is
5 self-evidently pro-competitive behaviour, and
6 an arrangement by which retailers allowed Imperial
7 an opportunity to respond is simply a manifestation, we
8 would suggest, of legitimate competition between
9 manufacturers. When one said allowed, of course the
10 retailers are not actually allowing anything in any real
11 sense, because, as I have already explained, there is
12 nothing ever to stop one manufacturer reducing his
13 price. In other words, the opportunity to respond
14 doesn't actually add anything. That's why in the cases
15 where it is not present, Imperial was enabled to act in
16 exactly the same way, which is to say "I see Gallaher's
17 price, there seems to be a Gallaher price promotion and
18 you are selling them below me, I am going to do my own
19 price promotion", and of course there would never be
20 anything that would stop you doing that.

21 What's important to observe is that
22 Professor Shaffer's rigid assumption is key to, we say,
23 the OFT's case. As Professor Froeb points out, once you
24 relax that assumption, you get -- even on
25 Professor Shaffer's model and even assuming that such

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1 a simplistic model has relevance -- a different result.

2 Professor Froeb you will find in core 3 at tab 31,
3 and this is his report from March of this year in reply
4 to Professor Shaffer.

5 At paragraphs 93 to 95, {C3/31 paragraph 93} he
6 explains that using precisely Dr Shaffer's mathematical
7 setting and methodology -- stopping for a moment, he
8 doesn't accept that this mathematical setting and
9 methodology are appropriate, he is just taking what
10 Professor Shaffer has done and he allows for a link
11 between the wholesale prices and RMS terms, then he
12 adopts a:

13 "... revised assumption that if one manufacturer
14 were to raise its wholesale price while the other does
15 not, it should expect that the parity agreement would be
16 replaced with a differential agreement proportional to
17 its price increase. Alternately, if a manufacturer
18 lowers its price by, say, 3p, it should expect that the
19 differential would also adjust ..."

20 "Altering this one assumption entirely overturns the
21 result Professor Shaffer derived from his model. In
22 particular, the adoption of RMSs reduces wholesale and
23 retail prices and benefits the consumer. The economic
24 intuition for this change is straightforward.

25 A wholesale price decrease by one manufacturer shifts

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1 retail prices in its favour, providing a greater
 2 incentive to reduce prices. This encourages the rival
 3 manufacturer to also reduce its price to re-establish
 4 parity and so on. This virtuous cycle leads to lower
 5 wholesale and retail prices."
 6 Stopping for a moment, of course in fact the point
 7 that Professor Froeb was making, he is simply saying if
 8 one manufacturer has the ability to price cut, then and
 9 his price cut will be implemented, then, and he can feed
 10 that through to the retail price, then he will try and
 11 cut his price because that's a way of getting market
 12 share, so that's pro-competitive.
 13 The point he is making then in paragraph 95:
 14 "Given how sensitive Professor Shaffer's results are
 15 to his assumption that RMSs are rigid and
 16 non-negotiable, I do not believe that his theoretical
 17 conclusions can be seen as conclusive. If RMSs are
 18 renegotiable upon changes and wholesale prices (as both
 19 Professor Shaffer and the OFT allow) then his own model
 20 suggests that they are likely to be pro-competitive. In
 21 either case, if there is any doubt about the specific
 22 mechanics of these agreements, the conflicting results
 23 of Professor Shaffer's and my assumptions suggests an
 24 effects-based inquiry, rather than object based, is more
 25 appropriate."

1 In fact, Professor Shaffer, you will see, there are
 2 two references where he recognises that once you relax
 3 his assumption, that may have a pro-competitive effect.
 4 The first is in his 2007 report, which you have in
 5 core 6 at tab 64. If you go to paragraph 51, he says:
 6 "One caveat to this is that the reasoning above
 7 presumes that the retailers are required to maintain the
 8 parity and differentials as specified in their trading
 9 arrangements, regardless of any disparities in each
 10 retailer's wholesale prices."
 11 Stopping there for a moment, my reasoning, he is
 12 saying, has been on the basis of the assumption that
 13 parity and differential requirements were required to be
 14 maintained even where the manufacturers changed the
 15 wholesale price.
 16 He then says:
 17 "If, on the other hand, manufacturer B's wholesale
 18 prices are not fixed and if manufacturer A is committed
 19 to matching any lower wholesale price offered by
 20 manufacturer B as a way to ensure that retailers
 21 maintain parity, then the retailer's incentives to
 22 obtain lower wholesale prices may increase when they
 23 have trading arrangements. This is because in this case
 24 a strategic retailer may be able to parlay a wholesale
 25 price concession from one manufacturer into a lower

1 wholesale price from the other manufacturer, thereby
 2 increasing its ability and incentive to negotiate
 3 a lower wholesale price."
 4 In other words, what he is focusing on here is
 5 simply a situation where the retailer knows that
 6 Imperial, say, is committed, is the way he puts it, to
 7 matching a lower wholesale price offered by Gallaher.
 8 The retailer has no obligation to do anything, but what
 9 he does is he may put down the price and then he -- not
 10 because actually Gallaher in this example have reduced
 11 the price but because he is just trying to negotiate
 12 a lower wholesale price from Imperial. In other words,
 13 he uses the fact that he is essentially at liberty to do
 14 what he likes to get one manufacturer to reduce the
 15 wholesale price, making him believe that he has got to
 16 do that in order to be competitive.
 17 Now, he is right about that, that's one effect of
 18 the way all of this can operate. But the other -- so
 19 there is one caveat to his view -- caveat you will find
 20 in the joint experts' statement in core bundle 12 at
 21 tab 125, page 58. {CB12/125/58}. The statement is:
 22 "Under appellant expert's interpretation of the
 23 P&Ds, retail prices would be expected to be lower with
 24 P&Ds than in the absence of the P&Ds."
 25 His evidence is he agrees. What he then says is:

1 "Under Froeb and Dryden's interpretation, in those
 2 circumstances in which we see P&Ds, I would expect that
 3 at least some retail prices would be lower than in the
 4 absence of P&Ds. However, if there are periods in which
 5 there is a lag between the two manufacturers'
 6 announcements of their wholesale prices I would expect
 7 to observe one manufacturer's retail price going up and
 8 the other manufacturer's retail price going down in
 9 order to maintain the margin parity.
 10 "Furthermore, as stated previously, I am currently
 11 unaware of plausible circumstances under which certain
 12 manufacturers would find it profitable to offer P&Ds
 13 under these interpretations."
 14 The key point is if Professor Shaffer's assumption
 15 is wrong as to the way the P&Ds operate and the
 16 appellants' experts' understanding of how they operate
 17 is correct, will they lead to lower prices, his answer
 18 is yes, they will. He has a caveat for a particular
 19 circumstance but in relation to the overall position it
 20 doesn't make any difference.
 21 Just to interpose here, the central plank point
 22 which I have already discussed in relation to price
 23 increases is not being addressed.
 24 What one would have thought in the light of
 25 paragraph 51 of the 2007 report and the statement here,

1 and the light of the fact that the OFT is forced to
 2 acknowledge that there was no automatic obligation, in
 3 fact one sees what they have said about the right to
 4 respond, one would have thought they would then have to
 5 acknowledge that that was the end of the case, because
 6 what is the anticompetitive effect of which they are
 7 complaining?

8 What you will then see is there is yet a further
 9 variant coming forward, and now the variant is this: the
 10 RMSs, it appears, are said to be nonetheless
 11 anticompetitive because they make it easier for Imperial
 12 to match price changes by Gallaher, and therefore,
 13 because Imperial's going to be able to compete more
 14 effectively with Gallaher and reduce prices, over time
 15 they say that will disincentivise Gallaher from reducing
 16 its prices. That's the further variant upon the case.

17 This comes forward very much, we would suggest, as
 18 a sleight of hand. The way you will see it, and this is
 19 interesting, is if you still have to hand the joint
 20 statement, if you would turn to page 74, the Chairman
 21 will remember that we had a rather tedious debate about
 22 who was going to do the drafting and so on, and so this
 23 document appears in two parts. This is the part which
 24 was drafted by the appellant experts, and you can see
 25 part 1 was:

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1 "Key assumptions underlying GS's static theory of
 2 harm."
 3 This is rather important.
 4 "The following propositions set out the appellant
 5 experts' understanding of the assumptions adopted by
 6 Professor Shaffer. 1. Where the relative retail prices
 7 of brands A and B are linked in P&Ds, if the
 8 differentials in the P&Ds were fixed, Professor
 9 Shaffer's static theory of harm assumes there is an
 10 obligation upon each retailer to increase and/or
 11 decrease the retail price of brands A and B in parallel
 12 following any increase and/or decrease in the wholesale
 13 price."

14 Then they set out the mechanisms, which is the
 15 lock-step, that that was a requirement. Now, if you
 16 look at all of the appellants' experts, they explain
 17 that that is what they understand Professor Shaffer's
 18 report says, and indeed that is what Professor Shaffer's
 19 report says.

20 What you will find here --

21 **THE CHAIRMAN:** Those (i) to (iv), do those map onto the
 22 paragraph 40 that we saw in the skeleton?

23 **MR HOWARD:** They do. The wording may not be identical, but
 24 they certainly map on in the sense of the same concepts.

25 What is then interesting, unanimity, they all agree,

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1 but Professor Shaffer, you will see, is now -- there is
 2 a bit of a departure here, because he says:
 3 "I agree that under the OFT's interpretation of
 4 P&Ds, if the specified P&D differential between brands A
 5 and B were fixed, then the retailer would be expected to
 6 increase or decrease the retail prices of brands A and B
 7 in parallel, following an increase/decrease in the
 8 wholesale price. The framework I set out in my 2010
 9 report explains why this would be expected to be
 10 anticompetitive. The key to the theory of harm is that
 11 with P&Ds retail prices would be expected to move in the
 12 same direction following a wholesale price change,
 13 whereas in the counterfactual world without P&Ds, there
 14 would either be no such expectation or, if there was
 15 such an expectation, the retailer would not be expected
 16 in the absence of P&Ds to change the retail price of the
 17 rival brands by as much as it would change it with
 18 P&Ds."

19 Now, this appears to be putting forward a rather
 20 different case, which is, you remember, in
 21 Professor Shaffer's report you had the requirement of
 22 lock-step, then he modified that with uncertain
 23 compliance; now, what he appears to be saying, when the
 24 very assumptions are defined, he seems reluctant to
 25 agree that these were his assumptions, which you can see

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1 absolutely clearly laid out in that report, and instead
 2 puts forward the explanation here.

3 Now, the points one can make about this are as
 4 follows: firstly, Professor Shaffer's theory and model
 5 were clearly articulated on the basis of a supposed
 6 lock-step. It's also clear, secondly, that therefore
 7 his theory was based on something which bore no
 8 relationship to the facts. Thirdly, Professor Shaffer
 9 now appears to be moving away from his lock-step, his
 10 case based on requirements of Imperial and obligations
 11 on the retailer, which was something everybody
 12 understood he was talking about. Now we appear to be in
 13 something very vague and amorphous, we are away from
 14 obligations and restrictions, and in a world where there
 15 is an expectation that fixed differentials will continue
 16 to be applied. No doubt he would alternatively say, if
 17 it's maxima differentials, an expectation that they
 18 would be applied.

19 But all of this, with respect, begs the key
 20 question: what is the nature of the agreement about
 21 which complaint is made? What is the restriction that
 22 is now said to apply? Because what appears to be
 23 contemplated is that, although the P&Ds or the RMSs,
 24 whatever you want to call it, do not impose any
 25 requirement, they may in some ill-defined way give rise

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1 to an expectation, which expectation may have an effect,
 2 but in what way? And the question that of course is not
 3 addressed, let alone answered: how is any of this
 4 different to the effect of the nature of this market,
 5 transparent, concentrated, highly taxed and regulated?
 6 What is the theory of harm? What is the empirical
 7 evidence that is supporting it, other than pure
 8 assertion by Professor Shaffer? There is absolutely
 9 nothing. Moreover, whether or not over time a situation
 10 might arise in which, because of the nature of the
 11 market, it's said manufacturers are not competing as
 12 vigorously as they might, that requires an effects
 13 analysis.
 14 If it's being said the existence of the RMSs somehow
 15 increased the likelihood that a price reduction by one
 16 manufacturer will be followed by a price reduction by
 17 the other manufacturer, one has to compare that with the
 18 situation where they are price cutting without the RMSs.
 19 In other words, why does the RMS make any difference at
 20 all? But even if you say, well, it may make it more
 21 likely that one manufacturer is going to price cut, why
 22 is that a bad thing? Prima facie it's a jolly good
 23 thing. If you are then going to say, well, the fact
 24 that it's more likely that Imperial will price cut and
 25 you are then saying that will have an anticompetitive

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1 effect in the long-term, it's not rocket science, this,
 2 you would need to -- this would be something which is
 3 vigorously challenged -- look at the empirical evidence.
 4 You can't just have Professor Shaffer saying "I feel it
 5 in my bones that over time, somehow this is going to
 6 result in higher prices", and that's basically what we
 7 are left with.

