This Transcript has not been proof read or corrected. It is a working tool for the Tribunal for use in preparing its judgment. It will be placed on the Tribunal Website for readers to see how matters were conducted at the public hearing of these proceedings and is not to be relied on or cited in the context of any other proceedings. The Tribunal's judgment in this matter will be the final and definitive record.

IN THE COMPETITION APPEAL TRIBUNAL

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

Victoria House,
Bloomsbury Place,
London WC1A 2EB

28 September 2011

Before:

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

Sitting as a Tribunal in England and Wales

BETWEEN:

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

CO-OPERATIVE GROUP LIMITED

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

WM MORRISON SUPERMARKET PLC

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

(1) SAFEWAY STORES LIMITED
(2) SAFEWAY LIMITED

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

HEARING (DAY 5)

Note: Excisions in this transcript marked "[…][C]" relate to passages excluded.

APPEARANCES

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

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

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

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

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

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

______

Wednesday, 28 September 2011

(10.00 am)

THE CHAIRMAN: Before you start, Mr Lasok, I have been asked by our technical people to draw your attention to the fact that the wifi service out in the main area behind the court is rather overloaded, I gather, and that is interfering with the LiveNote feed. No doubt everyone in the room has at least one electronic gizmo which is sending and receiving information the whole time, and this is causing problems. So rather than just close down the wifi connection, can I ask you, let's experiment today, if people can substantially reduce their usage of it during the course of the day, and if we are able to do that, then we will be able to keep the connection going. But if we can't reduce the usage of it, then we may have to close down the wifi link out there. So could everybody bear that in mind, please.

Opening submissions by MR LASOK (continued)

MR LASOK: Madam, I wonder whether the Tribunal could turn to the June 2000 ITL/Morrison agreement, which is in annex 17 at tab 4. {D17/4} I am not going to go through every single one of these trading agreements, but I am going to pick on at this instance, at any rate, two: This one and the Somerfield agreement, this one partly because submissions have already been made about it.

If you look at the second page, which I think the relevant bits are not confidential, under the heading "Pricing" we see that ITL agrees to "maintain levels of off-invoice bonuses provided ITL prices are in line with our current strategy", and that takes you to appendix 2 which sets out the strategy of parities and specified differentials.

You will observe that the provision that we are looking at is not concerned with whether the price is, as it were, determined or affected by a decision made by the retailer acting autonomously or the retailer acting in response to, for example, an egging on by Gallaher or indeed ITL.

The point is that whoever is suggesting that the retailer should price one of the brands listed in appendix 2, the idea is that Morrisons should maintain the ITL price in accordance with the current strategy.

Then after the sentence referring to Regal and John Player, you have notice that if the pricing strategy changes, Morrisons would be notified and a new pricing would take effect.

Then you have Morrisons to confirm instore promotional activities which may affect pricing strategy, and that again related to any kind of instore promotional activities, whether it was a Morrisons own

initiative or whether it was somebody else's initiative, but you will see that we have an opportunity to respond clause in the next sentence, in the form:

"ITL agree to maintain bonus levels in line with appendix 1, should we elect not to respond to other manufacturers' pricing initiatives."

So the opportunity to respond clause operated only where the promotional activity was the initiative of another manufacturer.

So, if you like, the get-out applied only if Morrison was implementing a Gallaher promotional initiative. If Morrison was initiating an own initiative promotional activity, the opportunity to respond clause didn't apply, and that meant that Morrisons remained committed to pricing the ITL brands in accordance with appendix 2.

So what that meant was that, if Morrisons decided to do a promotion on one of the Gallaher brands that is mentioned in appendix 2, it had to treat the linked ITL brand as indicated in appendix 2.

So if we were talking, for example, about the first group of linked brands in appendix 2, if Morrisons decided to do a promotional activity in relation to one of the Gallaher brands, it would have to treat the ITL linked brand in exactly the same way. It couldn't turn

round to ITL and rely on the opportunity to respond clause, thus throwing the burden on ITL to decide how the ITL brand price ought to be determined.

Now, this, of course, I fully accept, is in the context of the first sentence under the heading "Pricing" where we have the agreement "to maintain levels of off-invoice bonuses provided ITL prices are in line with our current strategy".

But the point here is that Morrisons did go along with this, that's to say they agreed to operate the ITL pricing strategy, and if one wanted confirmation of that, you could actually get it from the later ITL/Morrisons trading agreement which is in the same annex at tab 85.

Because on the second page of tab 85, under the heading "Pricing" and I think this is again not confidential, it says:

"Morrison agree to continue supporting Imperial Tobacco's pricing strategy."

Then there is a reference to two fundamental criteria of ITL's strategy which included an achievement of the natural price list differentials that exist between the manufacturers. In the next line, you have another relevant reference, the phrase "The continued achievement of those differentials".

So the point here simply is that there was a clear commitment by Morrison to subscribe to the ITL pricing strategy, exemplified in the strategic pricing requirements that, in the ITL documents, we find as pages attached to the agreements which are sometimes updated from time to time.

So there is a commitment by Morrisons in relation to its own initiative pricing decisions to subscribe to the ITL P&Ds and textually the same applied should there be a Gallaher initiative, because Morrisons was committed to replicating, achieving the ITL pricing strategy based on P&Ds, even if it was a Gallaher initiative, and the only get-out clause that it had was in the event that Gallaher reduced the prices because that triggered the opportunity to respond clause.

So what I would now like to do is to turn to another example of one of these agreements. The Morrisons agreement that we have just looked at in 2000 had, in the appendix 2, the parity and the specified differential, but I want to turn to look at the Somerfield agreement, which was drafted in a slightly different way, because I want to illustrate how that agreement was actually construed and applied in practice as between ITL and Somerfield, because one of the points that we have been making is that, since the trading

agreements form part of a wider evidential matrix, one has to look at the practical implementation of these arrangements, and one can't simply limit oneself to construing the terms of an agreement, particularly where, as we say, even if the agreement was expressed in terms of maxima, it was understood and applied in terms of fixed parities and differentials.

One of the reasons for saying that is actually it arises out of a comment made by Mr Good in his first witness statement, this is the one at -- I am not going to ask you to turn to it now -- core bundle 3 at tab 36, {C3/36} and it's in paragraphs 18 and the third sentence of paragraph 19, because he talks about price targets, so these P&D requirements in the schedules were, in his view, relative price targets, and his comment is that they were complied with. Where they weren't complied with, he says, by the retailers, he says it was "usually through poor shelf price controls". So it seems that his understanding of how these things actually operated was slightly different from the way that it's been presented by ITL and in fact that approach is supported by the position of Somerfield.

Now, if you go to annex 20/18, tab 18. {D20/18} The reason for going to tab 18 is because we have here, dated 14 May 2001, an updated summary of the pricing

positions for the ITL brands, and you have in the third paragraph, it's the one in the middle of the page, an opportunity to respond clause -- I say "clause", this is a letter confirming certain points, so it has the ring of a contractual document. After that paragraph, you have another one that says:

"When no additional price reductions are being funded by another manufacturer, selling prices should be in line with the strategic pricing requirements and payments will be based on store adherence to this."

So that again shows the point that I was earlier making in relation to Morrisons, that the way this operated was that the retailer, when they accepted this kind of arrangement, which is we say what they did, they ended up committing themselves without qualification to the P&D requirements of the manufacturer, and the only get-out clause was in relation to a rival manufacturer initiated price change, which involved a reduction, triggering an opportunity to respond clause. But in all other respects, the arrangements were such that the retailer was committed to the P&D requirement.

This particular document has got the strategy pricing requirements on page 3, and if you look right at the bottom, you will see that Drum was to be no more expensive than Amber Leaf. It's the two items at the

bottom of the page.

Now, the contention advanced by ITL, and I think also by others, is that when you have that kind of phraseology, what you are talking about is the setting of a ceiling, and there was nothing to prevent the retailer from pricing below the ceiling, so that Drum could be priced anywhere below Amber Leaf, the idea was it should not be priced anywhere above Amber Leaf.

Now, later on, there was an agreement which was signed by Somerfield in September, and which is at tab 20, and this agreement -- if you go to tab 20, you can see that it was for the calendar year 2001, you have the dates on which it was signed, and it's one of those documents which was signed on different dates, it appears to have been signed on behalf of ITL in February 2001 and signed on behalf of Somerfield in September.

If you go to the fourth page, you have the requirements and rewards for 2001, this relates to the Somerfield stores themselves and the requirement was that:

"The ITL brands at strategy pricing in a minimum of [X] of Somerfield stores."

If you move a couple of pages further on, you see the parallel agreement which was for the Kwik Save stores.

One thing I have been reminded, I am rather obsessed by these confidentiality boxes, but I think that in my document I have page numbering in the bottom right-hand corner, if you go to page 33, you have the document which is headed "Somerfield Group TDP", that's the Trade Development Programme, I think, "2001 Payment Scale", and if you just look under the heading "Somerfield", the first group of figures are "Pricing Strategy", and you see that there were percentage figures so that they had to hit accuracy as to those percentage figures in order to get the amounts specified.

Then we have a similar situation so far as the Kwik Save stores are concerned. The Kwik Save part of the agreements starts -- I have another page 33, so I think the page numbering, the printed page numbering is completely misleading. It's the next page after the one containing the payment scale, and about three pages further on from that, we have a similar provision under the heading "Requirements and Rewards for 2001" with the ITL brands at strategy pricing in a minimum percentage of Kwik Save stores.

We don't have a pricing requirement schedule setting out parities and differentials attached to this agreement. The more important thing is that we have already seen in the document at tab 18 what the May

required pricing position was, and that was, as I have said, that Drum was to be no more expensive than Amber Leaf.

If you go to 20, tab 19, a little bit before this, I think 29(b) confirms that the strategic pricing requirements were actually the same as in May.

Going back to 19, we see here, this is an internal ITL document about the Somerfield/Kwik Save Drum pricing, it dates to August 2001, and what is reported is that ITL had been advised that Amber Leaf would be moving up in price in the Somerfield and Kwik Save stores from 15 August, and there was an internal ITL instruction to prepare a new price file for Somerfield that showed prices for Drum matching Amber Leaf.

Now, so just pausing there for a minute, ITL's understanding of the arrangement was not that Drum should be priced no higher than Amber Leaf, ITL's understanding was that Drum should be priced at the same level as Amber Leaf. This of course is an internal ITL document. But when one looks at what happened as between ITL and Somerfield, and in the documentation that we have, we have to wait until October before we can pick up the trail of this. We get it in tab 23.

DR SCOTT: Sorry, Mr Lasok, I am a little confused by tab 29B, which appears to reflect the position in

January 2002, outside the period of the agreement.

You said that 29B confirmed ...

MR LASOK: No, the point that I was seeking to make was that the differential hadn't changed. The only documents that we have that identify what the strategic pricing requirement was, which was before and after, all say that Drum is to be no more than Amber Leaf. And of course the contention is that phraseology of that nature made it free to the retailer to price below the linked brand. It's asserted that there were no fixed parities, and here we have a situation in which ITL seeks to achieve a fixed parity, that's the internal ITL document in August.

When we come to tab 23, we are now in October, and you see that what had happened was that ITL's merchandisers had visited various Kwik Save stores, and they had observed that there was a difference in the price of Drum and Amber Leaf, and in the penultimate paragraph of that email, which is an email from --

THE CHAIRMAN: Which tab are you at now?

MR LASOK: Sorry, this is 23. In the penultimate paragraph, which is by the first holepunch, ITL says:

"We would like to have Drum at the same price as Amber Leaf, whatever that is, for each packing in each fascia."

The reference to fascia appears to be a reference to the Somerfield group of stores on the one hand and the Kwik Save group of stores on the other. ITL asks Somerfield to investigate and clarify the position. Then if you go to the next tab, 24, we are in November now.

THE CHAIRMAN: Wait one minute. (Pause). Yes.

MR LASOK: If you go to tab 24, this is ITL to Somerfield, and under the first heading, which is "Pricing", ITL acknowledges Somerfield's adjusting a number of prices in response to an email of 15 October. Now, we have in the bundle two 15 October emails which are the ones at tabs 21 and 22, but I just mention that for the sake of the cross-reference, and the writer of the email says that there were a number of problems, and he says:

"That it would be appreciated if you could correct."

There is then a reference to a visit to a particular Somerfield store, which wasn't pricing Amber Leaf and Drum at the same level, because Amber Leaf was at, and I think this figure is not confidential, £2.18, while Drum was priced at £2.12.

So if you just pause there for a minute, so far as the evidence indicates, Somerfield was compliant with the agreement with ITL because the agreement on ITL's interpretation allowed Somerfield to price below

Amber Leaf, because the restriction was on it going above Amber Leaf.

But the writer, in this paragraph, says in the second line:

"If Amber Leaf has increased in price, as it appears to have done, then ITL would wish to increase the price of Drum to match Amber Leaf and achieve parity pricing. Please advise your intentions."

The same applies to the Kwik Save store mentioned under the next heading, in the middle of the page, in the paragraph beginning "Once again Amber Leaf", you have the sentence:

"Once again, it would be appreciated if the price of Drum could be increased to achieve parity pricing with Amber Leaf."

Then you have another reference to Drum 12.5 grams, whereas previously we have been looking at Drum 25 and 50, and it says:

"Please increase the price to achieve a minus 10 pence differential between Golden Virginia [which is an ITL brand] 12.5."

Then there is a further reference to Panama multipacks and the Small Classic Filters that concerned price reductions, but again the object here is to ensure that the ITL brand is priced by reference to the parity

and differential.

So far as we know, what then happened was that we get the communications in tab 25, and this appears to be, I think, an internal communication within ITL in which one arm of ITL is keeping the other in the picture. It reports apparently a conversation that took place on 6 November with Steve Clarke of Somerfield, and under the heading "Pricing" it says:

"Steve has reassured me that effective install Wednesday next week, the following price changes will be effective."

Then there is a reference to Amber Leaf and Drum. Now, here what is said is:

"The price of Amber Leaf is to be reduced to achieve parity pricing with Drum pack size for pack size. According to Steve the reduction is as a result of Gallaher pricing activity during October."

There is then a further reference to Steve wishing to increase Drum to match Amber Leaf at 8.29. But what I would like to do for a moment is to focus on what we derive from this sequence of documents, because what has been going on is that, according to ITL's interpretation of the trading agreements and these P&D arrangements, Somerfield has been acting perfectly properly and in accordance with what ITL says is the P&D requirement

because they contend that the P&D requirement is a maximum. But what we actually see is in effect ITL complaining to Somerfield that in particular stores they have spotted that, horror of horrors, Somerfield is actually complying with its agreement as written, because Somerfield is pricing Drum below Amber Leaf, and that is not what ITL wants. ITL wants parity. And actually, ITL doesn't mind whether the parity means going up or going down, as long as there is parity. That, you may remember, is the earlier email where ITL says "What we want is the same price, whatever it is".

Now, in the event, what happened was that instead of Drum going up, Amber Leaf came down as a result of a Gallaher price initiative and what we actually seem to see here is the operation of one part of these arrangements which is Somerfield accepting that it doesn't matter who among the manufacturers is initiating the price change, the critical question is its commitment to securing parity in this particular case.

So it doesn't matter who is making the move, the critical question is: are the two linked brands being priced in accordance with an interpretation of the arrangements that does not permit their application as maximum prices?

The Tribunal may think that this corroborates

Mr Good's evidence that these strategic pricing requirements were targets, and targets are supposed to be hit.

His view, as I repeat, seems to be that they were not hit, only when you had poor shelf price controls.

Now, what I would like to do now is to turn, if I can, to -- I am sorry.

DR SCOTT: Sorry, before we leave this annex, I am still confused about 29B in which I don't find a reference to either Amber Leaf or Drum --

MR LASOK: There is a 29(b) --

DR SCOTT: -- let alone to a general pricing strategy.

MR LASOK: It's (b). There is a 29(b).

DR SCOTT: Oh, so 29(b) rather than 29B.

MR LASOK: I am however relying upon my junior for this, so if anything goes wrong on that, I will stand aside and let the ire of the Tribunal fall on him.

DR SCOTT: My thing had flipped over, so I only had one 29B visible and that was 29B, not 29(b).

THE CHAIRMAN: Just looking back at tab 19 for a moment, there Imperial seems to have got wind of the fact that Amber Leaf is going up, as the subsequent tabs seem to indicate it indeed did. When it says "Prepare a new price file showing the following prices which match Amber Leaf and bonuses", what was the purpose of preparing a new price file in that circumstance?

MR LASOK: Well, certainly in other cases the price file is compiled by the manufacturer in order to assist the retailer, because it gives the retailer all the figures in a row, including the selling price, so that the retailer doesn't have to do its own calculations, and in this particular instance, what they wanted to do, among other things, was to correct the bonus that they were going to pay to Somerfield. This supposes that you have to price movement in accordance with their desire to match Amber Leaf.

