IN THE COMPETITION APPEAL TRIBUNAL

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

Victoria House,
Bloomsbury Place,
London WC1A 2EB

4 October 2011

Before:

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

Sitting as a Tribunal in England and Wales

BETWEEN:

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

CO-OPERATIVE GROUP LIMITED

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

WM MORRISON SUPERMARKET PLC

Appellant

– v –

OFFICE OF FAIR TRADING

Respondent

(1) SAFEWAY STORES LIMITED
(2) SAFEWAY LIMITED

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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

Appellants

– v –

OFFICE OF FAIR TRADING

Respondent

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HEARING (DAY 7)

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.

Tuesday, 4 October 2011

(10.15 am)

MR ROGER BATTY (continued)

Cross-examination by MR LASOK (continued)

THE CHAIRMAN: Good morning, everybody. Good morning, Mr Batty.
A. Good morning.
THE CHAIRMAN: Yes, Mr Lasok.
MR LASOK: Good morning Mr Batty.
A. Good morning.
Q. Do you have your witness statement in front of you?
A. Yes, I have.
Q. Could you turn to page 28, please.
A. Yes.
Q. Could you just read to yourself paragraph 4.36, and 4.40, and the first sentence of 4.41. So that's 4.36, 4.40 and the first sentence of 4.41.

(Pause)

A. Yes.
Q. When you used the word "historically" in 4.36, and when you refer in the first sentence of 4.41 to the "genesis for the introduction of the price list differentials", am I right in thinking that you are going back to the position as it was before you came on the scene in 1996?
A. Yes, I was a national account manager working in the

department from 1984 onwards, so had in-depth knowledge of that period of time, from when I started as a national account manager up to 1996 when I took over running the department.
Q. You have heard Mr Good's evidence, I think, were you in court when he gave ...
A. Yes, I was, yeah.
Q. Do you disagree with anything that he said?
A. No, I think it's such a long time ago the timings to be precise on what happened when and with whom are very difficult to recall, but I do remember the period of time in the late 1980s when our pricing appeared to be out of line and we lost market share because we were at a competitive disadvantage, and I think that was basically the origins of it. I don't believe there was a particular moment in time when, very suddenly, this became the policy for everybody everywhere, but that did happen over a period of time, probably four or five, six years maybe.
Q. Now, in 4.40 you say that the objective was to incentivise retailers not to increase the shelf price in a marketplace where retailers were prone to increase the shelf price of ITL's products, but that's not consistent with a number of the documents, some of which we have seen on Friday, where ITL was putting prices up. That's

true, isn't it?
A. I think a lot of the examples that we looked at on Friday were examples of promotions coming to an end, and I think logically for every piece of correspondence there is that denotes a price going up because a promotion has ended, somewhere prior to that moment there was another piece of a document or a conversation or a price file which showed the price going down.
Q. Well, can I give you an example? If you look at annex 20, tab 24, {D20/24} this should be an email sent by Nick Law on 2 November 2001, and it was copied to you. If you read -- we have already looked at this, but I don't know whether you still remember it -- the bit under the heading "Pricing", down to the second holepunch, I put it to you that these are instances where ITL is getting the price changed in order to match and achieve parity pricing. There is no indication that this has anything to do with the ending of a promotion.
A. Well, I am not able to comment whether it's ending a promotion or not, because I don't know the background to it prior to this 2 November.
Q. Although it's something that you were copied in on?
A. Well, that's true, but it was November 2001.
Q. Right. Well, if you don't know the background, how can you make a generalised statement that if prices are

going up, it will be because there is a promotion coming to an end?
A. Because I think generally that was the case, and certainly I think the majority of documents that were shown to me on Friday which showed a price increase were documents that related to the reduction of a bonus, so an increase in cost price for the retailer which undoubtedly the retailer would reflect in an increase in its shelf price.
Q. You can put that one away. Could you look at annex 18, and could you go to tab 22, please. {D18/22}. Could you read, you will see this is a letter dated 15 November 2000 from Mr Matthews to Fiona Bayley. There is no indication that you were copied in on this one, but if you read the first three paragraphs, you will see that this is where ITL indicates to Sainsbury's that its strategy is parity between Richmond Kingsize and Dorchester Kingsize, and Sainsbury's for that reason asked to increase the shelf price of Richmond.

(Pause)

Now, these documents refer to a strategy to maintain parities, that strategy existed, didn't it?
A. Certainly the price that we were competing against was the Dorchester price.
Q. Can you answer the question, please? There was an ITL

strategy that involved parity between Richmond and Dorchester at this time?

A. We chose to put the Richmond pricing alongside Dorchester pricing.

Q. So the objective cannot have been to incentivise retailers not to increase the shelf price of ITL products in a marketplace where retailers were prone to increase the shelf price of ITL products?

A. Well, I would point out that this letter actually is the end of a promotion, that we reduced the price of Richmond at some point, Kingsize, to enable the launch of Richmond Superkings to take place at a competitive price, and from what I remember, the Richmond Kingsize brand was reduced to £3.29 across the sort of cut price universe, that's the target price we were aiming for, and eventually we decided to end that promotion when we saw that the Dorchester price, which I believe had followed us down, then resumed at £3.34, an increase of 5p. So this is another example of us ending a promotion, reducing a retrospective promotional payment, and making the assumption that the retailer wouldn't want to fund a promotion themselves, and they would put the price up by the amount that the retrospective discount was being reduced by.

Q. I am sorry, Mr Batty, but that's not what the letter

says, is it?

A. Well, it does in the box below where it shows the -- it says:

"In order to maintain your cash margin position, the bonus levels at £3.34 should be as follows ... "

Q. I am going to read you the preceding paragraph:

"You may remember from my presentation on the price repositioning of Richmond Kingsize (and launch of Richmond Superkings) that our strategy is parity with Dorchester Kingsize. In light of this and not to hold the market up, I would [be] grateful if you would increase the shelf price of Richmond Kingsize and Lights 20s from £3.29 to £3.34."

It was quite clearly a strategy that had been explained to Sainsbury's, isn't it?

A. Yes, that's what it looks like on the face of that paragraph.

MR HOWARD: I wonder if Mr Lasok could make clear whether he is disputing that this was in fact the end of a tactical bonus. If necessary, if he is disputing that, he ought to take the witness to tab 19 and to tab 23, because a lot of these questions -- and it's the same on Friday --

THE CHAIRMAN: Well, I don't think that's quite the point. The point is whether, at the end of the tactical bonus,

ITL merely informed the retailer of the coming end of the tactical bonus and indicated "Well, if you want to maintain your margin, this is the shelf price", or whether this letter is going beyond that and telling them that they should increase the shelf price.

MR HOWARD: I understand that's a point that can be made, but we seem to be having two different debates. One is as to whether this was in fact related to the end of a tactical bonus, and they are just saying "Put the price up", and the other is, if it is the end of a tactical bonus, as you are saying, is this the appropriate way to express it. But if the first point is being challenged, that's what I am not clear about, as to whether Mr Lasok is saying that simply isn't true, it wasn't anything to do with the end of a tactical bonus.

THE CHAIRMAN: Well, my thought was that that was the case with the previous document but not necessarily the case with this document, but perhaps you could clarify, Mr Lasok.

MR LASOK: The point that I am putting to you, Mr Batty, is that there was an ITL strategy of maintaining parity between Richmond and Dorchester, that strategy had been explained to Sainsbury in a presentation given by Mr Matthews, and accordingly Mr Matthews, on behalf of

ITL, was asking Sainsbury to increase the shelf price of Richmond to a specific price point, £3.34, in order to maintain the parity.

A. Yeah, I mean, I feel that I am sort of dealing with a semantic difference from, sort of from my point of view here, over the expression of the way that the emphasis is being put on "Strategy". I mean, I think that all our brands had a position against a competing brand based on the recommended retail price positions, and I think that in this case this is similar. I can't remember what the recommended prices were at the time, but my guess would be they would be the same.

DR SCOTT: My recollection from last week is that we talked about what happened in the wake of a Budgetary change or an MPI, and here they had taken place in the previous August, and then we had talked about certain turbulence, and during the turbulence we had the promotions to which Mr Howard had referred.

What appears to be going on now is a return to the stable state, which according to the letter reflects the strategy of ITL in terms of achieving parity. Does that make sense?

A. Yes, I think so. I make the point as well that I have no knowledge of what the presentation was that Paul Matthews made to Sainsbury's, and how he expressed that price position, and that's -- maybe that's something should be asked of Paul Matthews.

THE CHAIRMAN: Well, it's being asked of you, Mr Batty, because in your witness statement you make this reference to ITL seeking to incentivise retailers not to increase the price of ITL's products, and that these differentials were aimed at not increasing the shelf price, and this document is being put to you to find out if, whether once you have read that, you wish to revise the rather absolute nature of what you say in your witness statement.

A. Right. I mean, I think that the point here that I haven't made is that Richmond Kingsize was a new brand, Dorchester was an established brand, and so I mean, when we brought any brand out, it had got to have a position in the marketplace to compete. So maybe you could argue that at this point the strategy was to be alongside Dorchester, at worst. If it was cheaper than, then we wouldn't concern ourselves too much. But certainly in this situation in this letter, the amount of money that I can remember us having to budget for to pay for these activities was a point that we couldn't continue forever.

DR SCOTT: So if we stay with the letter and just compare it with your witness statement for a moment, in 2.40 you

say:

"Retailers remain free to set their own shelf prices for ITL's products at whatever level they wish."

Then we find the letter being very specific about -- sorry, I am in the box, which is why I have to be careful -- 3.34 is mentioned outside the box, but if you look at what's in the box, there are then certain other things in the box which I mustn't mention but which you can see, so be careful what you say, which suggest --

THE CHAIRMAN: Well, can you see them? Because that's confidential.

A. No. Certainly I've got it, I know what's in that box.

DR SCOTT: So what's in the box suggests that ITL are suggesting to Sainsbury's that, at the very least, if they price at 3.34 then what else is in the box will occur?

A. Yes.

DR SCOTT: Yes.

MR LASOK: Mr Batty, it looks more likely, looking at this letter, that what was on offer was a revision to the bonus levels so that the bonus levels would be appropriate to a shelf price that was at parity with Dorchester; is that correct?

A. Yes, if Dorchester was 3.34.

Q. So you were paying Sainsbury's to price at parity with

Dorchester?

A. For them to make the same margin as they were making at 3.29, yes.

Q. And that was pursuant to the strategy of parity between Richmond and Dorchester?

A. Yes, and no worse, and if it was better, great.

Q. If it was better Mr Matthews wouldn't have written this letter?

A. I think Mr Matthews wrote this letter to actually reduce the amount of money he was investing in this particular promotion. I think that's the nub of the issue here, that --

Q. Why doesn't he say that?

A. I don't know. That was for me, as running the department at this time, I can remember how much this activity was costing, and we had to withdraw from it as soon as we possibly could, and as soon as we saw a competitor's price going up, bearing in mind we had targeted that lower price because that product was probably at that price --

Q. Was Mr Matthews the kind of person who would give a presentation to a retailer that was inconsistent with ITL's pricing strategy?

A. He's not, no.

Q. Let's move on from there. You can put that away.

MR HOWARD: Could I just check, does the witness not have the same documents as we have, in the sense of, are the confidential parts blanked out in the witness's document?

A. No, they aren't.

MR HOWARD: They are not?

A. No.

MR HOWARD: I am sorry, I thought you said they were. That's fine.

MR LASOK: If you could go back to your witness statement, could you turn to page 29 and look at the last sentence of paragraph 4.42.

(Pause)

What I wanted to focus on in that sentence is your assertion that the retailers were aware that they had considerable power in any negotiations. That's just speculation on your part, isn't it?

A. No, I don't think it is speculation, it comes from years of experience of dealing with a lot of the retailers in question here.

Q. Did Sainsbury's think that it had considerable power in any negotiations with ITL?

A. Yes, it did.

Q. Oh, right.

A. Yeah.

Q. Can you turn to annex 18, please, and to tab 78. {D18/78}. There appears to be a possible misalliance of the tab numbers. I want to look at a memorandum dated 30 April 2003. Do you have that?
A. From Paul Matthews to myself?
Q. Yes.
A. Yeah.
Q. Okay. Now, it referred -- the subject of this is "Sainsbury", and in the second paragraph he refers to the fact that a Peter Hebblethwaite had been seconded to BWS, which I think is the beer, wines and spirits department in Sainsbury's, and tobacco was a part of BWS. Mr Matthews writes that Hebblethwaite had been seconded to give a greater management focus on tobacco. Then Mr Matthews says this:
"His assessment of the category is a bleak one ... dominance by two large manufacturers."
If you go down to the middle of the page, there is a bit which has a handwritten marginal note alongside it where he says:
"As an aside, albeit an important one, Peter is uncomfortable with the direct link between our investment and Sainsbury's shelf price. His view is that Sainsbury alone were responsible for the shelf prices of our SKUs as they are for their competitive

position."
Now, this looks like a pretty clear indication that you had been told by Mr Matthews that Sainsbury's did take the view that they were facing two large manufacturers who were dominant, and they were uncomfortable with this direct link between ITL's investment and Sainsbury's shelf price. Do you remember this?
A. I have a vague recollection of it, yes. Yeah.
Q. So do you want to reconsider the statement that you made in 4.42 that you were aware that the retailers had considerable power in any negotiations?
A. Well, no, I don't, because, I mean, from our perspective as a manufacturer/supplier, we were dependent on our products being available, visible on retailers' shelves at relatively competitive prices, to enable the consumer to buy them. And we understood that they were a continual threat from a retailer to actually, if you like, discriminate against us for commercial reasons, to withdraw their shelves as a facility for our products, and we were always aware that that was the ultimate sanction that they had, and I think the nature of our business in the way that our products got to consumers was changing at this time as well.
I mean, certainly the early part of my career with

Imperial Tobacco it was the vast majority of sales of our products were through the independent trade, but by the mid-1980s the multiple retailers were gathering strength and taking more and more of the market away from independent retailers, and I think sort of round about the time we are talking about here in the early 2000s, was about 50 per cent of the market went through multiples and 50 per cent still went through the independent CTN convenience stores, but it was moving, and certainly around about the time of my retirement, I think, in 2008, it was like a 60 per cent multiples, 40 per cent independents split. So we realised that, if you like, we had to keep onside with the multiples because it looked as though that was going to be a considerable part of the future of our brands lay in their hands, and that's the sort of balance of power that I am actually talking about here, that a retailer like Sainsbury's with something like 300 or 400 fairly large outlets, and at one time Sainsbury's were placed strategically in the southeast of England, and were very strong there, but by this time they were a national organisation, and we had to be aware of that, and that was my comment in my statement regarding the power of the multiples, and I think that applied to Tesco, Morrisons, and most of the other major retailers that we

dealt with.
DR SCOTT: Just to follow that up, can you recall, in the period 1984 to 2008, when you were involved, any major retailer actually ceasing to stock either ITL's tobacco products or Gallaher's tobacco products?
A. Not in total, but certain SKUs they would refuse to stock for a period of time, and we always had to have not just at the back of our mind but also at the front of our mind that when we were bringing new products to market, these outlets were crucial for us to get them to consumers, because of course by this time, most of the normal FMCG marketing and sales mechanics were taken away from us, the only things we had was product on shelf and price, basically.
DR SCOTT: The famous planograms.
A. Yes, yeah.
MR LASOK: The true position is that ITL considered that, as it was paying money to the retailers, it was entitled to influence the retailers' shelf prices, isn't that so?
A. I think the influence that we had was to try to get our brands on shelves at competitive prices, and strategy that we followed, which is I think outlined in -- sort of right through my statement, we actually did very well during this period of time and the strategy worked. And I think that -- I mean, one of the lessons we learnt was

that my earlier reference to the amount of product that was sold through the independent trade, I mean, one of the things that I used to get it in the neck for when I was running this department was that our performance in the multiples was not as good as in the independents, and in the independents there was a --

THE CHAIRMAN: What do you mean by "performance"?

A. Well, our market share position. So our market share was greater on the independent sector -- in the independent sector, so we sold comparatively more of our products through the independent sector than the multiple, and the only real significant difference was the way that the independents priced versus the multiples, and the vast majority of independents sold at recommended retail prices, and I think that was another, if you like, another thread in the development of the strategy aligned to RRP differentials, and if it worked in the independents, which it quite clearly appeared to, I mean, even a penny difference on something like Embassy No 1 appeared to help the brand. It sounds insignificant, but that's what the research showed.

MR LASOK: Can I revert to my question, and I hope this time I might get an answer.

ITL considered that, as a result of the payments it was making to retailers, it was entitled to influence

their shelf prices, and I'll add this, you were paying for strategic pricing by the retailer: yes or no?

A. We paid retailers to sell below recommended retail price, and we then paid retailers for tactical promotions when the price was down, as part of the trading agreements there were clauses in there about the strategic pricing policy that we had.

Q. You were paying for strategic pricing?

A. And some money went on that, yes, but relatively small amounts of money --

Q. The answer to my question is yes?

A. Yeah.

Q. I want that clear: the answer to my question is yes?

A. Yeah.

Q. Thank you. I want to go back to this business where we actually started off on, and that was the awareness of the retailers that they had considerable power in negotiations. I don't suppose you have looked at the witness statement of Mr Jolliff of Asda?

A. No.

Q. Right. Perhaps we ought to look at that. I suggest you keep your witness statement but you can put away the other bundle. If you could go to one of the core bundles, it will be number 10. Do you have redacted version? In which case perhaps we ought to hand up

a redacted version. (Handed). The reference for the Tribunal's benefit is core bundle 10, tab 109. {C10/109} That has the witness statement of Mr Jolliff, and I wanted to refer to paragraph 15. Do you have paragraph 15? It's the one that begins "These factors taken together ..."

A. Yeah.

Q. Could you just read the second and third sentences, please.

(Pause)

If you could also look on the previous page at the end of paragraph 14(b), it's the penultimate sentence beginning:

"If I took out a product line ..."

Do you have that one?

A. Yeah.

Q. Right. Well, Mr Jolliff of Asda doesn't appear to have believed that Asda had considerable power in any negotiations?

A. I would very strongly disagree with that statement. I mean, if -- I mean, our leading brand at this time was Lambert & Butler and if Asda threatened to remove Lambert & Butler from its shelves, then it would be a very powerful position, so I don't really understand that.