8 One can make a couple of points, really, as a matter
 9 of common sense, where one doesn't need a PhD in
 10 economics, whether or not a manufacturer chooses to
 11 compete on price will depend on the dynamics of the
 12 market. For example, when Gallaher is considering
 13 whether to implement a price cut, it must no doubt ask
 14 itself: what is the likelihood that Imperial will
 15 respond? And then it will ask itself: well, what's the
 16 size of the cut I am going to make? Then it will think:
 17 well, Imperial will have to think how long I'm likely to
 18 make this cut for, is it in Imperial's interest to match
 19 it, what other promotional activity are they funding?
 20 There are a whole series of things.

21 This is self-evidently not susceptible to some
 22 simplistic model of the type that Professor Shaffer put
 23 forward in 2007, which is based -- his model is based
 24 upon rigid assumptions. What you can't do, and this is
 25 basically where one gets to, you get a model which is

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1 based upon these very rigid assumptions and then what is
 2 sought to do is to jump and say "Well, never mind that",
 3 everything that the model shows is somehow still true in
 4 relation to what is a very different environment.

5 So once you recognise that the RMSs do not operate
 6 in the rigid manner, we suggest it is particularly
 7 counterintuitive to seek to classify them as an object
 8 infringement.

9 Now, there are a couple of sense checks which are
 10 important in relation to this. I remind you that
 11 Professor Shaffer's evidence is that from the moment the
 12 RMSs were agreed they had an anticompetitive effect.
 13 Well, if that were true, then Professor Shaffer's theory
 14 would easily be demonstrated.

15 Now, the evidence shows that in relation to a number
 16 of aspects empirically they contradict what
 17 Professor Shaffer puts forward. Market share, Imperial,
 18 during the relevant period, gained market share. You
 19 will find that evidence in both Mr Good's statement and
 20 in -- that's in Mr Good's first statement at
 21 paragraph 32, core 3, tab 36, {C3/36 paragraph 32} and
 22 the market share increase between 1999 and 2003 is in
 23 the notice of appeal, core 1, tab 2, {C1/2} when
 24 Imperial gained 6.1 per cent and Gallaher lost
 25 2.4 per cent.

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1 Prices. The weighted average real prices of
 2 Imperial's brands increased more rapidly after the
 3 alleged infringement period. That's set out in
 4 Mr Haberman's report at paragraphs 4.1 to 4.17. These
 5 figures are accepted by the OFT's expert, Mr Walker, see
 6 core 12, tab 124, page 6. {C12/124/6}.

7 So what does the OFT seek to do? They seek to
 8 dismiss the relevance of these figures, see
 9 paragraph 42.4 of the defence. But Mr Haberman has
 10 specifically ruled out the possibility that this factor
 11 can be attributed to any increase in costs or any
 12 fundamental change in the market structure or material
 13 change in the tobacco taxes. Mr Walker has since agreed
 14 that the evolution of retail prices is not explained by
 15 changes in Imperial's costs. That's core 12, tab 124,
 16 page 6. {C12/124/6} So that contradicts.

17 Manufacturers' margins. The evidence shows that
 18 Imperial's real gross profit margins were higher in the
 19 post infringement period than during it. That's table
 20 10 in Mr Ridyard's second report, core 3, tab 26,
 21 page 154. {C3/26/154}

22 Mr Ridyard explains that that isn't definitive
 23 proof, but it is a useful contra-indicate because if it
 24 were true that the existence of these agreements had
 25 serious anticompetitive effects, one would expect to see

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1 a major change in the nature of competition and
2 profitability.
3 The next point, which perhaps it is worth looking at
4 the joint statement for this, which is variability.
5 Mr Ridyard carried out a variability analysis which
6 tests whether the difference between the retail prices
7 of the brands that were paired in Imperial's RMSs were
8 subject to greater variability whilst the RMSs were in
9 place when compared to the subsequent period.

10 If you go to core bundle 12, at page 16, {C12/16
11 paragraph 2.6}:

12 "On the assumption that greater volatility in the
13 relative price of paired brands was observed during the
14 alleged period and afterwards, we disagree on the
15 consequences of any such observations."

16 Ridyard believes that:

17 "Such findings would be inconsistent with the theory
18 of harm because the mechanism for interprice brand
19 co-ordination described in that theory relies on RMSs
20 creating a tighter link between competing brands'
21 relative prices than would otherwise exist."

22 Walker:

23 "... [does] not believe that there is a theoretical
24 justification for believing that the alleged infringing
25 agreement should reduce volatility."

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1 If you then look at the clarification of the
2 experts, Mr Ridyard:
3 "The OFT's theory of harm alleges that the RMSs
4 increase the likelihood that one manufacturer's
5 unilateral price increase or decrease would be matched
6 by its rival and that through the RMSs, it was the
7 pricing decisions of participating retailers that played
8 this role of co-ordinating into brand competition by
9 keeping the relative prices of paired brands in line
10 with one another than they would otherwise have been.
11 If that was true, then I would expect to see greater
12 stability in the relative retail prices of paired brands
13 when they were covered by RMSs than when they were not."

14 Mr Walker simply says that:

15 "The theory of harm doesn't include a prediction
16 about the effect on price volatility."

17 It may not expressly, but that's obviously the
18 implicit basis of it, and that's the basis of the
19 conclusion you would draw from what Professor Shaffer
20 has said.

21 So that's a further counter indicator.

22 Then the performance of Richmond in particular,
23 Imperial gained market share in respect of Richmond, and
24 that leads me to one final point, which is this, and
25 it's really a point I started with yesterday or

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1 mentioned at an early stage: the period we are talking
2 about was a period of intense competition between
3 Imperial and Gallaher. That period of intense
4 competition is evidenced by the strategy documents which
5 we set out at section 2 of our reply. I invite you to
6 look at those. You will see that they are set out in
7 section 2, they directly contradict the OFT's contention
8 that the purpose of what was going on was to seek
9 stability rather than competitive advantage. It's
10 self-evident when you look at those documents that
11 Imperial, for its part, was seeking to compete and to
12 reduce the prices in order to gain market advantage.

13 So we say that the OFT's case, even before you come
14 to hear from Mr Brealey on the correct legal approach,
15 is utterly misconceived.

16 **THE CHAIRMAN:** Yes, thank you very much, Mr Howard, that's
17 been very helpful.

18 So now are we moving to hear from you, Ms Rose?

19 **MS ROSE:** Yes.

20 Opening submissions by MS ROSE

21 **MS ROSE:** There is a famous scene in Ken Loach's classic
22 movie "Kes", which I am sure the Tribunal will recall is
23 set in a grim northern boys' school, in which a boy is
24 sent with a message to the headmaster and he is told to
25 go and find him in his study, and he gets outside the

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1 headmaster's study and there is a group of other boys
2 waiting to go in and it turns out they are all waiting
3 to be caned. They go into the headmaster's study and
4 this boy tries to explain that he is not in the same
5 situation as them, he has been sent to the headmaster
6 and the headmaster tells him to shut up and canes him
7 anyway.

8 That's a bit how Shell feels about this case,
9 because Shell has been found to be a party to infringing
10 agreements under which it is said to have agreed with
11 the tobacco manufacturers to set the retail prices from
12 tobacco products in order to achieve the parity and
13 differential requirements between competing brands set
14 by those manufacturers. In making those findings, the
15 OFT has treated Shell in exactly the same way as all of
16 the retailers, people like Somerfield, Asda, Co-op, all
17 the other parties that you see in court. Indeed, you
18 will see in the OFT's decision that Shell is defined as
19 a retailer, and described as a retailer, and part of the
20 generic group of tobacco retailers.

21 Indeed, it goes further than that, because, as we
22 shall see in a little while, the critical paragraphs of
23 the OFT's decision in section 6 of the decision, where
24 the OFT actually finds the participation in the
25 infringing agreement, have simply been cut and pasted

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1 and applied to Shell in verbally identical terms to the
2 terms in which they are applied to the other retailers,
3 simply with the insertion of different gobbets of
4 evidence.

5 But Shell's situation was fundamentally different
6 from the situation of the tobacco retailers. For the
7 whole of the period of the alleged infringing agreement
8 between Shell and Gallaher and for the vast majority of
9 the period of the agreement between Shell and ITL, Shell
10 was not in fact retailing tobacco products, and Shell
11 was not in a position to set the retail price of tobacco
12 products.

13 The filling station sites which are owned by Shell,
14 which include of course the convenience stores, the
15 Shell Select stores that you will all be familiar with
16 which sell a range of products, including tobacco, were
17 and are operated by independent contractors in
18 accordance with a retail business agreement or RBA,
19 between the contractor and Shell. We are going to look
20 at that agreement in some detail shortly.

21 The introduction of the RBA between October 2000 and
22 August 2001 was a major commercial restructuring for
23 Shell, undertaken -- as we shall see in a moment --
24 because Shell was concerned about the underperformance
25 of its filling station sites, it was concerned that they

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1 were not sufficiently profitable and that the reason was
2 that there was not enough autonomy and entrepreneurial
3 spirit being operated by the filling station managers.

4 The solution, therefore, was to give to those
5 filling station managers a new role as an independent
6 contractor where they had responsibility for the conduct
7 of the business within parameters set by Shell, selling
8 a core range of products that were required by Shell as
9 well as their own locally selected products, and with
10 autonomy over the retail price that they were to charge
11 for those products, subject only to a maximum price, the
12 maximum price being set at a level that Shell would have
13 considered to be truly excessive, sometimes referred to
14 in the evidence as an "insult price", so it's a price
15 above which there would be a risk of alienating your
16 customer base.

17 This was a major commercial undertaking for Shell.
18 It involved, over a period of about nine months, wholly
19 restructuring hundreds of sites, and we will see the
20 evidence about that in a moment.

21 Crucially, as I've just said, under that agreement,
22 Shell is not entitled to set the retail price. It can
23 recommend a retail price and it can set a maximum price,
24 but the retailers, the contractors, not Shell, are free
25 to sell tobacco products at any price above or below the

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1 recommended retail price, any price up to the maximum.

2 The OFT's case against Shell is founded essentially
3 upon trading agreements entered into between Shell and
4 the tobacco manufacturers and contact between Shell and
5 the manufacturers.

6 The main preoccupation of those agreements and
7 indeed of the relationship between Shell and the
8 manufacturers related to the distribution and display of
9 tobacco products, because, as you heard yesterday from
10 Mr Howard, it's not permitted to advertise tobacco, and
11 therefore the display of tobacco products has become the
12 last means by which -- and not for very long, unless we
13 win -- the tobacco manufacturers are able to market
14 their product at point of sale. You have a gantry
15 that's branded and the display of the products in the
16 gantry and their positioning in the gantry is crucial
17 for the marketing of those products. And the
18 availability of the products is also of course crucial
19 for manufacturers.

20 As we shall see, that is the main preoccupation of
21 the trading agreements between Shell and the
22 manufacturers, and it is questions of what are called
23 the planograms, which are -- the diagrams show where the
24 different products are, but the planograms are the area
25 where the majority of bonus is earned.

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1 You will also see that Shell did have the power
2 under the RBA to require its sites to comply with the
3 planograms. The planograms were enforceable. You will
4 see in some of the evidence references to compliance,
5 compliance with the plan. That is not talking about
6 pricing, it is talking about the arrangement and the
7 distribution of cigarettes in the planogram.

8 The trading agreements also offered very modest
9 bonuses to Shell, if Shell maintained specified price
10 differentials and price parities between particular
11 competing brands and these are the provisions in the
12 trading agreements on which the OFT relies.

13 Now, we will look in a moment at the agreements
14 because I am told I am not allowed to say out loud the
15 size of the bonus between Shell and ITL. The Tribunal
16 may have picked it up. It is absolutely minuscule in
17 relation to the size of Shell's business.

18 Stepping back from this case for one moment, the
19 proposition that for that sum of money, ITL purchased
20 from Shell the right to set all of Shell's retail prices
21 across the United Kingdom is quite a surprising
22 proposition.

23 When you read those trading agreements in their
24 proper context and in terms of the factual matrix which
25 of course crucially includes the RBA, what is apparent

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1 is that the most that Shell is agreeing to do is to
 2 include the parities and differentials in its price
 3 files. The price files are the documents that recommend
 4 to the contractors a recommended retail price and
 5 a maximum price, and crucially that is not the setting
 6 of a retail price. Indeed, as the Tribunal will
 7 immediately have realised, that of course is the type of
 8 provision that is specifically permitted under the
 9 Block Exemption, because that is simply the
 10 recommendation of a retail price or the setting of
 11 a maximum retail price.