It's right to point out --

THE CHAIRMAN: So that's SP, selling price, that is the retail price or the wholesale price?

MR LASOK: I interpret that as the selling price. It's the retail price, yes.

THE CHAIRMAN: The retail price.

MR LASOK: And it's right to point out that in the correspondence we have just seen the focus is on the shelf price, the actual retail price.

THE CHAIRMAN: Yes, thank you.

MR LASOK: What I would like to do now is to turn to the situation of Morrison. Perhaps before I do that, I ought to mention that this episode that we have just seen, where the Somerfield/ITL trading agreement is

actually understood by ITL and applied on the basis that the parity between Drum and Amber Leaf was not a maximum figure, it was a fixed amount. This corroborates the view taken by Somerfield I think it's the response to -- it's an amended response to the OFT, in which effectively they admitted that even though the agreements, when you read them, looked as though they referred only to maximum prices, after they had had discussions with their buyers, they concluded that they had been applied as fixed prices. I think the reference to that, I can perhaps just give it to you rather than go to the document, is the Somerfield supplementary statement, which is in annex 20 at tab 83 the cross-references in that document are to paragraphs 2.3, 2.4, 2.6, 2.7, 2.12 and 2.14. This is the bit where Somerfield points out the operation in practice of the strategic pricing requirements, and they had reached that conclusion as the supplementary statement shows, after they had carried out internal investigations.

So it goes to the point that the Somerfield supplementary statement is credible because it's corroborated by documents of the sort that we have just seen.

MR HOWARD: Can I make a point? You will be aware of the fact that there are no Somerfield witnesses coming

forward, and at the appropriate time we will explain why we say it's just not open to the OFT to say Somerfield have said this in a document when they have chosen not to call anybody and put in a proper witness statement let alone tender a witness for cross-examination.

MR LASOK: And I would simply make the point that ITL themselves rely on Somerfield's statements, so it looks as though they think they can do so, but funnily enough the OFT can't. How very strange, but there we are, it's part of life's rich pattern.

MR HOWARD: I will respond to that by saying none of the Somerfield material is admissible for anybody, therefore none of it should be in the bundles. It's the OFT of course who are responsible for the decision, they are responsible for supporting it with evidence, and cheap forensic points like that don't amount to an answer to the point that there is no evidence from Somerfield.

MR LASOK: I do not want to get into a diatribe about this. The fact is that ITL open the door on this one, they themselves rely on Somerfield. It's also true to say that --

THE CHAIRMAN: Let's just hold it there for a moment. If there is going to be a dispute about the admissibility of some of the material on which anybody wants to rely, then that has to be dealt with in an organised manner,

and not by this interchange in the middle of opening. So perhaps you could discuss amongst you whether there is a dispute, and if there is, then it may be something on which we may need to rule in due course.

MR LASOK: I am much obliged.

So turning now to Morrison, by way of introduction, so far as Morrison is concerned, in early 2000, ITL and Gallaher had adopted a policy of parity between Mayfair and Richmond, and I'll just give the Tribunal references to documents that indicate that without going through those documents. The documents are annex 3, tab 1, and annex 17, tab 4.

Now, at some stage in the course of 2000 that changed, and ITL repositioned the Richmond brand by changing to a parity with Dorchester, and Gallaher did the same. In addition to that, as I pointed out yesterday, there was a policy position that both Gallaher and ITL adopted of maintaining a 5 pence differential between Richmond and Sterling.

In the course of 2001 and 2002 -- and I am just going to say what happened and without going to the documents, because to do so would take an awful long time -- what happened was that there were various changes in prices for Richmond, Dorchester and Sterling, and throughout the period the actual shelf prices, so far as one can see from the documentation, maintained consistently the parity between Richmond and Dorchester and the 5 pence difference between Richmond and Sterling.

At some point, it seems to have been about August/September 2002, there was a period in which Sterling changed to a 10 pence difference between itself and Richmond, it's not entirely clear from the documents exactly how long this period lasted, and then it reverted to 5 pence.

This process can be seen if one goes through the annexes relating to Morrison, which are annexes 7 and 17, and if you just -- when you go through the documents -- look at the references to Richmond and Dorchester. But because I would prefer not to do this, because it involves going through a number of the documents, I can give you a list of the references, and it might be useful if I did that.

So we can take it, let's say 7/12 and 17/50 show the price of Sterling in November 2001, and the two documents are separated by a few days, and Richmond was priced 5 pence higher.

Then you get 7/14 and 17/56 which date to the change that took place as from 4 March 2002. You get 3.12 and 17/57, which relate to what was happening in April 2002.

17/57 is one of the documents that shows that Morrison had carried out the earlier price change to Richmond. Then we get to a sequence, and I will have to look at a couple of these documents, marked by 7/19, 7/15 and 17/58, and these relate to what occurred in late May and June 2002.

What effectively happened was that Gallaher altered its RRPs but instructed retailers -- so it wasn't just Morrison that sent round-robins round -- to hold their shelf prices for certain brands which included Dorchester and Sterling. ITL responded by ensuring that there was no change in the ITL price. I'll explain why ITL thought that it had to do that. That's the document at 17/58, I think.

Then what happened was that, after we had gone through this episode in June 2002, things appear to have settled down a bit, because we then get the ITL movement upwards, it's the 10 pence increase in Richmond and Dorchester that I mentioned yesterday, and there the documents are 17/63, which was corrected by 17/64. There is a Gallaher internal document, 3.12 which indicates Gallaher's position. I think the next one after 17/64 is 4.8 -- I think it's actually 3.12, 4.8, but you can also look at 4.7 and 3.12 and I think that probably means that we only need to complete the

sequence if you look at 17/67 which is the September 2002 draft ITL/Morrison trading agreement which set out what was then a strategic pricing requirement which involved a parity between Richmond and Dorchester and the 5 pence differential between Richmond and Sterling.

Then you have another price increase which is evidenced by document 7/18. Then you get 17/68, which is an ITL similar one, and that leads on to the overall 10 pence increase in a period of, I think, about two months or slightly less, because the increases, although the signal was given or the instruction was given to increase the prices, the prices were to take effect after a period of time had elapsed, and there was one point at which it seems that ITL moved the date of one of the changes from 14 October to 23rd.

Now, in this sequence, when you look at it, you see a situation in which, on the basis of these documents, Morrison is making the alterations in its prices and keeping to the parity and differential requirements that had been set in the example that we are taking by both ITL and Gallaher because the requirements were symmetrical.

One can put it like this: Morrison is slavishly following the P&D requirements. As an actor in the

market, Morrison is effectively invisible. It's there as an instrument through which the manufacturers achieve on the shelves the parity and the differential that they were seeking, the parity between Richmond and Dorchester and the differential between Richmond and Sterling.

As I've said, the overall policy was that the Sterling/Richmond differential should be 5 pence, but during this period in the sort of the August/September/October bit, there is a point of several weeks in which the difference is 10 pence, and that is actually marked by another draft ITL/Morrison trading agreement which changes the differential from 5 to 10, and then they revert back to 5.

It's not entirely clear from the documents why Sterling moved from a 5 pence to a 10 pence differential. There is a suggestion in one document, which is document 4 -- it's annex 4, exhibit 8, {D4/8} that this may have been due to the presence of price marked packs at the time. But it doesn't really matter. The main thing is that what you are seeing is Morrison slavishly following the parities and differentials.

The point can be made -- and is made inter alia by ITL -- that when you look at this, this is all unilateral, because what you see is a series of instructions going from one manufacturer or another to

Morrison. But in our submission, when you look at the context of all this, it's within the context of a trading agreement that specifies adherence to the manufacturer's pricing strategy, it's all done consistently with the strategy notified to the retailer, and it's effectively a continuous course of conduct. These are not one-offs, they are not isolated incidents, it's a situation in which you see the working out of the arrangement between each of the manufacturers and the retailer, here Morrison, the purpose of the arrangement being to secure price movements that, whether in absolute terms the figures go up or down doesn't really matter, the point is the interest is to maintain the pre-fixed parity or differential. And Morrison never steps out of line so far as the evidence indicates.

Before I pass to Asda, I said I wanted to refer to one of these documents. That is 17/58. {D17/58} Now, 17/58 is a letter from ITL to Morrison dated 11 June 2002, and if you go to just below the first holepunch you will see that there is a passage that says:

"As you are already aware, one of our competitors has already announced a price increase effective June 25, 2002."

That was the Gallaher MPI. Then the writer says:

"This means that the differentials that exist naturally between our brands and our competitors will widen. This means I would expect to see the following example disparities from June 25th or from the date you implement our competitors' price increase."

Then you see the various differentials that are specified. They are not specified as being maximum prices, they are specified as being specific relationships, and in relation to -- I don't think this is confidential -- Richmond and Dorchester, we see that the move is from parity to minus 4 pence and minus 6 pence respectively depending on whether we are looking at Kingsize or Superkings.

In the last paragraph, the writer says:

"Clearly the differentials and resultant shelf prices between our roll-your-own, pipe, tobacco and cigar brands and those of our competitors will also widen."

So in that last paragraph, you see the relationship between the differentials and the shelf prices, because the differentials are carried over into the shelf prices.

Now, the move from parity to a minus figure was actually unnecessary if the relationship -- if the parity was no more than a maximum figure.

The point here was that ITL wanted to keep the Richmond shelf price at a specific price point, I say a specific price point, by relation to the Gallaher recommended retail price, and it was afraid that, as a result of the Gallaher change in the RRP, the retailer might construe that as requiring a change in the linked ITL brand price. So the purpose of this letter was to prevent an automatic reaction on the part of the retailer to the Gallaher price move, an automatic reaction that affected the price of the linked ITL brand. So it's an indication that at least ITL's understanding of how these things were going to operate was that the retailer would move or would be likely to move an ITL brand price which was the brand price where the brand was linked to a Gallaher brand and the Gallaher price moved.

THE CHAIRMAN: So this is taking a different stance from the stance we saw in relation to Drum and Amber Leaf, where you said those documents showed that ITL wasn't concerned at what level the prices were, provided there was parity, even if that meant Drum moving up to match an Amber Leaf price increase. Here they seem to be taking a different approach, which is that even though the competing brand has gone up, they don't want the ITL brand to follow.

MR LASOK: This is an instance where you have a countermanding instruction coming from the manufacturer.

In the event, what had actually happened was, as I said, that there had been a Gallaher price hold. What didn't happen was that the price of Richmond dropped 4 pence below Dorchester. Instead, what happened was that they maintained parity.

THE CHAIRMAN: Because the Dorchester price didn't in fact go up?

MR LASOK: The shelf price didn't. There was an alteration in the recommended retail price of Dorchester, but the shelf price didn't alter because Gallaher had issued an instruction to the retailers to hold the price. When one actually looks at the documents, you can see that the price didn't change. Because later on, there is an instruction to move the Dorchester price from a level that we can see was the pre-June level. The net effect of these exchanges was to maintain the parity. It wasn't a situation in which ITL is trying to achieve a reduction in the Richmond shelf price by a comparison with the Dorchester shelf price. What they did was they issued instructions that kept the prices at parity, despite the fact that there was an alteration in the RRPs and that meant that, for a period of time, the

Dorchester RRP was, if you like, out of step with the Richmond RRP.

So that was the problem that they were confronting. The two had got out of step, but the ultimate objective was parity, what were they going to do. In reality, if you look at the shelf prices, due to the Gallaher price hold, the shelf prices remained the same, and it prevented a movement of the Richmond price which might have been done because people got confused as a result of the fact that the RRPs were out of step. So they countermanded that and ensured that the parity remained at shelf price level.

DR SCOTT: Do we know what happened behind the scenes? Presumably we could look at the chart and see whether there was an MPI.

MR LASOK: This was a situation where there was a Gallaher MPI, Gallaher had announced sometime in May that Gallaher had -- there is an undated letter in the Morrison's file that deals with this. But Gallaher had, as from something like 31 May, been sending round to its retailers letters specifying a price hold, so that although the Gallaher RRPs were changing or some of them were changing, the shelf prices were to remain the same.

Then in the midst of all this, you get the ITL document, and 17/58 is not the only letter of that

nature that was sent, because it was a kind of round-robin to the retailers, and that was sent out warning people that the RRPs effectively couldn't be relied on as indicating parity as between Richmond and Dorchester, because as ITL was not at that stage altering its RRPs, what was happening was -- this is the instruction that goes out to the retailers -- that the differentials in the strategic pricing requirements were widening, and that's why you get the move from a parity to a minus 4. But as I've said, in terms of shelf prices, they maintained parity.

THE CHAIRMAN: Would that -- yes, the Gallaher increase in the RRP for Dorchester reflected an increase in the wholesale price, but then the provision of the bonus presumably brought that wholesale price back down so that the RRP didn't lead to an increase in the shelf price.

MR LASOK: That's correct, if you regard the wholesale price as being the price that features in the published price list. Of course, the problem is that, in the published price list, you actually see some prices that are fictitious, because what is published as being the cost price, which is the price at which -- the list price at which the manufacturer will sell a particular tobacco product is not the real wholesale price, because the

real wholesale price is determined by negotiation with the individual retailer. Hence, what actually happens in a situation like this, is that there is a change in the RRP but because Gallaher sends round to the retailers an email or a letter that says that there are price holds for certain of its brands, it means that the real wholesale price for those brands doesn't go up, and the retailer is expected to keep the shelf price at the pre-existing levels. And that's what they do.

Now, so far as Asda is concerned, and I'll try and get through this as quickly as possible, we can start off with some documents in annex 14, and if you go to tab 28, {D14/28} this is an internal ITL document, and here we see that ITL understands, and it says from a discreet source, [redacted], that the price of Amber Leaf, which is a Gallaher brand, is going to go up, and the intention is to move Drum to the same price as Golden Virginia, and the purpose is to maintain the parity and the differentials. We see a similar thing in relation to Sterling, Dorchester and Richmond.

Then if you go to 30, we see this being implemented in relation to Asda because it's an email from ITL to Mr Jolliff of Asda, indicating that ITL wants the price of the roll-your-own range to be increased as a consequence of the retail price of Amber Leaf.

We are going to seller price file afterwards, so if you go to the next tab-- I should say at the end of the email in tab 30 we have ITL asking Asda to confirm a date for the change.

Then if you go to the next tab, 31, you actually have the email in 30, I see now at the bottom of the page, and just above the second holepunch, it may be a bit difficult to read, it's an email from Mr Jolliff to ITL on 20 March 2001, and he says, this is an email in reply:

"Martin, this will be okay."

So Asda agree to that change and as the policy of matching Drum with Amber Leaf continued, Asda was happy with it as long as, if there were any price reductions, they were funded by the manufacturer. So, for example, if you go to, in the same annex, tab 58, this again is one of these email strings that we have to read in reverse order. The first email is on the second page, up at the top. It actually starts at the bottom of the first page, but the bit that I wanted to refer to is at the top of the second page, where it says:

"Firstly, our strategic pricing requirements are unchanged in that we wish to match Amber Leaf prices with Drum and to match the Samson price with Drum Milde."

The reply, which is on the first page starting about the middle of the page with the indication that it's an email from Kevin Lang of Asda to Graham Hall of ITL, says:

"That's fine, but if Imperial wish to compete with Gallahers on the Asda pitch and set appropriate retails, then I expect both to fund their own tactical pricing issues. Can we discuss when we meet?"

And that simply reflects the fact that if a retailer is faced with price reductions made by one manufacturer, and that manufacturer wants the price of the linked competing brand to go down as well, the retailer is reluctant to do that unless it is going to get some financing from the manufacturer because its margins are already thin.

THE CHAIRMAN: But I think ITL say, well, this shows that there was no obligation on Asda to make that reduction, absent tactical pricing bonus from ITL to enable them to do so.

MR LASOK: Yes, that's limited to the wholesaler initiated price moves. If this had been a retailer initiated price move there would have been no question. When you have a wholesaler initiated move, it was recognised in the opportunity to respond clauses that the --

THE CHAIRMAN: But I don't think there is an opportunity to

respond clause in the Asda contract, is there?

MR LASOK: No, but the opportunity to respond clauses recognise a commercial reality, which is that a retailer is likely to be sticky, when faced with a P&D arrangement that requires him to move a price downwards, but he's moving it downwards in response to a reduction made by the rival manufacturer. He may do it, and in fact he is supposed to do it, unless there is an opportunity to respond clause, it's anticipated that he will do it, but he is going to be a bit sticky.

It's perfectly understandable that in situations like this, the retailer is going to say "That's fine, that's my understanding, we know where we are on this one, but, you know, it helps me to do it if you provide me with some money, if you lot are funding all this".