Q. But the problem is in the word "if", isn't it?

A. Well, Mr Jolliff says:

"If I took account of product line in tobacco outlet, I would never get any greater negotiating power with the supplier."

I think I have just given an example where he would have a huge amount of negotiating power with us.

Q. He would be cutting his nose off to spite his face, wouldn't he?

A. Well, yes, but I would argue that he would be doing this similarly with other examples that he's perhaps quoting.

Q. All right, so there is a disagreement between you and Mr Jolliff; there is a disagreement between you and Mr Hebblethwaite; so I'll come back to the statement that you made in paragraph 4.42, where you say that the retailers were aware that they had considerable power, and put it to you that they didn't?

A. I believe that they did.

Q. You believe that they did?

A. Yes, I mean, my experience over goodness knows how many years of sitting down at a table literally being beaten up by a buying director at one of these organisations -- can I say it was a little bit like being in this witness box to some extent. But, you know, that was -- the retailers were powerful undoubtedly. Even though we

were a major supplier to them, that actually increased their power in some ways, because they knew that we were very dependent on them and were going to be over a fairly lengthy period of time.
Q. Despite the fact that cigarettes were a must-have product?
A. Cigarettes were, yes, but I would make the point that I think a lot of retailers would take a view that they weren't too concerned about which products that they had, we had to persuade them to take certain products because they were happy just selling a packet of cigarettes, they weren't bothered about which brand it was a lot of the time, it was our responsibility, our duty to make sure it was our brands that the retailer stocked.
Q. Well, I'll put it to you that in paragraph 4.42 you were just expressing a speculative opinion?
A. I would suggest that my experience says that I am not speculating at all, I know what I went through when I was doing that job.
Q. Now, ITL knew that Gallaher had got a parity and differential strategy, didn't they?
A. No.
Q. You didn't know?
A. No.

Q. ITL knew that Gallaher had a particular strategy in the marketplace?
A. Yes.
Q. You didn't know?
A. No.
THE CHAIRMAN: Those are two different questions. The question you were asked ...
MR LASOK: Shall I put the question again?
THE CHAIRMAN: Are you talking about a Gallaher strategy or are you talking about agreements with the retailers?
MR LASOK: I am talking about a Gallaher strategy.
Gallaher had a strategy to maintain differentials between some of its brands and some of the ITL brands; did you know that?
A. No.
Q. You did not know that?
A. No.
Q. Did you know that Gallaher had got agreements with retailers implementing that strategy?
A. No.
Q. Right. Well, you can put the confidential thing away and look at annex 15, please, and tab 11. {D15/11}. Tab 11 ought to be a national accounts business development plan for the CWS Retail account prepared in January 2002. It carries your signature on the first page; is that correct?
A. Yeah, this was -- the business development plans were an internal document that a national account manager would put together his strategy with an account.
Q. Was it usual for you to read any of these documents, or did you just sign them without reading them?
A. No, I read them.
Q. You read them. Could you turn to the eighth page, please. You should have stamped numbering on the bottom right-hand corner, and if you have it should be 211.
A. Yes.
Q. The writer of the report, who was Mr Goodall, says at the top of the page:
"I expect CWS Retail to challenge the strategy pricing differentials during this year. They believe that the manufacturers are restricting promotion and activity by demanding strategic differentials. This will affect all manufacturers over the coming year."
Did that not tell you, if you didn't know already, that other manufacturers had strategy pricing differentials?
A. It could but I don't think it did.
Q. It just didn't?
A. No, I don't think that registered at that time as meaning ... (Pause).

No, we didn't know what Gallaher's were doing. We could see things happening in the marketplace, and I don't believe that that indicates to me that Gallaher's have an agreement in place based on strategic differentials.
To begin with, there is four or five manufacturers in the marketplace, so I could have referred to any of those as well. It doesn't say specifically "Gallaher".
Q. What about the word "all", does that give a clue, do you think?
A. I don't know. I can't remember how that was connected, how it would affect all manufacturers over the coming year I don't know.
Q. Well, it wouldn't affect them if they didn't have strategic pricing differential, would it?
A. Maybe not.
Q. Maybe not? You just can't remember this?
A. No.
Q. No. Have you heard of Wes Feeney?
A. Yes, he worked for Gallaher's, I believe.
Q. Did you know that he knew that ITL had a parity and differential strategy?
A. I vaguely remember his name in connection with some correspondence with Shell, but apart from that, that's all I can remember.

Q. Do you think that you were a particularly observant employee of ITL, did you keep your eye on what was going on?
A. I believe I did, that was part of my -- one of my attributes.
Q. So Wes Feeney knows about ITL's parity and differential strategy, and you don't know about Gallaher's?
A. No.
Q. Well, I put it to you that it's a bit incredible?
A. Why is it incredible that a Gallaher employee would know something and automatically I would know the same or similar?
Q. No, I was just putting to you that if Wes Feeney can find out, I would suggest it's a little bit difficult to believe that you haven't found out?
A. No, I hadn't found out at all.
Q. Despite the fact that you have a document like the one that you have just been shown?
A. You know, I mean, we --
THE CHAIRMAN: At the beginning of your evidence this morning, maybe I misunderstood, when you were being asked about the genesis of the price differentials, you said:
"I don't believe there was a particular moment in time when, very suddenly, this became the policy for

everybody everywhere, but that did happen over a period of time, probably four or five, six years maybe."
When you said that, I understood that you were saying that ITL had started this policy of parities and differentials but that you were aware that over four, five, six years from when it was started, which was the mid-90s, was it, or early 90s, that then everyone was aware that everybody had these agreements?
A. I am sorry, that was my careless use of language, I think. By "everybody" I was meaning everybody at ITL. I was talking exclusively about Imperial Tobacco when I said "everybody". That was because that it would just broaden out the sort of reflection of price list differentials, RRP differentials, became an objective across the whole of the Imperial Tobacco sales operation over that period of time. So what was going on with Gallaher's I could hazard a few guesses at different times, but not to work out what their overall sort of strategic points were.
DR SCOTT: So as you watched successive MPIs taking place, and the subsequent turbulence and the resettling, and you observed what happened to the prices of Gallaher cigarettes and other tobacco products compared to ITL's, did the maintenance of parities in some cases and differentials in other cases to your mind look as though

it was entirely due to the implementation of ITL's strategy or in any sense to a strategy that Gallaher might have been pursuing?
A. I think we tended to get sort of wrapped up in brand strategy at the level we were at, as opposed to the overall view, and I think that it's -- the RRP situation was the one that, with brands in sort of families and tiers and groups, that there was an overall strategy from a brand perspective, how a company then translated that into activity at the sharp end with retailers, I knew how we did it, I didn't know how Gallaher's did it, if that answers the question.
DR SCOTT: Yes, that's helpful.
Let's take what's happening at the retail level. After changes in RRPs, we have seen that sometimes one manufacturer followed the other, sometimes there was a delay, sometimes there were temporary promotions, and then we talk about how that resolved. So you were observing the pricing at, let's say, retailer A, retailer A isn't pricing at RRPs, retailer A is pricing at some other level, but you are able to observe the way retailer A is pricing both ITL brands and Gallaher brands.
A. Yeah.
DR SCOTT: As you look at retailer A, did you get the

impression that the sorting out of the prices after this turbulence was due to retailer A being influenced by ITL's strategy or retailer A being influenced not just by ITL's strategy but possibly by the strategy of other manufacturers including Gallaher?
A. Yes, definitely, they would take an overview of what all the manufacturers were trying to achieve, and try to get what they wanted to achieve out of the result.
DR SCOTT: There has been mention of industry agreed approaches to pricing in the evidence. Did you get a sense that the industry, not in any collusive direct, you know, we are not suggesting any direct contact between yourselves and Gallaher, but things settled down into a pattern related to the RRPs?
A. Yeah, yeah. I mean, I think -- yeah. Yes.
DR SCOTT: Thank you.
MR LASOK: I wonder whether you could turn to annex 19, please, and to tab 57. {D19/57}. This should be a national accounts business development plan for the Shell account, dated to February 2003.
A. Yeah.
Q. It's not signed by you. Would you have seen this?
A. I can't be 100 per cent certain. We were in the process of altering the structure of the department, so it may well be that this could have been seen by a national

account manager that Breda Hughes reported to, or myself.
Q. Yes.
A. But I would have been aware of the document, I will take that responsibility, as I was responsible for the business development plans across the department.
Q. If you could turn to the fourth page of the document, there is an internal pagination at the middle of the bottom of the page, but there is also a stamp pagination in the bottom right. The stamp would be 222.
The first full paragraph at the top of the page, the one begins:
"Shell recommends a pricing policy ..."
Do you have that?
A. Yeah.
Q. That says in the third line:
"The price file was in a state of disrepair with many differentials out of line. Under the new category manager and with the aid of both Gallaher and ITL, this has been resolved and in the main differentials between manufacturers, comparable brands are now maintained."
Doesn't that indicate that Gallaher had a differential pricing strategy, in fact this is an indication that Gallaher and ITL had been helping Shell out and ensuring that its pricing maintained the

main differentials between them?
A. I think this was a reference to some of the correspondence I think I've read in the documents, where there was an exchange orchestrated I think at the centre by the Shell buyer or category manager, whatever he was called, where he sent documents with all manufacturers' products to both ourselves and to the Gallaher account manager, whose name I believe was Wes Feeney. And I think that the reality is that Breda Hughes, writing this internal document, perhaps wrote this very badly in terms of explaining what her perspective on it was. That's my -- she was referring to Imperial's differentials --
Q. Why do you say that she wrote it badly?
A. Well, I think the inference is that you could read into this paragraph that Gallaher helped to sort Imperial's differentials out, I think that's why it's badly written, and I don't believe that was the case.
Q. Well, that's not what she wrote, though?
A. No, I know it isn't, I think I've explained that, I think it was very badly written in that respect.
Q. So you just think that it should have been written differently?
A. Certainly, yeah.
Q. I would like to move on now to another topic, so you can

put --
THE CHAIRMAN: Can I just be clear that I understand what your evidence is on this point, then? As far as you were aware, Gallaher's pricing was totally independent of any relationship between the prices of its products and the prices of ITL products?
A. No, I don't think -- I don't think I am saying that, but --
THE CHAIRMAN: Well, perhaps you could clarify what you are saying.
A. I think Gallaher's undoubtedly would have had some target brands of theirs, and they would have had some brands of ours that they were targeting their brands against. Where they saw where their prices needed to be was in part reflected in the RRPs, and that would show quite clearly in the independent sector where a lot of retailers sold at RRPs, but in the multiples we were tending to be reactive to them so --
THE CHAIRMAN: But as far as you were aware at the time when you were dealing with this, did you understand that Gallaher set its RRPs in a relationship to ITL's RRPs?
A. Yeah, I think the conclusion has to be yes, they did, because of the similarity in movement, when prices increased, but bearing in mind -- I say the competitive state of the market, and also the type of companies we

were, Gallaher and Imperial, were both basically UK operating companies, and it's only in recent years that expansion into worldwide markets has happened, were very dependent on what happened in the UK to make the profit. So we were probably, as far as overheads costs were concerned, were very similar, so --
THE CHAIRMAN: Well, that might lead to a similarity of prices that just happened because of the similarity of costs, but my question was more whether you understood at the time that in setting their own RRPs they were influenced by looking at what the ITL RRPs were.
A. Yes, yes, I am sure, yes.
MR LASOK: I would like to move on now, Mr Batty, to a document that you refer to in paragraph 4.43 and following of your witness statement. This is a document which is in annex 16, tab 29. {D16/29}.
A. Sorry, which paragraph of my statement?
Q. It's 4.43.
A. Got it, yes.
Q. You quote large parts of the document, but it may be useful if you could refresh your memory by reading the document as a whole. Do you have it in front of you?
A. Is this Michael Williams' letter?
Q. Of 20 June 2002.
A. Yeah. (Pause). Yeah.

Q. So in your witness statement you describe the letter, and you quote from it. Then in paragraph 4.47 of your witness statement you interpret the letter and you say:

"Accordingly Mr Byas is seeking to encourage the retailer not to increase the price of the ITL product in circumstances where ITL had not increased the RRP of Embassy No 1, in an effort to win sales from B&H customers through offering a low priced product."

A. Yeah.

Q. If Mr Byas was simply encouraging the retailer not to increase the price, why did he say in the paragraph beginning "from the date of the Gallaher MPI", why does he say:

"Can you please ensure that these increased differentials are maintained."

A. Right, I think what happened at this juncture, we had had a series of manufacturer and Budget increases over a period of time, and internally we had decided that we were not going to have an immediate response to other manufacturers increasing their prices because we felt it was a good opportunity for us to gain a commercial advantage in the marketplace and have our brands at much lower prices relative to our competitors', and the thing that we were concerned about was that the retailer would assume that we were going to have a price increase and

would put the prices up, of our brands, ahead of any announcement by us. And I can remember distinctly at this point in time, whereas Mr Byas wouldn't know, but I think I certainly would have known, that we weren't planning to have a manufacturer's increase for several weeks. I mean, it might have been two to three months before we actually had our increase.

So this was an example of, I think, several pieces of correspondence by various national account managers that were sent to the multiple retailers to say "We want to have a bigger gap between our brands and our competing brands", and it was as simple as that, simple and straightforward as that. We wanted a competitive advantage, we weren't taking the price increase, "We don't want you, Mr Retailer, to think you can 'steal' this extra money in the short-term because we are not going to let you get away with that", because there was evidence on numerous occasions previously where retailers did decide to put prices up, that's their right, the absolute price on shelf is their responsibility.

So I think any inference that this is connected to some lock-steps in differential pricing is not so. We saw quite clearly that we had an advantage to maintain --

THE CHAIRMAN: I think perhaps you are anticipating the questions that Mr Lasok is going to ask, perhaps wait and see if he asks them.

MR LASOK: I was hoping that you would actually answer the question I put to you, because I was focusing on the phrase "Can you please ensure that these increased differentials are maintained".

A. Yeah.

Q. With respect, in your witness statement, you tone that one down, you just say that's encouragement, but that's not encouragement?

A. I think I've just tried to explain, what it's actually saying is "Don't put our prices up because" --

Q. That's right.

A. -- "you have no reason to at this stage, based on all the information we had."

Q. No, not quite, because in the third paragraph, Mr Byas 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."

A. Yeah.

Q. He is drawing the retailers' attention to ITL's strategy.

A. Yeah.

Q. And it's in that context that he asks the retailer to ensure that the revised differentials, the increased differentials as he refers to, are maintained. So it's not encouragement, he is drawing to the attention of the retailer the strategy and asks the retailer to comply with the strategy?

A. Yes, I think he is, but I think it's from the point of view that he believes that the retailer is likely, and particularly this retailer, who at this time was in serious financial trouble, would be looking to try to maximise its profit. One of the ways that it could maybe justify maximising its profit is by just putting our prices up, and saying "Well, there you are, Imperial, we are still within 3p of brand X, Y and Z or what have you, so that's fine, isn't it?" And we were saying ahead of that happening "No, it's not fine for you to even think about doing that", because we are making an investment, if you like, by not having a price increase by giving the consumer a better value, we wanted the consumer to benefit from that better value.

Q. It was because you were afraid that the retailer would observe the normal differentials that you sent a letter round altering the differentials?

A. Well, that's maybe how they would express it to us back,

but I don't think that's what we were doing. We were just saying "We are not having a price increase so our brands will be cheaper than relatively they were".
DR SCOTT: Just to clarify this, here we have a move away from the differentials as they had been, and this isn't a promotion in the sense that there is no mention of a promotional bonus, but this seems to be depending on the ongoing bonus. So presumably this letter changes the terms of the ongoing bonus; would that be right?
A. Yes. I think what is not said here in brackets, it's saying "And your cost prices haven't changed, so why would your retailers change, so please keep them as you have them at the moment".
DR SCOTT: So that to maintain the ongoing bonus, the retailer is being expected to maintain these new differentials?
A. Yes.
DR SCOTT: Yes. That's helpful, thank you.
MR LASOK: If the cost prices hadn't changed and you weren't asking the retailer to change the retail prices, why would the bonuses change?
A. The bonuses didn't change.
Q. So everything remained stable?
A. On our products, yes.
Q. Now, you said a moment ago that this was one of a number

of letters that were sent out to different retailers?
A. Mm.
Q. Could you look at -- you can put away that -- maybe keep it open just for a minute -- annex 14, and go to tab 54. {D14/54} This should be a letter dated 11 June 2002 from Imperial to Mr Jolliff of Asda.
A. Yeah.
Q. Is that the one you have?
A. Yes, I think it is.
Q. Could you read the letter in total, please.
(Pause)
A. Yeah.
Q. This is Mr Hall writing, not Mr Byas?
A. Yeah.
Q. But it's the same type of letter that was sent out by Imperial to -- as the letter that we have just seen addressed to First Quench, it is exactly the same problem but you see here Mr Hall is notifying the change in the strategic pricing requirements?
A. Yeah.
Q. So you would accept, wouldn't you, that this was done in order to ensure that the retailer kept their shelf prices in accordance with the revised parities and differentials instead of following the old ones?
A. Yes, and gave the consumer a good deal, I think. They

were lower prices than a consumer might have expected to see. I mean, a consumer would go into a branch of Asda and all of a sudden they would see that B&H was 6p, 9p dearer than Embassy No 1 or Marlboro, and we would hope that that would trigger a few extra sales for us.
Q. You can put annex 14 away and you can also put annex 15 away.
THE CHAIRMAN: So I understand, at tab 54, what you are saying there is that the page which is stamped 85, those differentials will have widened in relation to some brands because the Gallaher brands will have gone up in price but the ITL ones should remain the same?
MR LASOK: Yes, what had happened was that at tab 53 you have the ITL/Asda trading agreement that had been signed on 5 June, we don't have the schedule for that, but the third page of the document refers to strategic pricing being met, and therefore when the Gallaher change, although in fact in many respects the change didn't take place on the shelves, but when the change of the relative price positions marked by the RRPs occurred, as we can see from tab 54, ITL had to write round to Asda revising the strategic pricing requirements so as to ensure that Asda didn't, as a result of the previous requirements, automatically change the price of the ITL brands because of the change to the Gallaher brands.

