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IN THE COMPETITION

APPEAL TRIBUNAL

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

Victoria House,
Bloomsbury Place,
London WC1A 2EB

13 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 13)

Note: Excisions in this transcript marked “[...][C]” relate to passages excluded.

APPEARANCES

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

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

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

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

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

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

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1 Thursday, 13 October 2011
 2 (10.30 am)
 3 Housekeeping
 4 **THE CHAIRMAN:** Yes, good morning, everybody. This is
 5 a better copy of that page, is it?
 6 **MR THOMPSON:** Yes. Good morning, madam, gentlemen. Could
 7 I clarify what this is? This is a point that came up at
 8 15/3 of the annexes to the statement of objection, the
 9 point that was raised with Mr Messom, and I think
 10 Mr Goulthorp in fact.
 11 If one goes back to 15/3 {D15/3} -- it's just
 12 a point of clarification -- you will see that it's
 13 a slightly curious document, it's headed "Imperial
 14 Tobacco garrette and Tobacco Pricing". It appears to be
 15 a curious --
 16 **THE CHAIRMAN:** I don't think we have it at 15.
 17 **DR SCOTT:** It's behind.
 18 **MR THOMPSON:** It's just behind tab 3 of annex 15. (Pause).
 19 Do you have annex 15, tab 3? The third page, there
 20 should be a schedule or a matrix.
 21 **THE CHAIRMAN:** Oh, I see, sorry. It's this one.
 22 **MR THOMPSON:** If you stay with the old papers at the moment.
 23 **THE CHAIRMAN:** We thought it was this (indicated).
 24 **MR THOMPSON:** I am sorry, no, it's annex 15, tab 3. It's
 25 a two-page --

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1 **THE CHAIRMAN:** Oh, this is the discussion we had about
 2 whether there was the promotional ...
 3 **MR THOMPSON:** There should be a memo from Mr Goodall to
 4 Lisa Sage, and then two pages on, there is a slightly
 5 curious looking schedule on an angle, and if the
 6 Tribunal sees it's called "Imperial Tobacco garrette and
 7 Tobacco Pricing" and it looks like it's some form of
 8 photocopied composite. What I have handed up is the
 9 actual CRTG price matrix for the relevant period, and
 10 there you will see it's in the conventional form, normal
 11 pricing, promotion pricing, and then for example JP
 12 Special Kingsize is on promotion.
 13 Then if you turn through three or four pages, you
 14 will find period 7, part 2, and at the top it says:
 15 "Change to RSPs in line with new pricing policy,
 16 effectively July 9, 2000."
 17 There you will see that you have moved from what
 18 were four price bands in period 7 to three price bands
 19 in period 7/2. Does the Tribunal see that?
 20 If you turn to the second page you will find JP
 21 Special Kingsize for example on promotion in the
 22 conventional way.
 23 **THE CHAIRMAN:** Yes.
 24 **MR THOMPSON:** So it's simply a point of clarification. It
 25 seems that the Co-op system, as it were, carried on just

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1 the same, but for some reason either we have provided
 2 a composite photocopy to Imperial or Imperial put
 3 together a slightly unusual document for their internal
 4 purposes, patching it together from our -- it seems to
 5 be in a different font, so it may be that Imperial
 6 produced it itself, but that's simply for clarification.
 7 **THE CHAIRMAN:** Should we swap this in to 15/3?
 8 **MR THOMPSON:** It could be there or it could go into the new
 9 papers, whichever is more convenient. Should it go into
 10 15/3?
 11 **THE CHAIRMAN:** Yes, let's put it there.
 12 **MR THOMPSON:** I am grateful.
 13 **DR SCOTT:** Just to be clear, are the numbers the same or are
 14 the numbers different?
 15 **MR THOMPSON:** I must confess I haven't checked them either.
 16 What I think is that the normal pricing is simply
 17 converted, as it were, from current pricing to proposed
 18 pricing and the promotions are simply left out. That's
 19 what I think has been done, they just haven't bothered
 20 with the promotions in that schedule, since it's just
 21 about the changing bands.
 22 What I propose to do this morning --
 23 **THE CHAIRMAN:** Where is this ... (indicated)?
 24 **MR THOMPSON:** I am sorry, I don't know what that document
 25 is.

3

1 **DR SCOTT:** 0A, wasn't it?
 2 **MR THOMPSON:** I am sorry, I wasn't forewarned of this.
 3 Apparently it's a better version of the ethical pricing
 4 policy and it goes into 5 0A, I think. I am sorry, it's
 5 simply that the original version was illegible.
 6 I haven't actually got a copy of it, but it will
 7 obviously be provided to everyone in due course.
 8 (Pause)
 9 Further opening submissions by MR THOMPSON
 10 **MR THOMPSON:** What I was proposing to do now was simply --
 11 and it's I think two weeks ago since I made my
 12 opening -- make two or three minutes of summary of
 13 points that I made and points that the OFT made, and
 14 then to move on to some slightly more detailed
 15 submissions in relation to the Gallaher agreements and
 16 in particular the 2003 draft agreement and two worked
 17 examples which I hope will be of assistance to
 18 the Tribunal.
 19 So far as the main factual points we made in
 20 opening, I'll simply summarise them under various short
 21 propositions and give the references. First of all, we
 22 say that our pricing policy was based on price following
 23 by tiers, and that's Day 3, pages 59 to 61, and
 24 obviously Mr Messom gave evidence on that.
 25 Secondly, the price matrices were a management tool

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1 for unruly members of the CRTG group, and obviously for
2 CGL itself, and again Mr Messom and Mr Goulthorp,
3 particularly Mr Messom, gave evidence on that. My
4 reference was Day 3, page 61, lines 22 to 65, and
5 pages 86 and 87 of Day 3.

6 Thirdly, the price matrices were shared with the
7 manufacturers to confirm the correctness of complex
8 pricing and discounting issues, and that's at the same
9 reference.

10 Fourthly, there is no evidence of any obligation
11 asserted by either manufacturer as against CGL, and we
12 have made that point at page 85, pages 111 to 112.

13 Fifthly, in relation to the original Gallaher
14 agreement, we see: first of all, it was based on RRP
15 movements, and Mr Goodall has indicated that the ITL
16 policy was equivalent; it was based on maxima, and you
17 will recall that there was express provision for that in
18 the original Gallaher agreement, and again Mr Goodall
19 has said that ITL had a similar approach; and, thirdly,
20 a right to respond to competitor promotions, and again
21 that was expressly provided for in the Gallaher
22 agreement. One sees all this at Day 3, pages 96 to 100.

23 We also say that it was part of a wider incentives
24 agreement dealing with such things as advertising,
25 et cetera, and we made this point at pages 96 and 107.

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1 We made the point that Dorchester, as Gallaher's
2 fighting brand, as it were, at that time, was expressly
3 excluded from the comparators, and one sees that at
4 page 100 of Day 3.

5 Then finally, we make the point that the
6 unchallenged Gallaher evidence is that P&Ds did not
7 apply during promotional periods, and one finds that at
8 Day 3, pages 115 to 116, and that's statement of
9 objections annex 3/17, page 2. You may recall that
10 Mr Lasok took the Tribunal to the adjacent paragraph to
11 the one that I rely on without commenting on the
12 paragraph that I rely on in relation to that point. So
13 it's not entirely clear whether the OFT accepts that as
14 far as Gallaher was concerned P&Ds didn't apply during
15 promotional periods, but it's obviously very
16 inconsistent with the perpetual reliance on Dorchester
17 and Richmond which were on promotion almost throughout
18 this entire period.

19 So far as the OFT's approach is concerned, so far as
20 we understand it from Mr Lasok's opening, he appears to
21 agree with us that an individual assessment of the
22 context for each retailer is needed, one finds that at
23 Day 4, pages 108 to 109, and as far as we understood it,
24 he appears to accept that there was no obligation for
25 retailers to match manufacturer price reductions, but

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1 only a right to respond. He made some play of the
2 difference between manufacturer initiatives and retailer
3 initiatives at Day 5, page 7.

4 So far as the positive case on the facts,
5 the Tribunal may recall some emphasis being made on,
6 I think it was a new OFT theory or point, about
7 bombardment. Mr Lasok repeatedly suggested that there
8 were numerous examples of aggressive emails from
9 manufacturers about competitors pressurising retailers
10 to move their retail prices, and one finds that at
11 pages 117 to 120. Another element that he made --

12 **THE CHAIRMAN:** Of what?

13 **MR THOMPSON:** Of Day 4, I am sorry.

14 He also made repeated reference to retailers as
15 instruments of the manufacturers. Perhaps the best
16 quotation is Day 4, page 70, lines 13 to 15, where
17 Mr Lasok says this:

18 "The retailer isn't a player, the retailer is
19 an instrument used by the manufacturer so that the
20 manufacturer can effect an alteration to retail prices."

21 Then he also says this at Day 5, page 45, lines 15
22 to 16 and pages 23 to 24, where he describes various
23 retailers as compliant instruments, as invisible, and as
24 slavishly following the orders of the manufacturers.

25 What we say is that if the OFT puts the case like

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1 that, then what is sauce for the OFT goose is also sauce
2 for the CGL gander. There were -- and the Tribunal will
3 recall this -- no references to any such contacts in
4 relation to CGL in the OFT opening. There is no
5 reference to CGL in paragraph 40 of the OFT's skeleton
6 argument, CB4/45, {C4/45} line 24, and there were very
7 few references to any such contacts in either the
8 cross-examination of Mr Goodall or Mr Messom or
9 Mr Goulthorp, and I would invite the Tribunal to find
10 that none of the references that were made came anywhere
11 near to a bombardment theory, and the evidence to date
12 is that the CGL negotiations in particular were
13 particularly difficult, and that CRTG as a group was
14 a particularly unlikely instrument of the policy of the
15 manufacturers, for reasons that Mr Goodall in particular
16 gave.

17 I am not going to say anything more about the ITL
18 agreements, apart from the fact that we recall that
19 Mr Goodall's evidence is now that there were never any
20 schedules in relation to ITL. His testimony bears out
21 the strategy document at tab 8 of annex 15, {D15/8} that
22 this was a pragmatic approach based on RRP differentials
23 rather than any sort of rigid or binding policy. And in
24 relation to the first two trading agreements, which you
25 may recall were effectively decentralised, we would say

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1 that payments were made under those agreements. Insofar
 2 as they were made and as far as we know there were made
 3 under both agreements, we say the payments issue cuts
 4 both ways. Given the vagueness of any requirement and
 5 the lack of any contacts evidence, we would say that
 6 this tends to confirm our submission that this was
 7 simply payment for the right to trade in the way that
 8 Mr Goodall explained. In relation to the third and
 9 fourth trading agreements, obviously the Tribunal is in
 10 the process of hearing evidence, has heard from
 11 Mr Goulthorp and will in due course hear from Mr Owen
 12 what those agreements were about.

13 If I turn now to the Gallaher agreements, first of
 14 all the 2000 to 2002 agreements, I won't go back to the
 15 agreement, I would simply remind the Tribunal that those
 16 were terms agreed between September and October 2000,
 17 and the reference is annex 5, tab 7. {D5/7} I would,
 18 however, like briefly to show the Tribunal the 2003
 19 draft agreement, which may be the subject of
 20 cross-examination of Mr Owen, and that's annex 5,
 21 tab 21. {D5/21}.

22 I am sorry, before we look at that, could you turn
 23 back to tab 18 {D5/18} and the Tribunal there see
 24 an email from Mr Davison to Mr Owen. This is actually
 25 about the launch of Benson & Hedges' Silver brand and

1 some more support to that brand. Towards the bottom
 2 the Tribunal should find a paragraph starting
 3 "I will ..."
 4 Does the Tribunal see that?
 5 **THE CHAIRMAN:** Yes.
 6 **MR THOMPSON:** Mr Davison says:
 7 "I will also arrange for the necessary changes to be
 8 made to the previously issued trading agreement document
 9 and have a draft sent to you upon your return from
 10 holiday."

11 So it appears that the trading agreement was under
 12 discussion in May 2003. If one then turns to tab 21,
 13 {D5/21}, you should find the letter that I handed in
 14 dated 18 December to Mr Owen. If you turn over, it's
 15 from Mr Davison again. The first paragraph shows that
 16 there was a meeting between Mr Owen and Mr Goulthorp,
 17 with David Francis(?), who I assume was a more senior
 18 person than Mr Davison, although I don't know that for
 19 certain.

20 Then the second paragraph shows that the idea was
 21 that Gallaher would continue to make payments, as it
 22 were, on a provisional basis in relation to 2003.

23 Then there is reference to the Alldays acquisition,
 24 which will be familiar from the ITL documents. Then the
 25 idea is that the matter should go forward, effectively,

1 from beginning of January 2004, and we will hear about
 2 this from Mr Owen if Mr Williams sees fit to ask him
 3 about it.

4 The most important thing, I think, if you will turn
 5 to the agreement itself, and bearing in mind Dr Scott's
 6 admonitions that it may be better to look back to the
 7 original documents so we don't forget which bits may be
 8 confidential. Page 1, under 1(a), "Product Promotion":
 9 "Where account is involved in the promotion of
 10 a brand [the account is defined as CGL, I think, or
 11 CRTG] by a competitor of Gallaher, Gallaher shall be
 12 offered the opportunity to conduct similar promotional
 13 activity as far as the law will allow on a brand to be
 14 selected by Gallaher as soon as reasonably requested by
 15 Gallaher following that competitor's promotion."

16 So it's effectively an information obligation of
 17 maximum and possibly simply a right to respond clause of
 18 the kind that's familiar.

19 Then just for completeness, it may be worth turning
 20 to page 4, paragraph 5(c), and you will see there is
 21 special provision for two years of a special bonus in
 22 relation to Benson & Hedges Silver, so effectively
 23 that's part of, I think, what Mr Goodall gave evidence
 24 about, that in order to get the retailers to list new
 25 products, there were often effectively special deals

1 giving an incentive to the retailer to promote the new
 2 product. So it's an example of that, and it picks up
 3 the May 2003 email we were just looking at. And it may
 4 be worth looking on the first page just to see the term.

5 This term was intended to run for three years from
 6 1 January 2003 to 31 December 2005 inclusive, and so, as
 7 I understand it, although the payments continued
 8 throughout 2003, this was intended to be the terms of
 9 trade between the Co-op and Gallaher governing their
 10 relationship for the three-year period from January 2003
 11 to 2005, and one sees similar, as it were, late drafts
 12 including the first Gallaher agreement which ran from
 13 January 2000 but was actually agreed in October 2000.

14 I have been asked by Mr Williams: all I have is
 15 a draft agreement, and obviously Mr Owen will come on,
 16 so I can't go any further as to what was actually agreed
 17 in practice, but this is the best evidence we have.

18 Beyond tab 22, which the Tribunal will see is
 19 an email from Slaughter and May, who were representing
 20 Gallaher, and it's an email to the OFT, and it's about
 21 variations that I believe were made in 2003 at the start
 22 of the original investigation.

23 I say in passing that it's a minor grievance of the
 24 Co-op that we were not informed of this investigation
 25 until 2005, and one finds that at paragraph 2.96 of the

1 decision.
 2 The relevant point for present purposes is the third
 3 paragraph, there is a contrast between letters sent to
 4 TM Retail, Bargain Booze, Shell and Welcome Break. Then
 5 WH Smith Travel, First Quench and the Co-op. It says:
 6 "As the trading agreements in force in 2003 no
 7 longer included a clause 1(a) provision ..."
 8 Then there is reference to Alldays. On the face of
 9 it, that's a slightly cryptic comment in that
 10 the Tribunal will recall that there is indeed
 11 a clause 1(a) in the CGL draft trading agreement, but
 12 light is cast on this -- I am sorry to have to open
 13 a few more files, but if the Tribunal could bear with me
 14 and open --
 15 **THE CHAIRMAN:** If you know what it means then perhaps just
 16 tell us.
 17 **MR THOMPSON:** Well, if I give you the references --
 18 **THE CHAIRMAN:** Is it controversial what clause 1(a) means?
 19 **MR THOMPSON:** It may be appropriate simply to look at one
 20 example, which is annex 6 to the SO, tab 21. {D6/21}.
 21 We will see an agreement in very similar form, except
 22 that 1(a) says:
 23 "First Quench agrees to maintain the price
 24 differentials, price parities between Gallaher's brands
 25 and their respective competitive brands as set out in

1 appendix 1 at all times. Gallaher reserves the right to
 2 amend appendix 1 from time to time after consultation
 3 with First Quench."
 4 There are very similar agreements at annex 9, tab 9,
 5 and annex 12, tab 33. {D9/9} {D12/33}. I do not want
 6 to slander anyone, but I believe that those are Shell
 7 and Asda, but I'll be corrected if I am wrong. I can't
 8 remember which 9 and 12 are. (Pause). 9 is Shell, and
 9 12 is, I am sorry, TM Retail. So I would infer and
 10 invite the Tribunal to infer that the 1(a) that is being
 11 talked about is a parities and differentials clause and
 12 the Co-op one had been deleted by 2003.
 13 You may recall that on, whenever it was, Tuesday
 14 I think, I handed up various documents and in particular
 15 a schedule of contacts, and I am not proposing to go
 16 through all of these in any detail, I'll simply explain
 17 what they are by reference to the different trading
 18 agreements.
 19 I am told it's gone into tab 9 of the overflow
 20 bundle. It's a landscape document like this
 21 (indicated).
 22 If I could just explain what it is, it, as it were,
 23 goes together with our annex 4 to the reply, which
 24 I think I handed up a referenced version, but I don't
 25 think it's necessary to go to it. What I hope it does

1 in a useful form is go through all the specific evidence
 2 in relation to the Co-op in chronological order, first
 3 of all, in relation to Gallaher and then in relation to
 4 ITL. So, for example, the first page, and just over
 5 onto the second, there are four instances of contacts
 6 between Gallaher and the Co-op. And in relation to each
 7 of them, we set out the trading agreement, the date of
 8 contact, and the Co-op promotional period in square
 9 brackets, the SO annex reference, the products involved,
 10 so those are in relation to the Gallaher agreement the
 11 Gallaher products, the competing products in the
 12 Gallaher agreement, which is the only and I should say
 13 the first Gallaher agreement, which is the only version
 14 we have, the OFT analysis, both in the decision and the
 15 defence, the Co-op analysis in annex 4 to the reply, and
 16 then following on Mr Howard's analysis, brief comments
 17 on whether any of these instances fit into the OFT
 18 theory of harm, and perhaps unsurprisingly the answer is
 19 no to every one of the examples in the right-hand
 20 column, and we give very brief reasons why.
 21 In the left-hand column you will see that the date
 22 of the agreement, I've tried to put in the relevant
 23 point in the chronology.
 24 So in relation to 2000 there are four contacts which
 25 in brief summary are all simply offers of promotional

1 discounts and clearly get the OFT nowhere, in my
 2 submission.
 3 In the second year, 2001, there is a promotional
 4 support in relation to a Budget price increase. Item 6
 5 I'll come back to in a moment. Item 7 and 8 are the
 6 only two contacts in 2002, and items 9 and 10 are the
 7 only two contacts in 2003.
 8 **THE CHAIRMAN:** Do these include documents that are mentioned
 9 in footnotes as being relied on by the OFT as well as in
 10 the body of the decision?
 11 **MR THOMPSON:** They are in the body of decision and they are
 12 points that were, as it were, supported by some form of
 13 analysis in the defence, which we have assumed to be the
 14 points that the -- otherwise we have had no reasoning at
 15 all in relation to any other. These are all the points
 16 that were supported in the defence by the OFT. I think
 17 the other references are almost all pricing matrices,
 18 where obviously I have made detailed submissions and you
 19 have heard evidence about them.
 20 **DR SCOTT:** In essence the other point you are making is that
 21 there are so few of these --
 22 **MR THOMPSON:** Indeed.
 23 **DR SCOTT:** -- it hardly constitutes bombardment in the sense
 24 --
 25 **MR THOMPSON:** In fact, when you go through them they are all

1 of the utmost triviality, some of them simply saying
 2 that the bulk drop discount figure has been put in the
 3 wrong column, or as you have seen that Regal Filter is
 4 not in the same relationship as it should be to Regal
 5 20s, or else their right to respond clause or
 6 promotional discounts and they are all of the most utter
 7 triviality in our submission.