12 We submit that it is obvious that Shell did not
 13 agree to fix the actual shelf retail prices at its sites
 14 in any agreement with ITL or Gallaher. Shell was simply
 15 not in a position to perform any such agreement. Had it
 16 sought to impose fixed retail prices on its own
 17 independent contractors, it would immediately have been
 18 liable to an action for breach of contract, and there is
 19 no adequate response from the OFT to this obvious fact.
 20 I am going to come in a moment to what the OFT have
 21 actually said, and it is in our submission wholly
 22 inadequate.

23 Indeed, it goes further than that, because the
 24 tobacco manufacturers could not possibly have understood
 25 that Shell was agreeing to set fixed retail prices,

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1 leaving aside the fact that they were perfectly well
 2 aware of the existence of the RBA and of the structure
 3 of Shell's business. The price files themselves, as we
 4 shall see, were documents which passed regularly between
 5 Shell and the tobacco manufacturers and about which
 6 there was considerable discussion between Shell and the
 7 tobacco manufacturers.

8 It is clear on the face of those documents that they
 9 are not setting a retail price, because they contain two
 10 prices, a recommended retail price and a maximum retail
 11 price, and therefore any agreement whereby Shell agreed
 12 to reflect differentials and parities in a recommended
 13 retail price and a maximum retail price could not
 14 possibly result in the maintenance of those parities or
 15 differentials in shelf retail prices. This is obvious.

16 If you pass to the retailer a document that says,
 17 for example, Lambert & Butler between £3.80, and £4,
 18 recommended retail price £3.80, maximum £4,
 19 Benson & Hedges recommended retail price £3.80, £4, it
 20 is quite obvious that the retailer is not obliged to
 21 maintain a parity between Benson & Hedges and Lambert &
 22 Butler, because even on the face of the document itself
 23 there is a range between the prices, and we know that in
 24 fact under the RBA the recommended retail price wasn't
 25 a floor, it was what it says, it was a recommendation.

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1 If this is the correct analysis of Shell's agreement
 2 with the tobacco manufacturers, and we say that it quite
 3 obviously is when you look at those agreements in proper
 4 context, then the OFT's case against Shell, which is
 5 predicated on a finding of fact that Shell was a party
 6 to agreements to fix the retail prices of tobacco
 7 products fails. The OFT has simply never investigated,
 8 much less made any finding, as to whether or not
 9 an agreement by Shell to recommend to its contractors
 10 prices within a range reflecting parities and
 11 differentials between brands could constitute any
 12 infringement by object. One thing is certain, having
 13 heard Mr Howard's very clear exposition of the theory of
 14 harm, it certainly does not extend to any such
 15 situation.

16 We say the case in fact goes even further than that,
 17 because we say it is clear from the evidence that in
 18 fact Shell did not consider itself even to be
 19 constrained by the trading agreements to incorporate the
 20 differentials and parities in its price file. The
 21 position was that Shell understood that if it did do
 22 that there would be a very small incentive, the bonus,
 23 that would be provided as a result. But the bonus was
 24 so small that it didn't operate as a significant factor,
 25 and Shell in fact considered a range of factors when

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1 deciding how to position recommended retail prices and
 2 maximum prices on the price files. Most obviously it
 3 was concerned to ensure that its recommended retail
 4 prices were set at a level that would permit
 5 a reasonable margin to its independent contractors
 6 because it was, after all, making a recommendation to
 7 them.

8 The OFT has made much play in its decision and in
 9 its skeleton argument of the documents which show
 10 contacts between Shell employees and employees of the
 11 tobacco manufacturers where the manufacturers propose
 12 that the price files should be amended in particular
 13 ways to bring them into line with parities and
 14 differentials. We shall show in due course that in fact
 15 Shell frequently did not comply with those suggestions.

16 But more fundamentally, even if the OFT was able to
 17 prove that Shell always complied with the requests and
 18 that all Shell's price files reflected the
 19 manufacturers' preferred differentials and parities, the
 20 OFT's case would still fail because those price files
 21 did not set the retail price for tobacco in Shell's
 22 service stations.

23 What is striking is that the OFT has not produced
 24 any evidence at all that Shell, on any single occasion,
 25 instructed any of its contractors in any single filling

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1 station to alter a retail price in order to comply with
2 the parities and differentials on the price file. There
3 is no record of Shell ever having done that. As I've
4 said before, it's not surprising because if Shell had
5 tried to do that, the contractor would have simply told
6 them where to go and pointed out very politely that they
7 were in breach of the RBA.

8 With those introductory comments I would like to
9 make two very short legal points and then to consider
10 Shell's relationship with each of the manufacturers, and
11 then the flaws in the OFT's argument.

12 Turning to the legal framework, I do not intend to
13 make substantial submissions on law, I understand you
14 are going to get that from Mr Brealey on Monday, but
15 there are just two short points I want to make.

16 Can I invite you to turn to the Irish Beef case,
17 authorities bundle 3, tab 47. {A3/47} If we just go to
18 paragraph 14, the issue in this case was what had to be
19 shown in order to establish an object infringement, and
20 we see the question at paragraph 14:

21 "The national court asks whether agreements with
22 features such as those with BIDS arrangements are to be
23 regarded by reason of their object alone as being
24 anticompetitive and prohibited by article 81(1) or
25 whether it's necessary first to demonstrate that they

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1 have had anticompetitive effects.
2 "It must be recalled that to come within the
3 prohibition laid down in Article 81(1), an agreement
4 must have as its object or effect prevention,
5 restriction, distortion of competition in the Common
6 Market. It has, since the judgment in LTN, been settled
7 case law that the alternative nature of that requirement
8 indicated by the conjunction or leads first to the need
9 to consider the precise purpose of the agreement in the
10 economic context in which it has to be applied. When,
11 however, an analysis of the clauses of that agreement
12 does not reveal the effect on competition to be
13 sufficiently deleterious, its consequences should then
14 be considered."

15 First of all you are directed to consider the
16 precise terms of the agreement in question. Then at 16,
17 again we are told:

18 "... no need to take account of its effect once it
19 appears its object is to prevent, restrict or distort
20 competition. That examination must be made in the light
21 of the agreement's content and economic context."

22 Then at paragraph 17 there is the point that:

23 "The distinction between object and effects arises
24 from the fact that certain forms of conclusion by their
25 very nature are injurious to the proper functioning of

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1 normal competition."

2 Then at paragraph 21:

3 "To determine whether an agreement comes within the
4 prohibition at 81.1, close regard must be paid to the
5 wording of its provisions and to the objectives which it
6 is intended to attain."

7 The point that I want to make is to stress that the
8 ECJ makes in those paragraphs on the importance of
9 a proper analysis of the terms of the agreement, and
10 with great respect to the OFT it is a striking feature
11 of this case that its analysis of the actual nature of
12 the agreements between Shell and the tobacco
13 manufacturers is strikingly inadequate.

14 You will also note that it is the precise terms of
15 the individual agreement that must be considered. It is
16 not good enough for the regulator to identify a generic
17 template of an infringing agreement and then simply to
18 seek to shoehorn into that template the different facts
19 of different particular parties.

20 The second short legal point I want to make is in
21 relation to the GlaxoSmithKline case, that's in
22 authorities bundle 2, tab 36, paragraph 77 {A2/36
23 paragraph 77}. This passage is common ground and is
24 indeed relied upon by the OFT itself in its decision, if
25 I could just give you the reference it's paragraphs 3.29

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1 to 3.30 of the OFT's decision, this same passage is
2 relied on.

3 Paragraph 76, first of all, you can see the heading
4 "Concurrence of Wills" so this is how you determine
5 whether a particular party is a participant in the
6 agreement in question:

7 "In order for there to be an agreement, it is
8 sufficient that at least two undertakings have expressed
9 their joint intention to conduct themselves on the
10 market in a specific way.

11 "While it is therefore essential that the decisions
12 in which the Commission applies Article 81(1) show the
13 existence of a joint intention to act on the market in a
14 specific way, those decisions, contrary to GSK's
15 contention, are not required to establish the existence
16 of a joint intention to pursue an anticompetitive aim."

17 So it has to be shown that Shell, not ITL, not
18 Gallaher, that Shell was itself intending to act on the
19 market in a specific way. In the context of this case,
20 that means that the OFT has to establish that Shell was
21 intending to set the retail prices, and I stress set the
22 retail prices, for tobacco products in accordance with
23 the priorities and differentials on the price file.

24 Unless it can be shown that Shell itself had that
25 intention, then it was not a party to any infringing

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1 agreement.

2 **DR SCOTT:** Just to be precise there, you talked about it

3 a little earlier on, at 110/24, you talked about fixing

4 prices.

5 **MS ROSE:** Yes.

6 **DR SCOTT:** As I understand it, the allegation is not an

7 allegation of fixing prices, but of fixing parities or

8 differentials.

9 **MS ROSE:** We shall see in a moment exactly what the OFT

10 found. In fact, we can turn to it next, and I think it

11 will answer your question, sir. If we can take up the

12 OFT decision, if you turn to paragraph 6.1173, this is

13 the summary of the finding in relation to participation

14 in an infringing agreement by Shell. Page 375. ITL and

15 Shell, it's said:

16 "... were party to an agreement or concerted

17 practice whereby ITL co-ordinated with Shell the setting

18 [and I stress the word 'setting'] of Shell's retail

19 prices for tobacco products in order to achieve the

20 parity and differential requirements between competing

21 linked brands that were set by ITL in the pursuit of

22 ITL's retail pricing strategy."

23 The finding of the infringing agreement depends on

24 Shell having agreed to set the retail price. That's why

25 I say really the case against Shell just doesn't get off

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1 the ground, because not only did Shell not intend at any

2 stage to set a retail price, it had no power to do so.

3 That's the specific findings in relation to Shell.

4 We can see how that fits in to the overall findings if

5 we go back to the beginning of section 6 of this

6 decision, page 77.

7 First of all you can see that the heading of

8 section 6 is "Analysis of the Infringing Agreements" and

9 there is an overview:

10 "The salient factual elements of the infringing

11 agreements are set out below in the sections of this

12 decision evidencing each bilateral vertical infringement

13 agreement. The evidence demonstrates that under the

14 infringing agreements each manufacturer co-ordinated

15 with each retailer the setting of the retailer's retail

16 prices for tobacco products", et cetera.

17 You can see that the formula that's used there is

18 exactly the same as the formula that's used at 6.1173.

19 In fact, if you look through section 6 you will see that

20 there is a section for each retailer and that in

21 relation to each retailer the key term of the infringing

22 agreement is expressed in identical wording. That's why

23 I make the submission that in fact what the OFT was

24 obliged to do, to establish a case against Shell, was to

25 examine Shell's individual agreement in accordance with

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1 its own facts in its own factual matrix in its own legal

2 and economic context and look at its own precise terms.

3 What unfortunately the OFT appears to have done is

4 to have developed a platonic ideal of an infringing

5 agreement and then to seek to force Shell's facts to

6 comply with that, rather in the way of the original

7 Cinderella story where the ugly sisters' toes were cut

8 off so they would fit into the slipper. We submit that

9 is inadequate.

10 If you compare the section of section 6 that deals

11 with Shell with the equivalent sections that deal with

12 the other retailers, you will see whole paragraphs and

13 chunks of text simply lifted and cut and pasted into the

14 section.

15 There is another striking feature of section 6, and

16 that is there is no analysis at all in section 6 of the

17 RBA, and the question of whether Shell was a party to

18 an infringing agreement is decided in section 6 without

19 reference to the existence or terms of the RBA.

20 As we shall see, rather oddly, the OFT comes on to

21 consider the RBA in section 7 of its decision after it's

22 already reached the conclusion that Shell was a party to

23 an infringing agreement.

24 So with that look at the decision of the OFT, can we

25 now turn to the RBA, because we submit that it simply is

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1 not possible to understand the relationship between

2 Shell and the tobacco manufacturers or the agreements

3 between Shell and the tobacco manufacturers without

4 understanding the factual context into which those

5 agreements were entered into, and that included in

6 particular the very significant changes that Shell was

7 making to the structure of its business at this time.

8 Can we turn first to Mr Moss' evidence, core

9 bundle 11, tab 117. {C11/117} David Moss was at the

10 material time the UK retail sales and operations manager

11 of Shell, and you can see that at paragraph 8 of his

12 witness statement. If you read paragraphs 10 and 11, he

13 explains the decision, the situation in 1999 and the

14 discussion within Shell as to whether it was

15 appropriate, both in the UK and at a global level, to

16 maintain the direct management model, and the prevailing

17 view was that it was unsustainable, a major factor in

18 the poor performance of the UK petrol stations.