MR HOWARD: If I may say so, it is incredibly important that we actually get some clarity on the OFT's case about this. Is their case that there was a requirement on the retailers or an expectation of them to move the price down independently of any change here in Imperial's price, or is the case simply that they were going to move the price down if Imperial paid for it? The two, as a matter of obvious common sense, are rather different, and the OFT really must state now what their case is as to these arrangements.

THE CHAIRMAN: As I understand it, the case is that you are now making a distinction between price reductions of a competing brand which are at the initiative of the retailer and don't reflect any reduction in the wholesale price of that competing brand, in which case is it still your case that the retailer was obliged to bring down the price of the matching ITL brand, even if there was no ITL funding for that?

MR LASOK: If you looked at the, and it's exemplified in the written trading agreements, they envisage that the retailer will keep to the strategic pricing requirements, and that means that as prices go up and prices go down, they keep to them. The get-out provision was to be found in the opportunity to respond clause which was the point at which the bonuses, depending on how the clause was phrased, but in the case of some of them it was, for example, that if Gallaher reduced its prices then the retailer could go to ITL and inform ITL of the price reduction, and ITL would decide what it was going to do about it. At that point, there was no obligation on the retailer to reduce, because it could go to ITL and find out what ITL's reaction was.

THE CHAIRMAN: But if there is no opportunity to respond clause in the trading agreement, what is your case then in respect of the obligation on the retailer to reduce

the price of ITL brands when there is a price reduction in a Gallaher brand, in a linked Gallaher brand, triggered by a tactical bonus or other reduction in the wholesale price of the Gallaher brand?

MR LASOK: That's very simple, because if you looked at -- the best examples are the ones where you have written trading agreements which specify that or involve a commitment, because I was thinking when I said specify, because it can be specification, and it can be the kind of thing that you see in the early Morrisons agreement at 17/4, in which there is an inducement given on condition that they do certain things, and, as we know, Morrisons actually did commit themselves to do that, so it doesn't matter how the commitment originates, but where you have a commitment then there is a commitment, and it's perfectly possible that in a given situation, the retailer is reluctant to comply with its commitment, and then raises the matter with the manufacturer. But there is nothing surprising about that, because in ordinary commercial life you encounter situations in which people have agreed to do something in a contract and then they are confronted with a commercial situation, perhaps one that they hadn't anticipated, or hadn't anticipated fully, and they go back to the other contracting party and they say "What do we do about this?"

But that doesn't indicate that they had not agreed to do anything, it just indicates that they are confronted with a situation in which they are reluctant to do that which they have agreed to do, and in this instance we have the same thing. We have Asda is perfectly happy to go along with this, but it expresses a reluctance in the particular situation that it's dealing with. One has to bear in mind that the OFT's decision does refer, is based around, the idea of reduced uncertainty.

Moving on, anticipating a point that I will come to in due course, the debate about what's been usually called the theory of harm, is whether or not the OFT's analysis of these P&D requirements demonstrates that they are anticompetitive. But for that you look at what the decision actually says, and there is a distinction between agreeing to do something and implementation. There are always going to be implementation problems of one sort or another, and therefore there are going to be implement uncertainties.

THE CHAIRMAN: Yes, but the difficulty that we face is to distinguish between that conduct that we see in this correspondence which is relevant because it indicates the scope of the agreement between the parties and what

conduct you say is irrelevant because it relates only to implementation or non-implementation, and it seems that some of the disputes on the facts are how one characterises something, an event, an exchange between the parties, does it simply relate to implementation or failure or refusal to implement, or is it something that helps us determine what actually were the terms agreed between the parties?

MR LASOK: With respect, I don't think it's the terms that were agreed, but it's the understanding and expectation.

THE CHAIRMAN: Well, I used "terms agreed" to incorporate concertation or whatever.

MR LASOK: If you look at this exchange here, there is an understanding and an expectation that the implementation of it is coupled with the reservation expressed by Asda, but actually in our submission --

MR FLYNN: Madam, perhaps I could just ask my friend to say where in this exchange he identifies that there is this expectation. My submission to you yesterday was this made it perfectly clear that there was no such, and I also remind you that there is no opportunity to respond clause in the Asda agreement. So I just don't know where this discussion is going.

MR HOWARD: If I can just be -- sorry.

THE CHAIRMAN: At the moment we are simply having

a preliminary look at the documents, which we will presumably come back to when they are put to various witnesses, and then on the basis of what the documents say and what the witnesses say is the explanation for the document, we will have to arrive at our interpretation of those documents, and how they help us determine the matters that we have to decide, but at the moment you are opening your case and showing us this document and explaining what it is you say you are going to get from it at the end of the day.

MR LASOK: Yes, and I think it's fair to say that the starting point for this is that in fact what was happening before you get on to this document was that Asda was compliant with the parity and differential arrangements, I have already identified documents that show that.

THE CHAIRMAN: I think that Mr Howard's concern, as I understood it, was that in your answer as to the commercial reality of the response of Asda in this instance, even in the absence of an opportunity to respond clause even in their agreement, whether that meant that you were moving away from the position of saying that there was actually a commitment to reduce the ITL price in response to a Gallaher price reduction, even where the Gallaher price reduction is triggered by

a tactical bonus from Gallaher, and what I understand your answer to be is that, no, you are not moving away from that, as your case as to what the arrangement between ITL and Asda was, but you say this is just an instance of Asda being reluctant to abide by that commitment and having to be given a bit of a sweetener or whatever by ITL as part of their ongoing relationship, if I can paraphrase your response like that.

MR LASOK: Yes, because using the analogy of an ordinary commercial contract, the parties may have been signed up to something, but that doesn't prevent the other party, having committed itself to a course of action under the contract, at some later stage in the course of the period of the contract, turning round and trying to get something more out of the counterparty.

So in our submission, you have an incident here of that kind of behaviour. The commitment is there, the acceptance is there, that's fine, but then we have Asda trying to get a bit more out of the commercial relationship.

THE CHAIRMAN: Well, I hope, Mr Howard, that may or may not have clarified things for you, but I think that's probably a good point at which we can take a break before we go on.

(11.30 am)
(A short break)
(11.45 am)
MR LASOK: If you still have annex 14, would you turn to tab 53, please. {D14/53} This is the ITL/Asda agreement for the calendar year 2002, although, as you can see at the bottom, it's signed on 5 June 2002. I think you have already seen the third page which is headed "Trading agreement package", and it makes the payment made by ITL to Asda conditional to compliance with ITL's requirements on a number of matters, including strategic pricing.

Then if you go to tab 54, {D14/54} you will see an 11 June 2002 letter sent by ITL to Asda, and this is the Asda variant of the document that was sent to Morrisons around about the same time, and you will observe that the purpose of this letter was to inform Asda of the revised strategic pricing requirements, for the purpose of ensuring, we submit, that the Asda prices for ITL brands remained in line with the ITL strategic pricing requirements as they existed in the light of the Gallaher price change that had been published probably a few weeks before the date of this letter.

So this too is one of these instances in which ITL finds it necessary to write a letter of this sort

effectively to ensure that no automatic change in the ITL price occurs as a result of the change in the Gallaher RRPs.
DR SCOTT: Can I just ask a quick question about the schedule prepared by Hogan Lovells of the MPIs. The date which in this relates to what you have just said, are they the date upon which the MPI was to take effect?
MR LASOK: 25 June 2002 was the date on which the Gallaher MPI was to take effect.
DR SCOTT: So the date on here is the date on which it takes effect, not the date on which it's published?
MR LASOK: No, no, no, it was published, I am not sure actually whether we have a date indicating when it was published, but from the documents as a whole we can infer that the Gallaher MPI must have been published in May 2002. The reason for that is that there is a document dated 31 May which is a Gallaher price hold. So that indicates that the publication of the Gallaher MPI must have been before 31 May. Somebody may know when it was published, but offhand I don't know. I do know that the date for the implementation of the MPI was 25 June.
THE CHAIRMAN: But is that the date when the price hold ran out?
MR LASOK: No.

THE CHAIRMAN: Or is that the date on which, except for the price hold, it would have come into effect?
MR LASOK: No, the price hold was effective from 25 June. If you will bear with me for a moment, I'll just check whether 4/7 is the letter. (Pause). I don't think it is. It may be better to go to 26/42. (Pause).
DR SCOTT: Yes, 26/42 is 31 May 2002.
MR LASOK: That's right, and this of course is all expressed in the future tense. The "Subject" line says:

"Safeway MPI 25 June price holds."

I think that you can see from 43 in the same annex, I think it's a follow-on which asks them also to hold Hamlet Miniatures at the pre MPI prices. But I believe if you go back to 42 and look at the last line, it is not confidential, it says:

"All other brands to move as from 25 June by the relevant amount in the price list."
THE CHAIRMAN: So this letter at 54 of annex 14, this seems to be after Imperial has become aware of the price increases intended, but before it's become aware, if it does become aware, of the price hold instruction.
MR LASOK: So far as I am aware, it's obscure when ITL realise that there was a Gallaher price hold. Taking matters at face value, and assuming that it didn't know, then the purpose of 54 was it was necessitated by the

fact that they had just entered into the trading agreement with Asda and the purpose of this was to alert Asda to the strategic pricing requirements that were being put in place by ITL in order to take account of the Gallaher changes to its RRPs.

During the infringement period, there were regular discussions between ITL and Asda, and we can see some of these in annex 14/56, 59 and 64. {D14/56} I am just going to mention them. 56 is the one that talks about the purpose of the trade development programme, and the object of reflecting standard price list differentials against competing lines.

59 is another instance of an exchange about what was going on, as is 64. There is no mention in this correspondence at this time of any failure by Asda to maintain ITL's strategic pricing requirements, and ITL's internal reports -- and I think we can look at the ones which sort of span the period certainly of the correspondence covered in 14/56, 59, 64. The internal reports before and after state that almost all Asda stores achieved the strategic pricing requirements. That for the purpose of cross-reference, that's annex 14, tab 46 {D14/36}. At the eighth page there is, in that document, which is an internal ITL document, internal pagination on the bottom right-hand corner, and

the internal page number is 8 and the relevant passage is at the top of the page.

Another one is 14, tab 70, {D14/70} which is a similar internal ITL document, also internally paginated at the bottom right-hand corner, and the relevant page is page 9, again at the top of the page, but this time it's the second paragraph.

So it appears that ITL, on the basis of its monitoring of Asda at the time, had come to the conclusion that there was nothing to worry about Asda's compliance with the arrangement. When one reads in the documentation, it's both the ITL documentation and also the Gallaher documentation in annex 4. In our submission the impression that one gets was that, as in the case of Morrison, Asda was just a compliant instrument in the hands of the manufacturers. In some respects, of course, it was an active participant, because it did assist ITL in co-ordinating price movements, and I'll just give four cross-references to that. They are the documents at annex 14, tabs 10, 32, 40, and 49. {D14/10}

In opening, largely for reasons of time, I haven't gone to the parallel Gallaher documentation, but you see the same pattern of behaviour, in particular in terms of price movements, and again if one goes to the trouble of

looking at the parallel ITL and Gallaher documents for Asda and look, for example, at Richmond and Dorchester, you see that there is constant maintenance of the parity, pursuant of course to the policy that both manufacturers had.

Now I want to come to the Co-op. We have heard, or the Tribunal has heard, the Co-op's case, and you will remember that the Co-op was relatively decentralised and had several price tiers reflecting different sectors of the market in which its stores operated. I think at the beginning in the files there are four price tiers and then they reduce fairly early on to three price tiers. During the infringement period, the Co-op regularly sent to each of the manufacturers a price matrix asking the manufacturer to check and confirm the prices of the manufacturers' products, the Co-op told the OFT that the price matrices accurately reflected its pricing, and for your cross-reference that's annex 15, tab 25, page 5, paragraphs 8.1 to 8.3. {D15/25/5/8.1}

Now, the ITL/Co-op trading agreements heavily emphasised the importance of pricing in line with the agreed differentials across the entire Co-op group for which a payment would be made by ITL. We could take, for example, annex 15, tab 16. {D15/16}. Tab 16 is the 2002 trading terms, and on the first page by the second

holepunch you see the global amount that was to be paid for pricing and promotion.

If you go then to -- and I don't think this document has internal pagination, but it's the fifth page, which has the heading "Pricing and Promotion", and it starts by the first holepunch, and this is not confidential, I think, and it says:

"This element of the agreement is designed to ensure Imperial Tobacco products are priced in line with the industry agreed strategic pricing differentials across all segments of the tobacco category. A copy of the agreed differentials is attached. This payment is agreed to reward the consistent price disciplines offered by CRTG within the current three price bands currently operated. All Imperial brands must achieve this strategy across the complete CRTG group for the payments to be made."

Now, we don't have a copy of the agreed differentials that were attached. It was suggested on behalf of the Co-op that no agreed differentials ever existed, but that appears to be based upon a misreading of the witness statement of Mr Goodall, who simply says that no agreed differentials were attached, he doesn't say that none existed. In fact, if there hadn't been agreed differentials, it's difficult to understand how

the payment in question could have been made under the agreement, and we would therefore have expected to see some correspondence about this, but we don't at all.

It's a reasonable inference, whether attached or not to the agreement, there was a schedule of agreed differentials. What that schedule actually contained is a bit difficult to guess at, but it's not unreasonable to suppose that there was an extremely high likelihood that it included a parity between Richmond and Dorchester 20s, because that is a common feature across all the retailers.

The Gallaher/Co-op trading agreement, which is in annex 5, tab 7 {D5/7} -- which I won't go to -- also provided for payments to the Co-op if it complied with various disciplines including pricing. That's pages 2 and 8 to 9. You have seen that document, I think. Measurement of compliance and penalties for non-compliance appear in pages 11 to 12.

For an illustration of how things worked in practice, one can compare annex 15, tab 15, {D15/15} with a document in -- or rather two documents in annex 5. If you go to 15/15, this is in fact a multiple trade agreement which is an internal ITL document, and I think that it's basically instructions to the people who monitor the performance on the shelves and in the stores of the retailer in question.

In the box headed "Price and Availability", there is a reference to -- it says -- well, in the box there is a bit that says:

"Please report in call messaging if the [and then there is a reference to a brand family] is not to the correct differential against" and then there is a reference to the Gallaher brand.

But if you go to page 3, you will see a document that is the CRTG prices effective from 24 June 2002. I just wanted to look at Richmond 20s, and they start, second holepunch. So the first column gives you the name of the brand, the second column tells you the pack size, and almost alongside the second holepunch, you have Richmond Kingsize 20s, and then in the last three columns you have the tiering in the three types of Co-op outlet, and the prices are £3.52, £3.54 and £3.55.

Further down, you get to Richmond Superkings, and there the prices are £3.53, £3.55 and £3.56.

Then if you go to annex 5, tab 12, {D5/12} this is a price matrix, and if you go to the second page, you see that it's also the price increase effective 25 June, and it says in the second line of the heading:

"New costs/RSPS effective in Co-operative group June 24."

49

So this is why we can draw a comparison since we are looking at the pricing for the same period of time. If we look at Dorchester, which is marked on the left, forget about Dorchester 10s, but just look at 20s, the Kingsize 20s have a normal pricing of £3.62, £3.64, £3.65, but they were actually the subject of a promotion, and the actual prices are in the last three columns before you get to the notes, and they are £3.52, £3.54 and £3.55. When you get to Superkings, and again focus on the actual shelf prices, it's £3.53, £3.55 and £3.56. So they are exactly the same for all three tiers as the Richmond price.

Now, if you keep both annexes open and in 5 go to 5/14, 5/14 {D5/14} is a matrix and this deals with -- if you go to the second page, you see that it is September 23, 2002. You have Dorchester selling prices there, and you have them at, if you take the Kingsize group of 20s, at £3.54, £3.55, £3.58. The Superkings, which are in darker colour or shading, are £3.57, £3.58 and £3.59. This is under the column saying "Selling Price".

If you go to 15, and go to 15/19, you have a price matrix relating to the same period of time. If you go to the fifth page, which in my copy has a stamped page number 165, and look at the Richmond Kingsize 20s, which

50

are about two-thirds of the way down the page, they are after the Richmond Kingsize 10s, and the first Richmonds mentioned.

So the second Richmond Kingsize is 20s, and again you see that it's the actual price is not the normal pricing, it's the last three columns before you get to the notes, and it's £3.54, £3.55 and £3.58.

Then if you go to the bottom of the page, you see that it's £3.57, £3.58 and £3.59 which again is exactly the same as Dorchester.

In this particular set of documents, these two documents, we can compare the margins, because I think that the margin is the percentage figure underneath the price. That's not ITL document.

In the Gallaher document, which is whatever the annex is, tab 14 --

THE CHAIRMAN: It's 5.