8 In relation to ITL, just for completeness, there are
 9 no contacts at all in relation to 2000, so that's
 10 a rather simple line. There is only one in 2001, which
 11 is the point that was raised with Mr Messom. There are
 12 two in 2002, the Regal Filter one and the one about
 13 failing to pass on promotional discounts, and that's all
 14 for 2002, and then there is nothing at all for 2003.

15 So there is a pretty simple submission riding on the
 16 back of that table, but I won't go to it in any detail
 17 now.

18 So far as Gallaher is concerned, more generally,
 19 I have already made the point that the OFT has,
 20 effectively, a contract with Gallaher whereby
 21 Gallaher -- in return for a substantial amount of money
 22 in terms of discount -- has agreed to assist the OFT on
 23 this appeal, but it either hasn't been asked or hasn't
 24 been able to do anything useful to assist the OFT, and
 25 so it falls to us to try to explain to the Tribunal as

1 best we can what's going on in relation to Gallaher
 2 insofar as it appears from the documents. I think the
 3 first thing that may be useful in relation to the Co-op
 4 is simply to get the dramatis personae sorted out. By
 5 and large, the position on the buying side was constant:
 6 Mr Newton was the CGL buyer, although you will see that
 7 Mr Owen was involved in some of the negotiations in
 8 relation to the 2003 draft agreement and also the launch
 9 of Benson & Hedges Silver, and the terms that Gallaher
 10 were prepared to offer.

11 So far as the selling side goes, up until July 2001
 12 a Mr Tony McGuinness appears to have been the principal
 13 point of contact, the account manager, and after that
 14 the first document we have is April 2002, a Mr Davison
 15 appears to have replaced Mr McGuinness. So the
 16 references to Mr McGuinness are tabs 1 to 10 of annex 5,
 17 {D5/1} and for Mr Davison there is one rather curiously
 18 misplaced document at tab 12(d) of bundle 15,
 19 {D15/12(d)} which is the ITL bundle, I think it was
 20 inserted at the request of ITL and therefore went into
 21 the ITL bundle, even though it's a Gallaher document.
 22 And otherwise it's tabs 11 to 21 in relation to
 23 Mr Davison. So he was there from early in 2002 to the
 24 end of 2003.

25 What I was proposing to do for the remainder of this

1 time was simply to work through the two examples that
 2 one finds at 5/10 and 5/11, because I think they are
 3 quite illuminating, not only about the facts but also
 4 about the approach that the OFT has taken to try and
 5 prove anything in this case.

6 If one turns to tab 10 -- {D5/10} the other reason
 7 is that they concern one low price brand, Mayfair, and
 8 one roll-your-own brand, Samson -- indeed, two
 9 roll-your-own brands, Samson and Amber Leaf, which have
 10 been very central to the OFT's submissions in opening
 11 and therefore appear to be a fair test of its approach
 12 to the evidence.

13 One will see at 10 a letter from Mr McGuinness to
 14 Mr Newton of 12 July 2001, and he has clearly met with
 15 Mr Newton on 10 July, and agreed a Mayfair bonus for 20s
 16 and 100 multipacks. Then he sets out the detail, £3.60
 17 for 20s, and multipacks at £17.79 in all stores. So
 18 that's a flat price promotion he is seeking.

19 Then in addition, I have amended, it says the
 20 Amber Leaf but it should be the Samson bonus, and you
 21 will note a more generous contribution, swings and
 22 roundabouts.

23 "I am sure at 1.99 and 3.88 for 12.5 and 25 gram
 24 respectively we should observe some encouraging offtake
 25 and demand."

1 Obviously that final wording sits rather oddly with
 2 the OFT's case in any event.

3 If one then jumps forward to tab 11, {D5/11} you
 4 will find now Mr Davison has taken up the reins, and he
 5 sends an email to Mr Newton on 11 June 2002 which
 6 I believe is promotional period 8 of 2002, it's just
 7 about the time of the price increase that we have looked
 8 at on various occasions where Gallaher put up prices and
 9 ITL didn't follow for a little time.

10 "Again there have been discussions today", so
 11 11 June.

12 "Mayfair KS range: my proposal is remove the
 13 Kingsize range up to £3.55 across the tiers and hold
 14 this with the bonus provided to give a [and I've got
 15 mine blanked out but the Tribunal may be able to see]
 16 per pack profit margin. Maintain this price with effect
 17 from period 8 and run through to September, by which
 18 time we can review the situation in line with the
 19 marketplace."

20 And then Amber Leaf and Samson there is detail in
 21 relation to the varied bonuses in various tiers and
 22 I don't think it's necessary to go through that, the
 23 Amber Leaf in any detail, but you should see under
 24 "Samson":

25 "Samson to be maintained at 1.99 and 3.88, but with

1 improved margins."
 2 So that's the material. Then if we look at the
 3 decision and see what's said about this, we find this at
 4 6.595 to 6.596, page 236. It's the usual rather Delphic
 5 approach, simply quoting extracts from the letter and
 6 the email, without any explanation of why these two
 7 documents have been quoted. Then at 599, for example,
 8 there is a fairly obviously cut and pasted conclusion in
 9 very much the same sort of form as one finds after quite
 10 different contacts in relation to other retailers with
 11 simply "Asda" or "Shell" crossed out and "Co-op" put in,
 12 as it were, in biro. So that's all we get from the
 13 decision.

14 In the defence, which one finds at core bundle 5,
 15 tab 57, it's page 39, {C5/57/39}, paragraphs 143 to 149,
 16 it's a two-page passage, it may be worth the Tribunal
 17 just casting its eyes over it and then I'll emphasise
 18 the main points. You will see it's the letter dated
 19 12 July 2001 and then paragraph 146, the email of
 20 11 June 2002.

21 (Pause)

22 You will see the first sentence at 143, the general
 23 description:
 24 "Gallaher paying CGL tactical bonuses in order that
 25 CGL reduce the price of the Gallaher's Mayfair cigarette

21

1 brand and its Samson rolling tobacco brand to specified
 2 price points."
 3 Then there is reference to the pairing with Richmond
 4 and Royals in the Gallaher agreement. Then there is
 5 an inference from a document which is nothing to do with
 6 the Co-op that it was Gallaher's strategy -- in fact two
 7 documents -- and the OFT says it's clear that it was
 8 Gallaher's strategy to achieve parity pricing between
 9 Samson and Drum rolling tobacco, the ITL brand. Then
 10 an inference is stated, that the infringing agreement
 11 between Gallaher and CGL included a requirement that CGL
 12 price Samson and Drum rolling tobacco at parity. Then
 13 the OFT infers that Gallaher paid the tactical bonuses
 14 in order that CGL reduce its retail price from Mayfair
 15 and Samson so as to match a reduction in the price of
 16 a competing linked brand, so presumably either Richmond
 17 or Royals, and in the case of Samson, Drum.

18 Then a similar inference at the end of 146:

19 "Gallaher instructed CGL to increase the price of
 20 Mayfair so as to match the price increase of a competing
 21 linked brand", so presumably Richmond or Royals.

22 Then at 148:

23 "Gallaher paid the tactical bonuses in order that
 24 CGL reduce its retail price for Amber Leaf and Samson so
 25 as to match a reduction in the price of a competing

22

1 linked brand."
 2 Then there is curious wording one finds in the next
 3 sentence of 148 and also in the second sentence of 144:
 4 "Insofar as its inference is correct, the
 5 OFT considers this to be an instance of Gallaher using
 6 tactical bonuses [et cetera] in order to micromanage
 7 ..."
 8 This wording "insofar as the inference is correct"
 9 recurs throughout the OFT's defence against the Co-op,
 10 and we would say that this was a very tentative approach
 11 and it seems to us to imply that the OFT hasn't much
 12 confidence in the inference, hasn't possibly actually
 13 checked whether its inference is correct, and certainly
 14 so far as my reading of the textbooks is concerned, such
 15 an approach doesn't meet either the burden or the
 16 standard of proof required of the OFT simply to make
 17 inferences and then to wonder whether or not they are
 18 right, those inferences should actually be correct and
 19 shown to be correct.

20 If we look first of all at Samson, which I think is
 21 the simpler case, you will recall that at 5.10 there is
 22 reference to offtake and demand as a result of the
 23 promotions. I think this can be usefully compared with
 24 the document I referred to that ITL inserted, which is
 25 at bundle 15, tab 12(d). {D15/12(d)}. So that's

23

1 annex 15, tab 12(d).
 2 I think a moment ago I said that Mr Davison had
 3 taken over in April, but in fact this suggests he had
 4 taken over certainly by March 2002, because 12(d) is
 5 a letter from Mr Davison to Mr Newton summarising
 6 discussions made at a meeting on 25 March 2002, and he
 7 sets out a number of points under "Promotional period
 8 for periods 4 and 5 of 2002". So right in the middle of
 9 the period between the two documents we have been
 10 looking at. You will see that Mayfair range £3.50 for
 11 20, so substantially below the price we looked at in
 12 2001, and specific prices for multipack and 200
 13 multipack across all price bands. Then Amber Leaf,
 14 a specific price, £2.09 and £4.09, and Samson still at
 15 1.99 and 3.88.

16 Then over the page, a very interesting paragraph,
 17 the second paragraph:

18 "In addition to highlighting distribution
 19 achievements, it was also encouraging to report that the
 20 Gallaher cigarette market share increased during
 21 February by [and I don't have the figure] for the Co-op
 22 sector."

23 Then the last sentence of the paragraph is also very
 24 interesting:

25 "Further potential still remains for share and

24

1 volume increases with Mayfair, Dorchester, Amber Leaf
2 and Samson, while the special discounted prices are in
3 place."

4 Again we say that sits rather oddly with the OFT's
5 inference made in the defence. So against that
6 background, we thought it would be helpful to
7 the Tribunal to look at the actual facts in some more
8 detail, and that's the reason why we have prepared these
9 schedules which I handed up on Tuesday, and which are
10 simply extracts from the CRTG price matrices. As
11 I said, the Samson case is the simpler case, I am told
12 it's tab 11 of the additional documents, if they have
13 come to the Tribunal in that form.

14 Does the Tribunal have the Samson schedule? It
15 should have Drum and Amber Leaf on the first column
16 for 2000/3.

17 **THE CHAIRMAN:** Yes.

18 **MR THOMPSON:** We have coloured it where there is
19 a misalignment in terms of parity or differential. So
20 for example in the first line you will see the MRPs for
21 Drum and Amber Leaf are at 1.95, whereas the resale
22 prices quoted by Co-op are all over the place, and don't
23 correspond to that, and there appears to be a promotion
24 running on Drum, even though actually the Amber Leaf
25 prices are quite considerably lower.

25

1 Then there is a bit of a patchwork during that page.
2 But so far as it's relevant for present purposes, you
3 will see that there is no reference to Samson as a Co-op
4 product until the second page, 2001 promotional period
5 10. Does the Tribunal see that?

6 **THE CHAIRMAN:** So what are the coloured ones?

7 **MR THOMPSON:** That's where the prices are out of line with
8 the relevant MRP differentials, so out of line with the
9 Gallaher agreement, as we understand it. I should say
10 out of line with the fixed approach that the OFT adopts.
11 We haven't coloured the maxima, we have simply looked at
12 the actual figure.

13 The first reference to Samson is at 2001, period 10,
14 when it's launched at an MRP of £2.07. This is in the
15 12.5 gram version. You will see that pricing at that
16 point for Drum, Amber Leaf and Samson is equal in all
17 bands. I am sorry, the MRP is £2.15, the pricing in all
18 bands is £2.07, and it says "new product in range" in
19 the right-hand column.

20 I'm looking at price band 6, you will see that
21 that's the lowest price, they are all £2.07.

22 Then the next month, which is the month we are
23 concerned with, the MRP remains at parity, but the
24 Samson price drops to £1.99, so 8p out, and below
25 an obvious price point at £2.

26

1 In a way, the short point I am making, one sees that
2 the remaining schedules, not only at 12.5 grams but also
3 at 25 grams, from then throughout the rest of the
4 infringement period, Samson is out of line with Drum in
5 every single period, every single price band. So far
6 from this being an example of a movement to comply with
7 parity and differentials, it was clearly a promotional
8 discount intended to go outside parity and
9 differentials, and that's why there was an encouraging
10 offtake in demand planned and, as far as we can see,
11 achieved, as far as Mr Davison was concerned, by
12 March 2002.

13 One sees that not only in relation to 12.5 grams but
14 also in relation to 25 grams, if one turns through
15 a couple of pages, exactly the same pattern, rather
16 a patchwork between Drum and Amber Leaf through 2000.
17 Samson launched in 2001, 10, at parity, and then dropped
18 out of parity, in this case 16p out of parity, and
19 maintained out of parity for the next two years,
20 apparently the deliberate policy of Gallaher and without
21 complaint apparently from Gallaher or indeed from ITL.

22 **THE CHAIRMAN:** But the promotional support that's listed in
23 the comments, is that funded by Gallaher?

24 **MR THOMPSON:** Yes. So increased the promotional support at
25 one point, and in fact there is --

27

1 **THE CHAIRMAN:** But what you are saying is there is no
2 evidence of them altering the P&D as between Samson and
3 these other brands?

4 **MR THOMPSON:** The inference is from the OFT that Samson was
5 targeted against Drum for parities and differentials,
6 presumably to try and drive up prices. What actually
7 happened is when it was launched it was put at parity
8 for one promotional period and then the price was
9 dropped, presumably to generate price pressure and to
10 stimulate demand, and the contemporary correspondence
11 confirms that. But it's obviously the complete opposite
12 of the OFT's inference, and rather bears out the
13 suggestion that when they say "insofar as our inference
14 is correct" they have not actually bothered to look at
15 the documents they have had for six years which would
16 have shown that it was plainly and obviously a complete
17 nonsense as an inference.

18 **THE CHAIRMAN:** Just to be sure I'm clear, then, when you say
19 "MRP differential" at the top of the fourth column, that
20 is derived from the fact that we know from the published
21 MRPs in the column just to the left that the MRPs
22 published by ITL and Gallaher had all these at the same
23 MRPs?

24 **MR THOMPSON:** Yes, these are simply extracts from our
25 pricing matrices, rather than encumber the Tribunal with

28

1 the entire two volumes of pricing matrices, we have
 2 simply lifted the examples that the OFT has chosen as
 3 its best examples and had a look to see how good they
 4 actually are. In fact, they are awful.
 5 **DR SCOTT:** Just to help me, what you are saying is that
 6 Gallaher specified the Drum/Samson pairing; yes?
 7 **MR THOMPSON:** According to the OFT.
 8 **DR SCOTT:** Yes.
 9 **MR THOMPSON:** It is said to be clear. We don't know, these
 10 are internal Gallaher documents we have never seen, but
 11 the OFT has inferred that Samson targeted Drum.
 12 **DR SCOTT:** So we don't actually have -- that's an inference,
 13 rather than a ...
 14 **MR THOMPSON:** It's paragraph 143 of the --
 15 **DR SCOTT:** No, I was looking at 143, I was just trying to
 16 remember whether it's -- how can I put it -- a pure
 17 inference or whether there is any actual reference or
 18 whether it provides through the RRP's being the same.
 19 **MR THOMPSON:** Would the help the Tribunal to look at the
 20 document? It's ...
 21 **DR SCOTT:** 5/10.
 22 **MR THOMPSON:** It's actually annex 3, document 4, I think.
 23 I am afraid I am working on the virtual version of this.
 24 (Pause). I am told it's on page 3.
 25 **THE CHAIRMAN:** Yes, Amber Leaf parity with Cutters Choice,

1 Samson parity with Drum.
 2 **MR THOMPSON:** Yes, so they say it's clear that there was
 3 a policy of parity with Drum and that we had agreed to
 4 comply strictly with this. When you actually look at
 5 it, it was launched for three weeks at parity but then
 6 in order to stimulate demand, it was immediately dropped
 7 to below parity, and it did indeed apparently stimulate
 8 demand, and --
 9 **THE CHAIRMAN:** Well, could you just clarify what you mean by
 10 "it was immediately dropped"?
 11 **MR THOMPSON:** If you look, the first document --
 12 **THE CHAIRMAN:** Yes, I see it's now below it, but who was
 13 immediately dropping it, and what was the mechanism for
 14 immediately dropping it?
 15 **MR THOMPSON:** One sees that from 5/10. There is more detail
 16 in the promotional plan on the back of 5/10. You will
 17 see a substantial retro bonus, I think, of [redacted].
 18 I am sorry, I think I have just named another
 19 confidential number.
 20 **DR SCOTT:** So we see from Gallaher document, internal
 21 numbering 3(ii):
 22 "Samson was at parity with Drum (10p below per
 23 12.5 grams until further notice)."
 24 So clearly there were two things going on there, and
 25 then, so having launched it at parity they then seemed

1 to take it down in the following promotional period --
 2 **MR THOMPSON:** Yes.
 3 **DR SCOTT:** -- to get that offtake. What's the date of tab 4
 4 that we looked at, that's March 2001?
 5 **MR THOMPSON:** July 2001, I think.
 6 **DR SCOTT:** It says "March".
 7 **MR THOMPSON:** I am sorry, yes, the original policy document
 8 is in March, and then there is a further document at
 9 tab 7.
 10 **DR SCOTT:** As we understand the evidence, Gallaher --
 11 **MR THOMPSON:** Sorry, tab 9.
 12 **DR SCOTT:** -- have to fit in with the promotional periods
 13 provided by the Co-op.
 14 **MR THOMPSON:** Yes.
 15 **DR SCOTT:** So they launch it in one promotional period and
 16 then they take it down in the next promotional period.
 17 **MR THOMPSON:** Yes.
 18 **DR SCOTT:** Which presumably entitles them to have money off
 19 a label.
 20 **THE CHAIRMAN:** But the oddity is that at tab 9 it still says
 21 "Samson parity with Drum" even though they have been
 22 spending a great deal of money offering tactical support
 23 to keep it below that.
 24 **MR THOMPSON:** Yes. So far as the Co-op is concerned, we
 25 obviously knew nothing about any of this, or we know

1 nothing about these internal documents, there is no
 2 evidence that they were shown to us or anything of that
 3 kind, but simply an inference that the OFT has chosen to
 4 draw for the defence, presumably the decision.
 5 **THE CHAIRMAN:** What you know at the Co-op is that the MRPs
 6 seem to remain at parity.
 7 **MR THOMPSON:** Yes.
 8 **THE CHAIRMAN:** But that you are getting extra money to
 9 reduce the price of Samson.
 10 **MR THOMPSON:** Yes, and in fact promotions go up at some
 11 points, we actually get additional promotions during the
 12 period. And very curiously at the time of the general
 13 price increase at promotional period 8, part 2, which
 14 one finds, the price of Amber Leaf and Samson actually
 15 was reduced -- sorry, the MRP was reduced by 12p, and
 16 was not followed by Drum, not followed down by ITL, for
 17 an extensive period, although Drum did run a promotion
 18 apparently in period 11 to match the £1.99, and then
 19 actually matched the price reduction in period 12.
 20 Frankly, it appears to us that this is an obvious case
 21 of aggressive price competition driving the price down,
 22 certainly not an example of P&Ds intended to push the
 23 price up.
 24 **DR SCOTT:** You may not recall the answer to this, but my
 25 recollection from the ITL skeleton was that in ITL the

1 pairing was Drum and Amber Leaf; is that right? That's
 2 right, Mr Howard?
 3 **MR HOWARD:** Yes.
 4 **DR SCOTT:** So here we have an example of a Gallaher pairing
 5 which isn't necessarily reflected by ITL.
 6 **MR HOWARD:** Absolutely right, and there are quite a lot of
 7 examples of that. It's one of the things that's
 8 conveniently overlooked.
 9 **THE CHAIRMAN:** The point you get from this is that insofar
 10 as the OFT is relying on the promotion of Samson as
 11 being intended to bring the price of Samson back down to
 12 be in the same relationship to Drum as the MRPs were in
 13 relationship between Drum and Samson, that's not the
 14 case; here it seems from these figures that the
 15 promotional bonus was to bring the price of Samson down
 16 below the level of Drum even though the MRPs remained
 17 the same, subject to that point when the MRPs reflected
 18 a 12p differential.
 19 **MR THOMPSON:** We focused on 5/10 but if you then turn to
 20 5/11, which is around the periods 8 and following of
 21 2002, you will see that this goes for both Amber Leaf
 22 and Drum. What you see is a very substantial decrease
 23 in the MRP of 12p for both Amber Leaf and Samson, which
 24 is again completely inconsistent with the Shaffer OFT
 25 theory, in that the MRP goes down but the Drum,

1 Amber Leaf and Samson retail prices are all over the
 2 place for 2002, 9, 10 and 11, and it's only apparently
 3 when ITL offers a major promotion of 22p below MRP and
 4 then drops its own retail price in 2002, 12, that it
 5 manages to re-establish some form of alignment with
 6 Amber Leaf, but it doesn't appear that the Co-op felt
 7 under any constraint to either manufacturer to keep
 8 things in order.
 9 So in my submission that's strongly consistent with
 10 Mr Messom and Mr Goulthorp and Mr Goodall's evidence,
 11 and makes it clear that the inference that the OFT
 12 sought to draw in relation to Samson seems to have been
 13 purely surmised based on the fact that it's theory is
 14 such a nice theory that it must be right, as it were,
 15 regardless of the facts.
 16 If we look at the Mayfair position, that's
 17 different. I don't know whether the Tribunal wishes to
 18 take a break or shall I finish?
 19 **THE CHAIRMAN:** How much longer do you have to go?
 20 **MR THOMPSON:** I don't know how long that took, but it maybe
 21 will take 15 or 20 minutes.
 22 **THE CHAIRMAN:** Is that going to be ...
 23 **MR THOMPSON:** That's the only other point I was going to
 24 make. Do you want to deal with that now?
 25 **THE CHAIRMAN:** Let's finish this, then.