19 Then he explains that the RBA model was formulated

20 between August 1999 and January 2000 and that its

21 structure was agreed by the first quarter of 2000

22 necessary legal documents, and then he explains its

23 implementation.

24 Then paragraphs 12 down to 18, he explains the

25 strategy and that Shell had identified the problem that,

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1 even though it was very good at selling motor fuel, it
 2 wasn't so good at convenience retailing, not
 3 surprisingly, and the best way to deal with that problem
 4 was to enable retailers to optimise the convenience
 5 retailing business stream. That's at paragraph 12.
 6 Expectation that moving to the RBA would result in
 7 better management of the convenience retailing.
 8 Retailers would have both more freedom to innovate,
 9 drive sales and control costs, and also more incentive
 10 to do so because they were going to share in the profits
 11 of the retailer.
 12 Then there is an explanation of precisely what
 13 a major overhaul this was, that a lot of the existing
 14 managers, they all had to be reinterviewed and a number
 15 didn't make it because they didn't have the necessary
 16 entrepreneurial skills, it was a very different role
 17 than that which had applied in the original service
 18 stations.
 19 Then at paragraphs 19 down to 23 he describes how
 20 the RBA works, and he calls it a fundamental change to
 21 how Shell's UK retail petrol station business was run.
 22 It gave autonomy to the retailers in how they ran their
 23 business, which included the convenience store element.
 24 The principle was Shell would only retain ownership and
 25 control of certain aspects of the business such as the

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1 wet stock -- that's essentially motor fuel -- price over
 2 the wet stock, land, health and safety standards and
 3 operation standards of the forecourt.
 4 Then:
 5 "The retailer was to be an independent
 6 businessperson who had invested in the business and
 7 would have ownership and control of the dry stock
 8 (non-fuel stock such as convenience goods) and the
 9 employees. In short, the RBA contractors would be
 10 acting as agent for Shell in selling the fuel and acting
 11 on their own account in convenience retailing but paying
 12 a commission to Shell in respect of the same."
 13 Then at 22:
 14 "Although business control was given to the RBA
 15 contractors, Shell wished to try and maintain some
 16 consistency across the shops in terms of standards, at
 17 least so as to protect the Shell brand. As such, Shell
 18 required particular core products to be stocked,
 19 approximately 90 per cent of the total, specified how
 20 they should be displayed. It also recommended a retail
 21 price for each product and stipulated a maximum price to
 22 ensure that overpriced merchandise at one location would
 23 not reflect badly on the Shell brand in the eyes of
 24 customers.
 25 "Shell would not, and under the RBA could not, have

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1 dictated the actual price the product should be sold at
 2 beyond requiring the RBA contractors to remain below the
 3 maximum price.
 4 "I am not aware of any occasion on which Shell told
 5 RBA contractors what to do with their dry stock other
 6 than in compliance with the principle in the RBA and
 7 discussed above. I am aware of no example of Shell
 8 telling RBA contractors what price to use beyond
 9 provided recommended and maximum prices."
 10 He says he thinks he would have known if it had
 11 happened.
 12 **DR SCOTT:** Just a small technical point, in fact if I came
 13 into a Shell store, because of the flash trading, I am
 14 actually contracting with Shell, aren't I?
 15 **MS ROSE:** That's correct, we will see that in the RBA
 16 itself, that what happens at the point of sale is that
 17 the contractor sells the cigarettes to Shell and Shell
 18 sells them to you. He explains that at paragraph 31,
 19 and he explains the reasons for it. It's essentially
 20 because otherwise you would have had to have two VAT
 21 numbers, separate VAT receipts, and it would have been
 22 wholly unworkable and very irritating for the person who
 23 wanted a tank of petrol and 20 cigarettes, so it was
 24 purely a mechanism. But Shell had no control at all
 25 over the terms of the sale, it was the contractor who

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1 agreed the price and essentially was the retailer in
 2 substance.
 3 Then the success of the RBA is described at
 4 paragraphs 35 to 37, basically it has done what was
 5 hoped of it and still in use in the UK and has been
 6 adopted elsewhere in the world.
 7 So this was a major undertaking for Shell, and the
 8 terms of the RBA itself can be seen, if you take
 9 volume 2 of Shell's notice of appeal, at tab 34.
 10 Behind tab 34 it should say annex E. There is
 11 Mr Conrad's witness statement and if you go to tab 1
 12 behind that you should have the RBA.
 13 **DR SCOTT:** There is volume 2 --
 14 **MS ROSE:** Volume 2, tab 34, then do you see annex E.
 15 **DR SCOTT:** Tab 34 I have as National Grid v Ofgem.
 16 **MS ROSE:** If you go a little way beyond it, you see annex E
 17 and 1, and if you go to the 1, that should be exhibit
 18 AC1, which is the RBA.
 19 **THE CHAIRMAN:** Right.
 20 **MS ROSE:** If you look at clause 1 that deals with the
 21 appointment of the retailer. You will notice
 22 immediately that retailer here doesn't refer to Shell,
 23 retailer refers to the independent contractor. At
 24 clause 1, without going through it in detail, you see
 25 the parameters of the business that's to be operated by

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1 the retailer.
 2 Then at clause 2, the aims and objectives of the
 3 agreement, and you will see that the two bottom bullet
 4 points include engaging in the business at the site and
 5 enhancing and retaining Shell's reputation on the
 6 profitability of the site to the benefit of both
 7 parties.

8 Then clause 3 deals with motor fuels, clause 4 with
 9 the car wash and car vacuum, and clause 5, the shop and
 10 sale of what are called NFR goods, which means basically
 11 everything except fuel. If you look in the glossary at
 12 the front of the screen, you will see NFR is essentially
 13 defined as anything that's not motor fuel.

14 "The retailer will carry out the business of a sale
 15 of goods and services through the shop at the site in
 16 accordance with the manuals and purchase of his own
 17 account all NFR goods for sale through the shop at the
 18 site."

19 So the retailer buys the cigarettes himself.

20 "NFR goods consist of two types: core range and
 21 local range. The core range [and this includes the
 22 cigarettes on the price files we need to be concerned
 23 with] can only be purchased from the Shell distribution
 24 system or any other supplier approved by Shell."

25 So there is a Shell approved supplier who provides

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1 the core range. Then:
 2 "Pricing of NFR Goods" is clause 5.6.
 3 "The retailer will determine the retail price at
 4 which the retailer will sell all NFR goods as follows.
 5 In respect of core range, Shell will set out in the
 6 manuals recommended retail prices and maximum retail
 7 prices. These shall not amount to fixed or minimum
 8 retail prices and the retailer will be entitled to set
 9 the retail prices at any amount up to and including the
 10 relevant maximum retail price. The maximum retail
 11 prices will be set at levels above which prices would be
 12 considered excessive and without justification. The
 13 existence of the maximum retail prices is not intended
 14 to limit the retailer's real commercial freedom."

15 We submit that that clause really could not be any
 16 clearer, and that it's a fundamental part of the
 17 successful operation of this whole commercial
 18 enterprise, because the whole point of the new system is
 19 to give the contractors autonomy to run their own
 20 businesses, so that in a particular locality they will
 21 be sensitive to the local competition about price levels
 22 and they will be able to judge what's the appropriate
 23 competitive prices to charge for particular products,
 24 and they might decide for example that particular
 25 products are very attractive and a good way of getting

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1 footfall and therefore be prepared to cut their margin
 2 on particular products to get people in to buy fuel or
 3 other products, and the whole point of this system is
 4 that Shell had concluded that a system where Shell was
 5 centrally setting prices for the whole of the UK just
 6 wasn't working and you needed to give these people the
 7 ability to run their own business.

8 The whole of the OFT's case is inconsistent with
 9 this business model, because as we have just seen the
 10 OFT has made a finding that Shell intended, by its
 11 agreements with the tobacco manufacturers, to set the
 12 retail price for these petrol stations in a way that
 13 would not only have been a breach of Shell's own freshly
 14 minted RBA, but inconsistent with its whole commercial
 15 purpose.

16 When you weigh up for Shell the economic
 17 implications of its whole new commercial model enshrined
 18 in the RBA against the size of the bonus that was being
 19 offered by the tobacco manufacturers, we say that this
 20 case just departs from reality.

21 **THE CHAIRMAN:** Would you say it would have been a breach of
 22 the RBA for Shell to say to the retailer: look, this is
 23 the recommended retail price, this is the maximum price
 24 of all these different tobacco products, we don't mind
 25 where within that range you choose to set your price,

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1 but please be aware that we would like you to set
 2 whatever price you choose, there has to be this 3p
 3 difference between the Lambert & Butler or
 4 Benson & Hedges.

5 **MS ROSE:** Yes, ma'am, that would have clearly been a breach
 6 of 5.6 because 5.6 says:

7 "The retailer will be entitled to set the retail
 8 prices at any amount up to and including the relevant
 9 maximum retail price."

10 So Shell, it would have been a clear breach of that
 11 clause for Shell to seek to impose relativities, even if
 12 it was not seeking to fix the absolute price, it would
 13 have been a clear breach of this agreement.

14 Not surprisingly there is no evidence at all that
 15 Shell ever sought to do that. The OFT doesn't even
 16 point to any evidence that it says potentially shows
 17 Shell trying to do that.

18 You can see, by the way, the flash sale point,
 19 that's clause 5.7, that deals with the flash sale, and
 20 it's made clear that it's still at the price depended
 21 upon by the retailer as set out in clause 5.6.

22 Contrast the freedom that is given to the retailer
 23 to set the retail price with the question of NFR goods
 24 and layout. This is clause 5.11.

25 "The retailer must merchandise NFR goods in

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1 accordance with store layout plans provided by Shell
2 allowing for the insertion of the local range and
3 planograms provided by Shell for each category of the
4 core range. Local range will not be represented in the
5 planograms."

6 That's why I made the submission earlier that there
7 is a key distinction to be drawn between Shell's role in
8 relation to the stocking of cigarettes and the
9 planograms for their display and Shell's role in
10 relation to pricing of cigarettes, because Shell was
11 entitled under this agreement to require shops to stock
12 particular brands and to display them in particular
13 layouts, and so that was indeed an issue about the
14 compliance of local stores, but Shell was not entitled
15 to require particular retail prices or even particular
16 relativities of retail prices.

17 5.19, promotions:

18 "The retailer will, as set out in the manuals,
19 comply with Shell's requirements in respect of
20 promotions relating to motor fuel and comply with
21 Shell's requirements in respect of all other promotions
22 should the retailer choose to take part in them."

23 So again you see a distinction between motor fuel
24 where they have to comply with Shell promotions and
25 other types of promotions which would include tobacco

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1 products where they have a choice whether to participate
2 in the promotion, but if they do, they must participate
3 in the promotion in accordance with its terms.

4 Then clause 6 deals with the operation of the
5 business, that needn't concern us. Fees and method of
6 payment is at clause 8 and in short what it comes down
7 to is a royalty payment, a percentage of sales. Then
8 breach and termination. There is a yellow card/red card
9 system where you get a warning, and a breach warning
10 notice, it's at 9.2, and the matters for which you get
11 one include, the third bullet:

12 "More than ten core range items priced above maximum
13 retail price during any three month period."

14 Four bullets from the end:

15 "Stocking of NFR goods contrary to Shell's
16 instructions", clause 5.5."

17 So there you can see again the precise ambit of
18 Shell's ability to control, maximum retail price,
19 stocking requirements.

20 Then the final point to note at page 227,
21 article 11, 11.2 is an entire agreement clause.

22 **MR SUMMERS:** May I just ask a question about the planograms?

23 **MS ROSE:** Yes.

24 **MR SUMMERS:** I don't see any reference here to the provision
25 of gantries, and yet actually a planogram would seem to

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1 me to be dependent upon the particular style of gantry
2 that was going to be used. Was that dictated by Shell
3 in agreement with the manufacturers to which gantry was
4 going to be used, or was that up to the individual
5 retailer to select a gantry?

6 **MS ROSE:** It's certainly not covered in the ITL agreement.

7 When we look at the Gallaher agreement we can see if it
8 specifically refers to the gantry, I can't remember off
9 the top of my head. The facts were that there is
10 a certain amount of evidence that shows that ITL
11 certainly was exercised about the fact that Shell had
12 purchased a large quantity of particular gantries that
13 ITL wasn't particularly happy about, and we see there is
14 a certain amount of argy-bargy over the question of the
15 gantries.

16 In terms of this agreement, of course one of the
17 matters that Shell has the right to dictate under the
18 agreement is the layout of the shop, so that would
19 include the display of the cigarettes in the gantry.