MR LASOK: Yes, 5/14, we have the cash margin and there is a sort of percentage on returns, percentage on cost figure. But so far as I can see, although the shelf prices are the same, the margins are different. This is a point that relates to an argument that has surfaced in some of the appellants, which is that it's called a margin parity argument and the idea is that somehow this was related, these P&D requirements were somehow

51

related to the margins. But this is an illustration where we have actually got the information to compare contemporaneously the margins of two linked brands, and we find that although the shelf price is the same, the margins are actually different.

There are other documents of a similar nature which also show that shelf prices can be the same but the margins are different, and I would like to take a little diversion and have a look at those. It involves a comparison between the document in annex 18, tab 87. {D18/87}

THE CHAIRMAN: Can we put away --

MR LASOK: You can put away those two. This is going to require a certain degree of jiggling around, but it will only be with two files.

So if you have 18/87 -- the other annex would be number 8, by the way. We can look at 8 and 18. This is a price file, but it's one that is historical, in the sense that it gives information relating to a number of different periods of time. In my copy I have pagination stamped at the bottom right-hand corner, and if you go -- the relevant page is 322. On 322 you have the headings at the top. The left-hand heading is the abbreviated form of Sainsbury. Then you have the brand. If you go to the last five columns, the fifth from the

52

right is the pack retail price "(UDEX suggested retail price)". The next one is the Q5 margin as a percentage. Then we have the "Q5 Margin Cash", and then the start date and the finish date.

If you go down on the left-hand column, it starts off with Regal, and then it moves into Richmond, and we are looking at Richmond 10s, but after the Richmond 10s, of which there are four, we have Richmond Kingsize, and these are 20s. The first line of the Richmond Kingsize 20s, if you run your finger along to the fifth column from the right, you should see that the pack retail price is £3.44, the Q5 margin percentage is [redacted].

DR SCOTT: Hold on, that seems to be confidential.

MR LASOK: I'm terribly sorry, I'm suddenly being told it's confidential.

THE CHAIRMAN: The two on the either side of it are boxed, I think.

DR SCOTT: If one goes to the top of Q5, the box embraces Q5 margin and Q5 margin cash.

MR LASOK: Tell you what, I won't mention figures.

Anyway, you have a percentage figure for the Q5 margin. Then you have the figure in currency, and then you have a start date which I don't think the start and the end dates are confidential, but anyway you have the start date and you have the end date. If you go down,

and the document that I am going to refer you to in relation to that line is annex 8, tab 33. {D8/33}

This is a margin spreadsheet, and if you look at the second page, you see a series of headings. The headings are not carried over into the following page -- they are intermittently. You will see that if you look at the fifth column from the left, including the "Comments and Discount" column, you have a column which is "Previous Shelf Price", and then to its right you have the "Current Shelf Price" and then to its right again the "Capital Margin", the "Percentage Margin", and then you have the "Comments" box.

Bearing that in mind, if you go on to the next page, you have Dorchester figuring about an inch, if one can use old currency measurements, down from the start of the matrix, and the first Dorchester is Kingsize 20s. If you run your finger along, you get to the fifth column from the right, which you can actually see is the previous shelf price, because in fact if you look further down you have another row which gives the column headings, which is useful.

The previous shelf price was [redacted], and -- sorry, a figure.

Then the current shelf price and the date for this is on the first page of the document, and it's

25 February 2002. So it's within the period covered by the line in 18/87 that I took you to. So we have the current shelf price, which is the same as the shelf price for Richmond.

Then we have the cash margin and the margin expressed in percentage terms. But here again, although the shelf price is the same, the margins are different. I think if one does a calculation, the Richmond margin is [redacted] the Dorchester margin. The same thing can be seen if you compare two other lines in the document at 18, tab 87, because on the same page that I --

MR HOWARD: Can I just interrupt to say I imagine the Tribunal realises that we, on this side, don't have unredacted copies of the Gallaher documents so it is slightly difficult for us to follow the points being made.

THE CHAIRMAN: But those of you in the confidentiality ring should have them. Oh, not third party information.

MR HOWARD: As things stand, we do not have a number of the columns here, and we can't follow what's being said.

MR LASOK: The better thing maybe is if I just carry on, because it will take me about two minutes, and then we can try and sort this out.

If you go back to 18/87, I left off at the first Richmond Kingsize 20s, if you go to the third one, you

have the Kingsize 20s and again if you go to the fifth column from the right you have the retail price, you have the Q5 margin in percentage terms, the Q5 margin in cash terms, and then the start and end dates.

Parallel to that is in annex 8 at tab 42, {D8/42} where we have a Gallaher matrix for Sainsbury's, 1 July 2002, and therefore within the period. If you go to the second page, and go down to Dorchester Kingsize 20s, and again do the same exercise looking at the fifth column from the right, the shelf prices in fact here are the same, and then you have the figures for cash margin, and again we see the situation that the shelf prices are identical but the margins are different.

THE CHAIRMAN: What's the difference between, looking at 18/87 and that batch of seven different kinds of Richmond Kingsize 20s, those seven amongst themselves?

MR LASOK: Amongst themselves the main difference is between Kingsize and Superkings, and then within each group you have them described as mild, menthol and lights, and things like that. You also see actually that some of these are different pack sizes, because if you are looking in 8/42, the first Dorchester Kingsize is a 20, and then --

THE CHAIRMAN: Just looking at 87 --

MR LASOK: I am sorry, are you referring to 18/87?

THE CHAIRMAN: Yes.
MR LASOK: In 18/87 what they have done is for some reason they have set out an historical price matrix which indicates, for the same product, what the price was over time at different periods.
So in the last two columns on the right, when it says "start date" and "finish date", it refers to the period of time during which a particular price and margin held good. That's why you are referring to millions of these Richmonds, because the Richmonds run from about a third of the way down the page right to the very bottom, and over on the other page. I think the other page is entirely occupied by Richmond. These are not different variants of Richmond, they are simply the different periods in which the same variant was on sale at a particular price or margin.
THE CHAIRMAN: So which was the second product, then, that you were drawing our attention to?
MR LASOK: In 87, that's to say annex 18, tab 87, I was just looking by way of example at the Richmond Kingsize 20s, it's the first Kingsize 20s --
THE CHAIRMAN: Yes, I have that one. Which was the second one?
MR LASOK: But then, you see, it's the same thing, because the third one down is also Richmond Kingsize 20. The

comment in the second column from the left is that it bears a reference to a new trading agreement. But what you get -- and the third reference I should say is the fifth one down from the one I started off with, which is also Richmond Kingsize 20s. So we are looking at the same product. It's all grouped together.
THE CHAIRMAN: But over a different time period?
MR LASOK: Yes, it's under the same number in the first column. They are all grouped together and they have different numbers. So I am just looking at the same thing with the same number. We see there the evolution of the prices of that variant of Richmond over time, together with the variation in the margin. The purpose of this exercise is -- it's a terrible thing, I suppose, you know, looking at these different matrices -- to point to the fact that we can identify time periods in which, when we compare, using these as an example, Richmond and Dorchester, we can see the same shelf price but the margins are different. The third example involved a cross-reference to annex 8 at tab 55, {D8/55} but this is the kind of thing that one perhaps suggests might be carried out in private and relaxation, probably with a calming drink.
DR SCOTT: Just sticking with these for a moment, we see in the third line of Richmond Kingsize, and I think this

won't have been redacted, that there is the retrospective implementation of the trading agreement, which is footnoted, so that the margin, which is redacted, changes. If we look back across, the figure is redacted, there is both a tactical bonus and an additional bonus. When we look back across to 8/42, {D8/42} we see that there is also a tactical reduction going on there. So it looks as though we have a lot of tactics which are resulting in the same price.
MR LASOK: Yes. It's relevant, bearing that in mind, when you consider the point made by Gallaher to the OFT, that the P&Ds didn't operate in relation to promotions, because in fact this is an illustration of promotions being in effect in relation to both the Richmond and the Dorchester brands, but nonetheless the pricing is the same, you have these tactical bonuses, but the point I wanted to make was not so much that the pricing was the same --
THE CHAIRMAN: It's the margins point.
MR LASOK: -- it's the margins point, because we can actually see concrete illustrations of the fact that the margins were going off in one direction but the prices, as it were, the shelf prices were going off in another. You don't have this relationship between margins and shelf prices that some of the appellants, but not all of

them, have been hypothesising.
That was the purpose of that exercise, just to put that thing away, and I am now going to pass on from the Co-op, we can put these documents away, and go to consider, I hope fairly quickly, Safeway.
So Safeway, the first point that I wanted to deal with was the suggestion that there was no P&D requirement in the Safeway/ITL trading agreement. I think it's common ground that there was a trading agreement, nobody has been able to identify a copy, and ITL has taken the position that it's up to the OFT to prove that in the trading relationship between ITL and Safeway there was a fixed P&D requirement. I need to address that, and this will involve me going through about half a dozen documents, but that I think will enable me to tidy away the whole of Safeway because it will deal with a number of other points concerning Safeway that arise.
DR SCOTT: Can we just clarify, Mr Howard, my recollection of your reply was that you might have changed your position on whether there was or wasn't a trading agreement?
MR HOWARD: I'll have to refresh my memory on that.
DR SCOTT: I think it's 46 to 53 on my note, but I haven't checked it. It would be helpful to know.

MR LASOK: I thought the ITL/Safeway reply at paragraph 53 contested that there was an agreement between ITL and Safeway on P&Ds.

DR SCOTT: That was my recollection, yes.

MR LASOK: And it was said that it was up to the OFT to prove that. My understanding is that Safeway itself takes a similar position.

Now, a number of the documents in annex 28 actually referred to strategic pricing requirements.

The first I would like to go to is 28, tab 9. {D28/9} This is ITL writing to Safeway on 11 May 2000, and the writer says, about halfway into the first line:

"In response to your price reduction on Mayfair 20s ... and the subsequent/equal move of Richmond 20s, I am confirming that from Monday, 15 May 2000, the following price reductions will be implemented to achieve the appropriate strategic pricing differentials."

This, the Tribunal will recall, was the period of time before ITL repositioned Richmond so that it was at parity with Dorchester. This is the period when the parity was with Mayfair. So here we submit this is a clear indication of an understanding between the parties that Safeway was to comply with the strategic pricing differentials.

Then if you go in the same file to 15, this is a document from Imperial to Safeway dated 5 July 2000. I am actually only interested in item 2 headed "BP/Safeway Pricing". This concerns pricing at Safeway's service stations, which it was operating in conjunction with BP. You will see in the Safeway documentation occasional references to PFS, and that is short for "petrol filling stations". There is a document that explains that, but this is one of the documents which, in relation to item 1 on the right-hand side, has a PFS, and that's what it refers to, petrol filling stations.

Then in this item 2, we see that ITL is complaining that ITL brands are being disadvantaged against the competitive brand, and then there is a list. You can see that, in the second column from the left, there is a reference to a target differential. The column on the right also has a target price, and various differentials are listed.

On the second page, the target differential for the two products there mentioned is a parity. The last line of the communication says:

"As with the above, I would be grateful if you could investigate these discrepancies and advise."

Then if you go to 50, this is 14 February 2002:

"I should be grateful if you would correct the following pricing errors as soon as possible."

If you look at these pricing errors, and it's quite interesting because if you look at the end of the paragraph dealing with Richmond Superkings, it says in the last sentence:

"Please reduce Richmond Superkings to [a price] in those lowered price stores to match Dorchester SKs."

The last sentence of the next paragraph is the same:

"Please correct to match."

Then we have, further on, a reference to Amber Leaf and Drum, and what we have in the --

THE CHAIRMAN: When it says it's split equally, does that mean half of the stores are pricing at the first price and half the stores at the second price, or is this --

MR LASOK: Well, I myself cannot say what that means. Mr Byas was the writer of this letter. All I can do is to speculate, but it seems to me that the stores are equally split between pricing at 2.09 and 2.10.

You will recall that the parity that we have seen previously is for Amber Leaf and Drum to be the same price. I am just checking back to 2.15, because it suddenly slipped my mind as to whether that was said on the second page.

We have seen from other documents relating to other

retailers that there was an intention on ITL's part to have parity between Amber Leaf and Drum. It is actually confirmed here. In the paragraph we are looking at about Amber Leaf in the second line we have a reference to Golden Virginia being correct at the plus 10p differential. But then the writer says:

"I recommend that Amber Leaf is increased to match Drum and Old Holborn increased to match Golden Virginia."

Amber Leaf of course is a Gallaher brand, Drum is an ITL brand, Old Holborn is a Gallaher brand, and Golden Virginia is the ITL brand. This again is redolent, firstly, of an understanding between Safeway and ITL that Safeway was to price in this particular way. He doesn't, you know, suggest in this letter that he is suggesting something new, something that Safeway would find unexpected and a surprise.

One can see that also from the use of the word "correct" in the first line, because that implies that there has been a divergence from a previous understanding as to what was going to happen. The other thing about this letter is that, once again, we have language, "match" and so forth, that is consistent with the OFT's interpretation of the parity and differential requirements but is wholly inconsistent with the view espoused by ITL.

Of course we see reductions but we also see a recommendation for a price increase, which goes back to the point that I have been making that ITL's P&D strategy was focused rather more on the relativity of the price rather than where exactly it was.

The other interesting thing of course is the recommendation that a Gallaher brand be increased to match Golden Virginia.

The next document is 54, {D28/54} another one of these increases to match in the first numbered paragraph. There is also a correction suggested, this is at the end of point 2, to both the Dorchester and the Richmond prices, Dorchester of course being a Gallaher brand.

Then the next document, 55, {D28/55} ITL again to Safeway, March 2002, and the writer says: "I set out below the changes needed to correct pricing of ITL brands in Safeway."

Paragraph 1 starts off with a "please reduce the price of Richmond", but the important point is that it's a reduction to match.

At the end of that paragraph, the writer says:

"Parity with Dorchester is the objective in all stores and petrol filling stations."

Paragraph 2 is again "reduce to match". Paragraph 3, in the second line, is "reduce to match", and he says at the end:

"Parity is the policy on the 25 gram and also with Drum Milde."

Paragraph 4, there is a complaint that Golden Virginia is more expensive than Old Holborn, and the writer says:

"... when we are paying for parity at [various figures in pence] more than Drum/Amber Leaf."

Now, do you note here that what the relativity is, is Golden Virginia at a level more than Drum and Amber Leaf, which are the two at parity. The variant figures in pence relate to, I think, the price tiers or the pack sizes. But the main point, that's a relatively unimportant detail, here is that they were paying for a particular, or regarded themselves as paying for a particular price level by reference to several brands.

The next paragraph in 4 is, in the second line -- there is a reference to moving into line with other grocers, but the writer adds:

"... and move both Golden Virginia and Old Holborn up to the common price of £2.28."

Now, this is not a recommendation to reduce the price of the other linked brands, it's a solution which

involves increasing both the Golden Virginia brand and Old Holborn, Old Holborn being a Gallaher brand.

Then the writer talks about the cessation of the bonus on Golden Virginia and asks Safeway to advise Gallaher of that move. That I think is all that I need from that document.

57 {D28/57} is a handwritten document from Mr Byas of ITL to Safeway. One notes what he says in point 1, it's again about a minus 3 pence differential -- that's not a confidential figure -- by reference to the linked brand. Point 2 emphasises parity. In the last sentence of the letter, he says:

"I can accept the 3p (not 2p) difference but we must have parity."

THE CHAIRMAN: So the 3p not 2p is the reference to the difference between the Kingsize and the Superking size?

MR LASOK: I think this is the differential between Kingsize and Superkings, so he can accept a difference between Superkings and Kingsize of 3 pence rather than 2, but he says he has to have parity between, on the one hand, the Dorchester Kingsize and on the other the Richmond Kingsize and between the Dorchester Superkings and the Richmond Superkings.

The next document, 58, {D28/58} confirmed items covered at a meeting. I would go to the second page,

and to paragraph 6. Which refers to -- I am sorry.

DR SCOTT: So what he is saying in 2, and he doesn't mind the absolute level, provided that parity is maintained?

MR LASOK: So far as the difference between Kingsize and Superkings, it doesn't matter if the differential between them -- I don't think -- that is itself a relativity but it's a relativity between variants of a given house, but he is not worried about that, as long as the horizontal position is the same, it's parity. You know, these are horizontal pricing arrangements, actually, but there we are.

Page 2 of tab 58, {D28/58} paragraph 6 records that ITL and Safeway had gone through pricing enquiries, and had corrected the price of Richmond so as to match Dorchester. Now, again, it is true that this is a reduction of the price of Richmond, but it's a reduction to match. In the next, following sentence there is a reference to Embassy No 1 and Regal, and again the price change here is "to retain their differential against" the linked Gallaher brand.

The next document, 59. {D28/59} This is one of the documents that ITL circulated to retailers as a result of the Gallaher MPI signalled in, probably May of that year. It starts off by saying that Gallaher, Rothmans and Philip Morris have announced MPIs. It says ITL have no current plans to increase prices, but then says:

"A very important aspect of ITL's pricing strategy is the differential pricing between our leading brands and selected other manufacturers' brands in the same segment."