THE CHAIRMAN: Is that a convenient moment to have the mid-morning break?
MR LASOK: Yes.
THE CHAIRMAN: We will take a break for ten minutes now. May I remind you, Mr Batty, that you mustn't speak to anybody during the break.
A. Okay.
(11.30 am)
(A short break)
(11.44 am)
MR LASOK: The document that we were looking at before the break was the one in annex 14 at tab 54. You comment on that document in paragraphs 4.54 to 4.56 of your witness statement. So maybe if you could read to yourself paragraphs 4.54 to 4.56.
(Pause)
A. Yes.
Q. Right. Now, what I'll put to you is very, very simple: the letter that we are looking at doesn't say what you say it says, it's about relativities, and it's about ITL altering its strategic pricing requirements in order to prevent an automatic move upwards in the price of ITL brands?
A. It is certainly to prevent an automatic upward movement in the price of ITL brands.

Q. If we go back to paragraph 4.50, you are talking there about what we have been calling an opportunity to respond clause, and I wonder whether you could just read 4.50 to yourself.
(Pause)
What you are saying there is, as I understand it, that the opportunity to respond clause, of which the example that you give is the one in one of the Morrisons trading agreements, had as its purpose enabling ITL to realign the price differentials?
A. Yes.
Q. Now, if we move on to page 32, and paragraph 4.57, again could you just read 4.57 to yourself, please.
(Pause)
A. Yes.
Q. I am afraid that I didn't quite follow this paragraph. Are you talking in this paragraph about price decreases that are initiated by a manufacturer or by the retailer?
A. Well, I think it could be either or both.
Q. So if the manufacturer initiated the price decrease, then a decrease in the rival brand would follow through the operation of the differentials?
A. If a competing manufacturer reduced the price of a brand, say, in Asda, we might observe that on the shelf through the multiple trade reps who were recording

prices at branch level, and/or the buyer, in this case this might have been John Jolliff, may have said "We have reduced the price of brand X by whatever" without any inference at that point as to how this has happened, and then we might respond to that by reducing our prices by offering a short-term tactical bonus to get our prices down to whatever level we thought was appropriate based on the original differentials.
Q. Wouldn't a better way of incentivising the retailer to decrease prices have been simply to offer the retailer a bonus conditional on the benefit being passed through to the consumer?
A. Yes, and we did that, at various times.
Q. So what was the purpose of the differentials?
A. I think the purpose of the differentials was because most of the time we were reacting to our competitors, we wanted to ensure that our prices were in a direct relationship with those at worst, if they were cheaper than -- or if the differential was wider in our favour, we would be happy with that. But that was the purpose of the differentials. And as well I think one of the other points that I ought to make in answer to that question was that when you looked at the number of SKUs, the number of lines that we were selling to a particular retailer, and I think there is a reference to one of the

Tesco price files in my statement where we had got something like 170 lines on a price file, it was quite an inefficient way of promoting product, going through line by line by line on promotional bonuses. Am I making sense?
THE CHAIRMAN: So you did what, instead of that?
A. Well, the differentials enabled us to actually observe what was happening in the marketplace and at times of price increases, to ease the transition from the old price to the new price. So -- yeah.
MR LASOK: But, for example, if you have a parity, as you had for some of these linked brands, the retailer's obligation could be met simply by pricing the two brands at the same price. There was no incentive to price below, in fact that was inconsistent with the idea of a parity, isn't that so?
A. Yes, but we were reacting to another manufacturer's move or a retailer's move on a price.
THE CHAIRMAN: At the end of that paragraph 4.57 you refer to "the retailer rendering itself more competitive for the products concerned than other competing multiple retailers", which implies that sometimes reductions were funded by ITL just for one retailer rather than for all of them.
A. Yes, there were occasionally, yeah. Yeah.

THE CHAIRMAN: If there was a reduction only by one retailer, would that make you think that that was more likely to be a retailer initiative rather than a manufacturer promotion which triggered reduction?
A. No, I mean, we could never be absolutely sure where it came from --
THE CHAIRMAN: No, but would that be more likely to --
A. -- but more often than not I think it was a manufacturer inspired reduction. I think there were very few examples of retailers actually reducing the prices from the prices we had seen on shelves of their own volition.
THE CHAIRMAN: What would be the reason for having a promotion with one retailer rather than across all retailers?
A. Well, from our perspective, it didn't make a lot of sense, other than to either keep one retailer happy, appease the retailer with a request that they had made, so it might be something that we did under those sorts of circumstances, but I think our sort of prime aim was to look at our brands across the marketplace.
THE CHAIRMAN: Yes, thank you.
DR SCOTT: You dealt with this area in paragraphs 2.32 down to 2.33 where you say:
"Retailers are unlikely to initiate a promotional strategy themselves for a tobacco product for numerous

reasons. It's usually necessary for tobacco manufacturers to fully find any discount to the shelf price if it wishes to offer its products more cheaply than those of its rivals to ensure that any reduction to the shelf price does not reduce the retailer's margin."
A. Yes.
DR SCOTT: Your concern, as I understand it, was always to try to ensure that ITL were not disadvantaged --
A. Yes.
DR SCOTT: -- against the other manufacturers?
A. Yes.
DR SCOTT: So that in that sense, as usual, it's the differential rather than the absolute level of pricing that you are concerned over?
A. Yes.
DR SCOTT: Thank you.
MR LASOK: Could you turn to page 37 of your witness statement, please, and I just wanted to ask you a question about paragraph 5.26 which refers to a presentation given by Mr Barry. The presentation is in annex 19 at tab 54A. {D19/54A} So it may be that the best thing is for you to read 5.25 and 5.26 to yourself, and then we will have a look at annex 19/54A:
(Pause)
Am I right in -- sorry, you have got to the

presentation?
A. I have got the presentation in front of me.
Q. I think that the bit you are referring to is on page -- now, this is a wonderful document, because it has pagination on the top left-hand and the bottom right-hand corners, although sometimes it's the top right-hand corner and the bottom right-hand corner. I think that the page is bottom right 101, top left 108.
A. 101 is headed up "Category Strategy", is that right?
Q. There is a reference to "right price" there. There is also another reference to right price, which is on a page numbered 117 on the top right and 110 on the bottom left. It's the last page, I think.
Did you attend this presentation?
A. I don't believe I did, no.
Q. Right.
A. I can't recollect attending.
Q. So when you tell us, in 5.26, what this presentation reflects, you are just reading the document?
A. Yeah.
Q. And telling us what it says?
A. Yeah.
Q. And you haven't got any additional evidence that you can give to us about the presentation or how matters were put in the presentation?

A. No.
Q. You can put that away.
A. Can I add a comment there? Because I think it's appropriate, in this summary, where it says "right price", I believe that this actually sums up what a lot of retailers actually did, back in their buying office, was assess the facts and then come to a conclusion over their own price, and set their price.
DR SCOTT: In seeking to influence these tobacco buyers, ITL sometimes engaged in trading agreements; that's right?
A. Yes. Because that added a bit of certainty, I think, for the retailer, because one of the objectives that a retail buyer would have is his revenue pot, so "how much money am I going to get from this supplier, this supplier, this supplier?", to satisfy his revenue targets, his margin targets.
DR SCOTT: So from the buyer's point of view there was an advantage to having a trading agreement so they knew where they stood?
A. Yeah, yeah, yeah.
MR LASOK: Moving on to 5.27, you are referring here to price files. Would you just like to read 5.27?
A. Yeah. (Pause).
Q. Did you know that ITL checked the price files to ensure consistency with the parity and differential

requirements?
A. Yeah, and to check the absolute prices in the marketplace as well. I mean, in this instance Shell had set their prices, so we were also looking at how that was reflected out in the Shell branches, which didn't necessarily reflect what Shell's head office were saying the prices should be.
Q. If we move to paragraph 5.28, and go to the last two lines on the bottom of page 37, I'll read out the bit -- perhaps it would be fairer if you read the whole of 5.28, but I am going to ask you a question about the last sentence.
(Pause)
A. Yeah.
Q. So far as the last sentence is concerned, it is right, isn't it, that ITL would notify Shell if parities and differentials were not being observed?
A. Yes, I think as part of the general to-ing and fro-ing about price, that would probably be included in the correspondence.
Q. You expected to see the parities and differentials observed in the shelf prices?
A. I don't think so very often in the Shell agreement or in the Shell situation for long periods of time, because of the nature of the way that Shell operators established

what their pricing was going to be. I think there was some considerable variations frequently, from even where Shell expected the prices to be, never mind where we hoped they would be.
Q. But the purpose of the trading agreements with Shell was to deal with shelf prices, amongst other things?
A. Yeah. I mean, we were -- with a retailer like Shell, we were probably more concerned about the distribution of our products in their outlets and the availability of our products in those outlets than we were necessarily about the pricing. I think that's reflected in the investment levels that we made with Shell, which was probably six or seven times greater on distribution and availability than they were on the pricing element.
Q. Now, could you go to paragraph 5.35, please, and just read that.
(Pause)
A. Yeah.
Q. You say here in the penultimate sentence that the relative shelf price between the two products might well reflect the relative difference between the RRPs, and you refer to the published RRPs as a natural benchmark for retailers. But you couldn't be sure that retailers would price in that way all the time, could you?
A. No, I couldn't be sure.

Q. And that's therefore why you have the strategic pricing requirements in the agreements?
A. I don't think you can generalise across how different retailers determine the prices. I mean, quite a lot of them use the RRP as a sort of starting benchmark, so they might knock 10p off a premium brand and 8p off a medium, mid-priced brand, and 6p or 7p off a low priced brand, but that could vary from retailer to retailer.
Q. But from your perspective, that's to say ITL's perspective, the strategic pricing requirements in the trading agreements ensured that the retailers would keep their pricing in line?
A. That was our hope, that the prices would be where we wanted them to be, which was competitive against other manufacturers' brands, and certainly one of the difficulties we had in dealing with achieving the pricing levels that we were seeking in the marketplace to remain competitive was where retailers had tiered pricing. Certainly when a lot of this activity on differentials started, there was a huge number of retailers who had tiered pricing, and over time that tended to flatten out, with the majority of retailers on almost absolute national pricing, and only a few on the tiered pricing.

Q. Could you turn to paragraph 6.2 of your witness statement, please, and could you just read that to yourself, please.
(Pause)
A. Yeah.
Q. Now, I want to take up with you a bit that you say towards the end of the second line in that paragraph, you say:
"It was never the case that ITL required a retailer to set a certain shelf price or agreed with the retailer what its shelf price was to be."
Now, is that a statement that you would like to change?
A. No, I think it's based on the fact that we would suggest prices to retailers and then it was up to the retailer to determine what its price was going to be, and there were a lot of factors involved in how we might have presented that suggested price, and a lot of factors involved in how the retailer then determined what his price was going to be.
Q. Let's deal with agreement with the retailer, and let's have a look at some examples of this. What about annex 18, tab 52. {D18/52}.
You have two emails here, you can read them in reverse order. I pause to say this should be, at the

top of the page, headed "Fiona Bayley" and you should then see a Fiona Bayley email sent on 11 February 2002 to Paul Matthews. Is that the page that you have?
A. Yes, I believe so.
Q. Yes.
A. (Pause) Yeah.
Q. So he, Mr Matthews, in the first email in the sequence, says that he would be grateful if Sainsbury's could move Drum to a parity position with Amber Leaf from 2.12 to 2.09, and Sainsbury's responds:
"Paul, 2.09 will be effective from 9 February."
Isn't that an agreement of a price with a retailer?
A. I think it's a promotion, because we are increasing the bonus for this and we obviously think that Drum is too expensive in Sainsbury's against the Amber Leaf price.
Q. You ask Sainsbury's to move the price to 2.09?
A. In brackets "or less".
Q. She agreed, but where does that say --
A. I'm sorry?
Q. Could you just point out to me where it appears in the email?
A. Well, it doesn't appear in the email but --
Q. So it's not there?
A. Not in the email.
Q. Why are you introducing things that are not in the

email?
A. Because that's the sort of nature of the sort of discussions that we had had with the retailer.
Q. Inventions?
A. Sorry?
Q. Inventions?
A. No. No, not inventions.
Q. How was Ms Bayley to know that the suggestion was not to move Drum from 2.12 to 2.09 but to move Drum from 2.12 to some other price at or below 2.09?
A. Because we would know that the retailer wouldn't chuck their own margin into this situation and take it lower than that.
Q. Why doesn't he say that when he deals with the increase in the bonus?
A. I don't know. I think that, you know, we would be happy if they went cheaper, is what we were saying.
Q. Where does he say that --
A. He doesn't say that.
Q. He doesn't say it at all. He doesn't indicate that --
A. No.
Q. -- you are prepared to increase the bonus if Sainsbury's prices below 2.09, does he?
A. No, but I can't believe that there is anything sinister or wrong in us reducing a price where a consumer gets

a benefit, is there?
Q. Now let's look at tab 54. {D18/54}. Again, this is where the emails are in the usual reverse order. The first email starts at the first holepunch. (Pause). So now here ITL wants Sainsbury's to move Richmond Superkings up and Sainsbury's agrees; isn't that so?
A. Yes, that's what it looks like, yeah.
Q. Yes.
A. But it's a reduction in the bonus reducing the cost price, so the retailer would put their price up, and we wouldn't expect the retailer -- I wouldn't have thought, under these circumstances -- not to. Custom and practice seemed to indicate that to us. I understand, I think, the point that you are making. But again, this is back to this commercial shorthand where salesmen are writing probably bad letters, in not expressing exactly what it is they are saying. Because I put the interpretation on here that "We are reducing the bonus, so if you want to make the same money as you are making at the moment, you need to go to this price".
MR SUMMERS: Is there any commercial shorthand missing here in relation to the upward movement here, when you say you put up tuppence to 3.47, are the words "or more" missing, just as the words "or less" were missing in the previous document?

A. No, I don't think so, on the basis that we were obviously aiming Richmond pricing at Sterling in this instance and we had probably seen Sterling at that sort of price, not necessarily in Sainsbury's but in other retailers, so we had an inkling that Gallaher's were -- had moved Sterling up in price.
MR SUMMERS: Are there any clues you can give us as to when we should interpret that there is missing a shorthand?
A. No, I am sorry, I can't.
MR SUMMERS: No general clues?
A. No. Except that generally speaking we were happy to move prices down and get amounts taken off packets of cigarettes on the shelf that we were paying for, and our expectation ended there, and I think the reverse expectation was that if we reduced the bonus by the amount that -- quoted in a letter, we were happy to see the price go up by that amount.
MR SUMMERS: Thank you.
MR LASOK: You can put that file away, and I wonder whether you could turn to annex 14. Could you go to tab 9, please. {D14/9}. There are a couple of bits that I would like to draw to your attention to see what comment you have. This is a letter dated 5 October 2000 from ITL to Mr Jolliff of Asda. Go to the second holepunch on the first page, you have just before it

a heading "Embassy No 1 Kingsize and Embassy Mild Multipacks", and it says:
"We agreed that selling prices would be reduced to ..."
Then on the next page, there is a reference at the top to Lambert & Butler and JPS pricing, and in the first line ITL informs Asda that it would be looking to move Lambert & Butler and JPS brands to a particular price.
Then under the heading "Richmond Pricing", the writer refers to a meeting, I think we have seen this before, at which Asda had advised ITL that Dorchester was moving to a specific price on 29 October. The writer says:
"We agreed that Richmond Kingsize 20s and Richmond Lights 20s will move to [the same price] on 29 October, which is the same day as the Dorchester move."
A. Right.
Q. Now, going back to your witness statement, paragraph 6.2, where you say it was never the case that ITL agreed with the retailer what its shelf price was to be, I asked you whether you would like to reconsider that? Do you still wish to hold to it?
A. I think the agreement reached in here is as

a consequence of a meeting, that it says "Further to our meeting on 3 October", and this was the end play and I don't know what happened in the discussions in that meeting, to establish that particular price. But in all cases, I think there is an inference that something is happening to the cost price, and I think this was Graham Hall, he is confirming back to John Jolliff the information on a price file of the price that John Jolliff has, I think, undoubtedly said "That's the price we are going to go out at", and Graham Hall has agreed to it, which in your terminology says "Yes, they agreed". I think it was an extended and probably a fairly complex debate that arrived at that point as part of a negotiation.
THE CHAIRMAN: A debate during which they would have negotiated about what the shelf price was going to be?
A. And what the cost price would be, it would probably be the starting point, and -- yeah, and the impact that might then have on the shelf price.
MR LASOK: So you think that it was Mr Jolliff who had the whizzo idea to increase the shelf price of Richmond so that it would be the same as the shelf price of Dorchester on the same date?
A. Well, that would, I think, certainly be discussed at the meeting.