20 **DR SCOTT:** Just two points. One, you mentioned the entire
21 agreement.

22 **MS ROSE:** Yes.

23 **DR SCOTT:** But you have already mentioned the concept of
24 requirements, some being mandatory requirements and some
25 being non-mandatory requirements which appear not to be

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1 rehearsed in the entire agreement, if you see what
2 I mean. That's one point.

3 The other is just to clarify in my own mind, my
4 recollection is that with Imperial, one of the alleged
5 agreements takes place before you start on the RBA --

6 **MS ROSE:** I will come on to the trading agreements
7 themselves.

8 **DR SCOTT:** I am just getting clear in my mind the
9 juxtaposition.

10 **MS ROSE:** The timing goes like this: the beginning of the
11 implementation of the RBA is October 2000, the first ITL
12 agreement is with effect from January 2001, during the
13 transitional period. We will explore that in a moment.
14 That's for one year. There is then a second agreement
15 with ITL with effect from January 2002.

16 The agreement with Gallaher is negotiated in
17 November 2001. So the Gallaher agreement post-dates the
18 full implementation of the RBA. The first ITL agreement
19 occurs during the transitional period.

20 Just so we can get a picture of the way that the RBA
21 was coming in, if we can just take up the notice of
22 appeal, bundle 2 again, there is a useful graphic.

23 **THE CHAIRMAN:** I do not want to stop you in mid-sentence,
24 but I think we need to break if only for five minutes.

25 **MS ROSE:** Yes. I don't know if you are able to sit a little

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1 late.

2 **THE CHAIRMAN:** I know you want to get finished. I think

3 probably we would rather --

4 **MS ROSE:** Can I just say this: in the same bundle that we

5 are in, if you go to page 467, this shows you the

6 transition between the Shell operated sites and the

7 independent retailer operated sites, so that as you can

8 see it starts with a pilot in October 2000. If you

9 look, January 2001, that's the date of the first ITL

10 agreement, and by that time there are 195 independent

11 retailer sites and 438 Shell operated sites. The

12 infringement is taken by the OFT to have commenced in

13 March 2001, and you can see that by that date the

14 majority of the sites are independent retailer operated.

15 There is 328 versus 306.

16 The following month there are twice as many

17 independent retailer sites as Shell sites. By May,

18 three times as many, only a quarter of the sites by this

19 time are Shell operated, and by June, the number of

20 Shell operated sites is de minimis.

21 That's perhaps a convenient moment.

22 **THE CHAIRMAN:** Yes, thanks very much. We will come back at

23 20 to 4 then.

24 (3.30 pm)

25 (A short break)

1 (3.40 pm)

2 **THE CHAIRMAN:** Just a quick word before we restart.

3 Mr Brealey, you may want to be thinking whether there is

4 anything that you can tell us at the end of proceedings

5 today that might be useful homework for us to do which

6 might enable you to shorten things on Monday morning as

7 far as reading authorities is concerned.

8 **MR BREALEY:** I will, thank you.

9 **THE CHAIRMAN:** Yes, Ms Rose.

10 **MS ROSE:** Can I now turn to the particular trading

11 agreements, and first of all to the agreement between

12 Shell and ITL.

13 If we stay in volume 2 notice of appeal bundle, and

14 these tabs are not the easiest, we are behind annex F,

15 page 479, the actual tab is numbered 6 but that doesn't

16 help you much, it's page 479.

17 This is of course trite law that a contract must be

18 construed in its factual context and the factual context

19 in which this contract is being signed is a situation in

20 which the introduction of the RBA, as we have just seen,

21 is already well advanced and is a significant change in

22 the commercial arrangement of Shell.

23 There are three headings on the page. The first

24 point to note is this is a very primitive agreement.

25 It's some way lower down the evolutionary tree than the

1 RBA, and it's clearly a piece of commercial shorthand.

2 That may reflect the relative commercial importance for

3 Shell of this agreement versus the RBA. It also

4 reflects, of course, the way in which it's to be

5 construed, that it's not to be taken as if it were

6 a statute. It's an informal commercial agreement and it

7 looks unlikely that it ever saw a lawyer. Not

8 necessarily a bad thing of course.

9 The first heading is "Prices":

10 "In return for Shell UK setting the selling out

11 prices at company owned sites reflecting ITL products,

12 no worse than the relative RRP compared to other

13 manufacturers' similar products, an annual payment [and

14 there you see the size of the bonus] A detailed list of

15 these requirements is as attached. Copy price lists

16 must be provided. Any errors corrected within two weeks

17 of notification to head office. ITL must be given the

18 opportunity to respond to other manufacturers' price

19 offers but may choose not to respond. At least

20 95 per cent of company owned sites must follow the

21 official Select price policy guidelines."

22 A number of points to make. The first is the

23 minuscule size of the incentive that's being provided to

24 Shell. I do submit that in the context of a company of

25 the scale of Shell, this is a fleabite, it's really of

1 no significance whatsoever. If you therefore just take

2 the agreement on its face, and ask: is this in any sense

3 a significant constraint on Shell's commercial

4 behaviour?, the answer is obviously no. If Shell

5 decides that it's in its interest to set recommended

6 retail prices or even fixed retail prices for those

7 sites still under its control, that it's in its interest

8 to do that at a particular level with different

9 differentials from those which ITL is advancing, it's

10 not going to be deterred from doing that by the anxiety

11 that this huge bonus is going to be forfeit.

12 That, we say, destroys the OFT's case put at its

13 highest, and indeed when you look at the evidence which

14 we are going to hear from the factual witnesses, in

15 particular from Annie Parker, who was the category

16 manager, we will hear from the witnesses that Shell

17 didn't take proposals from ITL or Gallaher as being

18 instructions, they were suggestions, and Shell would

19 consider them, consider other matters such as margins,

20 and decide on the basis of its own interests whether to

21 accept them or not.

22 The second point is that the focus of this agreement

23 is price lists, and by this date the price lists that

24 were being produced were the price files which contained

25 two prices, a recommended retail price and a maximum

1 retail price. What appears to have been the position at
2 this transitional period was that those sites operating
3 under the old arrangement would be expected to sell at
4 the RRP, although even in relation to those sites there
5 was some flexibility about pricing depending on local
6 conditions, but those sites which were already under the
7 RBA were only required to price below the maximum retail
8 price.

9 Then the third paragraph:

10 "At least 95 per cent must follow the official
11 Select price policy guidelines."

12 Of course you have to ask the question: what are the
13 official Select price policy guidelines? They are
14 certainly not defined in this very informal agreement.
15 In my submission, what they are is what I've just said
16 to you, that in relation to sites that are not under the
17 RBA, they mean they are expected to sell at the RRP
18 unless there is a good local reason why not, and in
19 respect of other sites it simply means below the MRP.

20 Then you see the next heading "Range", and this is
21 dealing with planograms and distribution, and I note
22 that it's marked as confidential, so I just ask you to
23 read that. You can see the -- it's still a modest
24 bonus -- relative size of that bonus by comparison with
25 the pricing bonus, which is an indication of the

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1 relative importance from the perspective of ITL of this
2 clause as compared to the first one.

3 So that's the 2001 agreement entered into in the
4 transitional period.

5 The following year there is a second ITL trading
6 agreement, which you will find at the next tab,
7 page 483. By this date, transition to the RBA is
8 complete. If you keep both tabs open for a moment and
9 look at the first sentence you will see an interesting
10 difference. The first one says:

11 "In return for Shell UK setting the selling out
12 prices at company owned sites."

13 The second one says:

14 "In return for Shell UK setting out prices at
15 company owned sites reflecting ITL products" and so
16 forth.

17 Now, I would suggest that what that is reflecting is
18 that by this date, both parties know that Shell doesn't
19 have any power to set the selling out prices at its
20 sites, the only power that it has is to set out prices
21 in the price file in accordance with the price file
22 format.

23 Then you will see the second paragraph now refers to
24 price files, and you will see that the third paragraph,
25 the one referring to 95 per cent of sites, has gone

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1 completely. So we submit that you can see some small
2 but not insignificant amendments made to the price
3 clause which reflect the fact that both parties now
4 understand that there are no more directly Shell owned
5 sites, there are only sites operating under the RBA, and
6 that Shell no longer has the power to set the retail
7 price.

8 We can see how the OFT deals with these two
9 agreements, if you take up the decision and go to
10 page 378, you will see the heading "Trading Agreements
11 Between ITL and Shell".

12 Just one general point, which is that I will be
13 generally referring to the decision of the OFT. The OFT
14 has sought, with great respect to it, to elaborate upon
15 or improve its case in its defence and skeleton
16 argument. Those are of no concern to the Tribunal
17 because the OFT's obligation was to set out its
18 reasoning and make its findings of fact and explain its
19 analysis in its decision, and that's the matter that's
20 under appeal.

21 So we go to paragraph 6.1186. That's another cut
22 and paste paragraph. Then 1187 identifies the two
23 trading agreements.

24 1188 says:

25 "Under the terms of TA1 [that's the first agreement]

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1 and TA2, ITL and Shell agree the following."

2 What you will see there is a misquote, because what
3 you actually have there is a strange hybrid. The first
4 paragraph appears in TA1 but not TA2, and it's the
5 reference to setting the selling out prices which isn't
6 in TA2 at all, and the second, the reference to the
7 price files, is in TA2, not TA1.

8 So that doesn't give one perhaps enormous
9 confidence that the OFT has examined this contract with
10 the precision that the ECJ requires as essential in the
11 Irish Beef case.

12 Then it says:

13 "In addition, TA1 stated at least 95 per cent of
14 company owned sites must follow the official Select
15 price policy guidelines."

16 You will note that there is no consideration at all
17 by the OFT of what that meant in this transitional
18 period, and you will also note that there is a footnote,
19 997:

20 "This provision does not appear in TA2."

21 Again, no consideration on the part of the OFT of
22 the significance of that fact. So we submit that in
23 fact all the significant indicators in these agreements
24 and most particularly in the second agreement
25 demonstrating the parties' mutual understanding of the

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1 limits of Shell's powers to set any retail prices are
 2 simply ignored or not analysed or misunderstood by the
 3 OFT.
 4 Now, the price file that's referred to, just to show
 5 you an example, if we go back to volume 2 of the appeal
 6 bundle, you can see an example at page 523, there are
 7 lots of these, but this is an example from October 2001,
 8 "Shell product master file list for RBA sites". You can
 9 see that you have the barcode product description, Shell
 10 stock code, main group supplier, supplier code, Shell
 11 invoice cost, pack size, and then recommended retail
 12 price and maximum retail price, and that's the standard
 13 format for all the prices. We submit that nobody
 14 reading that could understand that Shell was setting the
 15 retail price. It is clearly not, we would say.
 16 **THE CHAIRMAN:** What's the significance of some of them being
 17 underlined?
 18 **MS ROSE:** That relates to particular matters in the witness
 19 statement to which this relates. We will deal with that
 20 later, but it's not relevant to the point that I am
 21 making.
 22 Now, as a matter of fact, we know what ITL
 23 understood the position to be. If you take up annex 19
 24 to the statement of objections, thereby a number of
 25 internal ITL documents where they summarise their

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1 understanding of the development of Shell's new
 2 commercial structure. The first of these is at document
 3 30. The whole of this is confidential, which makes it
 4 slightly difficult to make submissions on it.
 5 This is page 199, tab 30, you will note the date on
 6 this, this is March 2001. This is the beginning of the
 7 infringement period, in the OFT's decision. You see the
 8 heading "Background", and can I invite you to read the
 9 first paragraph under that heading.
 10 (Pause)
 11 I am told I can read out part of this paragraph.
 12 It's marked non-confidential in Mr Howard's but
 13 confidential in mine.
 14 "The key point is that there is an explanation of
 15 the transitional period. 700 of the sites are company
 16 owned, all traders Select, the remaining 500 are dealer
 17 sites over whom Shell have no control regarding the
 18 shop. Shell directly manage around 300 Select shops.
 19 The balance of the Select sites [so it's already
 20 a majority] are run by self-employed agents who own the
 21 shop stock but are given strong guidance by Shell with
 22 regard prices, range, source of supply and display but
 23 he/she makes the final decision.
 24 "Current agent agreement was introduced in the last
 25 12 months, has given operators a higher share of the