1 **MR THOMPSON:** I am grateful.
 2 In relation to Mayfair, we handed up two schedules,
 3 one in relation to Superkings and one in relation to
 4 Kingsize, and they are at tabs 10 and 12 of the
 5 additional documents, if that's where the Tribunal has
 6 them. I think the most helpful starting point, and
 7 I can simply quote it, it's a passage from the evidence
 8 of Mr Batty on Day 7, page 5, lines 9 to 13, where he
 9 says:
 10 "We reduced the price of Richmond at some point
 11 Kingsize to enable the launch of Richmond Superkings to
 12 take place at a competitive price."
 13 If one looks at the Superkings schedule --
 14 **DR SCOTT:** Is this 10 or 12?
 15 **MR THOMPSON:** It's 12, sir, it's quite a short schedule, and
 16 it starts at 2001, 1. That's not simply because we have
 17 been lazy, but that's because Richmond Superkings were
 18 launched in the first promotional period of 2001. If
 19 you turn over to the second page, you will see in 2002
 20 quite a lot of yellow, and in particular at 2002, 9, you
 21 will see a third line appear, which is the launch of
 22 Mayfair Superkings, and you will see that it was
 23 launched 12p above Richmond Superkings and 6p above
 24 Dorchester, but that the pricing did not correspond to
 25 P&Ds, and it was then maintained at that price right

1 through until 2003, period 5, when it was raised by 6p,
 2 but the differential narrowed so it was only 3p even at
 3 the end of the period. So it was out of line throughout
 4 the period from its launch in 2002, period 9.
 5 You may wonder why I've looked at that, but bearing
 6 in mind Mr Batty's observation, if we look back to the
 7 Kingsize table, tab 10, you should see in the first page
 8 that the period from 2003, period 3 through to 2000,
 9 period 10, Mayfair and Richmond, certainly in RSP 1, as
 10 it is called there, or RSP 6, are broadly speaking at
 11 parity in terms of resale prices even though the MRPs
 12 aren't necessarily always the same.
 13 But then, from 2000, period 11 onwards, the Richmond
 14 selling price drops quite dramatically to £3.34, and
 15 stays at £3.34 over the page until the start of 2001
 16 when you will see the MRP drops to £3.44, whereas it was
 17 previously £3.54. So what appears to happen is that
 18 Richmond realigns against Dorchester just at the time
 19 when Richmond Superkings is launched.
 20 So by the period with which we are concerned, which
 21 I think is 2001, 11, towards the bottom of that page,
 22 you will see that Richmond Kingsize is at £3.46 in the
 23 Co-op, whereas it's at £3.59 for Mayfair, and so there
 24 is a parity of 15p opened up by then, whereas the price
 25 war between Richmond and Dorchester is in full swing and

1 the parities aren't aligned, and in my submission it's
2 quite clear that the reduction between 2001, period 10
3 and 2001, 11 has nothing to do with Richmond, because at
4 that point Richmond and Dorchester are fighting it out
5 and Mayfair is effectively floating above that.

6 If you then turn to the next period, the end of
7 2001, the beginning of 2002, you should find Mayfair at
8 £3.75 at the end of 2001, MRP, and pricing at £3.59 to
9 60 still being held. But then at the beginning of 2002,
10 although the MRP stays the same, the Kingsize sale price
11 suddenly drops to a flat price of £3.50 across all
12 bands, and that is then maintained throughout 2002 right
13 up to the period with which we are concerned, 2002, 8.

14 So if you find 2002, 8 you will find Mayfair still at
15 £3.75 MRP, 10p above Richmond and Dorchester, and at
16 a flat price of £3.50, in fact it's actually priced
17 below Richmond and Dorchester.

18 Then the next month, price rise, with which we are
19 all familiar --

20 **DR SCOTT:** Sorry, I don't --

21 **MR THOMPSON:** Do you have 2002, 8 at the top --

22 **DR SCOTT:** 2002 ...

23 **MR THOMPSON:** You should have ...

24 **DR SCOTT:** I see, so it is -- if I can read this out? -- at
25 £3.50 and the other two are at 3.52, 3.54, 3.55?

1 **MR THOMPSON:** Yes. So what's happened is that Mayfair's MRP
2 has been held constant all the way from the end of 2001,
3 2001, 12, when there was an ITL MPI, it's been held
4 constant all the way through, even though there have
5 been other MPIs, and the resale price has been held at
6 a flat £3.50 throughout 2002 up to 2002, 8. You will
7 recall that 2002, 9, Mayfair Superkings is launched.

8 So the document with which we are concerned, the
9 second one, is 2002, 8, part 2, where the MRP stays at
10 £3.75 but the flat price increases from £3.50 to £3.55.
11 Do you see that? That price for Kingsize is maintained
12 for a period right through until 2002, 13, and the MRP
13 is maintained right the way through until the same 2003,
14 5, part 2, when it goes up by 6p. But the comparison
15 between Mayfair and Richmond is out throughout the
16 entire period going back to the original period in 2000.

17 So, in my submission, the suggestion that the
18 reduction in 2001, 11, or the increase in 2002, 9, had
19 anything to do with P&Ds with Richmond is obviously
20 wrong. Mayfair was being used in a quite different way,
21 initially at a higher price and then, during 2002 -- and
22 you recall the reference from Mr Davison to the special
23 promotion leading to an increase in share -- it was
24 being held at a very low price with a massive promotion,
25 throughout 2002 up to the launch of the Superkings, at

1 which point the MRP was held down but there was a small
2 increase in the promoted price, but there was still
3 a 10p promotion going on even at that stage.

4 So in my submission this is obviously a case of
5 strategic promotional pricing and not a case of P&Ds.

6 My junior is, I am not sure ahead of me but
7 certainly beside me, saying: what about the comparison
8 with Royals and Rothmans? Is it possible that what was
9 going on here was a comparison with Royals and Rothmans?

10 One can see that there is something in this, it is true
11 to some degree in relation to the first instance, and
12 one finds that at tab 10. I am afraid we will need to
13 look briefly at the schedules. You may recall that the
14 terms of what was agreed was that there would be
15 a promotion for 20s and 100 multipacks with an agreed
16 retail of £3.60 for 20s, and £17.79 in all stores for
17 multipacks. One can see what actually happened at --

18 **DR SCOTT:** Sorry, tab 10?

19 **MR THOMPSON:** That's at tab 10.

20 **DR SCOTT:** Tab 10 of?

21 **MR THOMPSON:** Of annex 5, I am sorry. {D5/10a}.

22 I am afraid it's one of those instances where one
23 will need to keep two fingers in the bundles. First of
24 all, at 10(a), page 2, about halfway down you should
25 find Mayfair Kingsize 20s with an MRP of £3.70 and

1 promotional pricing of £3.59, £3.59 and £3.60. Then
2 a little further down you should find five times 20s at
3 promotional pricing of £17.79 across the board, and then
4 for good measure ten times 20s at I think £35.39, £35.59
5 and £36.39.

6 If you then turn through to tab (c), on the front
7 page you will see Rothmans Royals, Rothmans Royals
8 multipack, and Rothmans Royals multipack ten times 20s
9 and the MRPs are the same, the 20s price is the same,
10 £3.59, £3.59, £3.60, the multipack five times 20s is 10p
11 higher, £17.89, £17.89, £17.89, and the ten times 20s
12 price is a flat £35.59, so slightly higher than the
13 lowest Co-op price, the same as the middle price, and
14 lower than the highest price. So, in my submission,
15 a reasonable inference to have made would be that the
16 Co-op was seeking to match on 20s and getting promised
17 by that but not complying with the terms of the
18 promotion because it was pricing at £3.59 rather than
19 £3.60. But it did accept the promotional money on five
20 times 20s, and priced 10p below Rothmans using that
21 promotion, so again that doesn't really sit with the
22 OFT's case. And then off its own bat it priced out of
23 line with parities in relation to ten times 20s, and the
24 Gallaher didn't pay for the promotion in that case, but
25 obviously didn't complain that the Co-op was pricing out

1 of line. So in my submission none of that really is
 2 grist to the OFT mill. What this looks like is
 3 promotional funding which the Co-op takes, but then does
 4 its own thing on pricing using that money.
 5 Then finally, for completeness, and I'll take this
 6 very briefly by reference to annex 4 to our reply, in
 7 relation to the second period you will recall that
 8 Mayfair at this point is heavily promoted and at a low
 9 price. Do you have annex 4 to our reply? It's
 10 paragraph 128.
 11 **THE CHAIRMAN:** Where is this in the bundle?
 12 **MR THOMPSON:** I am sorry, it's bundle 7, tab 77. {D7/77}
 13 We have given you the period 8 figures. It could
 14 perfectly well have been the period 9 figures but we
 15 have given you the period 8 figures, and you will see
 16 that Mayfair was then an MRP of £3.75, but it was being
 17 priced 20p below that across all price bands. By
 18 comparison Richmond was MRP was 10p below, but it was
 19 being priced 3, 1 and level with Mayfair at the three
 20 different bands and Royals was at £3.81, so 6p above on
 21 MRP, but it was being priced variationally at 16, 18 and
 22 21p above the MRP differential. So again it's a pretty
 23 spectacular inference that the OFT has made and one that
 24 clearly didn't involve troubling itself with the facts.
 25 So obviously I would rely on this as a general issue

1 for the Tribunal to bear in mind when the OFT uses
 2 expressions such as "insofar as this inference may be
 3 correct" and puts things on a rather speculative basis
 4 to witnesses not only in relation to the Co-op but more
 5 generally. So that's what I wanted to say.
 6 **THE CHAIRMAN:** Thank you very much. Then we will have
 7 Mr Owen after our break. We will come back at five past
 8 12.
 9 (11.55 am)
 10 (A short break)
 11 (12.05 pm)
 12 **MR THOMPSON:** I would like to call Mr Owen, please.
 13 MR MARK RAYMOND OWEN (sworn)
 14 Examination-in-chief by MR THOMPSON
 15 **MR THOMPSON:** Mr Owen, do you have bundle 7 in front of you?
 16 **A.** Yes.
 17 **Q.** Can you turn right to the back, the very last document
 18 in it. You finally get to page 485, and you should find
 19 the first witness statement of Mark Raymond Owen; is
 20 that correct?
 21 **A.** That's correct, yes.
 22 **Q.** If you turn to the back, page 491, you should find
 23 a signature. Is that your signature?
 24 **A.** That is, yes.
 25 **Q.** Is this your statement in this matter?

1 **A.** Yes, it is.
 2 **Q.** I believe you have one or two very small points of
 3 correction, if I could just take you to, I think, first
 4 of all, is it at the beginning?
 5 **A.** Yes.
 6 **Q.** What is the --
 7 **A.** It's actually [address redacted].
 8 **Q.** Thank you. Then at paragraph 5.5, (c), if we could look
 9 at that first, at line 6 and line 8 you refer twice to
 10 Gallaher. Is that correct or --
 11 **A.** No, it should have been Imperial Tobacco, because that's
 12 what the document referred to.
 13 **Q.** Yes. Then just two points of clarification on the
 14 documents. At the beginning, do you have a bundle 15?
 15 **A.** Yes.
 16 **Q.** These are the papers that the Tribunal has, and which we
 17 have been working off. Can you just turn to tab 16,
 18 {D15/16}, and you should have a letter there, which is
 19 a two-page letter from you, and then --
 20 **THE CHAIRMAN:** Which bundle?
 21 **MR THOMPSON:** Sorry, annex 15, tab 16, I am sorry.
 22 Do you see that two page letter?
 23 **A.** Yeah.
 24 **Q.** Behind it, there is a four page document headed "CRTG
 25 Trading Agreement 2002". Do you see that?

1 **A.** Yes.
 2 **Q.** Going back to your 5.5 of your statement, your first
 3 sentence, when you say "The 2002 Trading Terms", what
 4 are you talking about there? Are you talking about the
 5 first or the second or both?
 6 **A.** I am referring to my letter, the letter from me.
 7 **Q.** I think there is a similar point in paragraph 5.6. Are
 8 you referring to your letter, the draft agreement or
 9 both?
 10 **A.** My letter.
 11 **Q.** Then could you turn on to tab 21? No, you need to pick
 12 up bundle 5. Tab 21. Do you have a letter there or is
 13 it simply a trading agreement?
 14 **A.** No, I have --
 15 **THE CHAIRMAN:** Yes, you must be a bit clearer, do you mean
 16 bundle 5 or annex?
 17 **MR THOMPSON:** I am sorry, madam, annex 5 to the statement of
 18 objection, I am sorry.
 19 **A.** There is a letter there with trading agreement attached
 20 to it.
 21 **Q.** Is it a Gallaher headed letter?
 22 **A.** Yes, it's a Gallaher letter.
 23 **Q.** You have that?
 24 **A.** Yes, I do.
 25 **Q.** Could we turn back to your statement for a moment,

1 paragraph 5.16, you will see in the third line:
 2 "I have also been referred to a letter of
 3 18 December 2003 from Mike Davison to myself attaching
 4 draft trading terms."
 5 Is that the letter you are talking about?
 6 A. Yes.
 7 **MR THOMPSON:** I am only asking because it was not originally
 8 in the bundles, so it's just to confirm it's the right
 9 letter.
 10 Thank you very much. I believe Mr Williams will
 11 have some questions for you.
 12 **THE CHAIRMAN:** Just wait one moment.
 13 (Pause)
 14 Yes, Mr Williams.
 15 Cross-examination by MR WILLIAMS
 16 **MR WILLIAMS:** Good morning, Mr Owen. Mr Owen, have you read
 17 the transcript of any of these proceedings so far?
 18 A. Yes.
 19 Q. Which days have you read the transcript of?
 20 A. Which, sorry?
 21 Q. Which days of the proceedings have you read the
 22 transcript of?
 23 A. Sorry, no, I have not read the days. Sorry, no.
 24 Q. I think you should have somewhere in front of you
 25 a chart showing the organisation of the Co-op at the

1 time we are looking at. Do you have that?
 2 A. I do, yes.
 3 Q. Can you see yourself on that?
 4 A. I can, yes.
 5 Q. So you were head of category buying for non-edible
 6 groceries?
 7 A. Correct.
 8 Q. Is that cleaning products and things like that?
 9 A. It would include pet food, paper, household products,
 10 health and beauty.
 11 Q. Non-edible by people, then?
 12 A. Non-edible, non-edible grocery.
 13 Q. This also records that you were seconded to work for
 14 Mike Goulthorp in this period. I think we see from your
 15 statement that that secondment started in late 2001?
 16 A. That's correct.
 17 Q. When did it come to an end?
 18 A. It would have been in August of the following year.
 19 Q. 2002?
 20 A. Yeah. It was actually two periods of secondment. There
 21 was the first period of secondment where I was working
 22 following the bringing together of United Co-operatives
 23 buying and the second period when we were negotiating
 24 following the acquisition of Alldays.
 25 Q. So can you just tell us what the two periods were, when

1 they started and when they finished?
 2 A. Yeah, the first period would have been the end of 2001
 3 to round about the end of August 2002 and then the
 4 latter part of that year would have been from
 5 December 2002 to about August 2003.
 6 Q. During the periods that you were on secondment, were you
 7 also doing your day job, if I can put it that way?
 8 A. No, I relinquished my duties to two of my deputies.
 9 Q. We see from the diagram that your equivalent in relation
 10 to tobacco was Kay Wheelton?
 11 A. That's correct.
 12 Q. Apart from the work you did on your secondment, is it
 13 right to say tobacco didn't form part of your
 14 responsibilities?
 15 A. Tobacco was not part of my day-to-day responsibilities,
 16 no.
 17 Q. The secondment related to a special project, as you
 18 describe it here, where you in the Co-op were
 19 centralising the process of agreeing trading terms with
 20 your larger suppliers?
 21 A. That is correct.
 22 Q. So your involvement with tobacco was really about
 23 establishing the terms of the trading relationships, the
 24 terms of the trading agreements?
 25 A. That's correct.

1 Q. It wasn't about the application of those agreements day
 2 to day?
 3 A. No.
 4 Q. And you weren't involved with the pricing of tobacco in
 5 stores?
 6 A. No.
 7 Q. Could you look at paragraph 4.3 of your statement,
 8 please, and just read it to yourself.
 9 (Pause)
 10 In the middle of that paragraph you say:
 11 "Whilst category buyers, including Peter Newton for
 12 tobacco, would not totally ignore them..."
 13 Am I right in thinking that this paragraph and in
 14 fact really this section of the statement is about the
 15 nature of Co-op's relationships with buyers generally --
 16 sorry, with suppliers generally rather than specifically
 17 about tobacco or Peter Newton?
 18 A. Yes, it's general.
 19 Q. Because you didn't, I think from what you have said,
 20 have any specific knowledge of what Peter Newton was
 21 doing?
 22 A. That's correct.
 23 Q. While we are in 4.3, and looking at the last two
 24 sentences, you say:
 25 "Whilst category buyers would lend a sympathetic ear

1 to maintain a good working relationship, they were under
 2 no specific obligation to do so. This is reflected in
 3 the category buyers' individual targets which were
 4 focused on sales and margin."
 5 So you are talking there about their internal
 6 targets, if I can put it that way, what Co-op wanted
 7 them to achieve?
 8 **A.** Sales and margin targets, yes.
 9 **Q.** You are dealing with two different things, there,
 10 really, aren't you, the first sentence is dealing with
 11 the question of whether you were under a specific
 12 obligation but that's presumably an obligation to the
 13 supplier, and then you go on to talk about the Co-op's
 14 internal targets, so that the second point doesn't
 15 really follow from the first point, you could be under
 16 an obligation to a supplier in relation to something
 17 that didn't form part of Co-op's internal targets;
 18 that's right, isn't it?
 19 **A.** I am not sure on the question there.
 20 **Q.** I'll put it to you again. The first sentence says
 21 essentially that buyers weren't under a specific
 22 obligation to take into account what the supplier wanted
 23 them to do, and I assume that there you are talking
 24 about an obligation to the supplier as part of
 25 a contract or agreement with the supplier?