There is then an example, or rather two examples are given, one is a differential and the other is a parity. In the next paragraph it says:

"From the date of the Gallaher MPI (24 June) can you please ensure that these increased differentials are maintained until such time as ITL introduce their own MPI."

Then he says:

"I appreciate that Gallaher has not increased all brands and that the increased differential will only apply on selected brands."

Again you see exactly the same pattern of behaviour. There is no reference to maximum prices, these are all fixed parities or differentials. The object of the exercise is to maintain a relativity with Gallaher.

THE CHAIRMAN: Well, isn't this the example for Safeway of the documents that you took us to in relation to this, that ITL actually wanted the differentials to widen at the point when Gallaher was indicating it was going to increase its prices but ITL was not going to increase

its prices?

MR LASOK: The question is whether you are looking at shelf prices or the RRPs, because the effective result of all this, certainly so far as Richmond and Dorchester were concerned, was to leave the shelf prices in the same way because the problem --

THE CHAIRMAN: Yes, but this is that same incident, isn't it?

MR LASOK: Yes, it's the same incident, it's part of that.

Then the next one is 61, {D28/61} and this is dated 3 July 2002 and refers to checks on the prices in Safeway stores. But you see by the second holepunch, he says:

"Superkings, Berkeley, Raffles should be the same price."

And refers to putting Safeway in line with other grocers. The point here is that the brands are different manufacturers' brands, ITL has Superkings; Gallaher's, Berkeley.

The next paragraph is again parity. Here it's Richmond and Dorchester should be the same price for both Kingsize and Superkings, and he refers to all other accounts, which are the other retailers, have Richmond at the price stated there for Kingsize and the price for Superkings, and then gives what the Safeway price should

be, and notes there is a divergence for Superkings.

In the last paragraph, he is referring at the beginning to Safeway being below the market and recommending a move up, but for present purposes the last sentence is relevant:

"JPS brands should follow L&B."

Actually those are both ITL brands. Then on the next page, the second paragraph, we have --

THE CHAIRMAN: So that's saying that JPS should also have an increase, is it?

MR LASOK: Yes. But for present purposes I don't think that's particularly important because they were both ITL brands.

Then on the next page, second paragraph, we have:

"GV should match Old Holborn after any ITL MPI."

So GV was the ITL brand, Old Holborn is the Gallaher brand. So here the instruction is that after the ITL MPI we should end up with a situation in which the parity is maintained.

The next paragraph is again an alteration to Drum to match Amber Leaf. Drum is the ITL brand, Amber Leaf is the Gallaher one.

The next paragraph is another reduction to match a linked product. In the middle of the page we have a reference to Cafe Creme, which was an ITL brand, and

here is says:

"Cafe Creme brand should be minus 6p [I think that's unconfidential] against Hamlet Mins."

"Hamlet Mins" was the miniature cigar that Gallaher was selling.

DR SCOTT: Just for clarity, the MPI in that paragraph is Gallaher's MPI that was going to be implemented on 25 June, because ITL don't have their equivalent MPI until 2 September, is it?

MR LASOK: I think that's correct.

THE CHAIRMAN: There they seem to have appreciated that actually the MPI has not been implemented.

MR LASOK: Then finally there is tab 77, {D28/77} and this is a letter dated 16 June 2003 from, in ITL to Safeway. There is a heading towards the bottom of that page, "MPI 23 June 2003" which deals with the implementation of the ITL MPI. You will observe that this concerns, among other things, the sale to Safeway of stock at the pre MPI price. This is the prebuy.

The last line on that page, before you get to the indented (a) is:

"ITL will deal with the matter on behalf of Safeway at no additional cost on condition that ..."

Then you have the conditions. If you turn to the next page, condition (b), which I think is non-confidential, is as follows:

"All Safeway stores' retail selling prices when changed will continue to reflect the differentials in recommended selling prices between ITL and other manufacturers."

Now, the end result, in our submission, is that we don't have a complete set of documents but the documents that we do have, extending over a relatively long period of time, justify fully the confident inference that ITL and Safeway had agreed parity and differential requirements. The passage I have just read out which talks about continuing, in our respectful submission, is adequate proof of that, but it's well substantiated and corroborated by the other material.

That's a convenient moment for me to stop.

THE CHAIRMAN: Yes. Thank you very much, Mr Lasok. Perhaps you could give some thought over the short adjournment to whether it's possible, in relation to those figures in the price schedules that you showed us on the margin point, to pick out the ones on which you wish to rely and then either seek Gallaher's consent to the disclosure of those or else we might order the disclosure of those or at least seek Gallaher's views on the disclosure of those so that even if not the whole of those spreadsheets at least the points on which you wish

to rely can be available to the other parties so that they can follow the point.

MR LASOK: I think it's not just ITL, it was the other appellants.

THE CHAIRMAN: Yes.

MR LASOK: Yes.

THE CHAIRMAN: Thank you. We will come back at 2 o'clock.

(1.03 pm)

(The short adjournment)

(2.00 pm)

MR LASOK: Madam, I wonder whether the Tribunal could go to annex 26, please, this is the Gallaher/Safeway bundle of documents. I have dealt with ITL and Safeway, and I just wanted to look at some documents exchanged between Gallaher and Safeway that indicate that the arrangements between those two undertakings also included respect for the Gallaher price list differentials. The first of these is tab 26 in annex 6. {D26/6}

In this document we see a number of familiar names, but in order to shortcircuit things, I wanted to look not so much at favourites like Richmond and so forth and Old Holborn and Golden Virginia, but at the rather more exotic Sobranie Cubans in paragraph 5, because at the bottom of this page, this is exhibit 6, we have the RRP

of Sobranie small cigars and so on, the Safeway price and the Safeway agreed price.

The Safeway agreed price is expressed -- I think these are non-confidential figures -- as things like 10 pence above Cafe Creme/Hamlet Miniatures. Cafe Creme is the ITL brand, Hamlet is Gallaher. Below that you have for slim cigars 10 pence above Classic which is an ITL brand and Hamlet, which is a Gallaher brand. Then we have 50 pence below King Edward Coronets.

This replicates the Gallaher policy position which is to be seen, and I think I'll just give you the reference, it's one of the Gallaher documents I think I may have taken you to yesterday, in annex 3, tab 4, at page 3, {D3/4/3} where you will see the Gallaher policy position regarding the price positioning of Sobranie, and that's exactly the same as what we see here.

Then if you go to exhibit 12 and just picking out bits at the bottom of 12, which is a Gallaher letter to Safeway in 2000, you have an item 5, and it said:

"You would agree to put these on parity with each other."

The next document is tab 23. {D26/23} Tab 23 is an email from Gallaher to Safeway mentioning two brands, one an ITL brand and the other one a Gallaher brand, and the last sentence says:

"Please can you put them at parity as soon as possible."

24 is a list of anomalies which all reflect Gallaher's policy. For example, if you just go to the first, number one, I think this is not confidential, the prices are given for Benson & Hedges and Regal. Benson & Hedges is the Gallaher brand, Regal is the ITL brand. The difference was 6 pence, and it says:

"The price list difference, 5 pence."

The other items are expressed in "should be" language, and at the very end of the email it says "Could you adjust this week".

Safeway would action Gallaher's requests to move prices, an example of that is tab 41. I think actually on reflection it's not 41. I am sorry, I know what I have done, I've moved to annex 28 by slipping over too many pages. 41 {D26/41} has the exchange of emails and starting off with an email from Gallaher to Safeway with price changes, and then the response in the middle of the page:

"These changes have been loaded with effect 03/03."

So in our submission the position regarding Gallaher and Safeway was exactly the same as the position regarding Safeway and ITL.

THE CHAIRMAN: Yes. Apart from that last document, the previous ones all have dates before March 2001, which is, I think, a point that Mr Saini was making, that those pre-date the start of the infringement as according to the decision.

MR LASOK: Yes. We can only use the documents that we have, but in our submission it would be pretty extraordinary if there had been a change in behaviour. No reason has been given why there should be a change in behaviour. So we submit that if you have a trail of documents that indicate that they were subscribing to the Gallaher P&D requirements, and if you have evidence that -- we know that Gallaher's strategic position remained the same, it never abandoned the idea of P&Ds, and if you have evidence that Safeway would comply then that is sufficient for present purposes.

I wanted now to turn to the position of Shell. Here, as you have heard from Ms Dinah Rose, the argument is that Shell at the most, as I understand her submissions, would have been liaising with Gallaher and ITL on the construction of price files that contained recommendations that would go to its independent contractors, but there was, in no sense, any belief or expectation on the part of anybody that the independent contractors were going to comply with the price files because they would do their own thing.

I want to take this fairly quickly. It's worthwhile just for a minute looking at a document in annex 9.

DR SCOTT: Sorry, Mr Lasok, just before we proceed, one of the points that she made to us was that Shell wasn't a retailer in the sense that others were retailers, and there were two aspects to that, one of which was the fact that even with the RBAs, the actual contract at the point of sale was still with Shell, and the other aspect was the introduction of the RBAs over a period, so there is a period when it's all non-RBA down to a period when --

MR LASOK: Yes, that's right.

DR SCOTT: Are you going to address us on those two points? Just to position where you are.

MR LASOK: We fully accept that what happened was that, by the time you got to, I think it was August 2001, you had reached a point at which there were only, I think it was something like 10 petrol stations that remained under the direct control of Shell. So progressively over the period of the ITL/Shell infringing agreement, which is both before August 2001 and after August 2001, what we have is a progressive movement. In the case of the Shell/Gallaher infringing agreement, that's from August 2001, and therefore in the period in which the switchover to independent contractors has been virtually

completed.

Our submission is that, when you actually look at the documents in the file, and I can't go for reasons of time over every single one of them, you don't see any change in pattern behaviour, and our submission therefore is that Shell did agree or concert pricing, shelf pricing, with ITL before and after August 2001, with Gallaher from the commencement of the infringing period for the Gallaher/Shell arrangement. It's perfectly true that there were independent contractors. There is the technical point that the contractors sold the goods back to Shell and then there was a technical sale by Shell to the customer at the very point at which, as it were, money changed hands.

But in our submission the gist of the complaint against Shell is the fact that it was agreeing and concerting these prices and that it had greater influence than it claims over the independent contractors.

I think, broadly speaking, there are two points that I wanted to make from the documents in relation to that. The first is that, if you look at the Shell price files, you basically see two prices. One is the Shell recommended price and then there is the maximum price. But there are documents indicating that the Shell

recommended price, the one that they were recommending to the independent contractors, was regarded as minimum price, one point, and that's the document that I wanted to go to now; and the second point is that, contrary to the submissions made by Shell, there is evidence that Gallaher and ITL understood that Shell had control over the independent contractors at the material time. In our submission, that is relevant evidence that supports the view that in practice the relationship between Shell and the independent contractors was not as portrayed by Shell to the Tribunal. Those are essentially the two points that I wanted to make in relation to Shell by reference to the documents.

So the first one involves a document in annex 9 at tab 15. {D9/15}

MS ROSE: I am sorry to interrupt my learned friend, but again I would like clarity over exactly what the OFT's case is. As I understood Mr Lasok, what he has just submitted is that he says that there is some material to suggest that the recommended retail price was seen as a minimum price. With great respect to Mr Lasok, that's not what the decision says. The decision says that Shell was involved in setting a fixed price. Is it now the case that the OFT is seeking only to contend that Shell's in a position to set a range of prices between the RRP and the maximum price, or is it maintaining the position that's in the decision?

MR LASOK: Well, interventions are always very welcome. Our position is that we maintain the position that is stated in the decision. The point that I am making is that there is some suggestion that what Shell did was to have a range of prices, we have the maximum beyond which people could not go, but the Shell recommended price was, I think, the way it was put, nothing other than a recommendation and nothing more than that. But in fact, if you look at document tab 15, and at the first email, this starts at the bottom of the second page. This is Shell, on 13 December 2001. So this is after the transition to the independent contractors, and a price file is sent to Gallaher, ITL and Rothmans, and they are asked to correct the price parities and differentials.

The penultimate paragraph says:

"If poss, we would like to send the file with both Shell and P&D codes with min and max retails, case size but not the cost to site."

That appears to be evidence that Shell understood that the Shell recommended price was the minimum price.

Then so far as the second point is concerned, which concerns the understanding of Gallaher and ITL, broadly

speaking we submit that when you look at the Shell evidence, the common sense conclusion is that Shell agreed or concerted with each of the manufacturers' pricing at shelf level by reference to the manufacturers' parity and differential requirements, and that was done on the basis that Shell was going to take steps to secure compliance by the independent contractors with the P&D requirements. An example of Gallaher's belief that that was so is in annex 9 at tab 42. {D9/42}

This dates to 18 March 2003, and it's from Gallaher to Shell. It appears to follow on from a previous discussion that I would suppose may have been an oral discussion, but it's not clear, and the email says:

"As just discussed, would it be possible to circulate a reminder to all stores that [one brand, which is a Gallaher brand] should be the same price as", and then there is a reference to an ITL brand.

An example or rather examples of -- the email ends by saying that this is the second outlet in a week, so they are clearly expecting that Shell is going to sort things out with the independent contractors and they want to keep all the independent contractors in line.

The ITL examples are in annex 19, tab 60. {D19/60} Tab 60 is a letter from ITL to Shell which enclosed

a pricing report for Shell sites called on by the salesforce. This relates to the period between 1 July and 14 July 2003, and the writer says:

"As you will see, the majority of brands have shelf prices within the Shell recommended and maximum prices, however the Richmond Kingsize 20s and Richmond Superkings 20s appear to have shelf prices above both the Shell RRP and maximum price."

Then the writer sets out what the prices ought to be, which is derived from the Shell price file, and he refers to the fact that the majority of sites are falling within a particular band. At the end of the letter, in the last sentence of the penultimate paragraph he says:

"I would be grateful if you could investigate this matter and let me know the outcome."

One of course sees that this is concerned with pricing by reference to the Shell minimum and maximum prices. I deliberately use the word "minimum" because the Shell recommended price appears from the first email what I took you to be a minimum price. The significant feature of this document for present purposes is that we say that it's evidence of the belief on the part of ITL that Shell had relevant influence over the contractors. It is curious that Shell was asked to not only

investigate the matter but let ITL know of the outcome. It's not immediately apparent what business it was of ITL's, but the main point about it is that it indicates ITL's belief of the control that Shell had over independent contractors.

I was also going to refer to the next document, 19/61, {D19/61} which is ITL emailing Shell on 13 August 2003, asking if -- I will quote it, it's:

"Just a quick note to ask if the Richmond Kingsize and Richmond Superkings prices have been brought back into line."

This is another one of the documents in which reference is made to a minimum price in the Shell price file. The last paragraph of the letter says:

"When we last spoke, you said that the prices would be corrected as from 11 August. Can you please let me know if this has happened?"

THE CHAIRMAN: I think it was also Breda Hughes who wrote the other email in the Gallaher documents.

MR LASOK: Well, you saw, I think, yesterday the multipartite exchanges that were going on in which Shell was sending out price files to Gallaher, ITL and Rothmans.

THE CHAIRMAN: No, but the email that you just showed us, which refers to the minimum price, was that also one that ...

MR LASOK: That's an ITL email. No, sorry, that's a Shell email. Annex 9, tab 15 {D9/15} is a Shell email that refers to a minimum price, and this is an ITL email to Shell that also refers to a minimum price.

THE CHAIRMAN: No, that was my mistake, I misremembered it.

MR LASOK: I think that Breda Hughes or Breda Canavan, as she is variously named, may have been copied into the earlier email that I referred to.

THE CHAIRMAN: Yes.

DR SCOTT: 9/15 at the top of the second page, Wes Feeny says:

"I would also add that the parities and differentials apply to both rec and max."

So he is expecting both parities and differentials, but he doesn't say "min".

MR LASOK: No.

So, in our respectful submission, the evidence is that the contemporaneous belief of both ITL and Gallaher was that Shell did have control over the independent contractors, that was why they were writing to Shell for different reasons in order to get the prices on the sites changed.

Finally in relation to the individual retailers I wanted to refer to a document that I think ITL took

you to in opening, which concerns T&S Stores, and is in annex 29. It's 29, tab 19. {D29/19} If you look at this letter which dates back to 12 July 2000, towards the bottom, after the second holepunch, there is a reference to "Differential errors" and a request to T&S to correct them the following week.

If you compare the prices given and the change required with the document at tab 11, which is the T&S Stores business agreement, and the price requirements are in my copy on the stamped page 32 in the bottom right-hand corner. We have here the list of linked brands. Regal is the one that follows Embassy No 1, which is at the top, Lambert & Butler and Classic are also there.

If you actually compare the differentials specified in the price requirements with what the writer of the letter at tab 19 wants, you will see that the changes required correspond to the differentials set out in tab 11.