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1 profit, plan is to reduce the managed site numbers
 2 dramatically but the target number is not known."
 3 So as at March 2001 ITL clearly are aware of the
 4 fact that the decision on price is made by the agent not
 5 by Shell, the way they put it is that Shell can give
 6 strong guidance, but they understand that Shell cannot
 7 make the decision, the decision is made by the agent.
 8 So there is simply no belief by ITL that Shell is in
 9 a position to set differentials or parities in relation
 10 to retail prices, they know they can't. They can
 11 suggest it, they can recommend it, but they cannot
 12 impose it.
 13 Then towards the bottom "Target differentials are
 14 achieved on all products most of the time", and then
 15 over the page, you will note under the heading
 16 "Problem", item 2:
 17 "Price differentials not achieved at some agents'
 18 sites, and occasionally errors from head office."
 19 So again an understanding that they can not achieve
 20 the price differentials at some agent sites because
 21 there is no power to impose.
 22 So that's in, as it were, the early days, during the
 23 transitional period.
 24 Then if you go forward, the following year, in the
 25 same file, tab 44 --

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1 **THE CHAIRMAN:** That does seem to assume that the desired
 2 price differentials are somehow being communicated to
 3 the agents.
 4 **MS ROSE:** Yes.
 5 **THE CHAIRMAN:** Which doesn't appear in the price files that
 6 you have shown us or in the RBA.
 7 **MS ROSE:** The price files communicate a recommended price
 8 and a maximum price. The only way that the
 9 differentials or parities are communicated to the agents
 10 is in the sense that the recommended retail price, let's
 11 say if there are two products where there is expected to
 12 be a parity, you would expect the recommended retail
 13 price and the maximum retail price for those products
 14 both to be set at the same level. That's the only way
 15 that it's communicated to the agents by Shell. It's up
 16 to the agent whether they price both at the recommended
 17 price, both at the maximum price, one at maximum, one
 18 below recommended retail, both somewhere in the middle.
 19 They have absolute discretion to do that. All that's
 20 being communicated to them is the parameter, and ITL
 21 understand that.
 22 **DR SCOTT:** And are sending round their staff --
 23 **MS ROSE:** To persuade them to do it. Absolutely, sir, and
 24 we see in the evidence that both ITL and Gallaher
 25 understand that the people they have to talk to are not

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1 Shell, they are the guys running the petrol stations.
 2 So what you see them doing is going round to the
 3 individual sites and trying to persuade people to price
 4 in accordance with their differentials. The reason that
 5 they are doing that is that they know that Shell is not
 6 doing that, has no intention of doing that, and has no
 7 power to do that. There is nothing to stop
 8 a manufacturer seeking to persuade a particular retailer
 9 to sell at a particular price, and more fundamentally of
 10 course that has nothing whatsoever to do with any
 11 infringement on the part of Shell. But the very fact
 12 that they are doing that shows that they understand that
 13 Shell can't do it.
 14 So that's in the transitional period. The following
 15 year, tab 44, so this is January 2002, again this is
 16 marked "confidential" but not in our -- good. So here
 17 we have a description of the situation now, second
 18 paragraph:
 19 "Before 1999, Shell had approximately 715 Select
 20 sites. The latter part of 1999, announced the whole of
 21 the sites to be transferred to Texaco" and so forth.
 22 "Up until two years ago, Select sites were run by
 23 Shell employed managers. However, a new scheme was
 24 introduced that has reduced the number of direct managed
 25 sites to nearly zero."

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1 Actually it was zero by this stage.
 2 "Shell Select sites are now run by self-employed
 3 agents. Agents own all shop stock but are given
 4 guidance ..."
 5 Note the word "strong" has now gone, so ITL now
 6 understand that it's simply guidance.
 7 "... given guidance by Shell with regard to range,
 8 merchandising, pricing and source of supply. Ultimately
 9 the final decision is that of the agent. The RBA is
 10 aimed to provide the agents with a higher share of the
 11 shop profits", and so on.
 12 Then at 209, just below the second holepunch:
 13 "Shell recommends a pricing policy to all Select
 14 sites. The price file consists of a Shell recommended
 15 price and a maximum price for each product. A copy of
 16 the price files provided to ITL. In the main,
 17 differentials between manufacturers' comparable brands
 18 are maintained, however, since the changeover of
 19 category managers some shoulder brands such as
 20 Superkings Lights are showing incorrect differentials."
 21 In my submission, that accurately represents what's
 22 actually going on as between Shell and ITL. What's
 23 happening is that ITL is seeking to persuade Shell to
 24 incorporate its preferred differentials and parities in
 25 the recommended retail price and the maximum price in

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1 the price file, and that's why there is so much
 2 interaction in relation to the price file. But on the
 3 full understanding that all that that price file is is
 4 a recommendation of a pricing policy of guidance that
 5 they put on the previous page which is in no way binding
 6 on the agent.
 7 So they know exactly what the score is. Again, we
 8 submit wholly inconsistent with the OFT's analysis.
 9 **DR SCOTT:** Going back to the requirement applied to
 10 promotions that we discussed earlier on, this is
 11 confidential, but if you go to the bottom of 210,
 12 whereas before what is mentioned in the last complete
 13 sentence on 210 had not been seen as a possibility, now
 14 it does appear to be seen as a possibility,
 15 notwithstanding the change of arrangements without
 16 knowing what it is.
 17 **MS ROSE:** Are you referring to a possible promotion?
 18 **DR SCOTT:** Yes.
 19 **MS ROSE:** As you know, the position under the RBA is that
 20 agents can decide --
 21 **DR SCOTT:** If they want to do it.
 22 **MS ROSE:** -- if they want to participate in a promotion and
 23 if they do, they participate in accordance with its
 24 terms. Again, we say nothing wrong with that. And more
 25 fundamentally not a finding considered by the OFT. The

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1 OFT's case is wholly inconsistent with this document.
 2 Now, what the OFT chose to emphasise in this
 3 document is the sentence that you see just opposite the
 4 first holepunch on 210 under the heading "Strengths".
 5 There are a number of problems with the OFT's case on
 6 that. The first is that it's by no means clear that
 7 that sentence refers to price at all, because, as we
 8 have seen, the main preoccupation of ITL is not price,
 9 it's distribution and display. We also know that under
 10 the RBA, the agents are under an obligation to comply
 11 with instructions in relation to planograms and
 12 distribution. So there is nothing to suggest that that
 13 refers to price at all. If it does refer to price, it's
 14 factually incorrect, and I shall show you the evidence
 15 from Shell's expert witness that shows that in fact,
 16 throughout this period, as you would expect, given the
 17 contractual arrangements, the agents are not pricing at
 18 RRP and are not pricing at the maximum, they are pricing
 19 at a whole range of different prices, and there is not
 20 even very much bunching. So if that is what they were
 21 intending to suggest, it is factually wrong but you
 22 can't tell from this document if that is in fact what it
 23 means.
 24 Over the page at 211 "Objectives", item 6:
 25 "Bring Shell recommended prices in line with ITL

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1 required differentials."
 2 Again we say accurately reflecting ITL's
 3 understanding of the limits of what Shell could do.
 4 Shell had no power to set prices, it could only
 5 recommend.
 6 Then under the heading "Strategy" there is
 7 a proposal, item 5, for a Shell price file that
 8 automatic changes the Shell recommended and maximum
 9 prices once each manufacturer RRP had been altered. Two
 10 points to make about that. First, that strategy was
 11 never implemented, and secondly, even if it had been, it
 12 would only refer to the recommended and maximum prices
 13 and would still not amount to the setting of a retail
 14 price.
 15 So the Tribunal can see the general theme of this,
 16 that we say it does not avail the OFT anything at all to
 17 show that ITL was seeking to persuade Shell to maintain
 18 differentials and parities in the price file. We say
 19 that Shell didn't consider itself under an obligation
 20 automatically to accept the proposals of ITL or Gallaher
 21 in relation to the price file, but whether it did or
 22 didn't is simply irrelevant, because the price file is
 23 nothing more than a recommendation.
 24 Then the final one of these, again the following
 25 year, this is February 2003, this is at tab 57, and

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1 again you see similar text on the first page about the
 2 background and the commercial structure. Then at
 3 page 220, just opposite the first holepunch, there is
 4 a paragraph relating to Annie Parker. There is much
 5 discussion then about planning and so forth. Then at
 6 222:
 7 "Shell recommends a pricing policy to all Select
 8 sites. The price file consists of a Shell recommended
 9 price and a maximum price for each product. A copy of
 10 the price file is provided to ITL. Under the previous
 11 category manager [that's Annie Parker] the price file
 12 was in a state of disrepair with many differentials out
 13 of line."
 14 So it's a clear statement from ITL that Shell was
 15 not complying even in relation to the price file. That,
 16 by the way, strongly suggests that the statement "good
 17 compliance at sites" in the previous document does not
 18 relate to price, because that was in the time of
 19 Annie Parker.
 20 "Under the new category manager and the aid of both
 21 Gallaher and ITL, this has been resolved. In the main,
 22 differentials between manufacturers' comparable brands
 23 are now maintained."
 24 Again just talking about the price file, which is
 25 recognised as a recommendation. So those are the

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1 internal ITL documents.
 2 On the question of actual compliance, there is the
 3 evidence of Mr Latremoliere, this is core bundle 11,
 4 tab 123, {C11/23} and he has done a statistical analysis
 5 of the actual shelf retail prices at Shell sites over
 6 the period of the alleged infringement and compared it
 7 with the parities and differentials set out in relation
 8 to the recommended retail prices and the maximum retail
 9 prices in the price file.
 10 Just to see the summary of his conclusions,
 11 paragraph 7.4, the figures are confidential, but you can
 12 see at 7.4 the figures that he gives for adherence to
 13 the Shell recommended retail price, and the graph, the
 14 table 2 above it, shows you the spread. There is
 15 pricing below recommended price, at recommended price,
 16 between it and the MRP, at the MRP and indeed above the
 17 maximum retail price, which is actually a breach of the
 18 RBA, but it shows that there simply isn't any
 19 compliance, certainly wholly inconsistent with this
 20 document, to suggest that the price file evidences any
 21 intention on the part of Shell to impose or set retail
 22 prices at particular levels.
 23 We see similar statistics at table 3, and at 7.6:
 24 "Comparing table 2 and 3 confirms adherence to the
 25 retail price was higher in 2000 and January and

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1 February 2001 than during the period of the alleged
 2 infringement."
 3 Which is not surprising because the period of the
 4 alleged infringement starts in March 2001, by which date
 5 the majority of the stores have already moved over to
 6 RBA.
 7 **DR SCOTT:** Am I right in saying that this says nothing about
 8 the parities in differentials, this is merely --
 9 **MS ROSE:** It is the retail prices and maxima, you are right,
 10 sir, but of course if you put the OFT's case at its
 11 highest, the highest the OFT's case can be put, and we
 12 say this is factually wrong, would be that in setting
 13 the recommended retail price, the maximum retail prices,
 14 Shell was adhering to the differentials and parities
 15 that ITL and Gallaher were seeking to persuade it to
 16 take on. So if you put the OFT's case as its highest,
 17 this demonstrates no compliance or no significant
 18 compliance, just a range entirely what you would expect,
 19 given Shell's commercial structure.
 20 There is further analysis, we don't need to go to it
 21 in detail but I would invite you to read the statement,
 22 and his conclusion is at 8.2 that the results are not
 23 consistent with Shell's RBA contractors as a group
 24 treating either the recommended price or the maximum
 25 price as fixed prices in the period 1 March 2001 to

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1 15 August 2003.
 2 So that, we say, is the really important evidence
 3 about the relationship between Shell and ITL. What does
 4 the OFT rely on? If we go back to the decision,
 5 paragraph 6.1180 to 1240, these paragraphs set out the
 6 reasoning of the OFT. So we start on page 376. Again
 7 this is entirely formulaic. You will see exactly the
 8 same headings and much of the same text in relation to
 9 all the retailers.
 10 The first is the heading "ITL strategy in relation
 11 to Shell's retail prices". It's difficult to see why
 12 that's relevant to whether Shell was engaged in
 13 an infringement at all, because as we have seen the
 14 question in GlaxoSmithKline is not whether ITL was
 15 intending to infringe competition law, the question is
 16 whether Shell had any intention to do a particular
 17 conduct on the market.
 18 They refer there to ITL documents that they say
 19 demonstrate that ITL's objective was that Shell should
 20 set the retail price for ITL's brands or competitor
 21 brands in accordance with ITL's retail pricing strategy
 22 and that such strategy was communicated to Shell.
 23 Remarkably, the documents they refer to in the
 24 following two paragraphs are the documents we have just
 25 been looking at, the national accounts business