1 **A.** Yeah.
 2 **Q.** Then you say:
 3 "This is reflected in the category buyers'
 4 individual targets which were focused on sales and
 5 margin."
 6 All I am saying is it's not surprising that your
 7 internal targets didn't reflect the things that you had
 8 agreed to do for suppliers?
 9 **A.** That's correct.
 10 **Q.** Turning to the matters that you dealt with on your
 11 secondment, we have seen from the documents that you
 12 were involved in negotiating a trading agreement with
 13 ITL in 2002. In 2.7 of your statement, if you just want
 14 to go back to that, you talk about meetings with top
 15 suppliers in 2001 and 2002 including ITL and Gallaher.
 16 You say at the end of that paragraph that reaching
 17 agreement could take a number of months. I want to work
 18 out the timing of this as far as we can in relation to
 19 the tobacco suppliers.
 20 Do you have annex 15 in front of you? I am really
 21 just showing you the document to refresh your memory, if
 22 that helps. It's 15/14. {D15/14}. Do you want to just
 23 cast your eye over it?
 24 (Pause)
 25 So this is a letter which Martin Goodall of ITL sent

1 to you in the middle of May 2002, and he refers to
 2 a meeting the previous week at which certain terms have
 3 been discussed, and he attaches a copy of those terms.
 4 Was this about the time that you became involved with
 5 tobacco in particular, do you think?
 6 **A.** The first meeting may have taken place earlier in the
 7 year, February/March time.
 8 **Q.** Do you remember that specifically or do you not
 9 remember?
 10 **A.** There could have been a number of meetings, as with any
 11 supplier negotiation you don't reach agreement at the
 12 first meetings.
 13 **Q.** But you don't remember?
 14 **A.** Not that specific meeting, no.
 15 **Q.** So 2.7 and 2.8 of the statement talk about negotiations
 16 with both ITL and Gallaher in 2001 and 2002. As far as
 17 Gallaher was concerned, when you started your secondment
 18 in late 2001, there was in place an agreement with
 19 Gallaher which ran until the end of 2002; do you
 20 remember that?
 21 **A.** I don't specifically remember any detail around that,
 22 because I can't specifically remember having any
 23 negotiation with Gallaher at that time.
 24 **Q.** So when you say in 2.7 "we organised meetings with the
 25 90 or so top suppliers including ITL, Gallaher and BAT",

1 you actually can't remember talking to Gallaher at that
 2 time?
 3 **A.** We would have called them in for a meeting but if there
 4 was an agreement in place we would have been discussing
 5 any opportunities there may have been to secure extra
 6 funding, but if there was an agreement in place there
 7 would have been an agreement in place.
 8 **Q.** So in 2.8, do you want to just read the first general
 9 part of 2.8 to yourself. Well, you can read the
 10 subparagraphs if that's helpful.
 11 (Pause)
 12 Here you talk about Gallaher specifically again, and
 13 you talk about them seeking support for certain
 14 promotional activities, but I think from what you have
 15 just said, you actually at that point in time,
 16 2001/2002, you weren't having that conversation with
 17 Gallaher?
 18 **A.** I wasn't, no.
 19 **Q.** In terms of what we do know about the negotiations with
 20 Gallaher, could you take out annex 5, please, which is
 21 the other file you should have in front of you, and turn
 22 to tab 21 of that. {D5/21}. Do you want to cast your
 23 eye over the letter there and the -- I am not going to
 24 ask you detailed questions about the draft terms behind
 25 it, but if you want to cast your eye over that, if

1 that's helpful, then please do so.
 2 (Pause)
 3 So this is a draft agreement from December 2003, and
 4 it appears that it was intended to be retrospective to
 5 the beginning of January. So that, I think in your
 6 statement at 15.17 you say that you can't remember the
 7 negotiations relating to this document. I think from
 8 something you said in response to one of my earlier
 9 questions actually by December 2003 you weren't on
 10 secondment to Mike Goulthorp, I think you said it
 11 finished in August?
 12 **A.** That's correct.
 13 **Q.** So this letter might have been addressed to you based on
 14 the fact that Gallaher knew you were in a particular
 15 role at a previous point, but actually you probably
 16 didn't deal with this?
 17 **A.** No, this relates to the second batch of negotiations
 18 which was following the acquisition of Alldays, and some
 19 of the negotiations would be quite protracted, and from
 20 August of that year 2003 I would have pretty much tied
 21 up all the loose ends and gone back to my day job.
 22 Clearly there would always be one or two negotiations
 23 that went on and on and on, and this would have been one
 24 of those negotiations that hadn't been concluded by the
 25 end of the period of my secondment.

1 **Q.** But you don't remember anything about the negotiations
 2 with Gallaher in 2003, I think you say in your
 3 statement?
 4 **A.** Not specifically, no.
 5 **THE CHAIRMAN:** After you finished your secondment, and there
 6 are these few stragglers, did you continue to deal with
 7 those stragglers even though your secondment had
 8 officially ended, or was there somebody else who took
 9 over dealing with them?
 10 **A.** It would be done on a case by case merit, if I felt
 11 I could bring that negotiation to a close, I would do.
 12 With this particular one I would have referred to back
 13 to the category.
 14 **THE CHAIRMAN:** Right.
 15 **MR WILLIAMS:** From that I think we can understand that you
 16 don't know whether any agreement was reached with
 17 Gallaher.
 18 **A.** No, I did not follow on from this letter.
 19 **Q.** So can we assume that there was no new agreement with
 20 Gallaher, then, throughout 2003, because that's what
 21 this document tells us?
 22 **A.** Well, I can't remember what would have been in place
 23 whilst this agreement had not been reached.
 24 **Q.** I understand that, but you do deal with this question in
 25 your witness statement at 5.17 in general terms rather

1 than specifically in relation to Gallaher. Do you want
 2 to refresh your memory in relation to that? It's 5.17.
 3 (Pause)
 4 Sorry, paragraph 5.17 of your witness statement,
 5 I am sorry.
 6 (Pause)
 7 **A.** Yes. Sorry, the question in relation to 5.17?
 8 **Q.** I haven't asked the question yet. I was going to focus
 9 on the words in the middle of the paragraph:
 10 "CGL would usually work under the old trading terms
 11 as varied by the negotiations."
 12 What I wanted to ask you is: let's assume, because
 13 we don't know any different, that the trading terms
 14 hadn't been varied during the period of 2003; in that
 15 situation, would you be surprised if dealing simply took
 16 place on the basis of the old agreement in its unvaried
 17 form?
 18 **A.** I don't know, because until a new agreement was reached,
 19 I was not involved with the old agreement.
 20 **Q.** I do understand that, but in this paragraph you comment
 21 in general terms on the way CGL would deal with
 22 suppliers, and I am only asking you in general terms if
 23 there was no varied agreement, if the parties hadn't
 24 gotten that far, would it surprise you -- and I am
 25 putting it no higher than that -- if the dealings had

1 carried on on the basis of the old agreement.
 2 **A.** In general terms it wouldn't surprise me if a previous
 3 agreement ran until the new one was agreed and the new
 4 one would be looked at either retrospectively or
 5 whatever to put things in place.
 6 **Q.** Thank you. Could you open annex 15 at tab 16 {D15/16}.
 7 This is a letter which comes a little bit after the
 8 letter at tab 14 which we looked at a little while ago.
 9 **A.** Yeah.
 10 **Q.** The earlier letter attached some terms which had been
 11 discussed at the meeting, and ITL sent you a draft of
 12 those terms at that stage. Here we have the same terms
 13 in substance attached -- sorry, behind this letter.
 14 It's a different document, because it's got
 15 a letterhead. You can see at the top of the "CRTG
 16 Trading Agreement 2006" it has an Imperial letterhead,
 17 and the document at tab 14 doesn't have a letterhead, so
 18 the content is the same, but it seems to be a different
 19 document.
 20 Were these terms attached to your letter of
 21 5 July 2002?
 22 **A.** No, they weren't.
 23 **Q.** When you say in the first line of your letter, "to
 24 confirm the Co-operative Retail Trading Group trading
 25 agreement for 2002", are you referring to the terms of

1 the trading agreement that ITL had previously sent to
 2 you?
 3 **A.** No, I am referring to the trading terms as I have set
 4 out in my letter to Imperial Tobacco.
 5 **THE CHAIRMAN:** Which letter?
 6 **A.** The letter dated 5 July.
 7 **DR SCOTT:** I think, Mr Owen, that the question is that you
 8 summarised the main elements, and then there are some
 9 sums of money which we are not meant read out, which are
 10 placed against four categories.
 11 **A.** Yeah.
 12 **DR SCOTT:** Three of which seem to correspond to what we have
 13 as pages 3 onwards in this tab. Is that your
 14 recollection, that those three items, range
 15 implementation, display planogram combined with pricing
 16 promotion, do in fact correspond to the items in the
 17 document which follows, some of which are marked in my
 18 copy as confidential?
 19 **A.** It looks like the numbers do tie up, yes, to the
 20 letter -- to the statement at the back.
 21 **DR SCOTT:** So does it seem likely that you had got the
 22 numbers out of the document at the back?
 23 **A.** No, I would have negotiated specific numbers. I had
 24 a sum of money to secure against this agreement, and for
 25 me it didn't matter how Imperial Tobacco broke those

1 funds down, I wasn't really interested, I was interested
 2 in the bottom sum of money, so if Imperial Tobacco
 3 decided that to justify their budget, they wanted to
 4 apportion that in one area more than another because it
 5 was easier for them to do so for their accounting,
 6 that's how they would have done. So they would have
 7 come back to me and said "That's how we are going to
 8 apportion the money". If I agreed with the total sum
 9 then I would write back confirming that that's the
 10 agreement.
 11 **DR SCOTT:** Yes, Mr Owen, if you look at your letter, your
 12 letter actually does something slightly different, your
 13 letter actually sets out rather specifically a breakdown
 14 of the sums. Is that correct?
 15 **A.** That's correct, yeah.
 16 **MR WILLIAMS:** It actually says "I would summarise the main
 17 elements as follows", so that contemplates that this is
 18 a summary of something a bit longer?
 19 **A.** Yeah.
 20 **Q.** The "something a bit longer" was the trading agreement
 21 for 2002, and the point I am putting to you is that it
 22 was the document which is attached to this letter, so
 23 that by the date of this letter, you were telling ITL
 24 that those were the agreed terms. You come on to deal
 25 with what those terms mean and their significance in

1 your statement, but at the moment I am at the prior
 2 stage: were these the agreed terms of the trading
 3 relationship 2002?
 4 **A.** The agreed terms for the trading relation for 2002 were
 5 as per my letter.
 6 **Q.** So you had not agreed, at this stage, is your evidence,
 7 the terms of the trading agreement that are in this tab
 8 behind the letter?
 9 **A.** My letter was the summary of terms that I agreed with
 10 Imperial Tobacco.
 11 **Q.** The summary of what?
 12 **A.** The sums of money.
 13 **Q.** Yes, but what were they summarised from?
 14 **A.** An agreement and ongoing dialogue and meetings that
 15 I had with Imperial Tobacco as to agree how the money
 16 should be proportioned.
 17 **Q.** Do you say that the terms that are behind the letter in
 18 tab 16 were never agreed, or do you accept that you
 19 agreed them in a series of letters at this time?
 20 **A.** No, I agreed the sum of money and a breakdown, as is on
 21 the letter. That's what I agreed.
 22 **MR SUMMERS:** Mr Owen, may I just be clear in my own mind
 23 here: are you saying you could actually have written
 24 a very simple letter to them saying in effect "We agree
 25 that our terms next year will result in a sum of money

1 to be paid?
 2 **A.** I could have done, yes, but I broke it down so --
 3 **MR SUMMERS:** Why did you need to break it down, given that
 4 what I understand you to say is that it was immaterial
 5 to you how it was broken down, you were only interested
 6 in the totality? I mean, what was the point for you of
 7 breaking it down?
 8 **A.** It was not a point for me, it was a point that gave
 9 Imperial Tobacco for their business a breakdown of how
 10 they wanted to justify their spend. So they had on
 11 record a letter from me that said "that's how we expect
 12 the money to come in", and that's how they would
 13 apportion it.
 14 **MR SUMMERS:** So you, in effect, although you would write
 15 this, in effect it was nothing to do with you, it was
 16 simply you recording how they proposed to break it down
 17 for their internal budgeting purposes?
 18 **A.** That's correct, because I was not close enough to the
 19 day-to-day, my job was to secure a sum of money.
 20 **MR SUMMERS:** Thank you.
 21 **MR WILLIAMS:** Can I take you up on that, Mr Owen, because
 22 what the letter says is "to confirm the CRTG trading
 23 agreement I would summarise the main elements as
 24 follows" so those are the main elements of the
 25 agreement; is that right?

1 A. That is what Imperial Tobacco would have presented to
 2 me --
 3 Q. No, you are summarising the agreement, that's what the
 4 letter says.
 5 A. Yes.
 6 Q. So had you agreed that these sums of money were paid
 7 with reference to these activities on the left-hand
 8 side? You had, hadn't you? That's what the letter
 9 says.
 10 A. No, I had agreed sums of money broken down as per the
 11 letter.
 12 **THE CHAIRMAN:** Was your expectation, then, that more junior
 13 people in both organisations would work out what needed
 14 to be done as far as range implementation, as far as
 15 display, as far as pricing and promotion were concerned?
 16 A. That's correct, yes, madam, the buyer was responsible
 17 for making sure that they delivered their sales targets
 18 and margin targets so that they needed the flexibility
 19 within their remit to do what was right for our
 20 business.
 21 **MR WILLIAMS:** You accept that you had these terms from ITL?
 22 You accept that they had been given to you as the basis
 23 for the trading relationship in 2002?
 24 A. They may have been given to me, but I wouldn't have paid
 25 much attention to them.

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1 **DR SCOTT:** Mr Owen, can I just understand something here:
 2 I assume that, on the other end of this relationship,
 3 they probably had targets and budgets for how much money
 4 they were going to earn from the Co-op.
 5 A. I would assume, yes.
 6 **DR SCOTT:** And that would have a high priority for them in
 7 making agreements.
 8 A. Yeah.
 9 **DR SCOTT:** So it probably didn't matter to them what tobacco
 10 products they delivered to you, provided they got that
 11 money?
 12 A. Who got the money, sorry, sir?
 13 **DR SCOTT:** Provided ITL received payments from the Co-op --
 14 A. Yeah.
 15 **DR SCOTT:** -- it wouldn't have mattered to them for what
 16 purposes you paid them money?
 17 A. I don't understand the question, I am sorry.
 18 **DR SCOTT:** Sorry. What's being put to you is that money was
 19 being paid by Imperial to the Co-op and, as you put it
 20 in your witness statement, there was a quid pro quo.
 21 That's what you say in your witness statement.
 22 A. Yeah.
 23 **DR SCOTT:** Now, the quid pro quo for the main payments from
 24 the Co-op to ITL was the provision of tobacco products.
 25 A. Correct, yes.

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1 **DR SCOTT:** So far as ITL were concerned, they wanted to end
 2 up with money, not with tobacco products left in their
 3 stores.
 4 A. Yes.
 5 **DR SCOTT:** And you would expect the tobacco products that
 6 you ordered to be delivered in return for the money that
 7 you paid?
 8 A. Yes.
 9 **DR SCOTT:** And yet what you are suggesting is that ITL were
 10 prepared to pay you money without regard to the quid pro
 11 quo that you mentioned in your statement; do I have that
 12 right?
 13 A. This would have been an agreement made at top level, how
 14 would the buyer then manage that agreement on
 15 a day-to-day basis was down to the buyer.
 16 **DR SCOTT:** So there is no sense of corporate responsibility?
 17 **THE CHAIRMAN:** So is this right: you agree the amounts of
 18 money, and then other people will flesh that out as to
 19 what both sides have to do in order to get that money?
 20 A. Throughout the course of the trading year, a buyer may
 21 need to change tactic strategy and my job is not to tie
 22 the hands of the buyer, my job was purely to negotiate
 23 an improved terms package for the benefit of the
 24 business.
 25 **THE CHAIRMAN:** Improved over what?

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1 A. Based on what we would currently be enjoying. So there
 2 is two occasions, the first occasion is when a former
 3 society became part of or handed its buying over to the
 4 group, so we would see that as being additional volumes
 5 through one contact point. And the second was with the
 6 acquisition of Alldays, which again we would view as
 7 additional volumes through our business that we had
 8 invested in and would be looking for support.
 9 **MR SUMMERS:** Sorry, I don't think we have quite finished on
 10 this: you say you don't want to tie the hands of the
 11 buyer; don't figures such as these broken down here
 12 actually tie the hands of the buyer?
 13 A. In my view, no, they didn't.
 14 **MR SUMMERS:** So would the buyer have actually, in discussion
 15 with you, agreed these figures?
 16 A. I can't remember, there may have been dialogue at the
 17 time with the buyer just to give the buyer an overview
 18 as to what we were aiming for, but I wouldn't have
 19 discussed it in any detail.
 20 **MR SUMMERS:** Okay, thank you.
 21 **MR WILLIAMS:** Mr Owen, you must have appreciated that in
 22 writing a letter to ITL which said "to confirm the
 23 trading agreement I would summarise the main elements as
 24 follows" and then by summarising the elements of the
 25 agreement that they had sent to you and which you

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1 accepted had been sent to you, that that would convey to
 2 ITL the message that you had agreed to the terms set out
 3 in the trading agreement document?
 4 **A.** I had agreed to a combined package, however ITL wanted
 5 to break down that investment was how they wanted to
 6 proportion it, but I expected that bottom line number to
 7 come in.
 8 **MR WILLIAMS:** Madam, I'll just make the point that we now
 9 run into the difficulty that Mr Owen's evidence is --
 10 **THE CHAIRMAN:** Well, wait a minute. When you said that you
 11 accepted that you had seen the expanded, if I can call
 12 it that, terms of the trading agreement, is that what
 13 you were sent at tab 14?
 14 **MR WILLIAMS:** It's the same document, madam, with
 15 a letterhead.
 16 **THE CHAIRMAN:** So looking at tab 14, you were sent that by
 17 Martin Goodall; is that right?
 18 **A.** Yes.
 19 **THE CHAIRMAN:** Then you wrote back the letter at tab 16, but
 20 you say without enclosing the last four pages of this?
 21 **A.** That's correct, madam.
 22 **THE CHAIRMAN:** But as far as you were concerned, what
 23 mattered was the numbers, that was your job, and what
 24 the details of what would need to be done to get that
 25 money was for other people to organise; is that a fair

1 summary?
 2 **A.** That's correct, madam.
 3 **MR WILLIAMS:** Do you accept that ITL would have read this
 4 letter as appearing to confirm your agreement to the
 5 expanded document?
 6 **A.** The letter was to confirm what I expected to be
 7 delivered as part of the revised terms on a cash basis.
 8 **Q.** That doesn't answer the question, I am afraid. Do you
 9 accept that ITL would have read this letter as
 10 confirming your agreement to the terms of the expanded
 11 document?
 12 **A.** I don't know.
 13 **Q.** You didn't think about that?
 14 **A.** No. The priority for me was to put a letter together
 15 which, on agreeing a final sum, delivered that sum. How
 16 ITL then wanted to break that money down was down to
 17 them.
 18 **Q.** I think your evidence in relation to the next letter we
 19 are about to look at is that it was carefully crafted.
 20 Would you say that this letter was carefully crafted?
 21 **A.** When you say carefully crafted, it was just to summarise
 22 the terms, the monies that were expected, so that we
 23 could move on and get on with trading.
 24 **MR WILLIAMS:** Madam, I just wanted to make the point that we
 25 now run into a slight difficulty which is that this

1 isn't the basis on which Co-op has made its appeal, it's
 2 made its appeal on the basis that the trading terms are
 3 the trading terms, but I'll carry on cross-examining
 4 Mr Owen on the basis of the evidence he has given.
 5 Could you turn to 15/17, please. {D15/17}. Are you
 6 familiar with this letter?
 7 **A.** Yes, I am, yes.
 8 **Q.** Let's ask you a few questions about the background to
 9 the letter. This is a letter from Mr Goulthorp.
 10 Mr Goulthorp told us on Tuesday that when this letter
 11 was sent he had never seen the terms of the trading
 12 agreement we were just looking at. The expanded
 13 document, I beg your pardon, the four page document.
 14 **THE CHAIRMAN:** He says he had seen the letter, your letter,
 15 but not the document behind it in that tab.
 16 **A.** Okay.
 17 **MR WILLIAMS:** He said that there was a first draft of the
 18 document and although he didn't actually say this, the
 19 implication was that he didn't do the first draft. So
 20 did you do the first draft of this letter?
 21 **A.** I can't remember. I believe that from memory it would
 22 have been a joint -- we would have got together and
 23 crafted this letter together.
 24 **Q.** Could you keep a finger in this tab -- in fact, do you
 25 want to read the second paragraph of the letter.