Q. Can you turn to tab 10, please. This is an internal email. It's actually an email to you --
A. Yeah.
Q. -- dated 5 October, it's the same date as the date of the letter, and we see -- I think the "JJ" -- I think it's no longer confidential.
A. Yes, it is all right.
Q. So we see that Mr Hall tells you that Asda had advised about the Dorchester price move, and then Mr Hall says:
"I have indicated that we will move Richmond to" the same price on the same date.
Does that ring any bells in your memory?
A. I think we have had one or two conversations about these 3.29 to 3.34 price moves, and I don't think it was any secret that we were reacting to the established brand, Dorchester, with the relatively new brand, Richmond. So we were tracking that. You know, this doesn't surprise me, nor do I see anything sinister in the way that this occurred. We have reduced the price, the cost price, and the retailer has done some calculations and decided that it's 3.34 --
DR SCOTT: Yes, I --
A. -- simplistically.
DR SCOTT: -- think it's probably helpful if we look at the facts rather than whether or not it's sinister. The

question being put to you is whether, in the light of what you are being shown by Mr Lasok, you want to reconsider what you said in your statement. There is nothing to stop you reconsidering your statement, you are having the opportunity now of seeing the history set out for you in all these documents, and if having seen the documents you want to reconsider what you said in your statement, there is no dishonour in doing so.
A. I certainly think tying that 6.2 with this, the word "agreed" appears in both, so yes.
MR LASOK: So it was the case that ITL might agree with a retailer what its shelf price was to be?
A. Ultimately, yes, they would.
Q. What about requiring the retailer to set a shelf price?
A. I should think the only requirement we put on a retailer to set a shelf price was in relation to an increase or reduction in bonus.
Q. What about ensuring that the retailer set a particular shelf price?
A. I think we could only ensure it by the retailer taking the bonus and then setting that price.
Q. Well, we have already seen one letter, the one to First Quench, I think it was, that you commented on earlier in the witness statement, in which you, ITL, wrote seeking to ensure that increased differentials

were maintained. That's --
A. Yeah.
Q. In case you have forgotten -- do you remember that one?
A. Yeah. Well, we would have liked to have ensured that those increased differentials were maintained, because we weren't having a price increase in that instance. So we would want to ensure that.
Q. What about, because you have annex 14 in front of you, turn to tab 63. {D14/63}. Again you have two emails here, the second one is from Graham Hall to Guy Mason, and it was sent on October 7, 2002. The second one is another email from Graham Hall to Mr Mason sent the following day. Could you just read the two, please.
(Pause)
A. Yeah.
Q. Now, this was a situation in which Mr Mason was an Asda man, wasn't he?
A. Yes.
Q. And the first email had been sent off to Asda, and what had happened internally was that ITL had set about making up a new price file for Asda which would be effective from 14 October. That's actually what you get at tab 62.
A. Yeah.
Q. Because tab 62 has, in the middle of the page, the first

email in tab 63.
A. Yeah.
Q. Then you have Graham Hall emailing Mr Carroll, who was an ITL person?
A. Yeah.
Q. Asking him to do a new price file. Then what happened was that, as we can see from tab 63, that ITL changed its mind and then asked Asda to delay the implementation of the rise until 21 October.
This again, isn't it, is ITL ensuring that Asda makes the changes in the pricing that ITL wishes?
A. Yes, it is, in the sense that Imperial have reduced the bonus payment, and I made that very clear in the letter that the current prices for Richmond Kingsize reflect additional price support of 5p per pack, and as part of our pricing strategy for Richmond Kingsize, we would be moving the prices up, ie taking away that 5p price support. And in fact not in its entirety, because it went -- yeah, in its entirety, 3.54 to 3.59.
Q. If one goes back to the first email in tab 63, this move was part of ITL's pricing strategy, you were moving the prices up in the market, and you were anticipating that Gallaher would follow?
A. Yes, we benchmarked Richmond against Dorchester at this time as opposed to Sterling, which was in a previous

piece of correspondence.
THE CHAIRMAN: There it rather looks as if you think that Gallaher will be benchmarking Dorchester against Richmond, rather than the other way around, doesn't it?
A. They may be, yeah.
Sorry, what's the question?
MR LASOK: Well, no, this is an instance of you seeking to achieve your pricing strategy through the retailer, you wanted the retailer to put your products on its shelves at the prices you indicated?
A. In simplistic terms, yes, but I think that if you go back to the way that the price file system worked, and just common practice. We would understand what the retailer's view would be, if we took 5p of his retrospective bonus away, that we would expect to see a 5p increase in that product, and the price file would reflect that, bearing in mind that the price file selling price details were the figures that we understood Asda were using in their stores in the marketplace, as established by them. Influenced by us, yes, but established by them.
DR SCOTT: Can I understand something here: you have explained to us that ITL were generally reactive.
A. Yeah.
DR SCOTT: Now, this is an email, in which Graham Hall says:

"We are anticipating that Gallaher will follow our lead by moving Dorchester Kingsize and Dorchester Superkings up by 5p per 20 in the not too distant future."
Which suggests that you may not have understood Gallaher's pricing strategy but Mr Hall thinks he does understand their pricing strategy?
A. Well, we might have seen an instance of where Dorchester has moved in another retailer, bearing in mind that not all retailers moved at the same time or even if there was a price change in a particular week, different retailers had different systems and different days of the week when they changed prices.
DR SCOTT: Yes, I can understand that, and we have seen in the case of the Co-op that they had a very particular approach to promotions and presumably other people had similar concerns.
Just staying with this reactive business, if I look at the period with which we are principally concerned, 2000 to 2003, am I right in thinking that Gallaher led the MPIs on two occasions and Imperial led the MPIs on three occasions?
A. I couldn't say for certain, but probably sound about right.
DR SCOTT: Yes. So that in fact quite often Imperial were

leading rather than following?
A. Depending on the timings of them, yes.
DR SCOTT: Yes, yes. Thank you.
MR LASOK: In fact, at this time, we are talking about the period August to October, it was Gallaher that was leading the price rise in Richmond and Dorchester. Sorry, ITL was leading the price rise.
A. As I said, in previous answers, that our promotional budgets weren't bottomless pits, and at some point you had to say enough is enough, we are spending too much, we need to get some revenue back in.
Q. Because I think that we have already seen other documents dating to this period in which ITL was asking retailers to increase their prices. On Friday we were looking at the Safeway document, which I think is 28/65, where ITL was encouraging Safeway to move upwards in the belief that Gallaher would follow.
A. We were probably reducing a retrospective bonus, I can't remember the precise instance that you --
Q. You have held the prices since June, as I understand it, a 10p increase in two stages, signalled in September and October. Do you remember that?
A. I would have to look at the document again to be absolutely certain I remembered it. Do you want me to look at a particular instance?

Q. I think we have been through the documents already that relate to this period of time.

I am well aware of the passage of time, and I wonder whether I could take you to paragraph 6.40 in your witness statement. Do you have 6.40?

A. Yeah.

Q. You are here referring to a document which you start talking about in paragraph 6.39. It's a document that's in annex 17, tab 28. {D17/28} Perhaps it would be a good idea just to have a look at it. You say in the last sentence of paragraph 6.40:

"The retailer sought ITL's assistance in calculating these changes, but the schedule did not require or instruct the retailer to sell at the identified prices whilst most of the content was historic/retrospective."

But am I right in pointing out that, if you look at the document itself, the last sentence before the one that says "thank you for all your patience" refers to a Richmond 5p shelf price increase from 9 April 2001, which was three days after the date of the letter and that was a response to a Gallaher price initiative?

A. This again is a 3.29 to 3.34 increase on Richmond, I think. That's what it says to me on the price file.

Q. I think that these are in the reverse order, because the one we are looking at, I think, is the -- is it not the

first page of schedules?

A. They haven't got any dates on these at all, I don't think.

Q. Let's count the pages. Page 1 is the covering email. If you look at page 2 in the middle of the page, you have Richmond Kingsize. If you look at the 20s, which is more or less exactly in the middle of the page, Kingsize 20s in the second column from the right are at 3.39?

A. Ah, right.

Q. Yeah? And the Richmond Superkings 20s, which are in the fourth line below, are at 3.40?

A. Mm.

Q. And then if you look at the next page, in the same position, you can see Richmond Kingsize, in the middle of the page, and it's 3.34 and 3.35. So it was a 5p increase --

A. Yeah.

Q. -- that was to operate from 9 April 2001?

A. Mm.

Q. That was in response to a Gallaher price increase; do you remember that?

A. I can't remember it being in direct response to a Gallaher increase but I know it's obviously a reduction in our retrospective discount.

Q. Right. If you can't remember that, that's fair enough. For the Tribunal's note, the reference to the Gallaher increase can be found in annex 7.

THE CHAIRMAN: The second one is supposed to be "Post Budget cost prices retails unchanged", according to the letter at page 85.

MR LASOK: The problem is that the attached schedules are in the wrong order, but we can work out that the first one immediately after the email is the fourth, because it's got the 5p price increase. The cross-reference to the Gallaher price change, as I've said, is in annex 7. One can look at tabs 9 and 10, or just tab 10 alone. But the witness doesn't recollect that there was a Gallaher increase at that time.

Now, could you go to paragraph 6.78. Could you just read that paragraph to yourself, please.

(Pause)

A. Yeah.

Q. This document here is in annex 28, tab 54, {D28/54}, but it's probably sufficient for present purposes if we just look at your quote, because you quote the document as saying:

"Please increase the price to match Dorchester."

Now, is this another illustration of the commercial shorthand that you are talking about in paragraph 6.77,

and in 6.80? It's not the same document as the one that we were looking at on Friday.

A. I think the letter referred to --

Q. Do you want to look at the letter as a whole, to refresh your memory rather than --

A. Annex 28, document 54, yeah.

Q. Perhaps we should do that. (Pause). Is this too a bit of commercial shorthand?

A. Yes, if you read the letter, I think the first point I would make about Mr Thomas at Safeway, I think I made some reference to him on Friday, about him probably being [redacted] that we had to deal with, Safeway were in dreadful problems at this time. I had a certain amount of sympathy for Mr Thomas in that he kept getting conflicting messages as to what Safeway's strategy was at that time, and one of the consequences of this was confusion over prices. We were confused because Safeway were telling us, "These are the prices that you should be finding in the marketplace", and hence this letter from George Byas, the national account manager, who has taken the time and trouble to go out and make calls today, so he has been into some Safeway outlets, and this is his, if you like, in-call report back to the buyer saying "Hang on a second, I think that the prices you told me were going

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to be around are not around, these are the prices that I kept finding", and in some cases there needed to be some alterations.
Q. So could --
A. In some cases, like the Richmond Superkings and Dorchester, we had obviously decided to reduce our retrospective tactical bonus on the 20s.
Q. Can you just tell me what the longhand version of this is?
A. Well, item 1 is: I have seen that Dorchester is priced at this price in your branches, so as a consequence to that, because I am supporting you at a lower level, I feel now for me to achieve my strategy, I can reduce the bonus, and if you want to make the same money as you were making previously, you will need to put the prices up.
The second one --
Q. Just pause at the first one. So you are not saying that he has gone round, seen that the price of Richmond Superkings is 2p below Dorchester, is overjoyed at the fact that the benefit of the bonus is being passed through to the consumer and is content with leaving Richmond at a competitive price vis-a-vis Dorchester? That's not the longhand version?
A. No, I don't think so.

Q. No?
A. No.
Q. He wants --
A. I mean, I think part of the strategy behind that sort of move is our experience was that, if Richmond Superkings was on the shelf at the same price as Dorchester, Richmond Superkings' market share increased. So we didn't need to support it, it was a better brand than Dorchester Superkings, and that meant that we could save some money, because we were confident that even if they were the same price, we would win the battle on the shelf for market share.
Q. So that he does mean what he is saying?
A. The bonus will be reduced accordingly, and adjusted on 100 multipacks.
Q. No, he does want Richmond Superkings to match Dorchester in price?
A. Yes.
Q. So it is not commercial shorthand?
A. Well, except what I have just explained is the shorthand that's missing, that we believed that the strategy behind Richmond Superkings is that as long as we are the same price as Dorchester, we are quite happy, because we will win the battle for market share.
Q. So for example, if you go to tab 57, in the same volume,

{D28/57}, this is a handwritten one, I want to focus on the last sentence but do please read the entire document.
(Pause)
A. Yeah. I think I understand this.
Q. So that at the end of it, what he appears to be saying is that -- I am looking at the last sentence -- he can accept a 3p difference, and that's between Kingsize and Superkings?
A. Yeah.
Q. Whichever brand we are talking about. But he says "We must have parity."
There must be parity between Dorchester and Richmond?
A. Yes, it probably should be written the other way around, that Imperial wants parity between Richmond and Dorchester, because Richmond is too expensive in this instance, I think.
Q. So this is a situation in which it's not commercial shorthand, he means exactly what he says?
A. We are too expensive here, I think, Richmond is too expensive. As I said, if they are the same price on shelf, we were happy. If Richmond Superkings was more expensive, as he said, in stores Richmond Superkings is plus 1p on Dorchester Superkings, so we would want

Richmond Superkings to be cheaper, and I guess that the supporting retrospective bonus would have actually borne that out.
Q. And you wanted them at parity?
A. Yeah, in this instance, in this, yeah.
Q. I wonder whether -- you can put that away now -- in your witness statement you could go back to page 12 and paragraph 2.30. Could you read that paragraph, please?
THE CHAIRMAN: Could you just say which paragraph again?
MR LASOK: I am sorry, it's paragraph 2.30 on page 12.
(Pause)
A. Yeah.
Q. You say here that, in the third line:
"Manufacturers need to incentivise retailers to pass on discounts and low prices to consumers in the form of lower prices."
Where do you get that from?
A. Because I've got experience that in certain instances retailers, if the cost price was reduced, it wouldn't necessarily follow that the shelf prices were reduced.
Q. Was Asda one of these retailers?
A. They may well have been.
Q. Asda says that it wasn't?
A. Well, it may well have been, I couldn't comment on the specifics of Asda. But I do know that retailers -- we

had an instance, I think it was probably to do with the Richmond Kingsize price repositioning, where we announced it as a reduction in cost price, and we suffered as a consequence of that, because several retailers took the cost price reduction but left the retail price where it was.
THE CHAIRMAN: Was Asda one of those?
A. I can't remember. I can't remember. I certainly remember Tesco was, but -- because I remember that as a sort of ongoing incident related to other things, but I cannot remember if Asda were one of those. I feel happy with that part of my statement that I didn't feel that I could trust retailers simplistically to accept that a cost price reduction was a retail price reduction, no. I mean, retailers saw it as an opportunity to enhance the margin. And why wouldn't they?
MR LASOK: This was your belief about how retailers would behave?
A. And my experience.
Q. Well, which retailers did you have this experience with?
A. Well, certainly Tesco is one that I can distinctly remember. I mean, beyond that, I am sorry, but you know, 2000 and whatever it was, I can't think back and remember specific examples, and I think it's unfair to

expect me to give specific examples this far removed from the date when all this was happening.
Q. If a retailer had an EDLP policy, why would you need to incentivise it to reduce its retail prices?
A. Well, define what an Every Day Low Price policy means. It's easy to say, but I think it's more difficult to actually implement, by specific, not just product but actual brand. Because a retailer's view of what price a low price should be may not be the same determination that we would have. So --
Q. If a retailer was in fairly open competition with another retailer, it would want to price its products attractively in order to compete, wouldn't it?
A. Yes. Yeah.
Q. So why would you need to incentivise it to do exactly the same thing, what it's going to do in any event?
A. Well, it wouldn't necessarily do that in any event, I don't think.
Q. On what basis do you think that?
A. Well, you are going to look at what the prices are in another retailer. Yeah? But they might not pick every brand and every product that we had, on our radar. I mean, there was a period of time where the only KVI in cigarette products was probably Benson & Hedges Kingsize, and everything related to that. I think that

was one of the points that Geoff Good made on Friday, about the fact that Embassy was not looked on in the same way, so an Every Day Low Price, I mean if an Every Day Low Price meant that B&H was reduced by 5p to match another retailer, it doesn't mean to say that Embassy No 1 would be reduced.
Q. Mr Good accepted that not all retailers needed incentivising to pass on lower wholesale prices.
A. That's possibly the case at the time he was running the ship.
Q. And you say that it changed after 1996?
A. I think that it changed progressively over a period of time, yeah, because of the growth of the multiple retailers in share of market that they had, because one of the factors that contributed to that was the move that all the multiple grocers had in trying to establish convenience offerings, and if you look at the price of product in convenience offerings compared to supermarkets, huge differences. Certainly one of our arguments with Tesco, for instance, was how can you, under the Tesco banner, be selling a Tesco price in a store which is 5p, 10p dearer in a Tesco Express?
Q. But apart from one incident involving Tesco, you can't remember, apparently, any instances and any other retailers supporting the broad statement that you make

in paragraph 2.30?
A. That's true. I have expressed Tesco as a definite example where I can put my hand on my heart and say I remember that. But for goodness sake, I mean, all the years I worked in this area doing this job, how am I supposed to be expected to remember specific instances unless there is something very significant surrounding that particular moment? I am sorry, I --
Q. You see, I find it very strange, because we have Mr Good, who accepts that when he is around in 1990 to 1996, some retailers might not pass though but others would, and you say that things changed after 1996 but you can't give any details to justify the statement?
A. Well, I think the only thing I can say was that the negotiations were never easy with multiple retailers, and it certainly got progressively more difficult as certain retailers got progressively bigger.
Q. One final question, Mr Batty: you have also said in your witness statement that there was fierce and vigorous competition between manufacturers such as ITL and Gallaher?
A. Yeah.
Q. Now, I put it to you that that's just your opinion based on your observation of what was going on in a context heavily coloured by the operation of these parity and

differential requirements; would you agree with that?
A. No, I wouldn't. The activities that were taking place whilst we were able to promote and market products were, I mean, almost endless. I think somewhere in the documents we have actually produced evidence of what those competitive elements were. I mean, purely and simply, the 2000 to 2003 period, I mean, what the whole of this investigation -- and certainly my part in it today and Friday -- I think fails to recognise is that the part that pricing played relative to the other battles we were having, which was over getting product listed, getting retailers to stock it and put it on shelves, once they had got it on shelves actually putting it into the form of a pictorial planogram guide as to how many pack facings there should be of different products, what position on shelf those should be, and there were fairly large amounts of money changing hands, to gain those advantages on shelf. Pricing was almost incidental to those things, in brackets as long as we were not competitively disadvantaged. But in addition to that, one of the biggest investments we were making at this time on a competitive level was for the provision of units in shops, where we were still allowed to have a head sign up which had a brand advert on. We were paying colossal sums of money, and in heavy

competition with both Gallaher's, Rothmans, Philip Morris, BAT, to actually secure what we believed were the important retailers to have that equipment in.
THE CHAIRMAN: Yes.
MR LASOK: I have no further questions.
THE CHAIRMAN: Yes, thank you very much. Well, we will break at that point for lunch. I am afraid you are not quite finished, Mr Batty, because the Tribunal members may have some questions to ask you, and then Mr Howard may have some questions to ask you after lunch, so I am afraid I still have to ask you not to speak to anybody about it.
A. Understood.
MR LASOK: Madam, could I say this: my assumption is that if Mr Howard wishes to re-examine Mr Batty, then his questions would be limited to re-examination and not examination-in-chief.
THE CHAIRMAN: Yes. We will reconvene at 2 o'clock.
(1.00 pm)
(The short adjournment)
(2.00 pm)
THE CHAIRMAN: The only point that we wondered whether you were the right person, Mr Batty, to explore this with, and Mr Howard might be able to give us a bit of guidance, on the first or second day when you were

opening, Mr Howard, we were asking some questions about how the RRP is arrived at and whether that's something that the Inland Revenue, are involved in. But I don't know whether that's something Mr Batty is able to talk to, or whether there was another witness you were planning to cover that with?
MR HOWARD: The honest answer is I don't know, but I would suggest we ask him, if he doesn't know he will tell us, and if he does know, he will be able to supply the details.
Questioned by THE TRIBUNAL
THE CHAIRMAN: Well, then I will ask you, Mr Batty.
We have heard a lot about the RRPs set by ITL, and our understanding is that an unusual feature of this industry is that the company has to set that, and that one aspect of the taxation of cigarettes is based on that RRP, and we were therefore wondering whether the setting of the RRP is something that is done in accordance with rules set by the Inland Revenue or in discussion with the Inland Revenue, or how the company arrives at that, and whether they are subject to any restrictions as to what they can set as the RRP, because of the implications of that for tax?
A. Right. I think the first thing to say is that the sort of recommended retail price mechanism, if that's the

right word for it, sort of goes back a very long way. For instance, when I first started working in the tobacco industry in about 1967 resale price maintenance was in force, so there was a selling price that every retailer had to adhere to and then resale price maintenance was abolished in about 1968 I think it was, and recommended retail prices took over at that point. I can't remember when the taxation system changed, it was part of the move into Europe, when it went from weight of tobacco to a sort of end product tax. But there are two elements that are affected by the retail price, that being the ad valorem, which is 22 per cent, I think, of the ... and VAT, whatever that particular rate is. As far as establishing a recommended retail price, that is, I believe, entirely up to each individual manufacturer to determine and the resulting RRPs will then generate the tax that the Revenue and Customs will then ask for, and it's entirely up to, in my case, Imperial Tobacco to work out how we are going to raise revenue from the sales of our products to pay dues and demands. So I think there was an example where Mr Good was talking about variations in the implementation of a tax increase where the Chancellor might say it's an 8p increase but there would be variations to that, based on possibly where we were aiming prices, where we thought the recommended retail price should be but also the rounding factor as well.