1 development plan. In my submission, it is impossible to
 2 read those documents as indicating that ITL had
 3 a strategy that Shell should set the retail price for
 4 ITL's brands. On the contrary, those documents
 5 recognise that Shell had no power to set the retail
 6 price for ITL's brands and only had the power to
 7 recommend or give guidance. So again we say this is
 8 simply an impossible reading of the relevant documents.
 9 The next heading at 378 is "Trading agreements
 10 between ITL and Shell", and here that's the analysis of
 11 the trading agreement which you have already heard my
 12 submissions on.
 13 I've already made the point that these trading
 14 agreements are both construed completely ignoring the
 15 existence of the RBA.
 16 Then they come on to consider the question of
 17 contact between ITL and Shell regarding retail prices,
 18 that's heading 3 at page 381, and there is a general
 19 assertion -- again this is boilerplate -- that:
 20 "The documents evidencing the contacts between ITL
 21 and Shell demonstrate that, 1 in relation to Shell's
 22 retail prices for ITL's brands, ITL communicated to
 23 Shell what Shell's retail prices should be, or asked or
 24 incentivised Shell to hold or alter Shell's retail
 25 prices and Shell informed ITL about or discussed with

1 ITL Shell's current or proposed retail prices."
 2 You will see identical paragraphs in relation to the
 3 other retailers. They are wholly inapposite to deal
 4 with the relationship between ITL and Shell, because the
 5 communications between ITL and Shell show no such thing.
 6 They do not show ITL communicating to Shell what Shell's
 7 retail prices should be, they show ITL communicating to
 8 Shell what its recommended or maximum retail prices
 9 should be, incentivising Shell to hold or alter Shell's
 10 recommended or maximum retail prices and Shell
 11 discussing with ITL Shell's current or proposed
 12 recommended or maximum retail prices. There is
 13 a complete failure by the OFT to grapple with this
 14 fundamental point.
 15 They deal then with bonuses, you have my submission
 16 on the relevance of the size of the bonus, and then with
 17 monitoring at paragraph 6.1232. This deals with
 18 monitoring of the price file and therefore is irrelevant
 19 for the reasons that I have already given. That's the
 20 totality of the OFT's case in relation to Shell and ITL
 21 and we say it simply fails.
 22 Can I now come on to Gallaher, and there is
 23 a significant overlap so hopefully we will be able to
 24 take it much quicker.
 25 The trading agreement between Shell and Gallaher was

1 not entered into until November 2001, after the RBA was
 2 already fully implemented, so this agreement must be
 3 read in a factual matrix in which Shell has no power to
 4 dictate a retail price, only has the power to require
 5 a maximum retail price, and we submit that it simply
 6 cannot be the case, cannot rationally be asserted, given
 7 the significance of the RBA which we have already
 8 discussed, that Shell in November 2001 was intending to
 9 enter into agreement with Gallaher whereby it would set
 10 retail prices in accordance with Gallaher's
 11 differentials and parities. That is simply
 12 an impossible submission to make about Shell's
 13 intention.
 14 Now, the agreement in question is the notice of
 15 appeal, bundle 2, tab 17. Tab 17 is not going to be
 16 a sufficient reference, given the multiplication of
 17 tabs. I will give you the page number, it's 569. It's
 18 a tab 17, one of a number.
 19 So this is the Shell/Gallaher trading agreement:
 20 "In consideration of Gallaher agreeing to pay the
 21 sums of money referred to below, account agrees to and
 22 shall comply with the following."
 23 The first point to note is this is a pretty
 24 primitive agreement, we have this word here "Account"
 25 which is not defined anywhere, but we take it to refer

1 to Shell. The evidence of Ms Parker, we don't need to
 2 turn it up but it is core bundle 11, tab 118,
 3 paragraph 10.1 {C11/118/10.1} is that she was sent this
 4 by Gallaher and she assumed it was a standard form. She
 5 would appear to have been right about that, because we
 6 also have agreements entered into by Gallaher at much
 7 the same time, with TM Retail and First Quench, which
 8 are in pretty similar form. The First Quench one is in
 9 annex 6, document 21, and the TM Retail one is annex 12,
 10 document 9.

11 So "Pricing":
 12 "Account agrees to maintain the price
 13 differentials/price parities between Gallaher's brands
 14 and their respective competitive brands as set out in
 15 appendix 1 at all times. Gallaher reserves the right to
 16 amend appendix 1 from time to time after consultation
 17 with account."

18 If you look at appendix 1, it identifies some
 19 parities, and then "Differentials", it says:

20 "Benson & Hedges Kingsize, Silk Cut Kingsize and
 21 Camel houses versus Embassy No 1."

22 So it's very, very far from being an adequate
 23 explanation of what on earth is meant here by
 24 maintaining parities and differentials.

25 There is a reason why this agreement may not have

1 been seen as very significant by either party, and it's
 2 the obvious reason, that Gallaher knew perfectly well
 3 that Shell could not impose any price differentials or
 4 parities, and was simply talking about recommended or
 5 maximum prices in the price file.

6 Now, we see that in Gallaher's own response to the
 7 OFT in 2005. This is notice of appeal, volume 1, tab 3.
 8 This is Gallaher's response to questions put to it by
 9 the OFT in the course of the investigation in 2005. You
 10 see that at page 71.

11 If you go to page 90:

12 "Please confirm status of these documents. Please
 13 provide an account of any meetings subsequently
 14 conducted as referred to in the meeting follow-up
 15 email."

16 Gallaher say this:

17 "Document 210035 is a revised appendix 1 and 2 to
 18 the trading agreement sent out for signature and
 19 return."

20 So it's a revised version of the page we just looked
 21 at.

22 "Appendix 1 shows parities and differentials to
 23 reflect current RRP's. Gallaher believes these
 24 appendices were never signed or chased up. It's also
 25 worth noting that Shell does not own the vast majority

1 of its forecourts. Agreement with Shell would not have
 2 bound independent forecourt operators."

3 In fact, Shell is quite correct, because Shell did
 4 own the land, but the point is right that Gallaher knew
 5 perfectly well that Shell couldn't bind the independent
 6 forecourt operators, and that's why this agreement was
 7 not seen as terribly important.

8 We submit that the clause 1(a) reference to price
 9 can only be a reference to the price files, to the
 10 recommended and maximum retail prices; it can't be
 11 a reference to retail pricing, which both parties knew
 12 was simply not on the table.

13 So far as the size of the bonus is concerned, that's
 14 dealt with at clause 4. Before we come to that, you can
 15 see back at page 570 in volume 2 of the appeal bundle,
 16 you can see that there are clauses that deal with
 17 merchandising units and distribution of brands and
 18 packings. We submit it's clear that these are the
 19 clauses that are of real importance to Gallaher. These
 20 are the clauses that deal with planograms and
 21 distribution, and you will note that they refer
 22 specifically to compliance by stores.

23 If you look, for example, at 2(c) -- these are
 24 confidential, so I can't read them out -- you will see
 25 a reference to "in all stores", and if you look at 3(b),

1 again you will see references to a percentage of stores
 2 which will expectedly be compliant by a particular date.

3 So these, unlike the general pricing term, are much
 4 more specific obligations which are intended to be
 5 implemented in stores, and these again are the
 6 provisions which attract the much more substantial
 7 bonuses.

8 The bonus in return for compliance of provision in
 9 paragraph 1, we see the bonus that's paid,
 10 coincidentally it should appears that in the two years
 11 that we are concerned with, the actual amount of bonus
 12 paid to Shell by Gallaher is almost identical to the
 13 amount paid by ITL, even though it's a different formula
 14 it's almost exactly the same figure.

15 So again, the points that I made about the extent to
 16 which this is even a significant constraint on the
 17 recommended prices apply.

18 Then the OFT relies on general condition 5(a):

19 "If any store within the account store group does
 20 not comply with the term or terms of this trading
 21 agreement Gallaher reserves the right to reduce the
 22 payment by an amount it considers is appropriate."

23 They argue that that's evidence this is intended to
 24 impose retail prices on individual stores.

25 We say first of all that cannot be the right

1 interpretation for the reasons I have already given,
 2 that both parties entering into this agreement know that
 3 Shell can't control the retail prices of individual
 4 stores; secondly that the natural interpretation of this
 5 clause in context is that it's actually referring to the
 6 specific obligations in relation to compliance by stores
 7 that apply to merchandising and distribution, where
 8 there are indeed obligations relating to particular
 9 stores.

10 The final point to make is that these terms are
 11 simply standard terms and you will see them repeated
 12 almost verbatim in the First Quench contract in
 13 particular.

14 If we now come to the OFT decision in relation to
 15 Gallaher, it starts at 6.1243 in the decision, it is the
 16 general finding, and you will note that the first date
 17 relied on is 21 August 2001, which is the first document
 18 relied on by the OFT, as we find out from footnote 1030:

19 "An infringing agreement existed between Gallaher
 20 and Shell whereby Gallaher co-ordinated with Shell and
 21 again the setting of Shell's retail prices for tobacco
 22 products."

23 So it's exactly the same format as in relation to
 24 ITL, and we see the same categories and virtually
 25 identical language used.

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1 So Gallaher's strategy in relation to Shell's retail
 2 prices, again we say this is simply irrelevant,
 3 particularly given Gallaher's statement of what it
 4 understood.

5 There is one point to make about that, which is of
 6 course that Gallaher has entered into a settlement
 7 agreement with the OFT. One of the terms of that
 8 settlement agreement was that Gallaher agreed to give
 9 its full co-operation to the OFT in relation to the
 10 OFT's conduct of this appeal. So if the OFT thought
 11 that Gallaher had any evidence to give that qualified or
 12 departed in any way from the answer that Gallaher gave
 13 to the OFT's question in 2005, it was in a position to
 14 call a witness to say that, but it chose not to do so,
 15 and we submit that in that situation it's not open to
 16 the OFT to go behind that material.

17 Then the trading agreement between Gallaher and
 18 Shell, so this starting at 1249 purports to be the OFT's
 19 analysis of the trading agreement.

20 Striking, again, no reference at all to the RBA,
 21 this is simply dealt with in a vacuum.

22 The conclusion at 6.1256, and this is in identical
 23 **terms to the same conclusion in relation to ITL:**

24 "The evidence demonstrates that there was a formal
 25 agreement pursuant to which Shell would set its retail

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1 prices in accordance with the parity and differential
 2 requirements set by Gallaher and that Shell was rewarded
 3 with the payment of a bonus for compliance with
 4 Gallaher's parity and differential price."

5 That's just an impossible construction of that
 6 agreement, given that it was introduced at a time when
 7 both parties knew that Shell had no power to do that.

8 Then contacts between Gallaher and Shell regarding
 9 retail prices. Again my submissions in relation to this
 10 are the same as in relation to ITL, what these show is
 11 Gallaher seeking to persuade Shell to change its price
 12 files, on a couple of occasions Gallaher complaining
 13 about pricing in stores. What they do not show at any
 14 point is Shell suggesting to Gallaher that it had any
 15 power to dictate to stores what they should charge or
 16 attempting to do so at any point.

17 So we have seen that the OFT ignores the RBA in
 18 section 6, which is the place where it should have
 19 considered it when it was considered whether, properly
 20 construed in its factual context, Shell's agreements
 21 with ITL or Gallaher were infringing agreements. It
 22 didn't do that. Instead it purported to address the RBA
 23 in section 7, and we see that at page 525, remarkably,
 24 under the heading "Legal Assessment". What's said at
 25 paragraph 7.1 is:

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1 "This section sets out the OFT's conclusions
 2 concerning the legal assessment of the infringing
 3 agreements described above by reference to the
 4 applicable constituent elements of the chapter 1
 5 prohibition."

6 Of course, the RBA has nothing to do with that, the
 7 RBA is part of the factual context within which the
 8 existence of an infringing agreement ought to have been
 9 analysed.

10 The RBA's addressed, we see the heading "Shell" at
 11 page 529, and starting at 7.18 there is an explanation
 12 of the changeover to the RBA, and Shell's submission is
 13 recorded at 7.22 that it was only able to suggest RRP's,
 14 had no power to dictate them.

15 We see the answer that the OFT has to this over the
 16 page. So Shell maintains at 7.24:

17 "Shell maintain that contractors decided their own
 18 retail prices subject to the maximum price in the RBA,
 19 and stated that it did not require, incentivise or
 20 pressurise contractors to price in line with parity and
 21 differential requirements, nor did it monitor
 22 contractors' prices of core range products, although it
 23 may occasionally have verified whether products were
 24 being sold above the maximum retail price."

25 I would add in practice that there is no evidence at

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1 all to contradict that, nothing whatsoever, not a single
2 piece of paper to contradict that.
3 Then:
4 "Shell also submitted the fact it did not sell
5 tobacco products or have control over contractors'
6 pricing meant no anticompetitive agreement between Shell
7 and the manufacturers was possible."

8 Then they say this:
9 "It is clear from the evidence at section 6(c)7
10 [which is the section we have just been looking at] that
11 Shell entered into an infringing agreement with each of
12 ITL and Gallaher."