1 (Pause)
 2 When you have read that paragraph, keep a finger
 3 there and turn back to tab 16, and to the last but one
 4 page which has the words "Pricing and Promotion", about
 5 a third of the way down. Do you see that?
 6 **A.** Yes.
 7 **Q.** So can you read the first paragraph under "Pricing and
 8 Promotion".
 9 (Pause)
 10 You say that the paragraph of your letter, which
 11 says "recognise the need to maintain price differentials
 12 against the competing segments of the tobacco category"
 13 has nothing to do with effectively the parties and
 14 differentials, the strategic pricing differentials
 15 described in this paragraph.
 16 **A.** No, it doesn't.
 17 **Q.** Would you agree that the language of the letter picks up
 18 the language of the agreement in that first paragraph of
 19 this section? The language "price differentials across
 20 the competing segments of the tobacco category" looks
 21 pretty similar to the words "pricing differentials
 22 across all segments of the tobacco category"; it's
 23 basically the same words?
 24 **A.** The wording is similar.
 25 **Q.** So when you wrote the letter of 9 July 2002 with

1 Mr Goulthorp, would you accept that you picked up the
 2 language of the paragraph, the first paragraph under
 3 "Pricing and Promotion" on purpose to convey
 4 a particular message to ITL?
 5 **A.** No, I wouldn't. Again, because we would have written
 6 the letter based on what we expected and pricing to us
 7 was about mid-tier, premium, low price.
 8 **Q.** Well, that's what you say in your witness statement, but
 9 can we just probe that a bit, please, because what the
 10 letter says is:
 11 "Price differentials across the competing segments
 12 of the tobacco category."
 13 So I think what you are saying is premium is
 14 a segment, and you want to maintain differentials across
 15 each segment; is that right?
 16 **A.** Retail segments, so there are different store formats,
 17 so we have superstores, market town and convenience.
 18 **Q.** Sorry, I thought in your witness statement you were
 19 saying that the segments were premium and mid -- perhaps
 20 just look back at that.
 21 **THE CHAIRMAN:** Perhaps just to ask you: what did you mean by
 22 competing segments of the tobacco category?
 23 **A.** That would be premium, mid, low tier. So the various
 24 elements of cigarette in terms of customer profile.
 25 **MR WILLIAMS:** Maintaining differentials across those

1 segments would mean maintaining differentials within
 2 each segment?
 3 **A.** It would mean that you wouldn't want to position
 4 a premium product at a value level, for example, or
 5 overprice a value product that means that customers stop
 6 buying that value product.
 7 **Q.** But that's maintaining differentials between the
 8 segments, not across the segments?
 9 **A.** That's between, yes.
 10 **Q.** But the letter says "Across the segments"?
 11 **A.** That's not what we would have done. The way in which it
 12 was done to make sure that we protect the very clear
 13 segmentation on cigarette branding between --
 14 **THE CHAIRMAN:** So do you think that the premium brands are
 15 a competing segment then with the budget or ultra low
 16 brand?
 17 **A.** Not necessarily a competing segment, but it's important
 18 that from attracting the right customers in the right
 19 store format you have the balance right in terms of
 20 where you position your price.
 21 **THE CHAIRMAN:** But here you do say "Across the competing
 22 segments of the tobacco category".
 23 **A.** Well, might be a slip in the wording.
 24 **MR WILLIAMS:** It's not a slip in the wording, though, is it?
 25 You have picked up the language from tab 16 and now you

1 are giving it a different interpretation?
 2 **A.** When we drafted the letter we would not have drafted the
 3 letter based on the detail of the agreement, because, as
 4 I've said, the most important thing for me as part of
 5 the negotiation was to secure and agree funding the
 6 actual amount. So I wouldn't have been looking at that
 7 in any detail.
 8 **DR SCOTT:** Mr Owen, can you explain something to me: what's
 9 your perception of customer behaviour in relation to
 10 purchasing a product like this, it needn't necessarily
 11 be this sort of product, is your perception that
 12 a customer comes into the store not sure whether they
 13 want a premium cigarette, or a medium cigarette or a low
 14 cigarette, and looks at the pricing and decides which
 15 category to buy? Is that your perception of customer
 16 behaviour?
 17 **A.** My perception is customers are generally fairly brand
 18 loyal.
 19 **DR SCOTT:** So if they are brand loyal then the pricing
 20 doesn't matter terribly much?
 21 **A.** It would do based on where we are in relation to our
 22 competitive set, so in terms of comparing ourselves to
 23 [redacted] so our larger stores we have to make sure we are
 24 in line with [redacted] our convenience stores, we would
 25 want to make sure we are in line with [redacted] or

1 [redacted]; and the mid-tier mid-sized stores, we would
 2 want to make sure we are in line with [redacted].
 3 **DR SCOTT:** Okay, so a price conscious customer wanting to
 4 buy a particular tobacco product has in mind the
 5 relativity between stores, and that matters to you
 6 because you are concerned with building Co-op's market
 7 share; is that right?
 8 **A.** Yes.
 9 **DR SCOTT:** If for a moment you put yourself into the mind of
 10 the recipient of your correspondence, would you believe
 11 that on the Gallaher side or on the ITL they were
 12 concerned with market share?
 13 **A.** I think what I am saying now, I wasn't that close to it
 14 at the time, so --
 15 **DR SCOTT:** No, no, forget for a moment how close you are to
 16 tobacco in particular. You are an experienced Co-op
 17 person, you have been there since -- how long?
 18 **A.** 12 years with this particular group, yes.
 19 **DR SCOTT:** So you are used to what we have called
 20 inter-retailer competition?
 21 **A.** That's correct, yes.
 22 **DR SCOTT:** And from that, I imagine you can understand
 23 inter-producer competition?
 24 **A.** Yes.
 25 **DR SCOTT:** So would it surprise you if your suppliers were

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1 concerned about the price differential between their
 2 brand and what they see as a competitor brand?
 3 **A.** It wouldn't surprise me.
 4 **DR SCOTT:** It wouldn't surprise you? So you might expect
 5 both ITL and Gallaher to be really quite interested in
 6 whether their brand is at parity or differential with
 7 their rival brand?
 8 **A.** I think what was paramount for the cigarette companies,
 9 as with any manufacturer or supplier of goods, is to
 10 drive volume and market share.
 11 **DR SCOTT:** Yes. We understand that. If we look at the
 12 document to which you are referring, if we go back to
 13 your top level for a moment, in your letter, we can see
 14 from the numbers that we aren't reading out that range
 15 and planogram compliance and support of a particular
 16 brand have quite a lot of money attached to them. But
 17 there is another item which gets a lot of money attached
 18 to it, about half the money, and that seems to be
 19 concerned with pricing information of particular brands.
 20 Would that resonate with your feelings about interbrand
 21 competition?
 22 **A.** Again, I wouldn't be close to the detail on that.
 23 **DR SCOTT:** Yes, but you are an experienced person in the
 24 Co-op, forget for a moment about whether it's tobacco.
 25 **A.** The most important thing was being competitive with our

1 competitive set, so making sure that the buyer had
 2 a flexibility to follow the price strategy that we had
 3 and made sure that, with whatever size store we had, we
 4 were in line with, whether it be [redacted] or
 5 convenience sector.
 6 **DR SCOTT:** Yes, so if that really matters to you as
 7 a retailer in terms of inter-retailer competition, might
 8 it not matter to a supplier, price relativities in
 9 relation to intersupplier, interbrand competition?
 10 **A.** I don't know what would be their driver. I don't know
 11 what was more important to them.
 12 **DR SCOTT:** Would this document have helped you to understand
 13 their priorities, that you have been negotiating?
 14 **A.** Yes, it would, but that wasn't my priority, my priority
 15 was --
 16 **DR SCOTT:** Getting money.
 17 **A.** Getting the money, yes.
 18 **DR SCOTT:** Okay, thank you.
 19 **MR WILLIAMS:** I think a few moments ago before Dr Scott
 20 asked you some questions, you said that the second
 21 paragraph of the letter at tab 17 contained a slip of
 22 the drafting. Could you read the third paragraph of the
 23 letter, please.
 24 (Pause)
 25 Could you then turn back to tab 16, and read the

1 second paragraph under "Pricing and Promotion".
 2 (Pause)
 3 Do you want to read what you said about that
 4 paragraph of the letter in your witness statement,
 5 paragraph 5.5(b). I am particularly interested in the
 6 last sentence.
 7 (Pause)
 8 **A.** Okay.
 9 **Q.** So you say that parities and differentials could in
 10 principle have been within the scope of this paragraph.
 11 I am not sure what you mean by that, but I think what
 12 you are saying is that the words --
 13 **THE CHAIRMAN:** Ask him what he means by that.
 14 **MR WILLIAMS:** The words of the paragraph do refer to P&Ds by
 15 tying into the agreement we have just been looking at,
 16 but you were thinking about something else, so that's
 17 not what it means?
 18 **A.** No, what that refers to is where we would put competing
 19 segments of the retail market, [redacted]
 20 [redacted]
 21 [redacted]
 22 **Q.** Are we looking at the same paragraph?
 23 **A.** Yes.
 24 **Q.** "This payment is agreed to reward the consistent price
 25 disciplines"?

1 **A.** Yes.
 2 **Q.** Okay. So I am sorry for interrupting.
 3 **A.** My understanding at the time was that convenience stores
 4 where there was an opportunity to increase retail price,
 5 we would do, and if manufacturers would pay bonuses to
 6 support promotional activity and in certain sectors of
 7 the business we were taking the opportunity to move
 8 retails up to enhance margin, then that was seen as
 9 an issue.
 10 **Q.** Sorry, are we talking about the paragraph of the letter
 11 that says:
 12 "In addition, the price guidelines will ensure that
 13 consistent price disciplines are applied by CRTG across
 14 the price bands currently operated"?
 15 **A.** Yes.
 16 **Q.** The agreement says:
 17 "The payment is agreed to reward the consistent
 18 price disciplines offered by CRTG within the current
 19 three price bands currently operated."
 20 So the language is pretty similar?
 21 **A.** Again --
 22 **Q.** I am just putting to you that the language is pretty
 23 similar?
 24 **A.** It looks similar, yes.
 25 **Q.** You say in your witness statement that P&Ds could in

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1 principle have been within the scope of this paragraph,
 2 but it wasn't an issue for you, and I am trying to ask
 3 you what you mean by that. Are you saying that P&Ds are
 4 within the language you used within the letter but you
 5 weren't thinking about P&Ds?
 6 **A.** We weren't thinking about P&Ds, we were thinking about
 7 the issue regarding the convenience estate where if
 8 there was an opportunity to increase retails, we would
 9 do.
 10 **Q.** So are you accepting that the language, just reading it
 11 on the page, does cross-refer to P&Ds by picking up the
 12 language of the trading agreement? Is that what you
 13 mean by "could in principle be within the scope of this
 14 paragraph"?
 15 **A.** (Pause). No, my view was, working with Mike to craft
 16 this letter, that parity and differentials was nothing
 17 to do with it.
 18 **Q.** What do you mean by "could in principle have been within
 19 the scope of this paragraph"?
 20 **A.** (Pause). If you look at the, my statement says that
 21 this statement is simply intended to give ITL some
 22 further comfort, and the reason being is again because
 23 we were, if the opportunity arose in the convenience
 24 sector, taking the opportunity to increase retail price
 25 and that might have been against bonuses that were being

1 offered, so it was an opportunity to enhance margins.
 2 **Q.** But how does that tie into "could in principle have been
 3 within the scope of this paragraph"?
 4 **A.** (Pause). Not sure.
 5 **MR WILLIAMS:** Madam, I don't know if that's a convenient
 6 moment.
 7 **THE CHAIRMAN:** Well, let me just put one possible
 8 explanation as to what you said, which is that when you
 9 were writing this letter with Mr Goulthorp, you used
 10 that language thinking, "Well, ITL may read this as us
 11 saying that we will pay some attention to their P&Ds
 12 their parities and differentials, between their brands
 13 and Gallaher brands, and if they read it like that,
 14 well, then, that's fine with me, but we have drafted it
 15 in a way which is sufficiently vague that actually we
 16 could later say 'oh, no, we weren't committing to comply
 17 with your P&Ds'.
 18 Is that sort of what you were thinking at the time?
 19 **A.** The way in which we crafted the letter was to ultimately
 20 give the buyer complete flexibility to do what the buyer
 21 needed to do to meet our pricing policy.
 22 **THE CHAIRMAN:** Yes, but what you were -- when you say in
 23 paragraph 5.5(b) "it was intended to give ITL some
 24 further comfort", comfort about what?
 25 **A.** Comfort about the way in which the monies were targeted,

1 how they were going to justify their spend to their
 2 accountants, or ...
 3 **THE CHAIRMAN:** Okay. That's probably a good point to break.
 4 We will come back, then, at five past 2.
 5 Mr Owen, you are in the middle of giving your
 6 evidence, so you mustn't discuss the case or your
 7 evidence with anybody else over the break. Do you
 8 understand?
 9 **A.** Yes.
 10 (1.05 pm)
 11 (The short adjournment)
 12 (2.05 pm)
 13 **THE CHAIRMAN:** Yes, Mr Williams.
 14 **MR WILLIAMS:** Good afternoon, Mr Owen.
 15 Before lunch we were looking at the letter of
 16 9 July. Do you still have that?
 17 **A.** Just give me the tab again, please.
 18 **Q.** It's tab 17.
 19 **A.** Yes.
 20 **Q.** I was putting to you that the second paragraph, which
 21 says:
 22 "In terms of the price differentials we are
 23 currently putting to the a price matrix for CRTG which
 24 defines our strategic pricing position. This document
 25 [ie the price matrix] will recognise the need to

1 maintain price differentials across the competing
 2 segments of the tobacco category."
 3 I was putting to you that that is a reference to the
 4 four page trading agreement which we see at the previous
 5 tab. Against that background, could you read the
 6 paragraph which starts:
 7 "The price matrix will recognise pricing
 8 opportunities."
 9 (Pause)
 10 So this is saying that the price matrices will also
 11 reflect the Co-op's policy. Perhaps I'll leave the word
 12 "also" out for the time being so we can keep it
 13 uncontroversial.
 14 "The price matrices will reflect Co-op's own pricing
 15 policy which is that the convenience stores will price
 16 at a higher level to try and make an improved margin,
 17 but the superstores and the market towns will price
 18 against their competitive set."
 19 Do you agree with that?
 20 **A.** The price matrix was designed to ensure that we remained
 21 in line with the market, ie [redacted], and
 22 [redacted].
 23 **Q.** That's the only paragraph of this letter that's about
 24 the Co-op's own pricing strategy, isn't it?
 25 **A.** (Pause). The second paragraph also makes reference to

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1 the price matrix as well.
 2 **Q.** What I am putting to you is that reading the second and
 3 fourth paragraphs together, what you are telling ITL is
 4 that the prices in the price matrix will reflect both
 5 Co-op's own strategy and ITL's strategy of pricing in
 6 accordance with ITL's strategic pricing differentials?
 7 **A.** The way in which the letter was constructed was to give
 8 ITL a degree of comfort, the most important thing was to
 9 ensure that in putting this together our pricing policy
 10 was the most important thing.
 11 **Q.** Can we move to the penultimate paragraph. Do you want
 12 to read that to yourself, which is "therefore, based on
 13 the above ..."
 14 (Pause)
 15 **A.** Okay.
 16 **Q.** What you say in your statement about this is -- do you
 17 want to look at it? It's 5.5(d). It says:
 18 "We are confirming in writing that the
 19 implementation of CGL's own pricing policy as set out in
 20 the letter will mean that it is still entitled to offer
 21 invoice support and the pricing promotion payments."
 22 But that isn't what the letter says. The letter
 23 says "therefore based on the above" and "the above" is
 24 everything that's above, including the references to the
 25 maintenance of pricing differentials.

1 **A.** The way in which that was constructed was, again, to
 2 ensure that we had a flexibility to price as we felt
 3 necessary to remain competitive within the market within
 4 the various segments, ie [redacted] [redacted] and
 5 [redacted] when we were matching against, and we were
 6 giving ourselves the flexibility in that letter to be **CGL**
 7 able to do what we wanted to, to -- **Confidential**
 8 **Q.** What it says is:
 9 "We are confident we have satisfied the requirements
 10 to ensure the payment of the ongoing invoice for
 11 discount to the negotiated central payments in respect
 12 of pricing and promotion."
 13 Do you agree that the central payments in respect of
 14 pricing and payments are the payments for compliance
 15 with strategic pricing differentials under the four page
 16 trading agreement I showed you?
 17 **A.** One of the issues that the manufacturers would have is
 18 if we were receiving bonuses to give, to do promotions,
 19 and we took money to do promotions and then we chose,
 20 for whatever reason, that we wanted to move prices up,
 21 they would have an issue with that.
 22 **Q.** What are the central payments in respect of pricing and
 23 promotion?
 24 **A.** So if the buyer was given bonuses to do specific
 25 promotional activity, but the buyer would also want the

1 flexibility maybe that in a convenience sector he didn't
 2 necessarily want to drop price that far, he may want the
 3 flexibility to increase price.
 4 **Q.** Those bonuses weren't central, though, were they? Those
 5 bonuses resulted in a reduction in the wholesale price?
 6 **A.** I am not sure in terms of the actual mechanics because
 7 I wasn't that close to the detail.
 8 **DR SCOTT:** Sorry, perhaps you can help me: I looked at the
 9 document at the back of 15/16, and I understand its
 10 terms in terms of pricing and promotion by point of
 11 sale, and it may help you to know that in looking at the
 12 pricing matrix we have seen periods where, in accordance
 13 with the agreement -- let's go to it for a moment and
 14 you will see what I mean. If you go back a page or two
 15 to that page with "pricing and promotion", it is in
 16 15/16. Okay?
 17 **A.** Yes.
 18 **DR SCOTT:** We have seen in the pricing matrix that there are
 19 against particular promotional periods times when point
 20 of sale material was being used without necessarily the
 21 price changing at all, in accordance with the provisions
 22 of this document on pricing and promotion. Now, what's
 23 not clear to me from looking at this document is how
 24 this document relates to bonus schemes which I don't
 25 find mentioned here, maybe I missed it, but I don't find

1 the bonusing for price promotions mentioned in here.
 2 What I do find is what I expect to find, which is the
 3 point of sale material that we see referred to in the
 4 pricing matrix. Can you explain to me where I find the
 5 bonusing in this section?
 6 **A.** I can't, I am sorry, because I wouldn't be that close to
 7 the detail of it.
 8 **DR SCOTT:** So when you say that it's referring to bonusing,
 9 that's a guess?
 10 **A.** It might be in the terminology. I am not sure to the
 11 detail, other than negotiating a set amount broken down
 12 against set criteria from a day-to-day basis, I wouldn't
 13 be close to what bonuses were available for what
 14 activity.
 15 **DR SCOTT:** Yes, but is this document dealing with price
 16 promotional bonusing? Because I don't find that in this
 17 document. I find other things in this document, but
 18 I don't find bonusing on price promotional bonuses.
 19 **A.** My recollection -- I don't know. I don't know.
 20 **DR SCOTT:** Okay, thank you.
 21 **MR WILLIAMS:** What the letter says, Mr Owen, is that you are
 22 confident that you have satisfied the requirements to
 23 ensure payment of ongoing off-invoice support discounts
 24 and negotiated central payments in respect of pricing
 25 and promotion, and that means and says that Co-op was

1 satisfying the requirements. We see in tab 16, which
 2 include requirements in relation to parities and
 3 differentials.
 4 **A.** The letter was not constructed in that way. The letter
 5 was constructed in such a way as to give ITL a degree of
 6 comfort as to how we wanted the money delivering, not
 7 against something specific in the contract.
 8 **THE CHAIRMAN:** So what did you understand by "requirements"
 9 there? What requirements were you referring to?
 10 **A.** The biggest concern that was brought to my attention was
 11 the fact that we did our own thing on pricing, so where
 12 certain bonuses were paid, the buyer chose to do what
 13 the buyer felt necessary. So in some ways taking money
 14 from the supplier but not necessarily investing or
 15 passing that on in a certain store or group of stores.
 16 **THE CHAIRMAN:** Are you talking there about the short-term
 17 tactical bonuses for particular products?
 18 **A.** It might have been, or it might have been more general,
 19 I don't know because again I wasn't close enough to it,
 20 Madam Chairman.
 21 **DR SCOTT:** In the paragraph above where it refers to mutual
 22 benefits, what benefits did you have in mind to ITL?
 23 **A.** The mutual benefits would be that on the back of
 24 bringing United Co-operatives' volumes into our estate,
 25 they would benefit from providing that incremental

1 volume to us through one contact point.
 2 **MR WILLIAMS:** Mr Owen, this letter is not consistent with
 3 the view that the Co-op thought that it was entitled to
 4 payment of these central payments in respect of pricing
 5 and promotion irrespective of whether it complied with
 6 ITL's requirements.
 7 **A.** (Pause). Sorry, can you --
 8 **Q.** That's a question.
 9 **A.** Sorry, can you rephrase that? Sorry.
 10 **Q.** This letter is not consistent with the idea that the
 11 Co-op believed it was entitled to payment of negotiated
 12 central payments in respect of pricing and promotion
 13 regardless of whether it satisfied ITL's requirements?
 14 **A.** The way in which the negotiations were conducted is that
 15 we would expect the payments to be made.
 16 **Q.** Can we go back, then, to tab 16, please, and to the
 17 section headed "Pricing and Promotion". I think you
 18 have accepted that you had this document or you had seen
 19 this document at the time of these various exchanges of
 20 correspondence?
 21 **A.** Sorry, which tab?
 22 **Q.** Tab 16, and the last but one page, the heading "Pricing
 23 and Promotion", the section we have been looking at.
 24 I can't remember if I asked you if you wanted to read
 25 that whole section before lunch. Do you want to read it

1 again? I am going to ask you a few questions about it.
 2 **A.** Again, as I've said earlier, I wouldn't have been
 3 involved in the detail of that.
 4 **Q.** Sorry, but I just asked you if you could remember
 5 whether you had seen the document at the time, for
 6 example, of the letter we have just been looking at?
 7 **A.** Are you referring to my letter or the --
 8 **Q.** I am referring to both this letter and the letter at
 9 tab 17, which is written four days later. I am just
 10 asking you whether you remember whether you had seen --
 11 **THE CHAIRMAN:** Are you referring to the letter or the --
 12 **MR WILLIAMS:** I am asking you whether you had seen the four
 13 page document headed "CRTG Trading Agreement 2002".
 14 **A.** I may have seen it.
 15 **Q.** You don't recall whether you had seen it?
 16 **THE CHAIRMAN:** I thought you had said that you had seen the
 17 one that was sent to you at tab 14, which is the same
 18 thing sent earlier.
 19 **MR WILLIAMS:** That was my understanding, madam, yes.
 20 **A.** Sorry, yes. Yes.
 21 **Q.** So you understood that this set out what ITL was seeking
 22 to achieve at the time, as regards pricing and
 23 promotion?
 24 **A.** Yes, but I wouldn't have got involved in the detail.
 25 That was not my remit to go down to that level.