Does the answer your -- it was quite a long question --

THE CHAIRMAN: Yes, so what you are saying is that even though there are implications for tax revenue of the RRP, in fact there is no Revenue guidance or interference or rules or whatever which impacts that, it's up to ITL to set it as it sees fit.

A. I think the only time it would, and certainly one of the times when we experienced some difficulties with it was with retailer own brands, where there was not necessarily a recommended retail price established for it, and that affected us when we bought a German company that had quite a lot of own label products and we felt we had to make sure that we complied with the regulations and had a recommended price which is supposed to reflect the level at which the majority of product is sold.

THE CHAIRMAN: Thank you very much.

MR HOWARD: I have been reminded that Mr Batty deals with this in his statement at 4.17 and 4.18 where he refers to the relevant regulations, I don't know if you wanted to look at that.

THE CHAIRMAN: We will in due course.

MR HOWARD: There is nothing I want to really add to that.

Just before I commence re-examination, I just want to make a general point, which is this, it's really to try and save some time: I am going to go to certain of the correspondence that Mr Lasok has taken Mr Batty to. A point we will be making in due course is that many of the letters that he was shown were not shown in their appropriate context. Now, it would take a long time if I go to every single one, so we will do that unless you direct otherwise by way of submission, but I will go to some of the more egregious examples.

THE CHAIRMAN: Yes.

MR HOWARD: I do not want to be criticised for not having taken Mr Batty to every single one.

THE CHAIRMAN: No, that's a matter that is appropriate for submission.

MR HOWARD: I am grateful. Quite a lot, you will realise, of what is -- it's not a criticism of Mr Lasok, because Mr Batty has dealt with things in his statement -- being put on correspondence to which he was not a party and some of which he didn't see is ultimately a matter of argument.

Re-examination by MR HOWARD

MR HOWARD: What I am going to do, Mr Batty, is you were taken to documents in relation to different retailers at

different times and we jumped about; I am going to try and discipline myself by taking you to specific retailers and to some of the documents you were shown and try and just seek some clarification. So I am going to start with First Quench, which you will find in annex 16, and you were taken to the First Quench trading agreement at tab 7. {D16/7}

Now, can you just help us first in relation to this: First Quench, what type of retailer is it?

A. Basically it was predominantly an off-licence retailer, so selling beers, wines and spirits.

Q. And in relation to tobacco, what was its approach to pricing?

A. It was seeking high prices -- well, high margins which resulted in high prices.

Q. Right. If we go to the trading agreement, Mr Lasok asked you a lot of questions about the words at paragraph 3, just before I come to ask you about that, I would like you to help us on this: if you look at the second page, you can see "Pricing" and then "Branches by tier". Do you see that?

A. Yeah.

Q. So "Pricing", on the left-hand side we have "Brand", and those -- I'll lead you where it's not controversial -- are obviously your different brands?

A. Yeah.

Q. Then explain to us the tiers, tiers 1 to 6, what's that?

A. So the First Quench estate, which from memory was something like 2,500 shops, which demonstrates the scale of retail outlets that were being dealt with and they divided their entire retail estate into these six different price tiers. So at the time that this trading agreement was put in place, which was November 2000, tier 1 was recommended retail price, tier 2 was 3p below RRP, and so on across to tier 6, which was 15p below RRP.

Q. Right. We see in fact tier 1 is all RRP, tier 2 is all minus 3, and then in tiers 3, 4, 5 and 6 there is variability as to the quantum of the differential below RRP, according to the different brands. Can you explain what that's all about?

A. Well, that was a decision obviously made by First Quench, based on their margin requirement to establish what level they wanted to be below RRP which would give them the margin that they required.

Q. Right. Now, we see just above "Pricing" there is a paragraph that reads:

"The current situation for both pricing and percentage of branches by tier ..."

Just explain to us, we can see there is a bit which

says "Branches by tier percentage", what's that all about?
A. That takes the six tiers of pricing and establishes the -- what we believed the volume that was produced by the stores that were in those tiers by brand.
Q. Right. The next sentence says:
"The current situation for both pricing and percentage of branches by tier is shown below. These levels will be used to monitor the position on a quarterly basis."
What's then being monitored, as you understand it?
A. The number of stores and the percentage of volume that was being sold below RRP.
Q. Right. So then when we go back to the first part of paragraph 3, and we see:
"The bonus level shown above will only be paid if existing levels of pricing and percentage of branches within each tier are maintained", where in the agreement do we find the existing levels of pricing and the percentage of branches within each pricing tier which are to be maintained?
A. I don't think it's in here, is it?
Q. What's the relationship between the levels of pricing and the percentage of branches and what we see below in relation to pricing and branches by tier percentage?

A. Well, I think that part of the support levels that we were paying were for them to sell below RRP, and this enabled us to calculate the volumes of product that were being sold below RRP and pay a percentage of the total bonus based on those figures.
Q. Where it says:
"A proportional reduction would be made should one or both of the following changes take place: movement of prices in any tier relative to RRP to a more expensive tier, transfer of branches to a more expensive tier."
Explain to us how that fits in in relation to what we see on the same page?
A. That was trying to protect our position should the retailer decide, as we believed they were probably going to, at some point, move branches from the right-hand end of the pricing tier chart closer to the left-hand end.
Q. Okay. Whilst we are in First Quench I would like to ask you about some particular correspondence. First, turn to tab 8.
MR LASOK: I don't think I took him to this document.
MR HOWARD: No, Mr Lasok carefully didn't, because he took him to 16/10 without showing him the context, and that's what I am now going to do, is show the context.
If every time I get to a letter that Mr Lasok hasn't shown, he is going to say that isn't proper

re-examination, it is perfectly proper re-examination if Mr Lasok has taken a witness to a document without showing him the appropriate context. That was his choice, and I would suggest that was not a proper way to cross-examine, but that's not my purpose at the moment. My purpose is to set the matter into context.
Now, at 16/8, {D16/8} we see this is a letter of 11 January 2001, and if you would look at item 11 on that page, please, could you just explain to us what's going on there?
A. This is obviously, I think, where Drum has been supported by a tactical bonus, and we are happy to remove the tactical bonus to some degree and we would like the price to be at or close to Amber Leaf.
Q. Well, let's see. The second sentence:
"You will confirm actual prices post MPI but the anticipated gross bonus from ITL to achieve parity is currently [redacted]."
So who is paying who what in that situation?
A. So Imperial Tobacco is paying a bonus to First Quench.
Q. Of how much?
A. Of --
Q. It's the money that's in the red box; right?
A. Yeah.
Q. If you would turn on to tab 11, {D16/11} and if you

would go -- this is the letter of 21 February 2001 -- to the second page of that, do you see paragraph (d)?
A. Yeah.
Q. So you can see:
"With effect from 1 February 2001 until further notice, Drum will be the same price as Amber Leaf at £1.99, a reduction of [redacted] for Drum."
Do you see that?
A. Yeah.
Q. So can you just explain to us what you understand is going on firstly about Amber Leaf? What is Gallaher doing, as you understand it, for Amber Leaf?
A. It looks like Amber Leaf has been promoted, at a 1.99 price point.
Q. And what is Imperial's reaction to that?
A. Our reaction is to reduce the price of Drum.
Q. Right, and how do you do that?
A. By a retrospective bonus to the retailer to price at £1.99 or less.
Q. So when we go to 16/10, {D16/10}, the letter on which Mr Lasok I think spent a lot of time, you see this is 9 February, and you see under paragraph 4, the third paragraph there, which says:
"I also note that Amber Leaf will move up to £1.99 from the date of the Gallaher MPI. Drum will match

Amber Leaf and I will set out a new bonus in the retro payment."

So firstly, was Drum, from what you have seen, moving up in price or down in price?

A. It appears to be moving down in price.

DR SCOTT: Can we just contextualise this in the context of the MPIs, because this is one of those cases, as I understand it, where Imperial are leading with an MPI.

MR HOWARD: What has happened, it's all set out, sir, in the documents, the questions on this all went off on a false tangent. Amber Leaf for some time was actually at about £1.90, and Drum was somewhat a way above that, because as you say Imperial had decided to put the price of Drum up. Gallaher -- and Gallaher had been funding it with a tactical promotion -- seems to have either withdrawn part of the tactical -- what they had then was an MPI and the effect of the MPI was then to push the price up, but they still had their tactical promotion, as I understand it, and that's why it moves up but it's at £1.99 as opposed to its RRP of, I think, £2.12. Imperial had been above but have decided that, although they had gone up with Drum and it had been up for some time, they had brought it down and here they are paying [redacted] per pack to match, as said in the letter.

So in relation to the bonus arrangements, firstly,

and the movement of the price of Drum, we have already seen, and you have confirmed, that it appeared there was this [redacted] bonus, now, can you explain to me, is that a tactical bonus or an ongoing bonus?

A. I believe that would be a tactical bonus, and would be spelt out in a document somewhere confirming.

Q. Yes, and in the context now of what we have seen of the letter, Mr Byas saying that "Drum will match Amber Leaf, and I will set out the new bonus in the retro payment", what is your understanding then of what is going on?

A. That we were reacting to competitor activity in the marketplace and trying to make sure our brands were in a competitive position.

Q. Right. Now, in terms of the [redacted] that you were paying to First Quench here, what were you expecting them to do with the [redacted] vis-a-vis the price of Drum?

A. I think at least reduce the price of Drum by the [redacted].

Q. Yes. When the retailer in these examples reduced the price of Amber Leaf as a result of a Gallaher promotion, absent your paying a bonus of [redacted] as we see you are doing, did you have any requirement of the retailer, here First Quench, that they should independently reduce the price of Drum?

A. No.

Q. Absent your paying for it, did you have any expectation that the retailer would independently reduce the price of Drum?

A. No.

Q. Now, you can put that one away, and we can go to volume 20, please, of the SO exhibits, and this one should be Somerfield. It's tab 9. Again, you were asked a lot of questions about the middle paragraph, but just before we look at that, I would just like you to explain to us the context of this by looking and re-reading and remind yourself firstly of the first section of the letter which deals with Lambert & Butler and John Player Special and then the bit that deals with Kwik Save. Could you read that?

(Pause)

In relation to the first part, L&B and JPS where Mr Hall is noting that the selling prices had been increased, and then he notes what the additional retro bonuses will then be -- sorry, will therefore end on 27 October, what's that all about? What's the relationship between the retro bonuses ending and the increase that one sees in the selling price?

A. Well, Mr Hall has observed somewhere that the selling prices in Somerfield and Kwik Save were increased by

probably Mr Clarke, the product group manager, and as a consequence of the relative increases in price, Graham Hall is reducing the retrospective bonuses, and it appears that Somerfield have made the decision on those prices and we are reacting to that.

Q. Right. Then under Kwik Save, what was happening there?

A. For the Panama and the Superkings?

Q. Yes. Take the Panama first, where he refers to the selling price and then he says:

"We are paying additional bonuses to achieve selling prices", which one can see are lower?

A. I think all the account manager is doing there is asking for value for money, that we were paying for a reduction to those levels and we weren't getting it.

Q. Just while we are on that, of course we will see some other examples, you were asked by Mr Lasok today whether or not retailers can always be trusted to pass through price reductions to the consumer. If we see what was happening with Lambert & Butler and JPS and then Kwik Save, does that tell us anything about, at least in this instance, the reliability of Somerfield?

A. Yeah, I think it does, and you know, I think it determines quite clearly that the retailers, Somerfield in this case, were responsible for establishing their own prices.

Q. Right. In the context, we see this discussion about bonuses where you have been paying money and Somerfield hadn't in fact been doing what you had been paying for, if you now focus on the middle paragraph, where it's said:

"I note you have reduced the selling price of Cafe Creme and Small Classics to 2.52. Our strategy on miniature cigars is normally to match Hamlet which appear to be unchanged at 2.62."

In the context of this letter, why do you understand it was necessary to write that?

A. I think this was the national account manager protecting Imperial Tobacco's position that we wouldn't be hit for an unexpected retrospective payment to support those lower prices.

Q. Could you next keep that open but could you be given ITL's appeal annex, volume 19. Could you turn to tab 7. Do you have that, tab 7? Could you look at page --

MR LASOK: Excuse me, we are trying to get it.

MR HOWARD: I am sorry, I beg your pardon.

A. Is this a document by courier?

MR HOWARD: It's a bundle which is the ITL appeal bundle, volume 19, it's the annexes to --

THE CHAIRMAN: Is it 14 March 2005?

MR HOWARD: No, it's a price ... it's at tab 19.7, it's

a long document with --

THE CHAIRMAN: Tab 19.

MR HOWARD: Sorry, our file has fallen apart. The front document is a letter to the OFT of 14 March 2005 from some solicitors in Bristol. Does the Tribunal all have that?

THE CHAIRMAN: Yes, that is at tab 7.

MR HOWARD: It is at tab 7 and I want to turn in that tab, in the top right-hand corner, to page 166. There we can see that it's a price file, I think that's what it's called, and it shows the prices of various things. Of course, we have just been looking at Cafe Creme, and the Classic Small cigars, and you should be able to see them. Cafe Creme is about 15 down. Do you see that?

A. Cafe Creme 10 pack?

Q. 10 pack, yes, and you can see if you run your finger along, in July 2000 they were at 2.62, and they stayed at 2.62 until October 2000 when they went to 2.52, and then they stayed at 2.52 until the end of November, and then in December they went to 2.49. Do you see that?

A. Yeah.

Q. Then if you would just look at the Classic Small cigars, which were also the subject of the correspondence, they were at 2.62 similarly for a while, and then they dropped, also in October, to 2.52, until the end of

November, and then in December they went to 2.49. Do you see that?

A. Yeah.

Q. Now, we know the letter that was written to Somerfield was on 6 November. Now, what conclusions do you draw from that as to Somerfield's policy in relation to the price of those cigars --

MR LASOK: I beg to interrupt. This is -- with all due respect to my learned friend, the witness can't be expected to speculate about what Somerfield was doing. This is not re-examination.

THE CHAIRMAN: Well, this price file is an internal Somerfield document, is it?

MR HOWARD: Well, I'll rephrase the question.

You were asked repeatedly by Mr Lasok questions about the sentence in the letter of 6 November, that "Our strategy is normally to match Hamlet Miniatures, which appear to be unchanged at 2.62".

As far as you understand, did Somerfield in fact change the price of those two cigars?

MR LASOK: This is, with all due respect, completely irrelevant. It's not a question about the meaning of the document that I was cross-examining him on.

THE CHAIRMAN: Well, I think your cross-examination was more directed to this one which is directed to the use of the

word "match" as to whether or not there were parities or maxima.

MR LASOK: That's quite correct, yes.

THE CHAIRMAN: Whereas I think the point that you are going towards is a slightly different point as to what was the purpose of drawing their attention to this apparent anomaly. Is that correctly guessing where you are heading to?

MR HOWARD: Certainly that was the question and Mr Batty in fact told Mr Lasok in answer to the cross-examination, when he said "why match, why match, why match", I think six times, and he said on more than one occasion that the purpose of what was being said was not actually to impose a requirement, but it was to point out there was this discrepancy and to put them on notice that they were not going to get a bonus for being 10p below. What I am simply asking the witness --

THE CHAIRMAN: Yes, well, if he gave that answer in cross-examination, are you expecting him to give a different answer?

MR HOWARD: No, I am not. We can move on quite quickly. As a matter of record, those are the prices that were actually charged by Somerfield.

DR SCOTT: So where are the paired prices?

MR HOWARD: I beg your pardon?