For example, I found it actually a bit difficult to deal with the Sovereign 100s, for which we have to look at the L&B 100s. But the easier one, I found at any rate, was the reference in tab 19 to Classic Twin because there it states in the letter that Classic Twin was set at -- I think this is unconfidential -- £5.44.

The change required was change to £5.54, equal to Hamlet 10s.

If you go to tab 11, you see just below the second holepunch under the heading "Classic" that all packings had to be "at least no more than the price of the same Hamlet packing". So in fact this is another one of these examples --

DR SCOTT: "At least no more"?

MR LASOK: I actually think "at least no more" is quite interesting as a concept. The main thing is the argument that we are looking here at maxima runs a bit thin if the change required in the letter at tab 19 is a change to the specific price, 5.54, that is equal to Hamlet 10s. Again it's another example, in this particular case, of an increase of the ITL brand in order to match the Gallaher brand.

THE CHAIRMAN: Well, do we know that? Do we know whether this resolved -- the differential errors meant that ... (Pause).

MR LASOK: My point is that the changes here are all changes that are designed to bring the brands into line with the parities and differentials that are set out in the document at tab 11.

THE CHAIRMAN: Yes, with the B&H Kingsize we don't know whether changing the Regal KS is to 20.45 would have

meant increasing it from the existing shelf price or reducing it from the existing shelf price, whereas with the Classic Twin you are saying that Classic Twin is an ITL brand, and they seem to be saying it should be increased from 5.44 to 5.54 to be equal to the Hamlet ...

MR LASOK: Yes.

THE CHAIRMAN: The two columns aren't necessarily the same thing in relation to each of the lines, I think that's ...

MR LASOK: You see, the thing is you can also trace Drum, because that was a change to Amber Leaf, and in tab 11 all packings of Drum were to be at least no more than the price of the same Amber Leaf package.

Reverting to tab 19, if you look at the Sovereign 100s, the comparison obviously is to L&B. Now, the thing is that the change required was either a change to the price of Sovereigns, which was to go up from 17.90 to 18, or L&B was to change to 18.40.

Now, in the price requirements schedule in tab 11, the differential between Sovereign and L&B was supposed to be 50 pence. So that's what they are doing. Where one can check it, one can see that this is requiring T&S to alter the prices so as to conform to the parity and differentials specified in the T&S agreement.

The reason why I took you to these two documents was because it was suggested by ITL in opening that the differential errors referred to in tab 19 are errors in the pricing strategy or implementation of the pricing strategy of T&S, but in fact we can see that they were errors in T&S' implementation of the agreed pricing strategy with ITL.

I wanted to turn now to a different factual topic, and that is the argument that the infringing agreements weren't in the interests of the retailers. This is advanced in particular, for example, in ITL's skeleton in paragraph 66, ITL asked rhetorically why retailers would cede their pricing freedom to ITL in respect of Gallaher products. What ITL then did, in paragraph 67, was to seek to substantiate that assertion on the basis of the example of a manufacturer driven price change. But ITL shirked from considering a retailer led price change, for rather obvious reasons.

Now, in parentheses I should note that in that part of ITL's skeleton we have an instant sort of Homer nodding, because ITL lumped all the retailers together as large and sophisticated companies with significant bargaining power, who, it's said, competed vigorously and would not want to become less competitive against their rivals.

One, in my respectful submission, needs to be a bit careful about that, because ITL's own evidence -- and it's Mr Batty's first statement, paragraphs 5.2 and 5.5 -- draws a distinction between the supermarkets who competed with each other and the convenience retailers who did not, and it's a simple and a rather obvious observation that not all the retailers could be described in the same terms, in terms of their size and sophistication and their ability to exercise bargaining power and so forth.

However, the slight problem about ITL's argument saying that the arrangements that prevailed in the market at this particular period were contrary to the interests of the retailers is that it wasn't ITL's view at the time, because, for example, in July 2003, there was an exchange between ITL and Asda about Asda's pricing policy, and in the course of the email exchange -- and I'll just give the quote and the reference, the reference is 14, tab 77, but in response to Asda, ITL says:

Confidential: Asda

[redacted]

So therefore it would appear that ITL thought that it was in the interests of the retailers because the

prevailing trends in the market at that time resulted in increased margins for retailers.

However, there is another problem about ITL's point, which is that it's entirely theoretical and bears no relationship to the facts, because one of the things that happened in reality is that ITL, Gallaher, we have evidence that we can refer to now concerning ITL, would comfort the retailer.

So, for example, ITL would tell the retailer if it was getting out of step with another retailer in relation to its pricing. By way of illustration of what ITL would do, we could go to annex 18 and to tab 28. {D18/28}

Tab 28 is an email from ITL to Fiona Bayley, which sets out for the benefit of Sainsbury's comparative pricing for various tobacco products across Sainsbury itself, Tesco and Asda. The comment made just below the first holepunch by the writer of the email is:

"Looks like there may be some headroom to move up."

The same kind of thing would apply where the retailer operated an internal pricing tier policy where it had variable prices across different types of store, and an example of that is 28/46. {D28/46} In 46 there is a reference to the implications with other suppliers. Sorry, the bit I actually wanted to look at was, at

least in my copy, which is a 2 August 2002 document -- I am terribly sorry, I am in 26 at tab 46, which should be an email of 2 August 2002. My junior tells me, and he is always certainly right, that I got it right the first time and it's 28/46. I am terribly sorry, it's 28/46.

This is just an example of the assistance that the ITL provided for the --

THE CHAIRMAN: That's where we were originally.

MR LASOK: That's correct, it was my error. So that's an illustration of the assistance that they provided, where a retailer had tiered pricing, so that they would give an indication as to what prices ought to be.

THE CHAIRMAN: But that's not as between one retailer and another, that's as between tiered stores of the same retailer.

MR LASOK: That's correct, this is an illustration giving assistance of pricing relating to tiering. If you put the two together, what you have is a situation in which ITL was prepared to provide information relating to the pricing of a rival retailer for the purpose of explaining to a retailer that it had headroom to go up. It was also prepared to indicate what the correct pricing should be for, when you had a tiering policy, so the ordinary natural inference is that it would do exactly the same if you had a combination both of a tiering policy and you were interested in what the rival stores, who also had tiering policies, were pricing.

DR SCOTT: You told us you were looking at a document of 2 August 2002, there is a document 2 November 2001. Are we looking at the right one?

MR LASOK: I am not sure about that. I think what I would do, given the time, is to move rapidly on to the next point.

THE CHAIRMAN: If your junior says it's the right one, then it must be.

MR LASOK: The great thing about juniors is that you can rely on them implicitly.

I wanted to make a comment about a submission made on behalf of ITL on Day 1, the transcript reference is Day 1, page 120, lines 20 to 23, where the submission was made that a retailer wouldn't want to put up the price of the Gallaher brand simply because ITL had put its prices up, whatever ITL was doing across the market, because the retailer would be concerned about being competitive on the Gallaher brand.

I think it was said on behalf of ITL that there was no evidence of the retailer being aware that ITL's requirements applied to other retailers as well. On

that point, there are a couple of documents that one can refer to, they are in annex 20 at tabs 58 and 74. {D20/58}{D20/74} At 58 in the middle of the page -- I should say I probably ought to start at the email at the bottom of the page, which is the first email in the string, where Somerfield sends a -- it's not quite a circular email but it's an email to Mr Hall, who was ITL, and Alan Hutcheon from Rothmans.

THE CHAIRMAN: There are some words in red squares in this.

MR LASOK: Yes. So what has happened is he tells them that they are aware of Somerfield's pricing policy, which was as described in the email. He asks for confirmation of the reported pricing of a number of tobacco products, so that he could update the Somerfield system. The reply comes back in the middle of the page, and in the second paragraph it confirms the price, and then says:

"We require it to be [and I won't mention the figure] less than Old Holborn."

Then there is another reference to prices in that other retailer and the email ends "over to you".

Tab 74 is a document similar in nature, 74 is from ITL, and it's an email to Somerfield. If you look at the heading "Drum 25 grams", the second paragraph after that heading by the first holepunch says what the strategy requirement was in Somerfield, and then refers

to the rival. In relation to Golden Virginia, there is again a reference to the strategy requirement in the rival for another product, and the strategy requirement in Somerfield. St Bruno is in the same vein.

The point about these rather complex trading relationships between the manufacturers and the retailers is that they combined a number of features that all tended to work in support of the observance of the strategic requirements which were based upon pricing relativities, and we can see the manufacturers covering off areas that might be of concern to the retailer such as the ones we have been looking at, which include the retailer's concern not to price out of line with a competing retailer, and also the retailer's interest in knowing what the manufacturer's strategy or pricing requirements were in relation to other retailers.

Effectively, ITL managed the relationship between its own P&D strategy and the concerns of the retailers in order to -- "enforce" is probably the wrong verb to use, but it was in order to further the objective of achieving this particular pricing strategy that it had adopted of linking its pricing of certain brands with the pricing of the related Gallaher brand.

I want to turn now to a different topic, which is the question of the evidence of adherence. Now,

adherence or the lack of it has been raised for two different purposes by the appellants. In some instances, appellants rely on adherence analysis for the purpose of answering the question whether or not there was an agreement or concerted practice, and if so, what its content was.

The second purpose that some appellants use adherence analysis for is to answer the question whether the object of the agreement or concerted practice was anticompetitive. These are two quite different purposes for which the appellants use adherence analysis.

The OFT itself noted the evidence on adherence that was put to it before it made the decision, and the decision reference is to paragraphs 6.290 to 295. The OFT concluded that the evidence put to it was consistent with its conclusion on the evidence as a whole as to the existence and nature of the infringing agreements. Basically, the position we are now at is one in which the OFT's position is really limited to commenting on the use made of adherence analysis by the appellants in support of their cases.

So far as the question whether or not an agreement or concerted practice existed, and if so what its content was, in our submission the evidence of adherence is of extremely limited probative value for a number of reasons. First, the data are incomplete. Secondly, there are different ways in which the data can be analysed. Thirdly, when analysed, the data can be interpreted in more than one way. Fourthly, it is a notorious fact that the retailers were not capable of ensuring that every store in a chain respected the chain's overall pricing policy, and therefore there is bound to be a level of non-adherence in any event. Fifthly, there are a variety of reasons why variations in pricing could occur from time to time, explanations that have nothing to do with the present case. The final point is that, in our submission, the adherence analysis misfires because it's directed at the wrong target. What matters, in our submission, is the evidence concerning the contacts between the manufacturer and the retailer which usually took place at the level of the national account manager for the manufacturer and the tobacco buyer or equivalent for the retailer.

What was going on in individual stores is a matter concerning the efficiency of the implementation processes within the organisation of a given retailer, and it doesn't detract from evidence that responsible people at the right level in the retailer had reached an understanding with the manufacturer.

One illustration of this, which I can do, I think, fairly quickly, concerns the position of Shell. Shell had agreed with ITL to sell Richmond at a specific price, and there was a failure to comply by various filling stations, even though Shell had instructed them to price at that level, and that's the document at annex 19, tab 24. {D19/24}.

But if we go to 19, tab 29, {D19/29} it is a letter from ITL to Shell dated 23 January 2001. If you look at the middle of the page, there is a heading "Richmond Kingsize Price Support" and the point is made that an offer to pay money had been made to Shell on condition that the selling out price was not above a specified level. There is a confidential figure in the next sentence, where Shell points out, and this is based on Shell's own monitoring of -- sorry, it's based on ITL's monitoring of Shell stores, stations, that the current situation was that a certain percentage of both the agent and managed sites were charging above the agreed price.

Now, in our submission, that's quite a useful sentence because the fact that there was adherence or rather non-adherence of that level didn't prevent ITL from using the expression "agreed price".

THE CHAIRMAN: In January 2001, where is that in the

transition?

MR LASOK: I can't remember the profile of the bar chart that Shell referred the Tribunal to last Thursday, but January --

THE CHAIRMAN: The start point --

MR LASOK: -- is pretty early on, I would suspect that at that stage most of the petrol stations would have been under Shell's direct management but not independent contractors. The point that I am making, and the reason why I didn't refer to this document at an earlier stage when I was looking at the belief of the manufacturers that Shell was in a position to control, is precisely for that reason concerning dates. The documents I referred to earlier are dated much later, they are 2003. So in our submission they are forceful probative material showing that Shell did have control over the independent contractors.

The point that I am making here is quite distinct and it's concerned with this problem about adherence. You can have non-adherence but that does not detract from the fact of an agreement.

THE CHAIRMAN: Well, non-adherence plus protest, I suppose, doesn't detract from the existence of the agreement, and here you would say, well, this amounts to protest, but non-adherence without protest is more ambiguous as to

whether it says anything about the existence of an agreement.

MR LASOK: Well, probably you would have to have non-adherence, knowledge of non-adherence, and persistence of known non-adherence, which might ultimately lead to the conclusion that there was no agreement.

However, so far as I recall it, we don't have that combination of factors here. It is right to say, of course, that the protest point is quite relevant, when you look at the contention that the exchanges running between the manufacturer and the retailer, which are the pricing instructions from the manufacturers to the retailer do not, it is said by the appellants, indicate that there is an agreement or a concerted practice because they are all unilateral. Because there you would expect to see evidence of the retailer replying to the manufacturer, pushing back. When you don't have that, then, in our submission, the evidence is robust to support the conclusion that there was acceptance on the part of the retailer, because that is a situation in which you expect a response from the retailer if there has been no agreement. If there is an agreement or understanding, then it's perfectly natural to observe no response.

In this particular instance, we have here an example of the manufacturer observing a certain level of non-adherence, but still pressing and saying "Well, we have an agreement nonetheless". The documentation that we have doesn't indicate that Shell denied that there was an agreed price or an agreement. It's also right to say that this particular situation may well have been exceptional because, in the next document, which is tab 31, we have the ITL internal report on Shell, and that is one that --

THE CHAIRMAN: It's tab 30. {D19/30}.

MR LASOK: It's tab 30. This is one that gives, in the first paragraph, a brief description of the state of play at Shell. Although I think it's right to say that by March 2001 it looks as though a considerable number of dealer sites were sites over which Shell had no control. But you see in the bottom of the page, it's the last full paragraph, and I think it's something that you have seen before:

"Target differentials are achieved on all products most of the time."

There is another reference, a couple of pages further on, the penultimate page of the document, under the heading "Problems", there is a number 2 that says:

"Price differentials not achieved at some agent

sites and occasional errors from head office."

None of this lack of adherence evidences or was regarded by ITL as evidencing the absence of an arrangement that it had with Shell.

If I turn now to consider the second purpose for which adherence analysis is being used, this is for the purpose of negating the OFT's analysis in the decision on the ground that if adherence was low, the agreements or concerted practices could not have had anticompetitive effect.

Well, the short answer to that is that if you are carrying out an object analysis, the finding of an object infringement cannot be controverted by claims, particularly claims based on rather dubious and incomplete evidence, that in the event, and as a matter of fact, the anticompetitive arrangement didn't succeed in achieving its goal. That's trite law.

But the further point is that everybody knew at the time that complete adherence could not be guaranteed in every single outlet every time, and there is ample undisputed evidence that the appellants sought to achieve it, that is to say they sought to achieve adherence, Gallaher and ITL in particular had methods, systems for monitoring what was actually going on in the individual stores, and we have seen some examples of

that. They reported back to the retailers. The retailers were conscious of the importance of feedback of that nature for the purpose of altering their shelf prices.

So that was the system that was put in place, which acknowledged imperfect shelf price controls, and in addition to that, we have seen agreements, trading agreements, in which payments are based upon the achievement of specified levels of adherence. One example is the Gallaher/Co-op agreement in annex 5 at tab 7. {D5/7} And you have very often the description of a methodology for working out how much the payment is going to be scaled back in order to take account of a failure to adhere to the relevant level.

But curiously enough, it was only after the OFT's investigations were well on their way that the appellants seem to have started looking at levels of adherence in the way in which they are now doing it for the purpose of presenting their appeals to the Tribunal. It's an oddity of this case -- which is concerned, like any Competition case, with the behaviour of businesses -- that the appellants have based their adherence analysis arguments upon ex post facto expert analysis of data seeking to draw conclusions from them, rather than going back to the methodology that for

business purposes they had actually selected at the material time when they were in a trading relationship with a particular retailer. Because at that stage, back in the past, where payments were being based upon adherence, adherence had a financial value, and they adopted a method of ensuring adherence, and we see the results in the documents, like the Shell document that I've taken you to a moment ago.

But when we look at all this contemporaneous material, which results from the contemporaneous methodologies used for business purposes, we don't see the kind of picture that is portrayed in the different ex post facto methodologies that have been adopted for forensic purposes in the course of these appeals by these appellants.