1 **Q.** But it was your remit to negotiate the trading agreement
 2 with ITL; that was your remit?
 3 **A.** That's correct.
 4 **Q.** And that is what ITL is putting forward as the terms of
 5 a trading agreement?
 6 **A.** Yes, but one of the things we tried to avoid is getting
 7 dragged down into the detail and thus tying the hands of
 8 the buyer.
 9 **Q.** That's different from saying it's not part of your
 10 remit?
 11 **A.** My remit was to negotiate terms at top level, at a very
 12 high level, and not necessarily get dragged down to the
 13 detail of specific elements of the agreement.
 14 **THE CHAIRMAN:** But would you count what's set out here as
 15 a level of detail lower than you were concerned with?
 16 **A.** Yes.
 17 **MR WILLIAMS:** I am going to ask you some questions about
 18 some of the provisions of this. You see in the first
 19 paragraph it says:
 20 "A copy of the agreed differentials is attached."
 21 There is a heading "Pricing and Promotion", first
 22 paragraph?
 23 **A.** Yes.
 24 **Q.** The last sentence:
 25 "A copy of the agreed differentials is attached".

1 A. I see that, yeah.
 2 Q. Do you remember whether there was an agreed schedule?
 3 A. I never remembered seeing a schedule.
 4 Q. So when ITL says they are agreed differentials, as far
 5 as you are concerned they weren't agreed?
 6 A. I would have known -- I didn't see a schedule which,
 7 again, I didn't pay that much detail to that.
 8 Q. You didn't think you should write back and say "There
 9 are no agreed differentials"?
 10 A. Well, I wouldn't write back because I wouldn't have paid
 11 that much attention to the detail, I wasn't close enough
 12 to it.
 13 Q. Do you have an understanding of what "the agreed
 14 differentials" is a reference to?
 15 A. No. I don't know.
 16 Q. You didn't understand it as a reference to ITL's
 17 strategy of maintaining differentials between its
 18 products and Gallaher's products?
 19 A. I wasn't aware.
 20 Q. As part of this remit, did you look at the 2001 trading
 21 agreement?
 22 A. I can't remember if I did.
 23 Q. So you conducted negotiations, I think you are saying,
 24 with ITL without paying the slightest bit of attention
 25 to the detail of anything that ITL was putting to you

1 for comment?
 2 A. The way in which we conducted the negotiations is that
 3 your finance team would analyse the numbers in terms of
 4 what they believed I should be targeting with trying to
 5 secure on behalf of the business. And basically being
 6 true to how we ran the negotiations, with not wanting to
 7 get sucked down into the detail, to keep it at very top
 8 level, we wouldn't -- we would avoid looking at what had
 9 gone on before but concentrate on the opportunities
 10 going forward.
 11 MR SUMMERS: Mr Owen, in tab 16, in the trading agreement
 12 documents which form part of that tab, there is some
 13 handwriting. Can you identify the handwriting?
 14 A. I cannot, no, sir.
 15 MR SUMMERS: Thank you.
 16 MR WILLIAMS: I think we looked at paragraph 4.3 of your
 17 witness statement earlier on, and you said that you
 18 envisaged that there would be discussions between ITL
 19 and the buyer, Mr Newton, about its promotional
 20 objectives and ITL seeking to influence the buyer. Do
 21 you remember that?
 22 A. Yes.
 23 Q. How could there have been any discussions between ITL
 24 and the buyer if there hadn't been agreed differentials
 25 at this time, as the agreement records?

1 A. I was referring to discussions that would take place
 2 with the buyer on a day-to-day basis, as part of
 3 planning activity, and that was it.
 4 Q. These are ITL's objectives, this is setting out ITL's
 5 objectives, this is setting out what ITL wants to talk
 6 to the buyer about?
 7 A. Yes, but the buyer, I can't speak for the buyer, the
 8 buyer would do what the buyer felt necessary to drive
 9 sales and improve margin.
 10 Q. That wasn't really what I was putting to you. What
 11 I was putting to you was if there is going to be
 12 a discussion about this, then it is going to have to be
 13 a discussion about something with content. So there
 14 must have been a schedule?
 15 A. I don't know, I haven't seen one.
 16 Q. Could you have a quick look at the last line of
 17 paragraph 4.4 of your witness statement, it's the last
 18 line I am interested in.
 19 A. Yes.
 20 Q. So I think here you say:
 21 "As manufacturers were paying for discounts, they
 22 were naturally keen to ensure that the full benefit was
 23 passed on to consumers."
 24 I'm just wondering what's different about parities
 25 and differentials?

1 A. That would be referring to the example that I've already
 2 been giving where suppliers would be paying for activity
 3 and the buyer might have been taking bonuses but
 4 deciding that in, say, convenience stores didn't want to
 5 necessarily pass all that onto the consumer and may take
 6 the opportunity to enhance the profit. So from
 7 a cigarette manufacturer's point of view, they might be
 8 a bit aggrieved paying money and for a retailer not
 9 necessarily investing in that product.
 10 THE CHAIRMAN: I think what Mr Williams is asking is: why
 11 wouldn't they be similarly aggrieved if they were paying
 12 you these sums of money that we are looking at and you
 13 didn't comply with the P&Ds?
 14 A. I don't know, it wasn't a discussion, from my
 15 perspective.
 16 MR WILLIAMS: It plainly was a discussion, Mr Owen. The
 17 discussion is in the documents that are being sent to
 18 you.
 19 A. Yes, but even though it's in the documents, it doesn't
 20 mean to say that I would discuss them. As I've said,
 21 I would not get drawn down to the detail.
 22 THE CHAIRMAN: Why would you not get drawn down to the
 23 detail?
 24 A. Because the strategy was to negotiate at top level and
 25 not get -- the strategy was to take the negotiation away

1 from the buyer, we believed that by doing that and
 2 negotiating at top level, we would be taking the
 3 suppliers out of their comfort zone and we felt that
 4 that strategy could be quite useful to help get more
 5 money, and to do that, if I was to get drawn down into
 6 the detail, I effectively become doing what the buyer
 7 does.
 8 **THE CHAIRMAN:** But how can you be aiming to protect the
 9 buyer's flexibility by appearing to sign up to terms
 10 which you hadn't investigated and didn't know what it
 11 was that ITL thought you were agreeing to do? I don't
 12 quite see how that protects the flexibility of the
 13 buyer.
 14 **A.** The way in which the deal was done is when it was signed
 15 off, I would envisage that the buyer would have
 16 discussions with the manufacturers about what the buyer
 17 wanted to do to take the business forward. That's why
 18 the way the letter was written was very, very top line.
 19 **MR WILLIAMS:** Could you turn back to tab 14, please,
 20 Mr Owen. This is a letter to you from Mr Goodall, and
 21 it says:
 22 "Dear Mark, thank you for the opportunity last week
 23 for Roger Batty and myself to present the Imperial
 24 trading agreement for the CRTG group. I hope you found
 25 the meeting as constructive and informative as we did.

1 As promised, please find below confirmation of the
 2 agreement we discussed. I have attached the agreement
 3 that formed the main agenda of the meeting. This is
 4 unchanged from the copies we worked through."
 5 So do you say you did not have a discussion with ITL
 6 about the contents of the documents that are attached to
 7 that letter?
 8 **A.** It's a long time ago. I mean, they may have put the
 9 documents in front of me, but again, whilst I might have
 10 looked through them, I wouldn't have necessarily tied
 11 myself down, I do not want to use the phrase, paid lip
 12 service to it, what was important for me is to make sure
 13 that I secured the bottom line number.
 14 **THE CHAIRMAN:** But it says here, reading this, it looks as
 15 if the agreement was on the table at the meeting and you
 16 worked through it, that's the phrase that Mr Goodall
 17 means, which one might think meant went through it
 18 paragraph by paragraph saying "Is this okay with you?
 19 Is this agreed?"
 20 **A.** It might have been that in terms of the way in which we
 21 wanted the money structuring, the breakdown of where
 22 they were going to apportion certain elements of the
 23 funding to arrive at the final total which we required.
 24 **MR SUMMERS:** Sorry, are you suggesting the total was built
 25 up, then, I mean, it was a bottom-up total? I thought

1 from your earlier evidence it was a top-down total, in
 2 other words the figure was then subdivided as they
 3 wished?
 4 **A.** That's right, yeah.
 5 **MR SUMMERS:** But you are suggesting now its built up, you
 6 say, "to arrive at" was the phrase you used, the final
 7 total?
 8 **A.** No, I would have been given a target to go for a cash
 9 sum or a percentage increase, it would be down to -- and
 10 I would have discussed that with the manufacturers.
 11 Then it would be down to them to decide, based on
 12 certain -- the way in which they wanted to cut the money
 13 to arrive to meet the requirements of their accountants
 14 where they would want to apportion that money.
 15 **DR SCOTT:** Mr Owen, can you turn back in your witness
 16 statement to paragraphs 2.8 and 2.9 and just read them
 17 through to yourself.
 18 (Pause)
 19 Okay?
 20 **A.** Yeah.
 21 **DR SCOTT:** What I understand you to be saying is that you
 22 did expect a quid pro quo; that's what you say in
 23 paragraph 2.8. Then:
 24 "In the case of our agreements with Gallaher and
 25 ITL, promotional activities included", and then you list

1 down a list which includes at (c) pricing/promotion.
 2 Then in 2.9 you say:
 3 "CGL were prepared to accept the inclusion of such
 4 promotional objectives in the trading agreements."
 5 Is that right?
 6 **A.** Yeah.
 7 **DR SCOTT:** So when you were taken through the agreement at
 8 the meeting referred to in the letter at tab 14, that
 9 would entirely tie in with what your witness statement
 10 says in paragraph 2.8?
 11 **A.** Yes.
 12 **DR SCOTT:** And then you say you were prepared to accept the
 13 inclusion of such promotional objectives in the trading
 14 agreements?
 15 **A.** Yes.
 16 **DR SCOTT:** So you wouldn't be surprised by that then being
 17 reflected in the letter that came from Mr Goodall to you
 18 on 13 May?
 19 **A.** Yeah.
 20 **DR SCOTT:** Is what you are saying to us that during the
 21 meeting you didn't actually pay attention to the quid
 22 pro quo, but you only paid attention at a high level?
 23 Because in your witness statement here, it seems that
 24 you do actually refer to pricing and promotion, both in
 25 relation to ITL and Gallaher?

1 A. Yeah, I have stated in my witness statement the way that
 2 the monies had been broken down.
 3 DR SCOTT: No, no. You talk about the quid pro quo.
 4 A. Yeah.
 5 DR SCOTT: Now, the quid pro quo is not money, the quid pro
 6 quo are the things that you have listed, which include
 7 pricing and promotion. And as we understand it from
 8 tab 14, there is an explanation of what pricing and
 9 promotion means in tab 14.
 10 A. Yes.
 11 DR SCOTT: So what you are saying in your witness statement
 12 is that you were prepared, CGL was prepared to accept
 13 the inclusion of such objectives in the trading
 14 agreements --
 15 A. The elements for --
 16 DR SCOTT: -- quid pro quo for the money?
 17 A. The elements for pricing and promotions again would be
 18 what the buyer agrees for specific promotions, bonuses,
 19 whatever you want to call it.
 20 DR SCOTT: Sorry, you had been, as I understand it, taken
 21 through the document at tab 14.
 22 A. Yeah.
 23 DR SCOTT: The buyer wasn't there.
 24 A. I can't remember the detail of that meeting, but I would
 25 have not paid a lot of attention to the detail behind

1 the specifics because going forward, I couldn't actually
 2 deliver it.
 3 DR SCOTT: Apologies about this but can we just put this in
 4 a bit of context. You have been in the Co-op for
 5 12 years?
 6 A. Yes.
 7 DR SCOTT: And the Co-op, as I recall, has throughout that
 8 period traded on a principle of ethical relationships
 9 with its suppliers?
 10 A. That's correct.
 11 DR SCOTT: And you sought throughout that period
 12 continuously to improve relationships with suppliers?
 13 A. Take every case and every supplier on its own merit.
 14 DR SCOTT: Yes. In relation to your agreements with
 15 suppliers, you have expected to audit, as I understand,
 16 the performance of your suppliers, so that the nature of
 17 those relationships, on the ethical basis that the Co-op
 18 has been trading under and has made a great play of in
 19 its promotional material, has been that you expect
 20 suppliers to abide by the terms of agreements made
 21 between the Co-op and themselves, and that the Co-op
 22 expects to audit the performance of them, and then, as
 23 I understand it, ideally to engage in correctional
 24 behaviour rather than terminating agreements unless
 25 something is very serious.

1 Do I have that right?
 2 A. Yes, but going back to the time when this was done, my
 3 brief was to --
 4 DR SCOTT: No, no, I am just asking about the framework in
 5 which the Co-op operates.
 6 A. It will have changed. It varies from agreement to
 7 agreement.
 8 DR SCOTT: Sorry, are you saying that the Co-op's ethics
 9 change from one agreement to another?
 10 A. No, I am not saying the Co-op's ethics change.
 11 DR SCOTT: Let's stay with the Co-op's ethics for a moment.
 12 My understanding of the Co-op is it takes trading
 13 relationships very seriously.
 14 A. Yes, it does.
 15 DR SCOTT: It takes ethical performance of agreements very,
 16 very seriously.
 17 A. Yes, it does.
 18 DR SCOTT: Are you saying that this was an exception to
 19 taking the ethics of performing agreements seriously?
 20 A. Yes, I am.
 21 DR SCOTT: Thank you.
 22 MR WILLIAMS: Could you just have the letter at tab 16 open
 23 in front of you, Mr Owen. I am just going to put
 24 something very straightforward to you. This letter is
 25 not a trading agreement, it is not of itself trading

1 terms, that's clear on the face of the document, and
 2 that when you talk about the trading agreement in your
 3 witness statement and trading terms in the letter at
 4 tab 17, you are not just talking about this letter, you
 5 are talking about the terms of the four page document
 6 which ITL had presented to you which it was clear ITL
 7 wanted you to agree to and which had obviously been the
 8 subject of discussion and negotiation between you.
 9 That's what you understood to form the basis of the
 10 trading agreement between you and ITL, and it was quite
 11 clear to you under that agreement that the sums that
 12 were going to be paid for parities and differentials
 13 were not simply cash handouts, they were bonuses paid
 14 for the purposes of ensuring the Co-op adhered to ITL's
 15 strategy?
 16 A. No. This letter was drafted to basically say "That is
 17 the agreement as we see it" and the buyer would do what
 18 the buyer felt necessary to secure the funding, but that
 19 letter, my letter, was the trading agreement.
 20 Q. Can you turn to 15/21, please, Mr Owen. Do you want to
 21 just read the letter?
 22 THE CHAIRMAN: Are you moving on to a different point now?
 23 MR WILLIAMS: Yes. Well, more or less, madam.
 24 THE CHAIRMAN: Because there is a law of diminishing
 25 returns.

1 **MR WILLIAMS:** No, I am moving on from 2002. I did feel I had
2 to put the case, madam.
3 **THE CHAIRMAN:** Yes, absolutely.
4 **MR WILLIAMS:** Do you want to read that letter to yourself at
5 15/21.
6 (Pause)
7 I am not sure it's a different point, madam, it's
8 a different year.
9 **THE CHAIRMAN:** Perhaps we can take this a little more
10 quickly.
11 **MR WILLIAMS:** I hope so.
12 (Pause)
13 So this letter covers a range of matters relating to
14 Alldays and so on. I wanted to focus on one sentence on
15 the second page of the letter, where Mr Goodall moves on
16 to the subject of the 2003 trading terms and he says:
17 "The elements behind this payment will need to be
18 agreed but must cover all of the disciplines as covered
19 in the 2002 agreement."
20 So it was clear to you at that stage that when you
21 were talking about an agreement for 2003, it was going
22 to cover the same elements as the 2002 agreement?
23 **A.** Yes, but I would have not dug into the detail of that.
24 **Q.** Do you want to just turn over to the next page, do you
25 want to refresh your memory in relation to this email.

1 (Pause)
2 **A.** Sorry, is this the one from --
3 **Q.** This is an email from you, actually.
4 **A.** Okay. (Pause). Okay.
5 **Q.** So paraphrasing this email, I hope not unfairly, you are
6 unhappy because ITL seems to be mixing up the subjects
7 of pricing policy in Alldays and furniture in Alldays
8 and a discussion about the corporate trading terms,
9 which I understand is a reference to the trading
10 agreement?
11 **A.** No. This is about the fact that Alldays are operating
12 on significantly higher retails, and what I wanted to do
13 was make sure that I secured the best terms, despite the
14 fact that Alldays would be pricing at a different level
15 to the current Co-op group.
16 **Q.** I do understand that. One of the points you make here,
17 when you say:
18 "As I stated during our conversation, as far as we
19 are concerned, these subject matters are in no way
20 related to the corporate trading terms."
21 I thought one of the points that you are making is
22 that the discussion about these Alldays issues is
23 separate from your point of view from a discussion about
24 the trading agreement?
25 **A.** That's right.