DR SCOTT: If you are talking about matching or not matching.
MR HOWARD: Well, they didn't, that's the point, they didn't match.
THE CHAIRMAN: But it looks as if they do exactly match.
MR HOWARD: No, that was the letter, that's the whole point, the letter was saying "We see that the price is now 2.52". The matching price would be 2.62. They in fact didn't move the -- they had been at 2.62, they themselves just moved to 2.52, and then they kept it there, and in fact went lower.
MR LASOK: With respect, this is just submission.
THE CHAIRMAN: Yes, it does -- I mean, we don't know whether Mr Hall had seen this price file or what he knew about Somerfield's intentions as to pricing.
MR HOWARD: No, it's my fault, I am obviously not making the point clear. I am not suggesting Mr Hall saw this document at the time, he obviously couldn't have seen it, because this post-dates what is the subject of the letter.
THE CHAIRMAN: Perhaps you should ask Mr Batty what it is that he understands is the meaning of that paragraph. I am not sure what the point of taking him to the price files was.
MR HOWARD: The point of this was simply to demonstrate to

you what is actually a matter of record, that Somerfield's prices in fact -- it's all been set out previously -- stay at 2.52 and then they reduce it further.
THE CHAIRMAN: Oh, I see.
MR HOWARD: Yes. Maybe you are not looking at the right brands or the right dates.
THE CHAIRMAN: No, I am. So what you are --
MR HOWARD: In relation to actually looking at what is actually happening, as a matter of --
THE CHAIRMAN: But I don't think that that was the point on which he was being cross-examined on this document --
MR HOWARD: No.
THE CHAIRMAN: -- which is more a matching. But your point is that in response to this it doesn't look as if they put the prices back up to 2.62.
MR HOWARD: I am sorry?
THE CHAIRMAN: Your point is they didn't put the price back up, they kept them both at 2.52 rather than putting them both back up to 2.62.
MR HOWARD: Let's move on, that's amongst the points.
While we have the Somerfield file, let's move on to -- you were asked a lot of questions about tab 24, both on Friday and today. We don't need to read this all out again.

Would you look at 20/28, which just follows this. In fact, at 20/28, you have the email of 2 November which Mr Lasok focused on, and then you have a further email from Mr Hall actually dealing with this.
You can see in the second paragraph he says:
"My understanding is that Nick spoke to Steve subsequently and agreed that Drum 12.5 and 25 grams would stay at £2.12 and £4.15, Amber Leaf would be coming down to match, but that Drum would move up from £8.09 to £8.29 from the 14th. I would therefore appreciate it if you could confirm exactly what prices are live on the system in each fascia, so that I can ensure that we make the correct bonus payments."
Now, explain to us the relationship of making the correct bonus payments and knowing what the prices are that they are charging?
A. Well, we would have to know precisely the prices that the retailer was selling at to be able to calculate accurately the bonus they were entitled to relative to the price they were previously at, or relative to the price we thought they were at. Does that ... So the retailer is saying one thing to us, we are finding something else out in the field, and we are trying to clarify what the actual price is.
THE CHAIRMAN: So you are saying you were paying them this

bonus to achieve a particular price, and now you need to know what prices they are actually charging to see if they are actually entitled to the bonus you are paying them?
A. Yes.
MR HOWARD: What we also see here is that, what one saw is that in the first email the writer talks about Amber Leaf appearing to have increased to £2.18, whilst Drum is still priced at £2.12, and then it says:
"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."
Now, in relation to bonuses, if the price of Drum is moved up, what's the significance of that in relation to any bonuses that were being paid?
A. We would reduce the retrospective bonus that was in place to correspond to the change in price.
THE CHAIRMAN: That's the tactical bonus?
A. Yes.
MR HOWARD: Now, what we then see is that you seemed to be being told by the retailer here that, although Amber Leaf has been at 2.18, it's actually coming down to £2.12, and therefore carry on with the bonus arrangement. Do you see that?
A. Yeah.

Q. Now, do you know in fact whether this retailer, Somerfield, did actually reduce the price of Amber Leaf as a result of Gallaher price promotion?
A. No.
Q. No. Now, can you just tell us this --
THE CHAIRMAN: No you don't know, or no they didn't reduce it?
A. No, I don't know.
MR HOWARD: We can see in fact what happened, if you would take the ...
MR LASOK: With respect again --
THE CHAIRMAN: Yes, I wonder whether this is something that this witness can help us with.
MR HOWARD: He can, I am not asking him to verify the facts. Well, take it from me for the moment, and the reference is in the SO response where there is a table at paragraph 6.680 which shows that in fact the price of Amber Leaf didn't come down and stayed at 2.18.
The question I want to ask you, Mr Batty, I am not asking you whether that is right or wrong, that can be verified: to what extent did you have experience of retailers telling you something, for instance, that Amber Leaf will come down or Gallaher will move in a particular way, and that not turning out to be true? I think it's been described as "parlaying".

A. Yes. When retailers told us things, we weren't quite sure whether it was actually going to happen or whether we were being played off against a competitor, for the retailer to extract a promotion from us and then obviously go back to our competitor and do the same situation with them. Quite often we would wait until we saw what happened in the marketplace before making a decision on what we would do.
Q. Could you put that bundle away and go to a bundle which is numbered 29, which is the T&S Stores. Just before we look at some of the documents about that, could you just help me by explaining again, T&S Stores, what's their position in terms of being a retailer? What are they all about?
A. T&S were, in the main, a convenience retailer, but had moved there from being predominantly a cut price retailer trading as Supercigs, where Supercigs actually describes very low pricing and were at some point -- and I can't remember the date -- taken over by Tesco. They also included the convenience store One Stop.
Q. Right. Now, what you were shown is a letter which related to Day & Nite stores, but before we come to look at that letter we need to look at two preceding letters. One, I am afraid -- I apologise -- is again not in this bundle, it's in the ITL appeal annex at tab 20 --

file 20, sorry, and it's at tab 8. I apologise for jumping around in bundles, but it's just that we don't have a chronological run. So if you go to tab 8, you should have a letter of 10 June from Imperial Tobacco to T&S. Do you see that?
A. Yeah.
Q. Right. Just cast your eye over that letter, and the relevant part dealing with Day & Nite is at the end. (Pause). Okay?
A. Mm. (Pause).
Q. Okay, Mr Batty?
A. Yeah.
Q. So from that, in the last paragraph, what we learn about the approach of T&S -- rather what's going on at Day & Nite stores, what's their pricing level?
A. I think that Day & Nite were selling at recommended retail prices, and that was at the time T&S were taking them over.
Q. So then if you go -- you can put that bundle away -- back to bundle 29, before we then get to -- the next letter that deals with this is at 29/18, which is 27 June, and you can see the section with Day & Nite stores, and the section under "Prices":
"We both agreed price policy and bonus structure needed to be brought to a correct natural level. I've

sent a recommended start point to you by email today showing prices and retro support levels which will be paid on EPOS sales data. The date for implementation of the above has been suggested as mid-July. Outstanding committed retro bonuses will be paid subject to pre-takeover prices being maintained until the July switchover."
I don't think there is anything else we need to worry about in the detail of that. If you then go to the letter that you were shown at 29/19 --
DR SCOTT: Sorry, could I interrupt?
MR HOWARD: Of course.
DR SCOTT: That point, I am slightly confused in that we have just had a letter which suggests -- and you have put it to the witness -- that Day & Nite were pricing at RRPs.
MR HOWARD: Yes.
DR SCOTT: We now have a letter which ITL says:
"We both agreed price policy and bonus structure needed to be brought to a correct natural level", which my recollection from our earlier discussions is the RRP level which suggests that they were already at it, that's why I'm pausing at that point.
MR HOWARD: Sorry, I am not sure I'm following your point.
DR SCOTT: The previous letter, it was put to the witness:

what was the pricing policy of Day & Nite?
MR HOWARD: The previous letter is the pricing policy of T&S in relation to Day & Nite.
DR SCOTT: Yes, which they had been taking over.
MR HOWARD: Yes.
A. I think it says in that letter that the majority of Day & Nite outlets are RRP, which infers some aren't, but it doesn't say whether they are above or below RRP, I don't think.
DR SCOTT: Right.
MR HOWARD: It says "most are selling at the RRP level".
DR SCOTT: So when we turn to the "natural", are we expecting "natural" to mean RRP level?
MR HOWARD: Mr Batty?
A. I would take from that the natural price for Day & Nite stores depending which category of store T&S moved them into in their pricing structure. That's what I would read into that.
DR SCOTT: Right.
MR HOWARD: Did T&S have a tiered level?
A. Yes, they did. I can't remember the full details of it. I can't remember, it might even have been by retail fascia, because they used so many different trading names, like Supercigs, One Stop.
Q. Tell us if you are not in a position to deal with this,

because we are asking you about letters that you didn't see, and Mr Culham is coming next, so he will be able to deal with it if you can't, or he is likely to be asked about it in any event. But you were asked about 29/19, and what you were specifically asked about is that the price of Classic Twin, which is a cigar, as I understand it, packs of cigars, you have found that they were set at 5.44, changing to 5.54, and we saw in the body of the letter that there are currently no short-term tactical bonuses on Day & Nite and no invoice bonuses except for agreed Rizla products. So are you able to cast any light on what is happening there, why a price increase is being suggested there?
MR LASOK: If you forgive me --
THE CHAIRMAN: Where are you reading from as to the Classic Twins?
MR HOWARD: Mr Lasok pointed out that band three, Classic Twin, there was a 10p price increase.
THE CHAIRMAN: Yes.
MR LASOK: If you forgive me, he was asked in cross-examination questions about this, he has given his answer, this is not re-examination.
THE CHAIRMAN: Yes, that is what re-examination, I thought, was supposed to be about, that if he wants to take him to another document, which you didn't take him to, to

ask him to reconsider the answer that he gave to you, that's what he is entitled to do, isn't it?
MR LASOK: That would be right if that was the question that was put to him.
THE CHAIRMAN: Well, what is the question that --
MR HOWARD: I have no idea what on earth this intervention is supposed to be. As you said, madam, he was taken to this, asked a number of questions about it, I am entitled to ask in re-examination questions about the document. That's what I was doing.
THE CHAIRMAN: So what is the question you are putting to him?
MR HOWARD: The question I am asking him: in the light of having now seen the context, the preceding correspondence, whether you are able to shed any light on why a price increase of 10p in relation to Classic Twin was being proposed in this letter?
A. I believe it's because we have identified from branch visits, which it says in the -- it's just above this box with the figures in, bands three and what have you, that there was a price there for B&H, there was a price for Sovereign, there was a price for Classic Twin, that we found out in the field which differed from the price that T&S had told us these products would be at in these stores. And so we were pointing out, because these were

Day & Nite stores which were transferring ownership, there appeared to be some confusion, that we needed to clear up, one, to know what sort of retrospective bonus we might have to pay, and secondly, to make sure that there weren't any retrospective bonuses expected of us that we wouldn't pay.
Q. Okay. Could we go on to Safeway. I beg your pardon.
DR SCOTT: But in the bit earlier on, we have read that:

"There are no special short-term tactical bonuses on Day & Nite sales/volumes and there are no off-invoice bonuses except for the agreed Rizla products."

That's not one of them. So it appears there weren't any bonuses to consider, that's what is confusing.
MR HOWARD: Well, that's the point -- go ahead, Mr Batty.
A. Yes, I think we considered there weren't any bonuses, but did T&S expect a bonus by establishing those prices?
THE CHAIRMAN: So you are saying that you suggested to them or you notified them that there seemed to be a 10p differential where there oughtn't to be, according to what they had told you they planned to do, and you were concerned that if you didn't point this out to them, to enable them to correct it, they might come back to you at some time in the future and say "Well, we thought there was a bonus and you should have pointed it out to us that the prices were wrong"?

A. Yes.
MR HOWARD: Thank you.
Now, could we go, trying to stick to my promise of doing it retailer by retailer, to Safeway now, which is in annex 28. I am not necessarily saying I am doing it in a logical order, but it's an order.
Could you turn to tab 54, I think you were shown this morning the letter at tab 54, as I recall {D28/54}, and the first sentence, about increasing the price of Richmond Superkings from 17 March by 2p to match Dorchester Superkings, the bonus will be reduced accordingly on 20s and adjusted on 100 multipacks. Just remind us for a moment there what's happening there?
A. As I said this morning, we were confident that as long as Richmond Superkings was no dearer than Dorchester Superkings, we would win the battle for sales on shelf, it was a better brand, had a bigger future than Dorchester, so we were confident as long as the prices were the same or in this case a little bit less, we were happy, but we didn't want to be spending money unnecessarily.
Q. Right. Then if you would look at tab 55, {D28/55} that was on 11 March, and now we are on 20 March, where Safeway in the first paragraph, are -- it says:
"... please reduce the price of Richmond Superkings

in supermarkets and PFS [petrol filling stations] by one penny to match Dorchester at £3.47. For some reason, Richmond went up by 3p, not 2p, from 17 March. Bonus levels have been reduced by [that sum] per thousand. Multipacks are currently price marked. Parity with the Dorchester is the objective in all stores and petrol filling stations."
So what's happened here, what are they talking about there where the price of Richmond has gone up by 3p, not 2p?
A. Clearly we have done some more store checks out in the field, and uncovered this fact that Richmond Superkings were increased by 3p, not the 2p that we had suggested, and the account manager is reminding the buyer of Safeway that we have reduced the retro bonus on Richmond Superkings by [redacted], which including tax is equivalent to [redacted] a packet. So that's the rationale for saying take that penny off.
Q. So were they still receiving a tactical bonus to be pricing at --
A. I guess from this, yes, because it says -- it doesn't say removal of the tactical bonus, it just says a reduction of.
Q. We then see, that was 20 March, and you were then taken to 57, so --

THE CHAIRMAN: That reference to bonus levels, is that general bonus levels or is that supposed to say, because you, Safeway, have priced it at a penny more, we are reducing your bonus by an amount?
A. No, that's the bonus that was necessary to equate to the 2p reduction that we were expecting -- sorry, increase that we were expecting.
THE CHAIRMAN: So you reduced the bonus by that amount per thousand, and expected the price to rise by 2p, but in fact it's gone up by 3p.
A. Yeah, and we are just reiterating that the bonus reduction only equates to the 2p.
MR HOWARD: Again just stopping there for a moment, what does this tell us about this particular retailer's propensity to take the money but not feed it through?
A. Well, it's saying that it's taking an extra penny on its price and enhancing its margin.
Q. That was 20 March, and then you were taken -- you weren't taken to that -- to tab 57, where on 25 April, so over a month later, we see in relation to pricing that George Byas in the penultimate few lines says:
"In stores Richmond SKUs is plus 1p on Dorchester. I can accept the 3p not 2p difference but we must have parity."
In the context of that, what did you understand was

going on?
A. Well, that we didn't mind the differential between Kingsize and Superkings being 3p but we wanted Richmond Superkings to be the same price as Dorchester.
Q. You can put that away but I want to now ask you some questions about Richmond.
A. Can I also point out that in that same letter there is a reference to Embassy No 1, where something similar has happened, and they are not pricing at the level that we would have expected them to and there is another reminder there to ...
Q. Oh yes, that's the paragraph that says:
"Embassy No 1 should be minus 3p, in superstores it's minus 2p."
So what's going on there in relation to the bonuses being paid?
A. Again, it's the retailer taking advantage of some extra margin.
Q. The retailer trousering the money?
A. Mm.
Q. Yes.
DR SCOTT: You have emphasised quite often that the retailers were free --
A. Yes.
DR SCOTT: -- to price at the level they wanted to price

at, so --
A. But I think at the same time part of the money that we were paying the retailer was for a maximum price.
DR SCOTT: Right.
MR HOWARD: Just following Dr Scott's point about the freedom, where you paid a tactical bonus, which -- let's take it in stages. Where you pay a tactical bonus, what is the purpose of that? So if you pay a tactical bonus of 5p per pack --
A. It's to create a price better for the consumer.
Q. Let's translate it into simple terms. You pay a tactical bonus of 5p per pack of Dorchester, say, as an example -- Richmond. Dorchester is the wrong one.
A. Wouldn't have paid a bonus on Dorchester.
Q. I am not a smoker, as is evident. You pay 5p per pack of Richmond, and now what are you expecting to happen to that 5p?
A. I am expecting to see at least a 5p reduction to the existing shelf price at that point in time.
Q. Right. Now, in relation to freedom of the retailer who has taken your 5p, firstly insofar as he wants to price at a greater discount than the 5p, were you seeking to restrict him from doing that?
A. No.
Q. Insofar as he wasn't intending to pass on the 5p and was

to trouser for himself 4p of it, was he entitled to do that?
A. No.
Q. No, okay, thank you.
Now, what I want to ask you about, I am going to lead into Sainsbury now, which is bundle 18. Before we start to look at that, I would like to set a context by just asking you to go in your witness statement, please -- which is in core volume 3, tab 33 {C3/33} -- and you have set out a table for us at page 6 of your witness statement which deals with the market shares of the key FMC brands. It's table 2, on page 6.
I just want you to explain to us, we can obviously see the figures in relation to Richmond, between 1999 and 2003, so if we can just put some flesh on the bones. When was Richmond actually started, launched by Imperial?
A. I think it was in 1999 as a Kingsize.
Q. Right. How was it that, in respect of Richmond, you were -- tell us how you were aiming to position it and get market share with a new brand?
A. I think if you look at the line above Richmond, it is Mayfair, and that shows how Mayfair, which was a brand that I think was originally launched at Lambert & Butler recommended retail level but was probably never sold

very well in cut price outlets at even the same reduced L&B price by Gallaher's. And Gallaher's were repositioning Mayfair into the low price and then the ultra low price sectors, and what you see here is Mayfair's market share growth growing, certainly in its first few years, totally unimpeded by a worthy competitor brand.
THE CHAIRMAN: So Mayfair had initially been positioned as a same level as Lambert & Butler, but then they had repositioned it into the low or ultra low band?
A. Yes.
THE CHAIRMAN: So Richmond was initially benchmarked against Mayfair?
A. I think it was originally, but the situation got more complex because of then the use of Dorchester and then Sterling as additional Gallaher brands, once they saw the legs that Richmond had got, and they were trying desperately to stop Richmond's growth.
MR HOWARD: This is what, in the papers, is described as the ultra low price, and I think you frankly described it as the cheap end of the market.
A. Yes. Not the cheapest because there was private label still around at that time, although can I just make the point about private label, that that started to disappear and that was one of the reasons we felt we

could pick volumes up once retailers were getting out of problem --
Q. Private label is own brand, is it, Tesco having their own cigarette, Tesco or whatever?
A. Yes.
Q. In relation to this ultra low price sector, firstly can you just explain to us, during this period 2000 to 2003, what was going on between the manufacturers in terms of competition, and how were they positioning themselves?
A. First of all, I think the remarkable brand in all of this was Lambert & Butler, because you can see Lambert & Butler in spite of the intense competition at prices below Lambert & Butler, they have actually intermittently at least maintained its position and grew slightly, and that was probably growing at the expense of Benson & Hedges, there were smokers trading down, but the main activity was around the ultra low price sector, which I have said we launched Richmond Kingsize and then launched Richmond Superkings. Gallaher's were fighting us with Mayfair, Rothmans I think brought out Royals, which was a 12 pack and a 24 pack as opposed to a 10 and a 20, which started to confuse the issue I think for consumers, in trying to work out which the best value was, and that brand, once it moved off its sort of launch platform, which was -- and I cannot remember the

exact details, but it was a good price to calculate that you were getting 24 for the price of 20, but once it moved from that platform, consumers couldn't work out whether they were getting a good deal or not, and so the battle then moved back to the Mayfair/Richmond and Gallaher's then introduced -- well, Dorchester they had bought from Reynolds a few years earlier to use as a cheap brand, and then they launched a brand called Sterling, and I think they launched that only in Tesco originally but then spread it across the marketplace.