13 This is pretty remarkable, because what the OFT is
14 saying here is "We reject Shell's submission that the
15 existence of the RBA means there was no infringing
16 agreement, and the reason we reject that is because we
17 have already found that they did enter into
18 an infringing agreement, but of course they made that
19 finding ignoring the context of the RBA as part of the
20 background of the relationship and particularly the
21 background of the agreements they were considering.

22 So they take as read the very point that they were
23 required to prove taking into account the RBA. Then
24 they say:

25 "It is equally clear that Shell was at all relevant

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1 times in a position to implement those infringing
2 agreements insofar as [please underline those words,
3 insofar as] Shell had the power to specify or negotiate
4 the terms under which the contractors were to operate
5 the Shell owned site, including terms as to the
6 contractor's retail pricing policies."

7 Now, that sentence is very difficult to understand,
8 and it is a sentence which continues to be pivotal in
9 the OFT's case. You will see it reappear in their
10 skeleton argument, which I'll show you in minute. With
11 great respect to the OFT, it is wholly meaningless.
12 What does "insofar as" mean? It must mean that Shell
13 may or may not have been in a position to renegotiate
14 its contracts with individual contractors so as to
15 permit Shell to set retail prices. They are certainly
16 not making a finding that Shell did have the power to do
17 that. They are saying insofar as it did, it could have
18 done. Well, of course it's entirely circular to say "If
19 I had the power to do X, I could have done X", but that
20 doesn't tell you anything useful at all.

21 More profoundly, this statement is commercially
22 bizarre. Shell had just completely rearranged the whole
23 structure of its filling station business in its
24 commercial interests, because it concluded that they
25 were not profitable because they didn't have sufficient

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1 autonomy and they needed to have the flexibility to
2 respond to local conditions. Why on earth would Shell,
3 in that situation, in order to obtain bonuses of the
4 size we have seen, from ITL and Gallaher, have been
5 willing to renegotiate the terms which it had just
6 developed over a period of months and rolled out in
7 a major programme over a period of further months? It's
8 quite extraordinary. And this paragraph, we submit, is
9 absolutely fatal to the OFT's case, it is wholly
10 inadequate.

11 Then they say this:

12 "Indeed, the fact that Shell was able to impose
13 maximum retail prices for tobacco products on the
14 contractors illustrates the scope of Shell to influence
15 the contractors' pricing policies."

16 With all due respect that is a complete
17 non sequitur. The maximum retail price is included in
18 the agreement because Shell has reputational concerns
19 that the individual contractors should not price their
20 goods so high as to damage Shell's brand, and that's
21 made very clear in the RBA itself. You will recall that
22 clause 576 says this is intended to be set so high that
23 it will not interfere with your commercial freedom.

24 To infer from that that Shell could or would have
25 wanted to reimpose the control over retail pricing which

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1 it had just gone to considerable pains to divest itself
2 of is just extraordinary.

3 Then at 7.27:

4 "Further, each manufacturer monitored Shell's
5 compliance with the infringing agreements both centrally
6 at Shell head office and individually at contractor
7 sites."

8 What does that mean? That means two things. First
9 of all, that ITL and Gallaher would communicate with
10 Shell about the price files; and secondly that they
11 would go to sites to try and persuade people to price in
12 accordance with differentials and parities. Again it
13 has nothing whatever to do with any agreement.

14 "In both cases, the evidence would seem to confirm
15 that the infringing agreements related to the retail
16 price of the manufactured products of Shell-owned sites
17 irrespective of whether they are operated by Shell or
18 contractors."

19 Bare assertion, with no evidence to back it up.

20 Then they say this:

21 "As the OFT has found that the infringing agreements
22 between Shell and each of ITL and Gallaher amount to
23 restrictions of competition by object, it's proceeded on
24 the basis that it is not necessary to demonstrate that
25 in relation to the infringing agreements Shell actually

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1 agreed terms as to pricing parities and differentials
 2 with the contractors operating Shell-owned site and
 3 enforced those terms, it's sufficient for the OFT to
 4 demonstrate that the terms of the infringing agreements
 5 between Shell and the manufacturers infringed the Act
 6 and that Shell and the manufacturers were in a position
 7 to implement the infringing agreements."
 8 Again, we submit that that analysis is completely
 9 inadequate, because what it overlooks is that if the
 10 only agreement that Shell had reached with the
 11 manufacturers was to recommend particular prices or to
 12 set a maximum, then that's not an infringing agreement
 13 at all.
 14 Then at 7.28:
 15 "It is perhaps also worth noting that up to
 16 October 2000 all Shell-owned sites were operated by
 17 Shell [true but irrelevant] and that the transfer of the
 18 operation of those sites was not completed until
 19 approximately July 2001."
 20 To which we say so what? Surely the OFT is not
 21 suggesting that it would have made a finding of
 22 an object infringement against Shell on the basis that
 23 a minority of its sites remained under Shell control
 24 between March and June 2001 because we have seen that by
 25 June there were hardly any left under Shell's control.

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1 that cannot seriously be a proposition that the OFT are
 2 advanced, indeed they have never advanced it.
 3 "Furthermore in the period following the transfer
 4 operation of Shell-owned sites, there is some evidence
 5 to suggest that Shell had agreed with Gallaher and ITL
 6 that it would ensure contractors' compliance with parity
 7 and differential requirements and/or that there was some
 8 expectation from the manufacturers Shell would do so and
 9 Shell received payments from the manufacturers for doing
 10 so."
 11 We submit that is simply contrary to the evidence
 12 that we have looked at.
 13 That is it, that is the totality of the OFT's
 14 reasoning in relation to Shell's business and the impact
 15 of the RBA. We submit it is obviously and fundamentally
 16 flawed.
 17 Now, I want to look at the way it's dealt with also
 18 in the skeleton argument.
 19 **THE CHAIRMAN:** Can I just pause a moment there to find out
 20 how much longer you --
 21 **MS ROSE:** I am very nearly finished.
 22 If we can just go to the OFT's skeleton argument,
 23 it's core bundle 4, tab 1, page 124, {C1/1/124} it
 24 starts at paragraph 440:
 25 "The OFT denies that clause 5.6 of the RBA sets out

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1 the limits of Shell's power in relation to the fixing or
 2 determination of retail prices. The evidence set out in
 3 the decision and below shows that (a) Shell entered into
 4 an infringing agreement with each of the manufacturers,
 5 (b) each infringing agreement related to retail price of
 6 the relevant manufacturers' products on Shell-owned
 7 sites and (c) each manufacturer monitored Shell's
 8 compliance with the infringing agreement."
 9 Again, a bootstraps argument because, having decided
 10 without regard to the existence of the RBA that there is
 11 an infringing agreement, they then rely on the existence
 12 of the infringing agreement to conclude that the terms
 13 of the RBA do not accurately reflect the scope of
 14 Shell's powers to set prices. Simply the reasoning is
 15 entirely the wrong way round. What is the basis for the
 16 bare denial at the beginning of 440 that clause 5.6 does
 17 not set out the limits of Shell's power in relation to
 18 fixing or determination of retail prices? The three
 19 subparagraphs (a), (b) and (c) are irrelevant to that
 20 question.
 21 There is no suggestion by the OFT anywhere that the
 22 RBA is a sham. That would be a remarkable suggestion,
 23 given its commercial significance for Shell, and there
 24 is no evidence identified by the OFT suggesting that
 25 notwithstanding one of submissions in clear and

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1 unequivocal terms of the RBA, including its entire
 2 agreement clause, that there is some other power that
 3 Shell would be able to exercise to set retail prices.
 4 441:
 5 "The evidence also demonstrates that at all relevant
 6 times, Shell was in a position to implement the
 7 infringing agreement insofar as [and here it is again,
 8 here is the same formula] Shell had the power to specify
 9 or negotiate the terms under which contractors were to
 10 operate the Shell-owned sites."
 11 It's exactly the same formula repeated. It made no
 12 sense when it appeared in section 7 of the OFT's
 13 decision, and with great respect to my learned friends
 14 it makes no more sense now.
 15 Trying to understand it, what they seem to be
 16 suggesting is even if Shell didn't have the power to set
 17 retail prices under the RBA, it could have renegotiated
 18 the RBA to give itself that power, and that in some way
 19 makes this an infringing agreement. So the proposition
 20 seems to be, if you are in a situation where you are not
 21 in a position to engage in conduct that has an adverse
 22 effect on competition, the fact that you might be able
 23 to negotiate an agreement in the future that would
 24 permit you to do it is enough for an object
 25 infringement. I am afraid I just don't understand that

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1 reasoning process.
 2 442:
 3 "Shell argues that it could not have entered into
 4 trading agreements with the manufacturers with the
 5 intention or purpose to set retail prices in accordance
 6 with the manufacturers' parity and fixed differential
 7 requirements as this would have been contrary to the
 8 terms of the RBA. Nevertheless the evidence showed
 9 Shell did in fact enter into such agreements".
 10 Again the cart before the horse argument begging the
 11 question.
 12 "The evidence does not show Shell intended to comply
 13 with the RBA rather than the trading agreements. On the
 14 contrary, the evidence shows that Shell acted on the
 15 terms of the trading agreements."
 16 I stress there is simply no evidence at all that
 17 Shell ever sought to impose retail prices or
 18 relativities or parities on any of its contractors.
 19 Then there is the point made that the manufacturers
 20 were aware of the terms of the RBA and all they say is
 21 that despite any knowledge the manufacturers may have
 22 had, they still expected Shell to set the retail prices
 23 in accordance with their parity and differential price.
 24 Contrary to the evidence you have seen the internal
 25 documents for ITL which demonstrate that that's simply

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1 wrong and you have also seen the Gallaher response to
 2 the OFT which again shows that that is wrong.
 3 That, again, is the entirety of the OFT's reasoning
 4 in relation to RBA and we submit it does not hold up.
 5 Now, I wanted to say something about ground 1 but
 6 I am now very short of time. Can I simply make the
 7 following points very briefly: first, that we maintain
 8 all of the arguments set out in our skeleton argument;
 9 secondly, that the essence of our submission in relation
 10 to ground 1 is that the action taken against Shell by
 11 the OFT amounts to an abuse of process because it was
 12 unfair and discriminatory and contrary to the OFT's own
 13 policy.
 14 The OFT itself, in its decision -- it's
 15 paragraphs 2.100 to 101 -- set out a clear policy that
 16 it would only proceed against companies that had at
 17 least a 1 per cent market share. We make two
 18 complaints, firstly that the setting of that policy in
 19 itself had a discriminatory and disproportionate impact
 20 on Shell because, on the OFT's logic, only Shell and
 21 Esso had slightly above the 1 per cent, the OFT decided
 22 that Shell had a 1.11 per cent market share, and the OFT
 23 then decided not to proceed against Esso, so Shell found
 24 itself the only petrol retailer to be accused and then
 25 found guilty of participation in unlawful conduct with

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1 reputational potentially financial implications for it,
 2 and we submit that that in itself is a factor that the
 3 OFT ought to have taken into account when it set its
 4 policy, its discriminatory impact.
 5 Secondly, we submit that in any event it breached
 6 its own policy because Shell could not be shown to have
 7 more than a 1 per cent market share and that's the
 8 expert evidence of Mr Heard. I will take up the detail
 9 of those points in my closing submissions because
 10 I don't have time to deal with that now.
 11 Unless there is any other matter on which I can
 12 assist the Tribunal, those are the opening submissions
 13 on behalf of Shell.
 14 **THE CHAIRMAN:** Thank you very much. Speedy though it was,
 15 it was also very helpful. So thank you for that. We
 16 will take on board the points that you make in relation
 17 to ground 1, and certainly you won't be disadvantaged by
 18 the fact that you were only able to refer in brief to
 19 those.
 20 So tomorrow we will have a chance to reflect on
 21 what's happened so far, and Mr Brealey, do you have
 22 anything that you can usefully give us to do over
 23 the ...
 24 **MR BREALEY:** What I can do, madam, is give the Tribunal, and
 25 then I'll give the other parties a copy, of basically

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1 the opening submissions, in a speaking note, so at least
 2 the Tribunal will know the cases I was going to refer
 3 to, where I was going and why I was saying it. It's not
 4 a kind of ready made document, it is something that was
 5 a speaking note, but I think it will shorten things,
 6 that's the good news, the bad news is it will give you
 7 three days to ask me some tricky questions, but I think
 8 it will shorten it on Monday morning.
 9 **THE CHAIRMAN:** You can distribute that in due course in the
 10 usual way. Thank you very much everywhere. I think we
 11 are meeting, some of us, at 10 o'clock Monday morning.
 12 Is that right? Then on the Tuesday I think we are
 13 meeting at 10.30. Thank you.
 14 (4.53 pm)
 15 (The court adjourned until 10.00 am on
 16 Monday, 26 September 2011)
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