1 **Q.** So the corporate trading terms are the trading
2 agreements?
3 **A.** Yes.
4 **Q.** So when a bit further down you say you should choose to
5 link them to the core terms package, you are talking
6 about the trading agreement then as well?
7 **A.** That's right, yeah.
8 **Q.** So here you characterise the trading agreement terms as
9 core terms?
10 **A.** Yeah.
11 **Q.** So that's not really consistent with the idea that this
12 is really just money for nothing, is it?
13 **A.** But this is about securing money for nothing.
14 **Q.** No, the core terms, the trading agreement, that's what
15 you are referring to when you talk about the core terms?
16 **A.** Yes.
17 **Q.** Yes, and I am saying if you talk about the terms of that
18 agreement as core terms of the relationship, that's not
19 really consistent with the idea that this is ITL just
20 giving you money for nothing, they are the core terms of
21 your relationship, pricing, promotions and all the other
22 things dealt with in the agreement?
23 **A.** Sorry, I am not clear of the point.
24 **Q.** You are describing the trading agreement as core terms,
25 not in a technical sense, you are just referring to it

1 as core terms.
2 **A.** Yeah.
3 **Q.** I am saying the idea that the terms of the agreement are
4 the core of your relationship, that's a very different
5 idea from, I think, the evidence you give, which is that
6 this is an unconditional payment?
7 **A.** Yes.
8 **Q.** Could you turn to tab 23, please, this is a letter from
9 Mr Goodall to you. Do you want to just read it through.
10 (Pause)
11 So at the start of the second paragraph, Mr Goodall
12 says:
13 "I understand your desire to separate the terms
14 discussion from the intended retail prices, but as you
15 will appreciate, a large element of the terms agreement
16 concerns retail price relationships within your stores."
17 There Mr Goodall is talking about parities and
18 differentials, isn't he?
19 **A.** No, he isn't. He is talking about the concern that he's
20 got because in Alldays, we had bought that business and
21 the retail prices were significantly higher than the
22 current Co-op business, and he was paying bonuses to the
23 Co-op group estate. Now, to basically transfer that
24 business to start supplying those stores he would feel
25 a bit aggrieved that we would be supplying the Alldays

1 estate on our terms, which were better, at significantly
 2 higher retail prices and not following any standard
 3 pricing tiers between our superstore, [redacted] and
 4 [redacted].
 5 **Q.** Are those matters dealt with in the trading agreement
 6 between you and ITL because that is what he is talking
 7 about?
 8 **A.** He is trying to link the two.
 9 **Q.** No, what he says is:
 10 "A large element of the terms agreements concerns
 11 retail price relationships within your stores."
 12 We have just been looking at what ITL meant by
 13 pricing and promotion when you were talking about this
 14 in 2002, and it's mostly parities and differentials with
 15 something about point of sale advertising material.
 16 **A.** No, his concern was about the Alldays estate.
 17 **Q.** Can you read the -- I just wanted to focus on the last
 18 two sentences of the third paragraph, starting with
 19 "I will expect all CRTG societies ..."
 20 (Pause)
 21 **A.** Yeah.
 22 **Q.** So Mr Goodall says "If you don't price in accordance
 23 with the matrix, I reserve the right to reduce invoice
 24 investment accordingly".
 25 **A.** Yes, again there were certain CRTG societies that quite

1 rightly would do what they wanted to do with retail
 2 price.
 3 **Q.** We have just seen from 15/17 that you were telling --
 4 sorry, that's the letter of 9 July -- ITL that the price
 5 matrices would reflect both your own strategy and the
 6 pricing differentials.
 7 So what this is saying is if you don't price in
 8 accordance with the matrix, which I understand is going
 9 to contain, amongst other things, compliance with the
 10 pricing differential, then I reserve the right to reduce
 11 the investment we are making in you on that basis?
 12 **A.** I can't comment on that, I don't know, I am not aware of
 13 the detail on the matrix.
 14 **Q.** This is a letter to you, you must have read it at the
 15 time and tried to understand it?
 16 **A.** CRTG societies were free to price as they saw fit based
 17 on --
 18 **THE CHAIRMAN:** Well, that's not the point. You produced
 19 this pricing matrix for them, they could ignore it or
 20 whatever they want. What we are focusing on is what was
 21 going to be included by CGL in the pricing matrix.
 22 That's what he is asking you about.
 23 **A.** Sorry, could you --
 24 **MR WILLIAMS:** Yes. We saw from the letter of 9 July that
 25 you were telling ITL that the price matrix was going to

1 reflect the pricing differentials so, when Mr Goodall
 2 says "If you don't comply with the matrix I reserve the
 3 right to reduce invoice investment accordingly", what he
 4 is getting at is if you don't do the things you have
 5 told ITL you will do, then he reserves the right to
 6 withdraw a bonus.
 7 **A.** This would be on promotional activity.
 8 **Q.** But you have told them the price matrix is going to
 9 contain prices which adhere to the pricing differentials
 10 as well?
 11 **A.** No, I don't ...
 12 **Q.** Could we look at the last sentence on this page.
 13 Perhaps you need to read it in the context of the
 14 paragraph that starts "On the subject of trading terms",
 15 actually.
 16 (Pause)
 17 **A.** Yes.
 18 **Q.** So again Mr Goodall is saying to you that the bonus you
 19 are going to be paid under the terms of the trading
 20 agreement is going to be based on the same activities as
 21 last year and he is going to tell you what the split is,
 22 he is going to allocate the money between them?
 23 **A.** I didn't see it as being the -- I saw it as just a way
 24 of apportioning money, breaking down over the --
 25 **Q.** He says he is going to confirm the split, so the split

1 is obviously meaningful?
 2 **A.** The split as in between the four core areas, but again
 3 I wouldn't have a say in how that was split, I was
 4 interested in the bottom line numbering.
 5 **Q.** I thought this was a negotiation?
 6 **A.** Yeah, it was.
 7 **Q.** Can you turn over to tab 24, please. So this is
 8 a letter which summarises the trading terms -- perhaps
 9 I shouldn't use the word "summarise", it is a word we
 10 looked at in the last document -- but it confirms the
 11 trading terms for the periods 1 January 2003 to 31
 12 December 2003 and all I am going to put to you again is
 13 that this document by itself doesn't contain meaningful
 14 trading terms, it doesn't say what's meant by, for
 15 example, pricing and promotions and so on and so forth,
 16 the only sensible way that you and Mr Goodall could have
 17 regarded this letter was as saying that "we have agreed
 18 a new sum of money for 2003 but it's going to be on the
 19 basis of the same terms as we had last year"?
 20 **A.** Again, I would have set this letter out as being top
 21 line and the buyer would have dealt with the detail
 22 below that.
 23 **THE CHAIRMAN:** The following page does go into some detail
 24 about other things, I don't know if you have those
 25 figures or whether they are blanked out on your copy?

1 A. In tab 24, madam?
 2 **THE CHAIRMAN:** Yes. On the second page, do you have figures
 3 in boxes or do you have --
 4 A. Yes.
 5 **THE CHAIRMAN:** -- blanks? That does look rather detailed,
 6 that you were setting out there. I realise this is not
 7 part of the support, it relates to other things. Was
 8 there any reason why you went into a great deal of
 9 detail there but weren't interested in the detail in
 10 relation to the total support figure at number one?
 11 A. From memory, there may have been specific things that
 12 they wanted to secure from this agreement as
 13 a negotiation, and wanted it outlining in the letter
 14 which I had agreed to do, because in the previous year
 15 I didn't, I just kept it very, very top line.
 16 **DR SCOTT:** So if we look back, then, to the letter of 23rd,
 17 which is in tab 23, you will see that Mr Goodall writes
 18 to you and in the third paragraph, he says:
 19 "If there are any exceptions I reserve the right to
 20 reduce invoice investment accordingly."
 21 Now, was your concern simply with agreeing money or
 22 with operators who started actually receiving money?
 23 A. Agreeing it, because rightly or wrongly we would take it
 24 that that money would be delivered at year end, we would
 25 secure those funds.

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1 **DR SCOTT:** Okay, so that paragraph would give you no cause
 2 for concern?
 3 A. No.
 4 **DR SCOTT:** And yet, when you get to the letter of 8 July,
 5 you are prepared to engage in a lot of detail about the
 6 quid pro quo?
 7 A. That's right, to give ITL a comfort factor so they had
 8 something to take back to base to justify the increased
 9 spend, because they will want to apportion the spend.
 10 **DR SCOTT:** And are you aware that ITL employed staff to
 11 visit -- sorry, are you coming to that?
 12 **MR WILLIAMS:** No. I think Mr Owen said that he had no
 13 involvement with pricing matters, and that this was the
 14 sum total of his involvement, so I wasn't going to come
 15 to that.
 16 **DR SCOTT:** I was merely going to --
 17 **MR WILLIAMS:** No, no, obviously if you want to ask the
 18 question, please do.
 19 **DR SCOTT:** It was merely: were you aware that suppliers
 20 quite often checked up on what was happening in the
 21 stores?
 22 A. I was aware.
 23 **DR SCOTT:** Yes.
 24 **MR WILLIAMS:** Could you have a look at paragraphs 3.1 and
 25 3.2 of your witness statement, please. Basically what

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1 you say here is:
 2 "Pricing below RRP was not connected to the trading
 3 agreement and tactical promotional bonuses were
 4 separately negotiated by the category buyer. I wasn't
 5 involved in the negotiation or implementation of this
 6 bonus and there was no link between it in the trading
 7 agreements. Neither of the bonuses therefore was in any
 8 way linked to the manufacturers' desired parity and
 9 differential terms."
 10 If you weren't involved with these bonuses or indeed
 11 with any aspect of pricing of tobacco in the Co-op,
 12 I don't understand how you can say that they weren't
 13 linked to desired parity and differential terms?
 14 A. No, I was just merely explaining my understanding of the
 15 two bonus mechanisms.
 16 Q. Do you know whether payment of a tactical bonuses was
 17 ever linked to a manufacturer's desire to be at parity
 18 with a competing brand?
 19 A. I don't know.
 20 Q. But you do say that in your statement, you say it was in
 21 no way linked to the manufacturers' desired parity and
 22 differential terms, so that's not right, you just don't
 23 know?
 24 A. I don't know -- well, no.
 25 Q. Then finally in 4.4, you say:

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1 "Manufacturers would sometimes complain if prices
 2 were above RRP or if an individual product was being
 3 priced above the manufacturer's agreed maximum
 4 promotional price."
 5 Again, you wouldn't know whether it was a maximum
 6 promotional price or not, would you?
 7 A. I wouldn't know what it was, no.
 8 **MR WILLIAMS:** I have nothing further.
 9 **THE CHAIRMAN:** Yes, it's Mr Thompson to go next.
 10 **MR THOMPSON:** Unless Mr Howard has any cross-examination?
 11 MR HOWARD: No.
 12 Re-examination by MR THOMPSON
 13 **MR THOMPSON:** Mr Owen, it may seem quite a long time ago,
 14 but you were asked a question about your statement as to
 15 whether there was a specific obligation to comply with
 16 parities and differentials. Do you remember that?
 17 A. Yes.
 18 Q. I am sorry, I've lost the reference, but I'll find it in
 19 just a moment. It's 4.3 of your statement. You say:
 20 "Category buyers would not totally ignore suppliers'
 21 requests but give the impression of lending
 22 a sympathetic ear to them to maintain a good working
 23 relationship but they were under no specific obligation
 24 to do so."
 25 Then it says:

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1 "This is reflected in the category buyers'
 2 individual targets which were focused on sales and
 3 margin and did not include anything relating to the
 4 trading agreements."
 5 The specific obligation, was that an obligation to
 6 CGL or an obligation to, say, ITL or Gallaher?
 7 **A.** We were under no specific obligation to ITL.
 8 **Q.** Yes. Because I had understood from the second
 9 paragraph, the second sentence, you were referring to
 10 CGL, but you are saying no obligation to ITL?
 11 **A.** Yes.
 12 **Q.** A little later on you were asked about central
 13 negotiation with Gallaher, and you said that if there
 14 was a trading agreement in place, as there was in 2002,
 15 then any negotiation would have probably left that in
 16 place, but there might have been discussions about extra
 17 funding. Do you remember saying that?
 18 **A.** Yes.
 19 **Q.** What sort of things might that have concerned?
 20 **A.** Well, it might be if the manufacturer wanted to put
 21 another listing on the table or something of that ilk,
 22 because that would be a way in which we could secure
 23 some extra funding, which would be over and above any
 24 standard agreement that was in place.
 25 **Q.** Your involvement with Mr Goulthorp was in 2002, and

1 2003, I think after the United acquisition or merger,
 2 and then after the Alldays. Was CGL then in a stronger
 3 or a weaker position as a negotiator in 2002 and 2003?
 4 **A.** A stronger position.
 5 **Q.** Why was that?
 6 **A.** Purely on the scale. When United Co-operatives came on
 7 board, that gave us another 600 stores, as part of our
 8 remit, and then when Alldays came on board that gave us
 9 another 630 stores.
 10 **Q.** Thank you. You were asked something about the Gallaher
 11 agreement 2003, which is at the back of bundle 5,
 12 annex 5, tab 21. {D5/21}. I think you essentially
 13 said that by that stage, you were out of this particular
 14 area and your only involvement was for odds and ends,
 15 tying up odds and ends; is that right?
 16 **A.** That's correct.
 17 **Q.** Do you have any recollection of the terms of the draft
 18 agreement?
 19 **A.** Not in any detail, no.
 20 **Q.** Just for information, can you look at paragraph 1, under
 21 the heading "Product Promotion", and if you read 1(a).
 22 (Pause)
 23 Can you recall anything about that provision or how
 24 it was arrived at?
 25 **A.** No, I can't.

1 **Q.** Then on page 4, (c) at the top of the page, can you
 2 remember anything about that?
 3 **A.** I can remember about that, that was the discussion that
 4 took place where they wanted to secure an additional
 5 listing.
 6 **Q.** Yes. Can we just turn back to tab 18, and you weren't
 7 asked about this and so I won't ask you anything more
 8 about Benson & Hedges Silver, though you deal with it in
 9 your witness statement; it's only the paragraph "I will
 10 also arrange", do you see that, towards the bottom?
 11 **A.** Yeah.
 12 **Q.** " ... for the necessary changes to be made to the
 13 previously issued trading agreement document and have
 14 a draft sent to you upon your return from holiday."
 15 So this is dated 23 May 2003. Does that jog your
 16 memory at all about any negotiations or how they went on
 17 the Gallaher agreement?
 18 **A.** The only discussion that I remember having with
 19 Gallaher's was where they were keen to secure
 20 an additional listing, that was paramount to them, and
 21 that was the only recollection I have regarding that.
 22 **Q.** So would there have been meetings about that, that sort
 23 of thing?
 24 **A.** There would have been a meeting, we would have met with
 25 them, yes.

1 **Q.** Can we now --
 2 **DR SCOTT:** Sorry, just sticking on that email for the
 3 moment, was this exceptional, you dealing with this
 4 level of detail?
 5 **A.** It was, yes, but I wouldn't have done it in isolation.
 6 They would have come to me with a proposal to say "this
 7 is a listing", I would have gone back to the buyer and
 8 said to the buyer, "Is that something that is going to
 9 have positive/negative impact on the category?", and
 10 taken a view from the buyer.
 11 **DR SCOTT:** But Mr Davison is writing to you rather than to
 12 Mr Newton?
 13 **A.** That's correct, because I was responsible for the
 14 overall negotiation, and if I could use this to secure
 15 extra funding, significant extra funding, because that
 16 was a lever that I had got, then that's what I would do.
 17 **MR THOMPSON:** Can we now come to the vexed question of the
 18 2002 negotiations, you have been asked a lot of
 19 questions about it, I will try and be as succinct as
 20 I can.
 21 Can we look first of all at tab 14. Sorry, this is
 22 now in bundle 15, annex 15. {D15/14}. In fact, before
 23 we do that, can we look at tab 13, which is a document
 24 which I don't suppose you were familiar with at the
 25 time. You will see it's a fax from Mr Goodall to

1 Mr Newton dated a couple of weeks before, 29 April 2002.
 2 Have you read this fax or email recently?
 3 A. I don't remember, sir, no.
 4 Q. Could you just have a quick look at it.
 5 (Pause)
 6 Do you understand what it's about?
 7 A. Well, it would appear to suggest that Imperial Tobacco
 8 are rather frustrated about investment that they are
 9 paid, that clearly we are not following.
 10 Q. Is that the type of document that you will expect to
 11 find, given the concerns you mentioned to Mr Williams in
 12 several of your answers?
 13 A. I would think so, yes.
 14 Q. You think that might have been in their mind at the time
 15 of the negotiations?
 16 A. Yes.
 17 Q. Thank you. If we now look at the document on
 18 13 May 2002, I imagine you are reasonably familiar with
 19 office stationery and how it works and that frequently
 20 documents are sent out and copies are retained. Do you
 21 interpret anything from the fact that there is no ITL
 22 letterhead either on the letter or on the draft trading
 23 agreement as to what sort of document this is?
 24 **THE CHAIRMAN:** Which document are you looking at?
 25 **MR THOMPSON:** Tab 14, madam. I think Mr Williams made

1 a contrast between the draft trading agreement at tab 14
 2 and the draft trading agreement at tab 16.
 3 **MR WILLIAMS:** If it helps, madam, I was just making the
 4 point that they seem to be physically different
 5 documents, I wasn't making a point about that, that's
 6 all I was saying.
 7 **DR SCOTT:** Are you suggesting, Mr Thompson, that whereas --
 8 **THE CHAIRMAN:** Well, let him perhaps ask the question.
 9 **MR THOMPSON:** I am just wondering whether you have any idea
 10 why there might not be a letterhead at tab 14 as against
 11 the letterhead at the document in draft at tab 16?
 12 A. I don't know.
 13 Q. At tab 14 it's said that "the draft that you worked
 14 through in the second paragraph is unchanged from the
 15 copies we worked through." Would you expect to sign up
 16 to draft agreements that were sent to you in
 17 an unchanged form?
 18 A. No, I would -- the agreement would be based on what
 19 I send to the supplier as the final document.
 20 Q. I think you have said on a number of occasions that the
 21 agreed terms were those that were specified in your
 22 letter, not in the draft from Imperial; is that correct?
 23 A. That's correct.
 24 Q. I think you said that the main purpose was to achieve
 25 improved terms, and so the last paragraph of this

1 letter, would that have been one that you were
 2 particularly interested in. It says:
 3 "An investment increase of [REDACTED] on the 2001
 4 trading agreement."
 5 A. Yes.
 6 Q. Similarly, while we are on this point at tab 23 there is
 7 a short paragraph in the letter of 23 May 2003, where --
 8 I don't know whether you have the two figures but they
 9 are obviously not confidential to you, but again there
 10 is a satisfyingly round sum said to be an increase, and
 11 I believe it's of a less round but equally satisfactory
 12 nature. Would that have been important to you?
 13 A. Yes, it would.
 14 Q. When you turn over the page to tab 24, there was some
 15 discussion of detail about Rizla, which I think is
 16 merely a detail about Alldays but in relation to the
 17 matter with which we are concerned, which is under the
 18 heading "The branded element", there is again some
 19 confidential figures, but as far as you were concerned
 20 is that the trading agreement that was entered into in
 21 2003?
 22 A. It is, yes.
 23 Q. So it was simply headline terms, that was all you were
 24 agreeing to; is that correct?
 25 A. That's correct.