In our submission, it's very, very simple. In a Competition case when you are looking at how businesses operate and the way they behave, the critical factor is to look at the business' contemporary understanding of what is going on. So if you raise the question of adherence, you need to know what was the contemporary understanding of adherence by the businesses when they were making those decisions. Your ex post facto analysis, using all kinds of bells and whistles, is frightfully interesting, and it may be role for another purpose, but it is not relevant for any of the purposes for which it is being advanced in the present appeals, because it is not relevant to the question whether or not there was an agreed or concerted practice, and it is not relevant to the perceptions of the undertakings at the material time, those perceptions were formed by the information that the undertakings had at that time. And that's why the contemporary documents in which the manufacturers opine or rather express their concluded view on the level of adherence by the retailers are, in our submission, the relevant evidence if at all we were looking at the question of adherence.

I want now to turn to a separate issue, and that's the question of parallel and symmetrical.

THE CHAIRMAN: Just noting the time, whether that's a good moment to break or whether we should hear what you have to say on parallel and symmetrical?

MR LASOK: That's a suitable moment.

THE CHAIRMAN: How much longer do you think you have, Mr Lasok?

MR LASOK: I would have thought -- is 4.30 possible?

THE CHAIRMAN: Yes, but probably not beyond 4.30.

MR LASOK: Well, I'll keep to 4.30, then. I don't think it's likely I would finish at 4.15 though.

THE CHAIRMAN: Very well. We will take a ten-minute break now and come back at 25 past.

(3.15 pm)

(A short break)

(3.25 pm)

MR LASOK: Madam, if I can I just want to make some short points about the parallel and symmetrical aspect of the case. This is dealt with in the decision at paragraphs 6.227 to 229.

The appellants' challenge to that part of the decision, in our submission, is flawed for three main reasons. First, there was a suggestion floated in ITL's opening submissions that the OFT had abandoned the position set out in the decision, but that simply seems to be based on a misunderstanding of the OFT's case, which can be cleared up very, very simply if one looks at the defence, paragraph 281, and the OFT's skeleton, paragraph 47.

A point related to that was made by ITL in opening, that if the parity and differential requirements were not parallel and symmetrical, they were inconsistent. Now, in relation to that, although both manufacturers were seeking to maintain P&Ds in relation to the retailers, there is actually no evidence at all of any clash between the two manufacturers' requirements causing any practical problems, it all seemed to work

rather smoothly from the point of view of the practicalities. So it may be that from a kind of intellectual viewpoint, if you analyse the parity and differential requirements as if they were algebraic formulae, you might not be able to put them together arithmetically, but in terms of the practicalities of what was really going on, there is no evidence of any practical difficulties.

Secondly, it's fair to say that the ability to analyse the extent of the parallel and symmetrical nature of the arrangements is dependent upon the available evidence which is incomplete. Where the matter can be tested by reference to contemporaneous lists of both manufacturers' requirements, which isn't always the case, the OFT's case holds up. One example of that is a comparison -- and I am not going to do it now due to lack of time but I'll just give the Tribunal the references -- between the documents in annex 3, tab 4, {D3/4} which is the Gallaher pricing objectives in, I think, March 2001, and the strategic pricing requirements annexed to the document at annex 20, tab 15. {D20/15} The strategic pricing requirements are on the sixth page. It's the Somerfield trading agreement with ITL. If you compare the two, you will find that there is not always a match, but if you look

at some of the brands, it's exactly the same in both the Gallaher strategy and in the ITL strategy.

The third point to make, and this is the last one before I move on to the last topic, is that the fact remains that in the decision the parallel and symmetrical point is classified by the OFT as an aggravating feature. Whether or not there are parallel and symmetrical P&D strategies affects only the magnitude of the anticompetitive harm. If at the end of the day the Tribunal were to conclude that the arrangements were not parallel and symmetrical -- which we rather suspect the Tribunal will not conclude because of documents like 3, tab 4, and 20, tab 15, {D3/4}{D20/15} but if you did conclude that, it wouldn't affect the fact that the infringing agreements were as stated in the decision object infringements.

I want to turn very briefly to another topic, and that is the assertion made, again in the course of ITL's opening, that a lot of the documents that we see show a series of competitive moves essentially of a unilateral nature by the manufacturers which have nothing to do with any agreement to maintain P&Ds. It was submitted, I think, that where you see one manufacturer moving its price up or down or wherever, the other one might also move up or down or wherever, and this is a competition working as between Gallaher and ITL, and it's said to be nothing to do with a P&D arrangement.

In our submission, the difficulty with that submission is that we have a factual context, indeed a clear factual context, evidenced by documents emanating from Gallaher and ITL that demonstrate beyond any shadow of a doubt that each of them had a strategy to maintain retail price parities and differentials.

The existence of agreements between the retailers and ITL and Gallaher that show that retail price parities and differentials were to be maintained is plain. It cannot be disputed. We also have, in the documents, express comments made by the manufacturers that price moves are nothing other than manifestations of the manufacturers' parity and differential requirements. For example, the ITL document that I showed the Tribunal this morning, which contained the phrase "we are paying for parity". All these documents, in our submission, provide a context for the other communications in which there is no express reference to the parities and differentials, because when we see those documents in this context, then where they are of the same nature as the documents that do expressly refer to parity and differential strategy, we can draw

a reliable inference that they form part of the same course of conduct. There are bound to be documents in the files that don't form part of this course of conduct, because, for example, we can have documents which clearly indicate that the intention of the author of the document is, for example, to ensure that pricing by the Shell independent contractors is in line with Shell's requirements and there is no reference in the document to ITL's or Gallaher's requirements.

We can have a document like that. That kind of document we use, we have used, because it illustrates a different point entirely, namely that the manufacturer in question, who emitted the document, entertained the belief that Shell controlled the independent contractors.

We don't use that document in order to demonstrate that there has been an agreement or concerted practice concerning parities and differentials.

So we are not roping in every single document that exists in these files and saying that each and every one of them is evidence of these P&D arrangements.

What we do say is that there is material that clearly and unambiguously is about P&D arrangements. If you have an ambiguous document, you must construe it carefully to see whether or not it forms part of the P&D

arrangements and their implementation, or whether it doesn't. Even if it doesn't, it doesn't count against the very clear evidence on the face of the document.

MR HOWARD: I am not entirely clear what the point is that Mr Lasok thinks he is making, but you will recall I have not denied that, firstly, Imperial had a strategy, you will see it in the witness statements, nor do we deny that there were, with a number of the retailers, RMS schedules or P&D requirements, and we can obviously debate what those were.

The point I was making is a lot of the correspondence is not about anything more than the tactical bonuses, it may have been part of the strategy to pay the tactical bonus to reduce the price below Gallaher, but my point was there is a separate arrangement, which is that tactical bonuses being paid and withdrawn in order to achieve a competitive position, that is what we say is normal workings of competition, one manufacturer seeking to undercut the other.

THE CHAIRMAN: Thank you.

MR LASOK: The next point related to this that I wanted to come to concerned the so-called opportunity to respond clause, because this too is advanced, as I understand it at any rate, in support of the proposition that there is

no P&D agreement as described in the decision because, if there had been a P&D agreement such as is described in the decision, the P&Ds would take effect automatically, and you wouldn't need an opportunity to respond clause.

Now, in our submission, the misunderstands the -- it's based on a complete misreading, in fact, of the -- decision. But the main point about the opportunity to respond clause is that -- as I've submitted earlier I think today -- is that it reflected a commercial reality in relation to a particular problem that arose in relation to the implementation of the P&D arrangements when the rival manufacturer reduced its price and the manufacturer with the agreement wanted to deal with that vis-a-vis the retailer, because the opportunity to respond clause simply caused there to be a discussion between the retailer and the manufacturer which had the trading agreement containing the parity and differential requirement as to what was going to happen next. But that, in fact, is a situation where the manufacturer retains control of the situation so that the opportunity to respond clause is nothing other than a particular aspect of the way in which the manufacturer was operating the P&D requirement in the context of the trading relationship with the retailer.

I'll return to so-called automaticity later on, but I think that I'll wind up on this particular point by making the observation that the monitoring documents that we have seen and the monitoring systems also support the conclusion that there were P&D requirements of the sort found in the decision, because these monitoring arrangements had, as one of their purposes, precisely to ensure that there was compliance by the retailer with the P&D requirements. We can see that, earlier today we saw an instruction written by ITL for the people who are monitoring Shell, which instructed them to monitor the application of a differential, I can't remember now whether it was a parity or a differential, as between two particular brands.

So that brings me now to making some submissions on what I will loosely call the theory of harm in the decision, although more properly it's the OFT's analysis of the anticompetitive object or the anticompetitive nature of the infringing agreements.

To begin with, in our submission, the experts' joint statement makes it clear that fundamentally the experts are in general agreement that, if you have a P&D restraint, you have an anticompetitive arrangement as it leads to increased prices. In order to get out of the consequences of that conclusion, the appellants' experts

hypothesise that if the facts were different then the outcome would not be anticompetitive, and that raises an entirely legitimate question of fact on which the Tribunal has to rule.

Apart from that, and more generally, the appellants have attacked the decision's analysis of the anticompetitive nature of the P&D arrangements on essentially four main grounds, and I do apologise if I leave anybody's prized submission out of account.

The first is the argument that the decision's analysis is implausible because it's based upon an interpretation of the facts that is contrary to ITL's commercial interest and by implication Gallaher's, given ITL's intention to use low wholesale prices to produce low retail prices.

In our submission, the problem with that argument is that it is factually incorrect.

The second argument is that the decision's analysis is implausible, very much for the same kind of reason, but here because the result in the decision is contrary to the interests of retailers. Now, that is also factually incorrect, and I made submissions on the interest of retailers I think just after lunch, pointing out that in these arrangements the manufacturers did cater for the interest of one retailer to be competitive

against another, because the focus of the manufacturer's strategy was to ensure that within a given retailer's premises the prices between the rival manufacturers' brands maintained the required parity or differential. And in order to further that objective, the manufacturers were sophisticated enough to have arrangements, contacts and so forth, with the retailers so that they could calm the retailers' concern that the operation of the P&D requirements wasn't going to bring the retailer out of line with its competitive position regarding other retailers.

The third argument advanced by, I think, some appellants but not all of them is the argument that the arrangement properly understood concerned margin parities. Now, this theory is based upon no known fact. I've drawn the Tribunal's attention to documents that do show that shelf prices could be the same even though the margins were different, and this argument appears to be based upon a well known logical fallacy, which is that correlation does not equal causation. What has happened is that people have burrowed into some statistics and they have drawn a causal relationship from a correlation. But the problem is, when you actually go to the facts, you cannot find any fact that supports this theory.

The final argument, and the one that I am going to spend a little time dealing with, is the spurious point that the OFT's analysis requires rigidity or automaticity in the behaviour of the retailer, and it is said that there is no such rigidity or automaticity, and some people say this is exemplified by the opportunity to respond clause, and therefore the analysis in the decision fails.

The problem is that the analysis in the decision goes off in a completely different direction, the decision says nothing of the sort that is attributed to the decision by the appellants, and Professor Shaffer doesn't support their view either.

At this point, tiresome though it may appear to be, it might be actually worthwhile looking at what the decision says. I know that that's a novel proposition, but it may have some utility.

If you go to page 129 of the decision, and start at 6.205. 6.205 refers to the fact that the infringing agreements as found by the OFT involved a co-ordination between the manufacturer and the retailer of the setting of the retailer's retail prices for tobacco products. It describes the particular nature of the co-ordination, which was to achieve the parity and differential requirements between the competing linked brands, those requirements being set by the manufacturer.

At the end of that paragraph, it says that each infringing agreement restricted the ability of the retailer to determine its retail prices for competing linked brands.

This is pursued in paragraph 6.206 with the observation that the P&Ds precluded the retailer from making price changes that fostered interbrand competition within the retailer's premises.

I think we can jump over the intervening paragraphs and go to 213, because the intervening paragraphs deal with a summary of certain arguments that were put to the OFT and a description of the plan of the following sections of the decision. 6.12 itself simply describes an example of a parity and a fixed differential requirement.

So when we get to 6.213, we have the statement that a parity or fixed differential requirement restricts the retailer's ability to determine the retail prices of competing linked brands because the relative prices of the competing brands are fixed on the basis of the required parity or differential.

It says:

"If a parity or fixed differential requirement is implemented, an increase or reduction in the retail

price of the one brand leads to a corresponding increase or reduction in the retail price of the competing linked brand by an equivalent amount."

So in 214 it says that:

"The parity or fixed differential requirement is capable of giving rise to significantly increased certainty for the manufacturer imposing the requirement that any change in the retail price of its brand will be matched by a corresponding change in the linked competing brand Y."

Here we have the phrase "significantly increased certainty". At this point, it is relevant to do a quick cross-reference to paragraph 6.254, because in that paragraph the OFT notes that the infringing agreements shared a key element of RPM, it says "to the extent that each infringing agreement restricted the ability of the buyer, in this case the retailer, to determine its retail prices."

If you go back to the sequence in the decision from 6.214 onwards, we have an argument set out in the decision concerning or describing the anticompetitive nature of the P&D requirements that is based upon an increase in certainty, alterations in the uncertainty or lack of transparency that exist in fully competitive markets.

This culminates in paragraphs 6.224 to 6.225, after a consideration of the opportunity to respond clause which is considered in 6.223. In 6.224, the OFT says that:

"Although the retailer may not have automatically changed the retail price of a brand in response to a change in the price of the competing linked brand, the evidence indicates that either the retailer would seek and be granted permission from the manufacturer to move the price, or that the manufacturer would instigate the price alignment by contacting the retailer."

In 225, the OFT says that:

"The evidence of contacts shows that there was a clear expectation on the part of manufacturers and an acceptance on the part of retailers that retail prices would be moved in line with the parity and differential requirements."

The theory of harm or the competition analysis that we find here is not based upon automaticity or rigidity. What it actually factors into the analysis is that there may be situations in which there isn't full implementation of the P&D requirement.

In 6.224 and 6.225 the point is made that, even if you don't get an automatic change in the retail prices, what you do get are contacts between the manufacturer

and the retailer against the background of an underlying expectation that prices will move in line with the P&D requirement.

All I've tried to do is to summarise in my own words what the decision says, that view of the facts is either right or wrong and the Tribunal has to decide whether it is right or wrong. We say --

THE CHAIRMAN: One of the themes that seems to have emerged over the past days is the differing significance that you and the retailers place on the apparent expectation that if a Gallaher price goes down, the Imperial price will only go down if Imperial gives a tactical bonus, and Imperial seem to say that was the situation. Therefore not only is there no rigidity or lock-step or whatever, but that blows a big hole in the theory of harm because that situation is indistinguishable from desirable competition at work, particularly in a market with only two players. Whereas I am not sure what you say is the significance, if any, of the evidence about retailers seemingly requiring a tactical bonus from ITL or from Gallaher in order to bring the price of their brand down when a competing brand has decreased in price.

MR LASOK: Yes. I think that there are two points that arise from that. It is inevitable that I am going to forget what the second one is by the time I've finished dealing with the first one.

The first one is that the appellants' approach is entirely formalistic. They don't look at the situation in terms of it being an ongoing working relationship between the manufacturer and the retailer. They take a snapshot. They freeze-frame everything. So, for example, they freeze-frame the trading agreement, and they say: well, if you look at the trading agreement, you have the opportunity to respond clause, and there you have it, there is the answer. But in our submission, that isn't the answer, because you have to see what actually happens.

The OFT's case is based on an analysis of an actual situation that existed over a period of time in the past, and that is evidenced in particular by these documents that we have been looking at, the trading agreements and the exchanges that illustrate what was going on.

So if you have an opportunity to respond clause, you may not have automaticity -- I am here using ITL's word rather than the OFT's -- at the level of the agreement, but what's that got to do with it? You want to know what is actually the position in the way these arrangements are actually implemented.

So, for example, the fact that there is an opportunity to respond clause actually is neither here nor there. Where you are looking at it from the perspective of the perceptions of the people in the market at the time and their decision-making processes, if all that is happening is that when the one manufacturer reduces its price, the consequence is that there is a discussion between the retailer and the other manufacturer, that tells you absolutely nothing that assists you in concluding that you are dealing with a benign arrangement. Because the problem about all this is that, in many respects, what happened was that the manufacturers, each of them, set up this particular structure that intrinsically and on any view was designed to limit the freedom of operators, specifically the retailers, and as a result of that, as the decision states, certain consequences flowed, and they flowed as a result of the interactions between mainly each manufacturer against the other, because now, instead of a manufacturer, as it were, acting in a kind of buccaneering way with regards to an equally buccaneering retailer, and therefore being very, very free in how they are pricing, in an oligopalistic market at manufacturer level, one manufacturer looks over their shoulder at the other.