Q. Against that background, and you may want to keep that table open, I want to look at the correspondence that you were shown relating to Tesco -- Sainsbury's, I beg your pardon.

If we just remind ourselves, in 2000 the market share of Richmond was 1.5, but in 2001 it goes to 6.1 per cent.

If you turn in volume 18, I think you were shown particularly 18/22, {D18/22} but again I am afraid we have to look elsewhere to see the full context, and you need to go to 18/19. {D18/19}

So this is in September 2000. So we see here, if you look in the second paragraph:

"As promised on Friday, I have detailed below the margin implications of you moving from 3.39 to 3.29 in

line with the 10p reduction of the recommended retail price of Richmond."

Stopping there for a moment, what was this 10p reduction in the RRP of Richmond all about?

A. Well, this was part of our competitive move to create a window to launch Richmond Superkings at a competitive price.

Q. Well, it's Richmond KS, it says, and Lights?

A. Yes, but if we had left Richmond Kingsize where it was, Richmond Superkings, which was a bigger cigarette, so you would expect to pay more for a bigger cigarette, would probably have been too expensive had we stayed with Richmond Kingsize at 3.39. So we took Richmond Kingsize down by 10p and launched Richmond Superkings at -- I can't remember what the launch price was.

Q. So Richmond are coming down by 10p. The next sentence:

"Because we have changed the Q rates ..."

What are the Q rates?

A. The Q rates are those listed in our standard price list, which are the sort of base buying price for anybody buying product from Imperial Tobacco.

THE CHAIRMAN: That's the volume discount rates?

A. Yeah.

MR HOWARD: So you changed the volume discounts and things like that to reflect those of Dorchester. Then you say:

"I would need to increase your bonus to maintain your cash margin position."

So that's going on there? That's the increase in the bonus to maintain the cash margin position at this stage?

A. That's the bonus that we would then have to pay to show the 3.29 price.

Q. Right. Now, so then if you go to 18/22, {D18/22} where what one sees is there is an increase in the shelf price of Dorchester in line with the broad marketplace. Just stop for moment. When one sees a reference like that to "in line with the broad marketplace", what's that a reference to?

A. That's a reference to what we have actually seen in the marketplace in several retailers, and probably in the multiple grocers.

Q. Right. Just before I ask you some more questions about that, if you would just turn on to tab 23, which is two days later, {D18/23} from an email, the one at the top of the page, from Paul Matthews to Fiona Bayley saying:

"Fiona, thanks for your quick response, I have amended the attached spreadsheet to show the end of the [redacted] bonus level and the start of the [redacted] bonus."

If you then go back to tab 22, can you explain to us

what is happening then in the light of, in relation to bonuses, where the price is moving up to 3.34?

A. The bonus is being reduced and you can see the figures in the confidential box, quite a big difference between the additional bonuses, and that should reflect the change to the price from 3.29 to 3.34.

Q. When we saw the bonuses that you were paying to get the price down to 3.29, having reduced the RRP, you have told us on several occasions something to the effect that the bonus pot is not bottomless, can you give us an idea of the sort of scale of the cost Imperial was bearing in order to position Richmond in such a way as to get it into the market?

A. Yeah. I mean, without remembering the precise detail it would be -- I would be talking to our financial controller about securing a budget that was in terms of several hundred thousand pounds to support these sorts of initiatives.

THE CHAIRMAN: In the box there, do you have the figures in the box?

A. Yes, I do.

THE CHAIRMAN: It looks, as far as margin is concerned, as if it's the same absolute amount but a lower, somewhat lower, percentage amount.

A. Yeah.

THE CHAIRMAN: Which surprises me because I thought we had had evidence that their main concern is with their percentage margins rather than the absolute pence.
A. Yes, and this is one of the difficult areas that the national account manager would undoubtedly have been challenged with in conversation with the buyer.
MR HOWARD: Unless anybody wants to ask anything more about that, could you turn forward in this bundle to tab 78. {D18/78} This is the 30 April memorandum relating to some discussions with Sainsbury's.
Did you know at that stage in April, on 30 April 2003, that Sainsbury's had entered into a leniency agreement with the Office of Fair Trading?
A. No.
Q. They didn't tell you anything about that?
A. No. No.
Q. I see. For your note, that's in March of 2003.
Now, we see in this letter that there is a paragraph about four or five down that:
"Sainsbury's tell me they are already in negotiations with other category suppliers. The implied threat is that we may be locked out should Gallaher or BAT outbid us."
Can you explain to me, what was the threat that you understood they were making about being locked out, what

does it mean?
A. I think that would be, in simplistic terms, not allowed at the table to discuss development of product through their business.
Q. In terms of, as it were, the muscle of people like Sainsbury's and the other multiple retailers, to what extent was this sort of threat something that you took seriously?
A. I mean, a very serious threat. We wanted our products to be available in as many places as possible, and in recognising the decline of the independent sector where we had previously been very, very strong in terms of brand performance and market share, we took seriously any threat that might suddenly wipe out opportunities in -- and I think Sainsbury's at this time had somewhere 300 or 400 outlets across the country.
THE CHAIRMAN: Is this to do with who is going to be category champion and that kind of thing?
A. Yes, it could be, yeah.
THE CHAIRMAN: Because the reference to "outbidding us" seems to have in mind something specific like who is going to supply the gantries or who is going to be product manager champion ...
A. Yes. Yes, so one manufacturer might get supposedly a privileged position in the relationship with that

retailer.
MR HOWARD: In this dark world, or whatever one calls it, where you are not permitted to advertise, what is the importance of things like the gantry and being the product champion and all these sorts of things, why does it matter?
A. Ultimately that's the final messages that we are able to give to potential consumers, and we would want to be in there fighting for every square inch of available space, whether that was to display product, to display advertising while advertising was still allowed, and to promote while any promotions were still allowed. I don't think the full regulations came in until late 2002/2003, from memory.
Q. Then in the next paragraph we see it says:
"As an aside, albeit an important one, Peter is uncomfortable with the direct link between our investment and Sainsbury's shelf price. His view is that Sainsbury's alone are responsible for the shelf prices of our SKUs as they are for their competitive position."
If you would go to the next tab, 79, {D18/79}, it's where the response was made to that point. If you would look at the penultimate paragraph --
MR LASOK: I think the Tribunal and the witness ought to

read the whole document.
MR HOWARD: Certainly. Tab 79, read the whole document.
(Pause)
DR SCOTT: Mr Howard, in tab 78, we have various handwritten annotations.
MR HOWARD: Yes.
DR SCOTT: The one which relates to the paragraph "As an aside", it says "Discuss a solution with PRM", who we assume is Paul Matthews. If this is Mr Batty's copy, does that look like your --
A. It is my scribble.
DR SCOTT: It is your scribble, Mr Batty. And then lower down, there is how much money, and then at the bottom in response to the question:
"Can I also say that I feel ill-educated about the Competition Act and I need some edification", and you put "KWC", which is presumably Mr Culham, who is going to come?
A. Yes, I can't remember why I put his initials alongside, but maybe they were hitting common responses at this time from another retailer, I don't know.
DR SCOTT: So would we expect, as a result of the first annotation, that the letter of 2 May is likely to have followed a discussion with you?
A. It may have done. You see there is some more notations

on that document at 79. That's gone in my file for the May meeting I was going to have with the national account managers because obviously this was becoming an issue that we needed to debate and understand from a commercial point of view across the department. This was the early signs that there was something odd happening, and one, we needed to find out what was happening, but secondly, we needed to find a solution to enable us to remain competitive.

DR SCOTT: Yes. It's just helpful to understand where this is at in that process.

MR HOWARD: So the letter of 2 May, did you see that at the time that it was sent?

A. It was obviously copied in to me somehow, but I don't know when I got that.

Q. To what extent does it reflect your views?

A. It certainly reflects some of my views but not quite in the same sort of language that Paul Matthews chooses to use, my language would have been considerably different, I think, to this. But I think there was a, quite clearly a blockage and a misunderstanding, mismatch, I think what Paul Matthews was saying here was "Look, if I come to you and I want brand X reducing by 5p and I am going to give you a bonus to reduce it by 5p from the price I am currently seeing on the shelf, why can't you

tell me you want to do that or you don't want to do that?", and I think that we didn't think there was any problem in us doing that, and that's really what Paul was pursuing, but I think making the point by throwing in considerable sums of money that were involved in our dealings with Sainsbury and saying "Look, why would you expect us to invest all this money if we are just going to give you money and not necessarily see anything in return".

MR HOWARD: I have quite a few more questions relating then to a couple of other retailers, if we are going to take a break, that is probably -- I haven't quite finished Sainsbury's but that's a separate topic.

THE CHAIRMAN: Okay, we will take a ten minute break at that point, thank you.

(3.30 pm)

(A short break)

(3.40 pm)

MR HOWARD: While we have bundle 18, could you turn to tab 52, please, which you were shown earlier today, which is an email of 5 February from Paul Matthews to Fiona Bayley. {D18/52}

You were asked questions about this in the context of it being said that Imperial are, I think, dictating the price. Could we just understand again what is

happening. Firstly, you see that Amber Leaf has been priced at £2.09, and we can see that Drum, from the email, coming in at £2.12. So in terms of your competitive position, what was the effect of that?

A. If they were moving from an uncompetitive price to the same price as Amber Leaf.

Q. Right. In order to enhance your competitive position and persuade the retailer to go along with assisting you, what was it you were actually doing in terms of paying them?

A. Increasing the bonus to pay for the amount of money the retailer would reduce the price by.

Q. If they reduced the price by 3p, how does it actually work? What is the bonus? What does it translate to per pack? Do you know?

A. I think it's the [redacted].

Q. Well, that's the total, [redacted], but if one is looking at --

A. Yes, so the difference between the two, so [redacted].

Q. Right, but how does that translate into the differential, if somebody is buying Drum at 12.5 grams, one pack?

A. Well, the [redacted] per pack doesn't include VAT, which obviously would net out when the calculation was done.

THE CHAIRMAN: So an "outer" is ten packs?

A. Yes, I think so.

MR HOWARD: I see, and then there's VAT, I see.

A. Earlier on we were looking at [redacted] per thousand cigarettes equating to [redacted] a packet, so the actual amount is [redacted] on a thousand cigarettes, that's 50 packets in a thousand, take the VAT off the pound and you have [redacted] I think at that time.

Q. So per pack, that's very helpful, you take off the VAT and it's [redacted]?

A. I think so, yeah.

Q. So who gets the benefit ultimately of the reduction of 3p per pack, who does that feed through to?

A. The purchaser at the point of sale.

Q. You have been asked a lot of questions about what is it one is seeking to express in the shorthand here. On this particular document, what are you saying the position is if Sainsbury's wanted to price below £2.09?

A. Quite happy for them to do it, but that was the maximum bonus we would be paying.

Q. Did you at any stage as far as you know say anything to Sainsbury's to restrict them in relation to that?

A. No. No.

DR SCOTT: If Sainsbury's had chosen to price your rival product at a lower price, then you might expect to react to that?

A. Yes, yeah, and increase our bonus.
MR HOWARD: I'll come on to some more questions about this in a moment, but just picking up Dr Scott's point, if Sainsbury's -- if you have reacted and paid a sum of money, 3p per packet, to get Sainsbury's to go down to 209p or at least 209p, if Gallaher say, oh, those dirty dogs Imperial, don't like that much, so now we are going to take down the price to 205p by paying another 4p, was there anything to stop Gallaher doing that or Sainsbury's taking the money from Gallaher?
A. No, absolutely not.
Q. And in relation to these promotions that we see lots and lots of times and we have gone through them -- well, let's leave it there, that's probably a sufficient answer.
Can I ask you to put that away and come, I think, to the final retailer, but I am afraid it will take probably a little bit of time, which is Asda, who are in file 14. When I say "the final", I think obviously there are others but I think that's what I need to cover.
First you were asked at some point this afternoon whether there was ever experience, I think, in relation to Asda, of their failing to pass on price reductions. Could we just turn to tab 23, first. {D14/23} In the

second paragraph we see Small Classic multipacks appear to have been unchanged at £12.39, whereas they should have moved down to £11.74, funded by a new additional retro bonus. So what's the complaint there that's going on?
A. Well, we have offered and it appears to have been accepted a new additional short-term tactical bonus to move the price of Small Classic down to 11.74, and I am assuming because it says "unchanged" from the price it was at the time this was written of £12.39. And Graham Hall is obviously trying to clarify why it hasn't happened.
Q. Yes.
A. This was based on reports from the field.
Q. Yes. We see, if you go to -- we see other examples, if you want, at tab 43, {D14/43}, the email at the foot of the page.
A. Yes.
Q. What's that talking about?
A. That again is suggesting that during a transition from a flash pack, which is a pack with X pence off, back on to what we would call standard packs, with a bonus being paid on the standard packs and the price that we were expecting for that reduction we weren't getting.
Q. Right. These are two examples, I could give you others,

but what does this tell us, as far as you know, about the propensity of Asda as to whether it was feeding through the lower prices to consumers?
A. I think examples of Asda not applying the retrospective bonuses that we were expecting to get to shelf prices and consumers.
Q. Right. Now, on a separate point could you turn back to -- this relates to questions that you had on Friday -- tab 2, please. Again, I think this is set in context for a document about which you were asked quite a lot of questions which comes a bit later. (Pause).
You were asked questions about document 9, the second page. We will come to that. What we need to see is the context, and if you go to tab 2, we can see it says:
"In response to the price reduction on Mayfair 20s from 3.44 to 3.39, we would like to reduce the following: Richmond KS Lights 3.44 to 3.39, parity with Mayfair 20s."
Stopping there for a moment, we have already looked at your schedule which showed the growth of Richmond, Richmond is only at this stage in its infancy, and you have told us already that originally you were pairing it, matching it against, benchmarking it against Mayfair. So here we see that reduction. Then we see L&B and JPS also coming down in price, and they are

benchmarked against Mayfair but at a plus 20p. Then we see some text about multipacks:
"We would like this activity to start when the Mayfair price moves down and end when the price returns to its normal level. An updated price file will follow. As always, this activity will be fully funded."
In relation to your evidence about your reacting to Gallaher, explain what's going on here?
A. Yeah, this is basically a reaction to Gallaher's trying to price Mayfair at a lower level than Richmond.
Q. Right.
A. So we are reacting to that move by making sure that they don't price below us. And also making sure that the relativities with L&B and JPS are in the right place as well.
DR SCOTT: This activity by Gallaher has yet to start?
A. Well, I don't know.
DR SCOTT: It says "We would like this activity to start when the Mayfair 20s price moves down"?
A. It might have started somewhere else, we might have seen it somewhere in the marketplace, another multiple grocer has already done it.
DR SCOTT: Right.
A. Sorry, I interrupted.
DR SCOTT: I was just interested that you can't be reacting

to something public here, because you are saying it hasn't even started; that's right.
MR HOWARD: But you are telling us that these things, you can see in one retailer, and it's --
A. Quite often, yes.
Q. -- Asda because I think Dr Scott was telling us correctly that they may have different dates and so on for implementing things. Is that right?
A. Yeah.
Q. So that was 9 May. If you then go to tab 10, {D14/10} we then have this email. I think in the discussion that took place about this, I think a lot of discussion was premised upon there being a price -- sorry, let's just look at what is said:
"JJ has today advised that his Dorchester price will be moving from 3.29 to 3.34 on 29 October and I have indicated that we will move Richmond to 3.34 on the same date."
A lot of the discussion that you had with the Tribunal and Mr Lasok's questions appeared to suggest that Richmond was being increased in price, but if you just turn your finger back to tab 2, where we see that at that stage Richmond was at 3.39, what is in fact happening to Richmond, as you understand it, in October?
A. I think this is a move away from the 10p reduction that

we had --
Q. Yes.
A. -- sometime between May 2000 and October 2000 --
Q. Right.
A. -- when Richmond Superkings were launched.
Q. Right, but also, remember if you look back at tab 2, we saw there the benchmark was against Mayfair?
A. Yeah.
Q. I think you have explained to us that at some point you then sought to benchmark against Dorchester. Now, tab 10, what is that telling us about that?
A. Well, that tab 10 is suggesting that Dorchester and Richmond were the same price, at 3.29, and that was undoubtedly part of the 10p reduction that we did, and changed the strategic position of Richmond in the marketplace vis-a-vis competitor brands.
THE CHAIRMAN: Because Dorchester was cheaper than Mayfair?
A. Yes.
MR HOWARD: But the move of Richmond that's taken place, is that a move -- the last time we saw Richmond's price it was 3.39, so was Richmond moving down to 3.34, or was it moving up?
A. I think Richmond went from 3.39 at some point after 9 May down to 3.29, which takes us to 5 October.
THE CHAIRMAN: Then it's moving up again to 3.34?

A. Yes.
MR HOWARD: If you look at tab 7, {D14/7} you can see that on 9 August Richmond was at 3.39. (Pause). Well, perhaps rather than spending a long time trying to trace it through with you, because we have other documents and it's been set out in the submissions already as to what was happening.
At tab 9, {D14/9} which is where we have, at the second page at tab 9 -- sorry, excuse me for one second. (Pause).
Under the Richmond pricing there, subsequent to our meeting you have advised that:
"Dorchester Kingsize will move to 3.34 on 29 October, and we agreed that Richmond Kingsize and Lights will move to 3.34."
In the context of the bonus arrangements, what do you understand was happening there?
A. Certainly if it was moving from 3.29 to 3.34 it would be a reduction of the 5p.
Q. Then:
"In relation to Lambert & Butler and JPS, we can see that when Mayfair moves up from 3.44 to 3.49 we will be looking to move Lambert & Butler and JPS to 3.65. I am currently awaiting confirmation as to when the Morrisons price will move to 3.65 and will advise of you this as

soon as possible."
If you look back at tab 2 again, you can see that L&B and JPS, the price had been reduced in response to Mayfair down to 3.59, then, because Mayfair is moving up, we see in this letter, then you are moving up the L&B and JPS. So what's going to happen to the bonus there?
A. Again, the bonus will be reduced by the amount that the products are going up by on shelf.
Q. Right.
THE CHAIRMAN: Why is Lambert & Butler and JPS going up to 3.65 when it's supposed to be 20p above Mayfair? Shouldn't it be 3.69?
A. I don't know.
MR LASOK: 14/54, page 2, has a 14p differential, if that helps.
MR HOWARD: Yes, if you go back to tab 2, I think it's the bit that's in brackets. No, that's not right.
THE CHAIRMAN: Well, the witness has said he doesn't know, so I suspect we have to leave it there.
MR HOWARD: Now, we have already seen -- in relation to what is going on here between the two manufacturers, to what extent are these different changes in position the subject of tactical bonuses and special promotions?
A. I think just about all of them so far.

Q. Right. You have been asked a lot of questions about why, in relation to these discussions, where you are either giving a tactical bonus or withdrawing it, you refer to a specific price. Could we just get absolutely clear from you: when you are paying a tactical bonus, why do you refer to a specific price point?

A. I think to ensure that we get value for money, and we base that specific price point on what we know the current price is on shelf, so I suppose it's hypothetical at the point when the offer is made to the retailer, that if we were to give you a 5p bonus on this brand, as the price stands at the moment we would expect to see the price on shelf to go from there to that 5p reduction. So that spells it out very clearly what we would expect.

Q. Right. Now, where you withdraw the tactical bonus, again so the converse position, explain to us why in the correspondence you refer to a price point rather than as, I think the Chairman has said, simply saying "We are withdrawing the bonus of 3p per pack"?

A. Again so that there is no confusion between our position and the retailer's position to establish that if you, Mr Retailer, because I am withdrawing this bonus from you, you wish to make the same profit and margin as you were making before the reduction, that is the price that

you would need to get to, to reinstate that position.

Q. Right. Now --

MR SUMMERS: May I just ask: what was actually to stop you agreeing the position with the retailer? It seems you leave this huge margin, this huge grey area which you then dispute as to whether they have done what you expected them to do and all the rest of it, but you are putting the money up, don't you expect something positive and documented in return?

A. Well, we do, but the custom and practice always seemed to be that it was the manufacturer/supplier that did the confirmation. If you left it to the retailer, you wouldn't hear anything. As you can see, some of these movements are quite complex, and unless we didn't note it and confirm it, neither party would, and that could potentially end up in disagreement.

MR SUMMERS: So these are confirmations of an agreement?

A. Confirmations of what we understand is going to happen, yes. I mean, sometimes a retailer --

MR SUMMERS: You never know whether the retailer has accepted this or not?

A. Not until you actually see it on shelf, that was the premise that we worked from, because of these examples that I think keep cropping up, where what we eventually saw on shelf at certain times with certain retailers was

different from what we had expected to see, and certainly in some cases they were different from what the retailer was expecting to see as well.

MR SUMMERS: Would you expect me to be able to think of other commercial agreements that might work in this way?

A. No. I mean, we took it as the norm, that this was how, over years of operating, that this sort of custom and practice had developed, and I think I made comment on Friday that one of the significant elements to all of this is that we see little, if no, correspondence from a retailer to the supplier about these matters. It's us going to them, and saying "Look, you know, this is what we believe was proposed at the last meeting, can you confirm that that's what's happening?"

MR SUMMERS: It's a form of handshake agreement, really, isn't it?

A. Yes, it is, but it's also a handshake agreement when you are not quite sure you trust the other party.

MR SUMMERS: I'm not sure how to describe that: a slap on the wrist agreement?

A. That was the nature of our relationships with most of the retailers. There was a -- I think there was a mistrust, certainly by us of them, I can't say exactly what their view of our relationship was, but -- in absolute terms, but I always felt threatened by the

retailers. I certainly didn't feel as though we had comfortable relationships with the retailers that would do everything we wanted them to do; far from it.

DR SCOTT: So you were having to monitor, I suppose, three different elements of their pricing: first, if you were bonusing them, to be under RRP, whether they were RRP.

A. Yes.

DR SCOTT: Second, if you were bonusing them for differentials or parity, whether they were abiding by the parities and differentials, and then third: oh dear, now we have to remember the bonuses which are tactical as well, and keep an eye on all three of those so that you can calculate the appropriate bonuses at the end of the day.

A. Yeah. Again I quote the Tesco price file which had something like 170 lines on it of ITL products, where bonuses had changed, it might have the same product three or four times, but different times of the past few weeks where things had changed. So it had to stay on the file from an historic point of view to make sure that when the retro claims came in from the retailer, that they all matched up.

While all this was going on, we were also trying to make sure our products were on shelf, that they were well displayed, and I think I would say ultimately that

the monitoring that took place was essential for us to make sure we were getting value for money, and if there were agreements in place where retailers just did as they were told by us, we wouldn't have had to have monitored them in the way that we did.
DR SCOTT: To give us some idea of the scale of the operation, roughly how many multiple trade representatives did you have in --
A. At the top end we had something like 60 with seven supervisor/managers running six or seven teams. And they were working -- they were only temporary, they were agency staff, and they worked three or four days a week, by average, continually compiling all this information, as well as the pricing about availability of product, position on shelf.
MR HOWARD: Could you turn to tab 63 in the Asda file. What we see is that, in the middle of the page, at least initially Mr Hall was saying to Guy Mason:
"Current prices for Richmond Kingsize reflect additional price support of [so much per pack] and then as part of the pricing strategy we are moving prices up in the market from 14 October to 3.59. We are anticipating that Gallaher will follow our lead."
I just want to ask you some questions about how all of this works. Do you know whether, in this instance,

there had been a Gallaher price promotion to which you were responding?
A. I don't for certain, but there may well have been.
Q. Right. Let's ask some questions based on that for a moment. So if you respond to a Gallaher tactical promotion and have your own promotion to match them, and then you decide to withdraw from the price battle, but Gallaher maintain their promotion, what's the requirement on the retailer as to what it's to do with the price of the Gallaher product?
A. None.
Q. Right.
A. We would expect our prices to go up and we would then have to make a decision as to what our next move was.
Q. In this particular case we can see you have said:
"We are anticipating Gallaher will follow our lead."
Then at the top of the page we see there was a delay in implementation.
If Gallaher did not follow your lead and they either continued their promotion or they kept their price down, was there any restriction on the retailer continuing to promote Gallaher?
A. No, none whatsoever.
Q. Was there anything in your arrangements with any of the retailers to inhibit either Gallaher or the retailers

from having these promotions?
A. No.
Q. If we consider the situation where you are putting up the price of an Imperial product where there is an MPI, so you put up the wholesale price of Imperial, as far as you were concerned, did you have any requirement where you put up the wholesale price of Imperial, for the retailer to actually put up the price of the Imperial product? Did he have to do that?
A. No, he didn't have to do that.
Q. Where you put up the price of the Imperial product, the wholesale price, what would you expect the retailer to do if you are selling your product to him at a higher price?
A. With the cost price increase they would put the price up and they would probably be saying to us "How much is it going up by? What does that do to the price file?"
Q. Right. Now, where the retailer puts up the price following a wholesale price increase, did you have any requirement of what the retailer should do, absent a Gallaher price increase, to any benchmarked or paired Gallaher brands?
A. No. No.
Q. If Gallaher chose not to have an MPI, was there any restriction as far as you were concerned on what the

retailer was entitled to do vis-a-vis pricing the Gallaher product?
A. No.
MR LASOK: Right, can I just observe that those questions should have been put in-chief.
MR HOWARD: These questions arise out of my learned friend's cross-examination, and I am perfectly entitled to put them. Mr Lasok asked a number of questions, in fact not on a fair basis, but which actually related to how the P&D strategy operated in practice.
DR SCOTT: In relation to that, Mr Batty, if that occurred, and ITL had a wholesale price increase -- the retailer comes back to you on the price file, what are the implications of that -- there are then retail price increases of ITL products --
A. Yes.
DR SCOTT: -- to which Gallaher don't react, so now the parities and differentials are out of sorts, at that stage.
A. Yes.
DR SCOTT: Presumably at that stage, where you had agreements in place, you were entitled not to pay any bonus of parity and differentials?
A. No. We didn't impose any penalties, but I mean, that was a self-inflicted own goal, if you like. There was

nothing from the action of the retailer that caused the differential to be out of line, it was our action that caused that.
DR SCOTT: Yes, so as a matter of practice, you wouldn't withdraw the bonus in that case --
A. No.
DR SCOTT: -- despite the fact your agreement might suggest otherwise?
A. Yes.
DR SCOTT: Thank you.
MR HOWARD: I don't know whether you have the transcript there. Is the transcript of Friday available? For the Tribunal's reference, Day 6, page 137. You were asked some questions about your expectations if you put up your prices, and what you said, Dr Scott said to you, you are envisaging in that letter, and it's similar to the one we have been looking at now, that everything would go up in this sector. You said:
"That's what we would hope, but because we didn't know what Gallaher's attitude or BAT's attitude would be to it, we had to sit and wait and see, as Gallaher sat and had to wait and see if we were going with an MPI earlier in the year ..."
Mr Lasok then said:
"Question: But there was an expectation, wasn't

there, that the Gallaher prices would go up to suit, that's why --
"Answer: I think there was a hope, you know, from a commercial point of view ...
"Question: I put it to you it was an expectation?
"Answer: It was a hope.
"Question: Why did the writer of the letter anticipate shelf prices ...
"Answer: Maybe in this instance because it was a national account manager dealing with probably the most inefficient buyer ...
"Question: I put it to you this is a letter which shows the operation of the parity and differential strategy that ITL had, that the price increases were encouraged as long as differentials and parities were maintained, and there was the expectation that the Gallaher prices would change to suit?
"Answer: I think that we expected prices to change on shelves at any time when the retailer's net buying price, net cost price, increased and this was an example where a retailer's and a whole raft of retailers' net cost prices were going to increase, mainly because of the MPI", but also because of tactical bonuses.
That's the reference to it, but what I want to ask you about, which Mr Lasok's questions, the way they were

phrased, didn't bring out: where you put up your prices, what is -- so you have an MPI -- your understanding of what Gallaher will do? So Gallaher see Imperial have an MPI which puts up prices by, say, 3p; what is your understanding of what Gallaher may or may not do in that instance?
A. Well, I think they would consider the commercial implications of having an increase themselves, which would obviously increase their margin, and make more profit, versus having a price hold and getting an advantage on shelf with their prices.
Q. To what extent is it a matter for Gallaher's commercial judgment as to whether they put up their prices?
A. Entirely theirs.
Q. In the event that Gallaher does not have an MPI, so it doesn't increase its price, did you have any expectation that independently the retailer would put up Gallaher's price, because of your MPI?
A. No. I mean, you might get odd retailers, particularly in the convenience sector, who might say: oh, cigarettes are going up, so they would put everything up. But that was, you know, very rare that that happened, but it did happen. You know, premium price retailers who were obsessed with margin, you know, may well do that, and hence that exchange that we had over us not having

a price increase and writing to the retailers, we were just making sure that that didn't happen.
Q. The papers are replete with examples of Imperial announcing an MPI, and then holding the price and paying bonuses to the retailers to do that. Why would Imperial do that? Can you explain?
A. Well, because we didn't want our prices to be uncompetitive, and we would do that, maybe at the time of the Budget, I certainly remember us doing it on Richmond family brands, to ensure that they remained competitive. We may also put prices up following an MPI, and then take a step back and say "We ain't doing very well, we need to do something about this" and one of the quickest ways to do it was to put in some tactical bonuses to reduce prices back down in selected retailers.
Q. Right. Now, in a situation, as we have been looking at in a number of these documents, where Gallaher runs a promotion, and we can see there are two possibilities where Gallaher run a promotion, you can respond or not respond. Let's just consider the two situations. First, you do respond. So Gallaher's cut the price of something by 5p and you cut the price by 5p throwing the money at the retailer. If Gallaher ends its promotion and so the retailer puts up the price of the Gallaher

product, did you have any requirement or expectation on the retailer as to what it was to do with the price of your product?
A. No. No, not until we had had a conversation with the retailer about that retrospective bonus. I mean, we might decide to end it as soon as we saw that changing or we might decide to hold it longer and gain a longer advantage.
Q. Where there is a Gallaher promotion and you don't respond, did that ever happen, Gallaher puts down the price and you don't respond?
A. I guess it must have done.
Q. Right.
A. At some point, because there were times when we just didn't have the funds available to respond.
Q. Right. So if the retailer accepts Gallaher's money and puts down the price of Gallaher's product, did you have any requirement where you weren't yourself paying some money, was there any requirement of what the retailer was to do with your product?
A. No. No, that was just one of those things that in the commercial world we would accept. That was competition. It was our choice not to compete, so couldn't hold the retailer responsible in any way for those things not being where we wanted them to be.

Q. During the period we are talking about, 2000 to 2003, can you give us an idea of the nature of the competition that was taking place in terms of these price promotions, and the frequency and so on?
A. Well, I think you know, that's brought out purely and simply with the Richmond example, where we had Richmond Kingsize established, we realised we needed to get a Superkings version out to try to protect the 100mm, that's the size of cigarette, because we were losing market share on Superkings, the John Player Superkings brand.
So we reduced Richmond by 10p to create enough space to bring that in, and I think you saw the size of some of the bonuses. Now, I reckon round about that time those bonuses that we were giving on Richmond to get it down that 10p, we were probably [redacted] on those brands, so it was costing us.

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Q. In terms of expenditure during this period, can you give us some idea, the amount of money that ITL was spending on the tactical bonuses, (a) in absolute terms and (b) in comparison with the ongoing brands, if you can?
A. I can't precisely, but it was -- I mean, I think our promotional budgets were something like [redacted] so, you know, it was in millions.
THE CHAIRMAN: But that would cover also all the investment

in planograms and --
A. No. No, that was separate. Talking just about price and margin support.
MR HOWARD: In relation to independent action by the retailer in lowering the price of, let's say, a Gallaher product, firstly to what extent in this market, you have told us you have been involved in it for a very long time, to what extent in fact do the retailers generally seek themselves to independently promote cigarettes by reducing the price?
A. Hardly ever. I mean, I think after the abolition of resale price maintenance, the sort of benchmarks were set about the amount of margin the retailer was prepared to put in as a price cut, and generally speaking the multiple grocers during this period were making 5 or 6 per cent VAT exclusive margins on our cigarette products. It varied along rolling tobacco and cigars, but the bulk of the profit was on factory made cigarettes, and of course each time we had an MPI, there was a small increase in the cash margin for the retailer. And I think we spoke on Friday about the fact that when there was a tax increase it reduced the percentage margin, which is what the retailers told us they were obsessed with, so that followed on.
MR HOWARD: Thank you very much indeed, Mr Batty, those are

my questions in re-examination.
THE CHAIRMAN: Thank you. You will no doubt be relieved to hear, Mr Batty, that that's all we need to hear from you for the time being at least.
A. Thank you.
THE CHAIRMAN: So I can release you from the witness box.
MR HOWARD: Thank you very much. When one says the witnesses are released, they are released absolutely, is that right?
THE CHAIRMAN: Well, I can't remember immediately whether Mr Batty is down to come back again.
MR HOWARD: He is not, it's just I noticed you said "released for the time being".
THE CHAIRMAN: That was only because I couldn't remember, in the moment, whether he was scheduled to come back at a later time.
MR HOWARD: I didn't mean it critically, I wasn't sure whether you meant therefore --
THE CHAIRMAN: No, it is entirely up to you now, Mr Batty, whether you choose to attend further days here or not.
MR HOWARD: I am sure we will see him a lot.

(The witness withdrew)

Discussion re timetabling

MR HOWARD: Can I just tell you where we are in terms of timetable. You will realise we have slipped a day, but the current view is that we will go on to Shell tomorrow morning. I will make a, I hope, relatively short opening on the Shell specific case. We would have called Mr Culham, but Ms Rose tells me that some of her witnesses are in difficulties beyond tomorrow, so she will call the Shell witnesses tomorrow, at least two of them, I think it's Annie Parker who is particularly in difficulties, so the idea is to at least dispose of at least two Shell witnesses tomorrow and then Mr Culham will come the following day.

Although we are a day behind, I anticipate that we had allowed a bit of slack in the timetable in relation to Co-op, which had three days, and I think two days ought to be enough but if it's not we ought to gradually catch up, subject to Mr Lasok of course.

THE CHAIRMAN: So you are going to have a short opening tomorrow but, Ms Rose, are you planning to say anything before you call your witnesses? We have in mind of course your opening --

MS ROSE: Madam, I wasn't planning to say anything else in opening. I was planning to call Mr Moss first to give an overview about the strategic direction of the business and the introduction of the RBA and then Annie Parker, and I do stress that it's important we finish both those witnesses tomorrow because of their

availability difficulties, and as I understand it, the time estimate was for one hour of cross-examination for Mr Moss, and two hours for Annie Parker.

THE CHAIRMAN: Not wishing to restrict you in any way, Mr Lasok, but my understanding was that the vast majority of the background of the introduction of the RBA is not controversial, there are some aspects of it which are controversial, but we have the content of the RBA, I think, well in mind, if that assists anyone with their planning for tomorrow.

MS ROSE: I don't know, madam, whether it would be a good idea to perhaps sit at 10 o'clock tomorrow morning, given the slight anxiety about timing.

THE CHAIRMAN: Yes. We will sit at 10 o'clock then tomorrow morning, if that is convenient with everyone. Thank you very much.

(4.32 pm)

(The court adjourned until 10.00 am on Wednesday, 5 October 2011)

INDEX