But that structure changes, because that structure is replaced by a kind of stratification that results from these P&D requirements, because now there is a pre-set policy determining how retail prices are going to move. And as soon as you get that, it is, in our submission, inevitably the case that the other, the rival manufacturer is going to perceive what is happening and therefore its responses are going to change, the dynamics change. Whereas previously you had a situation in which you had two manufacturers in a kind of oligopalistic relationship with each other, and then you had a bunch of retailers who would be doing their own thing, because some of them would be looking to another retailer, as soon as you start imposing the P&D requirements, you automatically and inevitably limit the options, if you like, open to people in the way they are going to approach pricing.

So, for example, what does the retailer do? The retailer, in these arrangements, has signed up to pricing one manufacturer's product by reference to the pricing of another manufacturer's product. The retailer is not in a situation in which it might say to itself "Well, I will do a promotion on the Gallaher product, but the Gallaher product alone". The retailer is in a situation in which the ordinary and natural meaning of

these arrangements is that the retailer -- we can simplify it by looking at a parity arrangement -- if the retailer alters the price of the Gallaher product, the retailer alters the price of the ITL product.

That's gone. You then have the interrelationship between the manufacturers, and whereas we would accept that in an oligopalistic market the manufacturers are structurally in a situation in which they are looking over their shoulder at each other, the reality is if you then stick in parity and differential requirements, you are enhancing the horizontal links between people who, the manufacturers who, at the best of times competition is limited because of the oligopalistic nature of the market, but that doesn't mean that they are entitled to go ahead and enter into agreements and concerted practices with other people whose inevitable effect -- I say inevitable effect, whose nature -- I did that deliberately, it's the only joke I am going to make in these proceedings, but at least it got a laugh -- arrangements whose nature is to reinforce this, it's a kind of sclerosis of what ought to be a freer, more competitive market in terms of pricing.

In the decision, we don't say that in order for this to happen the P&D requirements have to operate automatically so if you press a button here it inevitably follows in every single case that the same outcome emerges at the other end of the line. There are all kinds of reasons why there would be errors in implementation, why the mechanics may malfunction. But in our submission, that isn't the point. Once you have embarked upon this exercise, you have embarked upon the introduction into the market of a way of pricing that is subject to a kind of rigid formula. Here the rigidity exists, but the rigidity exists because the pricing decisions are by reference to the parities and the fixed differentials. We have an alternative argument on maximum prices, but the primary case made out in the decision is that these were fixed parities and fixed differentials, and as soon as you do that, all the signals that you would otherwise see, that would otherwise exist in the market, become, as it were, tainted by this particular way of doing the pricing, and it's almost an obsession, because when you look at these documents that we have seen, what are they doing? They are obsessed with the parity or the differential. They don't -- I am here really talking about the manufacturers. The manufacturers don't think outside that. "We are paying for parity, you must price to match."

When you go down that route, in our submission, you

inevitably produce this situation in which the dynamics change because the mutual expectations of manufacturers alter. There is this new factor that has come into the interplay that you would normally expect to see in a market, even a market of this nature that is oligopalistic at the level of the manufacturers. And this new factor is not a liberating factor, because this new factor is one that confines, that limits freedom, that restricts, and it doesn't matter if the retailer has accepted -- willingly entered into this restriction, done it well out of contractual obligation. It's signed up to the arrangements, it's compliant, it accepts.

We see that, within this, it's a relatively small market, we see these interchanges between the manufacturers, indirect through the retailers, and it's obvious that when you have an atmosphere in which the position of the retailer is coloured by its acceptance, compliance of and compliance with the P&D arrangements, this is going to get through, you can't hide that kind of thing, you can't conceal it, you can't re-introduce uncertainty into the market again, not in a market of this nature, not when you have exchanges like we see here, and that's the problem.

As soon as you have that change, it doesn't matter whether the performance or compliance with the P&D

requirements is 100 per cent in all cases, that doesn't matter, because actually what you have done is change the position by reference to what it was without the P&D requirements, and you have changed it adversely to the proper working of competition.

That actually is all that the case is. If there was 100 per cent compliance with the P&Ds, then the harm would be 100 per cent. But it doesn't have to be 100 per cent, because the mere fact that you have these things in operation and people are complying with them, the retailers are complying, the mere fact that you have that means that you have reduced the freedom that would previously exist, you have altered the perceptions of the wholesalers when they are thinking out how they are going to position themselves in terms of retail prices and also their wholesale prices, how they are going to relate to their competitor, with whom of course they should not be in any kind of contact. The problem is there is a bridge, and the bridge is formed by the parity and differential requirements.

MR HOWARD: I wonder if Mr Lasok could actually tell us what the P&D requirement is on this case, because it's most unclear to us.

MR LASOK: I don't think I have to, because it's set out in the decision. The decision is written, sad to say, not

in Chinese or Greek, but the last time I saw it, it was written in English, and it's been repeated in the defence and in the skeleton argument.

THE CHAIRMAN: Mr Lasok is opening case and you will all have the opportunity to respond to what he says. Now, he sat whilst you all opened your cases, so I think you can extend him the same courtesy.

Yes, Mr Lasok.

MR LASOK: Can I just take a quick consultation with my extremely learned juniors, who will tell me what I need to say next.

(Pause)

I think that I can probably wrap this up fairly quickly. One of the differences between at least some of the appellants and the OFT is that they approach the competition analysis from the perspective of the mechanisms that are used to implement the P&D requirements, whereas we are approaching it from the other end, and we are looking at it from the perspective of what the P&D requirements intrinsically are, and what their nature is, having regard to the context of the market.

This produces this phenomenon of the ships passing in the night, and a sort of mutual misunderstanding of what the point is.

The point, as I've tried to explain, is that you have in the P&D requirements a system, the system inevitably works upon the perceptions of the decision makers, the retailer and the two manufacturers, and this system is based upon a restriction on the ability of the retailer in terms of its determination of its retail prices.

All this, in our submission, is completely undeniable, because of the nature of the documents and a common sense understanding of what it is logically that these arrangements were intended to achieve, and I use the word "intention" in terms of the ordinary and natural consequences of one's own acts.

True it is that you can point to situations in which, in the mechanics for the implementation of the arrangements at any one time, there is a hiccup of one sort, for example in the course of an MPI, one manufacturer may go ahead at one point in time and a retailer may say "Ah, before I go to all the trouble of re-setting my internal arrangements and price files and telling everybody in all the stores that everything is going to change, I need to have a bit of certainty as to what the response of the competing manufacturer is going to be, because if I get this one wrong, I am going to have to re-do all the instructions that are going to

go out to the stores all over the country", and that is a practical implementation problem. But that simply goes to one consequence, which is that there may be a time lag between the implementation of the P&D requirement, a time lag that simply reflects a commercial reality.

But there remains this expectation that the P&Ds will be respected. For example, one of the documents that we saw earlier today, which was an ITL document about its deferred MPI in 2002, round about September, said to the retailer, post MPI, parities and differentials will be observed. So underlying all this is this constant theme, which is this expectation and understanding that, whatever happens, the prices will all sort themselves out and be based upon the parities and differentials. That's one of the reasons why, when I gave you that boring list of references to what happened in 2001, 2002, covering a period of several months where various things are going on, I made the point that when you actually look at Richmond and Dorchester, whatever is going on in relation to the prices, the parity is maintained, and that's the underlying, it's the leitmotif of the system that the manufacturers put into place.

As I have said, and I fear that I am repeating

myself, this then colours the approach, if you like the mentality that the retailer and the manufacturers have towards their own pricing decision, and we know that the retailers are in a slightly different position because when they sign up to the parity and differential requirements, there is no qualification, they are sort of tucked away, sorted out. As between the manufacturers, there is a slightly greater freedom of movement because there may be some issue as to when exactly they do an MPI, but the problem is that in the situation in which they now are, their mutual expectations as to what the other is going to do has altered, and now the mutual expectations are rather different, because there is an increased certainty -- not a complete certainty, there is a reduction in uncertainty, these are the two phrases that appear in the decision -- as to what the response will be.

When you analyse it in that way, you perceive that what you have now got is a situation in which the incentives work towards, at the very least, price stabilisation but actually it works more in the direction of prices going up. You can have the occasional strategic move downwards or whatever it is, but broadly speaking, the incentives have been altered because the safer initiative on the part of the

manufacturer, the one that is more likely to produce a response from the other manufacturer that is in the mutual interests of both of them, is going to be more likely an upward movement.

That is the fundamental difficulty. So you have a situation in which the harm -- and I am now going to read out, I hope, a legible note, I give credit for this to my learned junior. It's not in poetry, but I thought I would read it out anyway.

The harm is that when the manufacturer when setting its price is more likely to increase the wholesale prices and less likely to decrease because it has an increased expectation as a result of the P&D restriction on the retailer that the rival's retail price will follow. That's why --

THE CHAIRMAN: But does it make any difference, as far as you are concerned, that the expectation is that the retailer will increase the price off its own bat, or that the price will increase because the other manufacturer will increase their wholesale price?

MR LASOK: The retailer is squared away, because the thing about the retailer is that in these arrangements, and the best examples are ones where you have a written trading agreement, the retailer is stuck because the retailer has to comply with the P&D requirement, it signed up to it, and there isn't any let-out clause, because the opportunity to respond clause only applies when it's a manufacturer, a rival manufacturer, price reduction.

So in fact, the retailer almost drops out of the picture. The retailer, in compliance with the P&D obligation -- and I don't shrink from using the word "obligation" but I use it in the not quite contractual sense that ITL would use it -- is in a position that whatever he, she or it does with the prices of one of the linked brands, it has to do the same for the other in accordance with the P&D requirement.

So really what then happens is the attention shifts to the way that the manufacturers approach their ability to affect retail prices which ought primarily to be through the variations that they can introduce in their wholesale prices, with a view to either increasing or reducing the retail prices.

There the problem is that, in a world without P&Ds, when one manufacturer eyeballs another, there is a greater degree of uncertainty as to what the rival manufacturer is going to do. Now, we know that because this is an oligopalistic market at the level of the manufacturers, it's not the same degree of uncertainty that you get in a market characterised by perfect

competition. But, accepting that the starting point is that it's an oligopalistic market, the problem is that the looking over the shoulder that you get in an oligopalistic market is now one in which the uncertainties are, in terms of what the likely response of the rival manufacturer is going to be, reduced even more because of the introduction of a pattern of pricing.

Unless there is anything else that my learned junior would like me to say, that's our submission.

DR SCOTT: Just to go back to how it was and the reason why all this started, as I understand it Imperial faced, pre the introduction of P&Ds, a suspicion that the margins being taken by the retailers on Imperial products were significantly higher than those they were taking on Gallaher products; in other words Gallaher was being disadvantaged by the size of those margins.

So that what Mr Howard says is "we introduced these in order to have pass-through of our lower wholesale prices". Now, one of the things that Mr Howard has not yet seen is whether that was successful in terms of the margins actually achieved as between Gallaher and Imperial products, and that's an issue of confidential information.

But nonetheless, what appears to be happening is

that in the face of Imperial's attempts to deal with that margin differential, Gallaher are also concerned about being disadvantaged.

Now, without examining all that, that then takes us back to what is floating on what, and is what we are actually seeing the P&Ds interfering with floating on the wholesale price save where you have a tactical bonus.

MR LASOK: I think we don't have enough information to answer that question. For example, we don't know when Gallaher introduced its P&D requirements. What is curious is that the Gallaher statement doesn't give an explanation of why it happened that deals with it, that describes it in that way.

But of course it's right to say that, in our submission, at least, the P&D requirements weren't concerned at all with pass-through. They weren't directed at that, and by their nature, in our submission, they don't assist pass-through. I'll give you a brief example of that. You may remember that, I think it's in the first Morrison/ITL trading agreement in 17/4, that there is a pass-through provision because there is a bonus that is conditioned on the benefit of the bonus being passed through to the customer.

That follows on from the provisions dealing with the

parity and differential requirements, and in our submission that shows that the two are not related, because when a business document of that nature was drafted, if the purpose of signing up Morrison to the P&D requirement was to ensure that there would be pass-through, the obvious, in our submission, thing to do would be to relate the obligation to comply with the strategic pricing requirements to pass-through.

After all, they did it in relation to one bonus, why shouldn't they do it in relation to another payment that they are making? And we don't see this. We never see, in the documents, anywhere any connection drawn between the P&D requirements and their pass-through.

So I fully accept that this appears in the witness statements, but the problem is, looking at it from the perspective of the documentary, the contemporary documentary evidence that we have, we don't find the association there.

So our starting point, and perhaps finishing point on this question of the relationship between the P&D requirements and the pass-through problem is that they have nothing to do with each other, and we don't know whether Gallaher perceived that there was a pass-through problem, we have no documentary evidence that indicates that in June or December 1990 that ITL had perceived there to be a pass-through problem because the trade reports don't mention anything like that at all.

So there is undoubtedly a big question mark about the relevance of pass-through to all this, and in our submission, it's just a red herring which was brought in the form of reverse engineering of the justification for the introduction of the P&D requirements.

I ought to mention for the sake of completeness that in our submission this case has nothing to do with a margin parity problem either, because we don't see the retail pricing being related to margins, there is one document that I may have forgotten to draw to your attention in which ITL -- there are two documents. There is an ITL document that tells the retailer what the shelf prices are, and says "these are the shelf prices but we haven't worked out the cost prices yet". So they had determined the retail prices before they had worked out the wholesale prices.

There is another document in which ITL again says that the prices were going up 5 pence, by which it seems to have meant the wholesale prices, but it wanted the shelf prices to go up -- sorry, the wholesale prices were going up 4 pence, but it wanted the shelf prices to go up 5 pence. So, again, the problem is that the documents -- there are documents that point definitively

against the idea that margin parities have anything to do with this case, and there is no contemporary document that suggests that there is any kind of connection between margin parities and the P&D requirements.

THE CHAIRMAN: Yes. You will be giving us the references to those when you get to them in the course of the case, presumably?

MR LASOK: One possibility is that we could send an email with the references. I have them in my notes, but it will take me a bit to fiddle around and find them.

THE CHAIRMAN: Don't worry; in due course.

MR LASOK: We will send them to the Tribunal and to the other parties.

THE CHAIRMAN: Yes. Thank you very much, Mr Lasok. Now, tomorrow is a non-sitting day, and then on Friday we start with the witnesses of fact. Now, according to the timetable there are three witnesses mentioned, although the amount of time allocated to them is clearly substantially more than one day, so it's presumably expected that at least Mr Goodall will run into Tuesday. Is that right? So as far as our preparation for Friday, can you just remind us, somebody, where we find the witness statements that we need to read in preparation for Friday?

MR HOWARD: The three ITL witnesses are in core file 3.

THE CHAIRMAN: And all their witness statements are in ...

MR HOWARD: Core file 3, Mr Batty is at 33, {C3/33}, Mr Good is at 36 and 37, {C3/36} and Mr Goodall is at 38, 39 and 40. {C3/38}

MR LASOK: Can I just say, madam, that in the case of Mr Goodall, he made, I think, three witness statements. The first of them, as I read it, is concerned almost entirely with his relationship with the Co-op, and the second and third are concerned with more general matters. It's entirely possible that, since the testimony that he gives at this stage in the proceedings is, I think, going to be concerned with ITL and Co-op comes at a later stage, that the first witness statement may be of lesser importance.

THE CHAIRMAN: Yes, because he is also down for Thursday, 6 October just specifically relating to the Co-op.

MR HOWARD: Yes, he is coming back, and Mr Batty will be coming back, I think, I can't remember the date offhand.

(Pause)

An easier way to find the exhibits to the documents is in ITL files 3 and 4, the notice of appeal, and you will find where they were originally located, and that's where the exhibits are.

THE CHAIRMAN: But are those exhibits also in the annex bundles?

MR HOWARD: They are. It's a question of which you find easier.

THE CHAIRMAN: Yes. I do not want to have annotations on two different versions of the same document.

MR HOWARD: It's just saves you having to jump around. You can find them in those two files, but they are spread around the annex documents.

THE CHAIRMAN: I think we are starting at 10.30 on Friday, is that right?

DR SCOTT: Sorry, just one other question. Do we now have correlations between the exhibit numbers, Arthur Smith, 1, 2, 3, 4, and the current annexes -- well, the old annexes?

MR HOWARD: Sir, I am not sure I understand.

DR SCOTT: We will use an example of Arthur Smith produces a witness statement, and exhibited to that witness statement --

MR HOWARD: You should have an annotated version of his witness statement which gives you the pagination in the annex bundles.

DR SCOTT: Right.

MR HOWARD: But the original annotation is by reference to what is files 3 and 4, so you can easily find it in either place.

THE CHAIRMAN: Yes, thank you very much, everybody, and we will convene again at 10.30 on Friday.

(4.37 pm)

(The court adjourned until 10.30 am on Friday, 30 September 2011)

INDEX