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1 Q. Do you see any difference between what you agreed to in
 2 2003 and what you agreed to in 2002?
 3 A. No.
 4 Q. Thank you. Can we now look at the letters at tabs 16
 5 and 17. On your evidence, there was a very similar, in
 6 fact virtually identical, letter of 5 July 2002 which
 7 included the total matter that you had agreed to under
 8 headings which are slightly more broken out than in 2003
 9 but otherwise essentially the same.
 10 What I don't think you were asked by Mr Williams,
 11 but it would seem to me to be a very relevant question,
 12 which wasn't asked, is: why was the 9 July 2002 letter
 13 written? Do you have any recollection of that question?
 14 A. It might have been a reaction to me confirming the terms
 15 on our terms.
 16 Q. I think what I am getting at is: I think the OFT's case
 17 is that you had signed up to a detailed agreement on
 18 5 July, and then four days later you came up with
 19 a rather diluted version. Is that how you remember it,
 20 that having signed up to a detailed version you then
 21 four days later signed up to a less detailed; is that
 22 how you remember it?
 23 **MR WILLIAMS:** I don't think that's the basis on which it has
 24 been put to the witness, madam.
 25 **MR THOMPSON:** It was put in terms that they had agreed to

1 a draft trading agreement, and then he was asked a whole
 2 lot of questions about the 9 July letter.
 3 **THE CHAIRMAN:** Yes, but I don't think he was saying that it
 4 had been diluted by that stage. On the contrary,
 5 I thought that his case was that this letter is
 6 confirming to Mr Batty the agreement that we see on
 7 5 July at tab 16 as to the trading terms.
 8 **DR SCOTT:** And it goes across at a higher level so --
 9 **MR THOMPSON:** I think Mr Williams made a point that it was
 10 carefully crafted to give some comfort which I had
 11 understood to mean "diluted", but I will put it in those
 12 terms.
 13 **MR WILLIAMS:** I thought Mr Owen had made the point that it
 14 was carefully crafted to give some comfort.
 15 **THE CHAIRMAN:** Yes, I think the "carefully crafted" wording
 16 comes from either Mr Owen or Mr Goulthorp, but I don't
 17 think it's any part of the OFT's case, as I understood
 18 it, that the terms were diluted. It was summarised, is
 19 that what you mean, in the letter?
 20 **MR THOMPSON:** I doubt if I should go any further without
 21 submission. To my mind, there is a clear submission
 22 that I will in due course make about why such a letter
 23 will be written. In my submission, there is a question
 24 as to the consistency and that's a matter that I won't
 25 deal with now.

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1 **THE CHAIRMAN:** Well, perhaps you can just ask Mr Owen that.
 2 Can you remember why this letter was written to
 3 Mr Batty on 9 July?
 4 **A.** From memory, given the increased size of investment that
 5 Imperial were to make, whether it was to justify from
 6 their company's perspective rather than just handing
 7 over extra money and having nothing to back it up, they
 8 wanted some sort of reassurance from a trading
 9 perspective, that we weren't going to walk away or ...
 10 so maybe to support what was a fairly top line
 11 agreement.
 12 **DR SCOTT:** The way you put it to us earlier was that the
 13 Co-op had decided, I think, with, was it the top 90
 14 suppliers?
 15 **A.** That's correct, yeah.
 16 **DR SCOTT:** Up a level and so we see on 5 July a letter going
 17 across from you to Mr Goodall, and that -- let's try and
 18 use a neutral phrase -- is then let me say echoed,
 19 I don't mean echoed in any technical sense but simply
 20 that it's then, something happens at the higher level
 21 between Mr Goulthorp and the person he sees as his
 22 opposite number, namely Roger Batty. And that reflects
 23 the way in which the Co-op is trying to do the top level
 24 things.
 25 **A.** Yes. He might have been smarting a little bit somewhat

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1 from my note and felt it necessary to escalate.
 2 **MR THOMPSON:** Can we look at paragraphs 2.8 and 2.9 of your
 3 statement, which I think Dr Scott in particular asked
 4 you some questions about. I think Dr Scott, when he
 5 asked his questions, rather stopped at the comma at the
 6 beginning of 2.9, whereas the statement goes on:
 7 "Our aim was always to leave category buyers as much
 8 flexibility going forward as possible."
 9 And that's a point you emphasised. Then the last
 10 sentence:
 11 "This was reflected in the wording of the
 12 agreements, which, as can be seen, contained only a very
 13 loose description of the manufacturers' promotional
 14 objectives."
 15 In that sentence, what are you talking about? Are
 16 you talking about your letter again or about the trading
 17 agreement?
 18 **A.** About my -- the actual letter that I sent that is, as
 19 far as I am concerned, the trading agreement.
 20 **Q.** So when you look at the letter of 2002, I think (a) says
 21 range implementation, distribution, and in your letter
 22 it says range implementation; was that what you had in
 23 mind?
 24 **A.** Yes.
 25 **Q.** Under "display planogram merchandising", it says

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1 "display planogram compliance", was that what you had in
 2 mind?
 3 **A.** Yes.
 4 **Q.** And as against "pricing/promotion", you have "pricing
 5 and promotion", is that what you had in mind?
 6 **A.** Yes.
 7 **Q.** And advertising, here it just says "Marlboro support",
 8 but that's what you had in mind?
 9 **A.** Yes.
 10 **Q.** So when you points were made about ethical compliance,
 11 is there anything inconsistent with that in terms of
 12 this letter?
 13 **A.** Not in terms of the letter, no.
 14 **Q.** Can we now turn to what the letter of 9 July actually
 15 meant? The very first phrase:
 16 "Further to our recent integration negotiations ..."
 17 What did you understand by that?
 18 **A.** That would be when we took on board the business, the
 19 buying business, for United Co-operatives.
 20 **Q.** Was that what you were saying when you said this was
 21 primarily about that issue rather than P&Ds, was that
 22 what you were talking about?
 23 **A.** That was about the integration, the enlarged business.
 24 **Q.** Then I think Mr Williams said that there was nothing
 25 about this actually being the CRTG guidelines but this

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1 was all about compliance with ITL. The references to
 2 CRTG, you see them in the first, second and third
 3 paragraphs, was that what you had in mind about this
 4 being by CRTG?
 5 **A.** Yes, it would be a CRTG trading agreement.
 6 **Q.** In terms of how it was understood by Mr Batty, if you
 7 turn to the next tab, the first sentence, do you see
 8 it's a letter from Mr Batty to Mr Goulthorp?
 9 **A.** Yes.
 10 **Q.** Do you think he understood it in the same sense from
 11 what you can see there?
 12 **A.** Yes.
 13 **Q.** The OFT has made something of the similarities in
 14 wording in the second and third paragraphs. Can we just
 15 look back at the draft, and it may go to the point about
 16 diluted that I made which was perhaps putting words into
 17 your mouth, but if we can just look at the first
 18 sentence of the draft under "Pricing and Promotion". If
 19 you look at that, the wording I think that's latched
 20 onto is:
 21 "This element of the agreement is designed to ensure
 22 Imperial Tobacco products are priced in line with the
 23 industry agreed strategic pricing differentials across
 24 all segments of the tobacco category. A copy of the
 25 agreed differentials is attached."

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1 When you compare that to the second sentence of the
 2 second paragraph, would you say that the second sentence
 3 of the first paragraph is more or less specific than the
 4 terms of the agreement?
 5 **A.** Sorry, could you just re-state that, please?
 6 **Q.** Yes, there is a reference in the first paragraph here to
 7 "industry agreed strategic pricing differentials" and
 8 reference to a copy of the agreed differentials being
 9 attached. Do you find those in Mr Goulthorp's letter?
 10 **A.** No.
 11 **Q.** The fourth and most detailed paragraph in this letter,
 12 which I think is your point about RRP's and compliance;
 13 is that right?
 14 **A.** Yes, it is, yes.
 15 **Q.** Is there anything about that in the trading agreement?
 16 **A.** No.
 17 **Q.** So from your point of view, what did the wording
 18 "consistent price disciplines" mean as between you and
 19 ITL in this particular context?
 20 **A.** Consistent price disciplines was about our store, CRTG
 21 stores, operating base and supporting investment that
 22 was being made.
 23 **Q.** Perhaps a more general question: do you recall parities
 24 and differentials being a significant element in your
 25 discussions with Mr Batty and Mr Goodall in either 2002

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1 or 2003?
 2 **A.** No.
 3 **Q.** Can we now look at tab 21 of annex 15. {D15/21}.
 4 I think you have given in general terms evidence that
 5 the negotiations at this time were all about the
 6 integration of Alldays; is that right?
 7 **A.** That's correct.
 8 **Q.** Do you see the third paragraph of the letter of
 9 Mr Goodall to yourself? It says:
 10 "The trading terms element of the 2003 agreement is
 11 also dependent on all of the above issues [and I think
 12 that's about Alldays] but I am willing to outline the
 13 anticipated monies if an agreement can be reached."
 14 Would you have agreed with that approach of
 15 Mr Goodall linking the 2003 agreement with Alldays?
 16 **A.** If it delivered the money, then yes.
 17 **Q.** Let's just have a look and see what you say about that
 18 in your letter of reply. In particular the first two
 19 sentences of the second paragraph.
 20 **DR SCOTT:** Just to be clear, we are now in tab 22, yes?
 21 {D15/22}.
 22 **MR THOMPSON:** Tab 22, it's an email written in response
 23 a week later. I will repeat my question: did you accept
 24 a linkage between the trading agreement and your --
 25 **A.** No, I didn't, no.

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1 **Q.** Is that what you are talking about in that paragraph?
 2 **A.** Yes. Basically what they were trying to do is link the
 3 two, and I was trying to keep them separate.
 4 **THE CHAIRMAN:** The two of what?
 5 **A.** The two elements, the issue over Alldays pricing being
 6 substantially higher than the current estate, and they
 7 were concerned that once we started putting volume into
 8 an old Alldays depot, I would expect to see lower costs.
 9 **THE CHAIRMAN:** What were they trying to link that to?
 10 **A.** They were saying that "we are not going to give you the
 11 cheaper costs" because that would mean certain
 12 promotional bonuses that might have been in place
 13 wouldn't be honoured.
 14 **DR SCOTT:** And that's because Alldays were pricing at
 15 a premium?
 16 **A.** That's correct.
 17 **THE CHAIRMAN:** I still don't quite understand this issue
 18 about whether Alldays, even though they were pricing
 19 higher, whether they were still going to get the same
 20 net invoice cost, I can see that issue. What was your
 21 understanding of what they were trying to link that
 22 issue to?
 23 **A.** My understanding is they were trying to link the issue
 24 to the fact that pricing was dearer in the Alldays
 25 estate.

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1 **MR THOMPSON:** I do not want to delay. I think that it's
 2 fairly clear from the 12 May 2003 letter that ITL was
 3 trying to link a deal over Alldays with reaching
 4 an agreement on the new trading agreement. One sees
 5 that in the third paragraph and then in the following
 6 terms.
 7 **THE CHAIRMAN:** Yes, that's I think what the OFT is saying,
 8 but what I had understood in his cross-examination, that
 9 Mr Owen didn't accept that.
 10 **MR THOMPSON:** It's quite clear that he rejected any such
 11 linkage in --
 12 **THE CHAIRMAN:** Yes, but he didn't accept even that that was
 13 the linkage they were trying to make is my recollection.
 14 I may be misremembering that.
 15 **MR THOMPSON:** He was saying that they were quite independent
 16 of one another.
 17 **THE CHAIRMAN:** Yes, okay.
 18 **DR SCOTT:** That's reflected when he goes to "finally", and
 19 "again in isolation of our terms package, I would like
 20 to know whether you are currently thinking of retail
 21 pricing going forward".
 22 **MR THOMPSON:** Yes.
 23 If we then turn over to the letter of 23 May 2003,
 24 what we are concerned with -- I think we have looked at
 25 it already -- is the fourth paragraph "Trading Terms".

1 Do you see that?
 2 **A.** Yes.
 3 **Q.** The first, second and third paragraphs appear to be
 4 mainly concerned or exclusively concerned with Alldays,
 5 and what do you understand "invoice investment" and
 6 "CRTG terms" to mean in the third paragraph? It's
 7 a long time ago and it may be you can't remember, but
 8 what do you understand that to mean?
 9 **A.** That would have been about cost price, moving the
 10 Alldays business onto the current Co-op group cost
 11 prices, which were cheaper.
 12 **Q.** So it's nothing to do with either the central payments
 13 or parities and differentials --
 14 **A.** No.
 15 **Q.** Finally, on your evidence, either in relation to 2002 or
 16 2003, was there any specific allocation of obligations
 17 or expectations of Co-op or CRTG in relation to pricing
 18 as a condition for getting this central support?
 19 **A.** The agreements were structured very, very top line, so
 20 in terms of the deal and the way in which it was broken
 21 down, there was money listed against that but nothing
 22 specific that I'm aware of.
 23 **MR THOMPSON:** No further questions.
 24 **THE CHAIRMAN:** Thank you very much, Mr Owen, that completes
 25 your evidence in the case, and I can release you from

1 the witness box. Thank you very much for coming.
 2 (The witness withdrew)
 3 **MR THOMPSON:** I think that completes the Co-op's factual
 4 case, so it would be a good time to have a break.
 5 **THE CHAIRMAN:** Yes. We will come back in ten minutes' time
 6 and then it will be you, Mr Howard, opening in relation
 7 to Safeway and Morrisons?
 8 **MR HOWARD:** Not in relation to Safeway, in relation to
 9 Morrisons. I have taken an executive decision that we
 10 are unlikely to get to Mr Matthews, so I hope you don't
 11 mind, I have said he might go.
 12 (3.30 pm)
 13 (A short break)
 14 (3.40 pm)
 15 Further opening submissions by MR HOWARD
 16 **MR HOWARD:** Now to Morrisons. I am going, in relation to
 17 this opening, to actually spend more time than I have on
 18 the previous ones looking at the specific documents; in
 19 other words I am not going to go back into some of the
 20 arguments with which obviously you are now very
 21 familiar. All I will say about the position is that
 22 when you consider this account, again we need to always
 23 remember what we are looking at in all of this material
 24 is whether, as a result of the agreement or practice,
 25 Morrisons was subject to an obligation or requirement

1 such that its ability to favour Gallaher was restricted.
 2 That's essentially what we are looking for.
 3 Whilst, as I say, I don't intend to go back into the
 4 detail of the argument, but beyond pointing out at this
 5 stage that the OFT's case is in fact a very odd one,
 6 when you consider what was actually going on at the time
 7 in the tobacco market. Because one of the things that
 8 is absolutely clear is, firstly, there was a battle
 9 going on for market share, particularly a battle in the
 10 ultra low price segment. A major piece of artillery on
 11 the battlefield was price competition, and Imperial
 12 sought to be and was successful in this battle, and the
 13 result was that it actually increased its market share
 14 at the expense of its competitors.
 15 Now, Morrisons is a case, a particularly good
 16 example of that, and the point is actually neatly and
 17 graphically illustrated if I show you two references in
 18 the documents. SO bundle annex 17, tab 1 is one of
 19 these national account development plans. {D17/1}. At
 20 the moment what I want to show you is what it tells us
 21 about the market shares within Morrisons. Morrisons at
 22 this stage, I think you probably know, was a supermarket
 23 group which was essentially in the north of England,
 24 controlled by the Morrison family, I think they had
 25 about 38 per cent, although it was a public company, it

1 was in the FTSE 100, and then they subsequently, as we
2 all know, expanded, but at this stage its business was
3 based in the north.

4 If you look on the second page of this document, and
5 I don't think that -- I won't read them out but if you
6 note on this page the market shares in -- I understand
7 these are references to market shares in Morrisons, and
8 that's for the year to the end of January 2000. So you
9 can see that Imperial's share is, although large, less
10 than Gallaher's.

11 What's interesting is if you turn on to tab 96,
12 which is not actually the picture at the very end of the
13 alleged infringing period, but it's a period some two
14 years later, and if you go to the second page there you
15 will see that by 15 July 2002 -- in other words, it's
16 two and a half years on from what we were looking at,
17 I think, previously, yes, the end of January 2000, and
18 now on page 226 you see the market shares. So over that
19 period of two and a half years, Imperial increased their
20 market share very significantly, and one can see they
21 did that at the expense of Gallaher, if you go down
22 a bit, and also clearly at the expense of Rothmans.

23 Now, if one then -- if you stand back from all this,
24 and we are going to go through the documents, if you
25 actually ask yourself: how was it that this happened,

1 what you will actually see, because of the -- Morrisons
2 actually were significant players in retailing tobacco,
3 and what you will see is particularly that Richmond was
4 a significant brand and it would appear that a large
5 part of this is attributable to their managing to grow
6 Richmond.

7 Now, so that's a sort of general point we would make
8 as to that, this case is odd because what has actually
9 happened during this period is that Imperial, through
10 essentially a price strategy, which is a strategy of
11 getting these, particularly the low priced brands at
12 very low prices was actually able to grow its market
13 share, so it was a period of intense competition and the
14 competition is -- to say it's exclusively through price
15 is an exaggeration, because we know there are other
16 things that go on which are positioning yourself in the
17 planograms and stuff like that, but one of the things
18 which is actually pretty clear, and we will hear this
19 from other witnesses, that at the low price end -- it's
20 obvious the low price end is low price, that is just
21 tautologous, but the point is at the low price end there
22 is much less brand loyalty, so that people go into the
23 shop and if they have £3.50 or whatever it is to spend,
24 then what they are looking for is the brand which is at
25 £3.50, as opposed to established brands like Marlboro

1 and Benson & Hedges which may have a particular
2 following.

3 So a lot of the material you have already seen is
4 really, as you will have seen, a lot of the
5 correspondence is about this ultra low price end. We
6 see it in Dorchester, Richmond, Mayfair, Sterling,
7 that's all at that end, and I think you will probably
8 find that the roll-your-own end is again where we see
9 Amber Leaf and Drum and so on, that's at a similar end.

10 **MR SUMMERS:** Mr Howard, excuse me, just before we leave this
11 point, is this growth on a like for like basis, or
12 during this period did ITL acquire other agencies which
13 would have enabled them to grow their market share more
14 quickly?

15 **MR HOWARD:** I think they did -- I'll have to check, I think
16 during this period they may have acquired part of the
17 business which was run by BAT on agency. I'll have to
18 check, and the extent to which these figures are
19 affected by that. The essential point I make is not
20 affected by that; in other words, there may be 1 or
21 2 per cent which is attributable to Marlboro, I think,
22 coming across from one of the English manufacturers to
23 the other.

24 **DR SCOTT:** In fact, if you look at document 96 towards the
25 bottom of the page there is a paragraph which explains

1 some of this and explains the very high percentage now
2 commanded by ITL, which I am not reading out. Do you
3 see? I think I am allowed to tell you that it begins:

4 "As the majority of other ..."

5 It doesn't seem to be confidential. That paragraph
6 explains some of it. If you go up to the top of the
7 page, you can see the significant increases in volumes
8 at a time when presumably overall volumes weren't going
9 up.

10 **MR HOWARD:** Yes. The number of, as I understand it,
11 cigarettes consumed, if "consumed" is the right word for
12 a cigarette, I suppose it is, is relatively stable and
13 has been for some time, so that in other words the
14 smoking -- as we know, what has happened is over
15 a period of years the smoking population has declined
16 and to some extent I think that decline has stabilised,
17 but it certainly isn't going up.

18 I think the point that you can see, and there is no
19 question you are going to see this as we go through the
20 documents, and Morrisons is an example of growth by
21 Imperial over this period in its market share, and this
22 is within Morrisons, in fact Imperial grew its market
23 share, as you know, over this period as well. But the
24 relevance of it is not simply that they grew their
25 market share, but what are the real tools that are

1 available, and the tools that are essentially available,
 2 the main tool is ensuring that you are price
 3 competitive. In some cases that means pricing below the
 4 competition, or at least not greater than, and you have
 5 heard the evidence already about Richmond, but that,
 6 from Imperial's commercial view, their judgment was: as
 7 long as Richmond was priced at no greater than
 8 Dorchester, their perception was that it was a stronger
 9 brand, and they have been right about that.
 10 If we can go back to tab 1, one of the things about
 11 Morrisons is they are not actually in many respects
 12 different to the other retailers, in this sense -- when
 13 I say "the other retailers", the other supermarket
 14 retailers, in that all of them have this policy of
 15 benchmarking themselves. What one, I think, will see in
 16 the case of Morrisons is it's a much more
 17 straightforward business at this time. That may be
 18 partly because it was still essentially, you know,
 19 a smaller group, although very successful, but being run
 20 by Sir Ken Morrison, or he was still at least the
 21 titular head with a firm hand the tiller setting this
 22 direction. In the same way that we all know that
 23 Tesco's have had this very strong marketing policy of
 24 Every Day Low Prices, Morrisons -- and you see it on
 25 this document, the bit that's not confidential on

1 page 168 -- "competitive pricing, often proactive".
 2 That's very much their approach, they were
 3 benchmarking themselves, and essentially they had
 4 a clear pricing strategy. They say in their evidence
 5 that actually they very often themselves absorbed the
 6 cost out of their own margin. Now, you will obviously
 7 have to hear from Mr Eastwood how that worked, but
 8 that's certainly his evidence.
 9 Now, the reason I stress this, (a) because we say
 10 it's inconsistent with the OFT case of there being
 11 an anticompetitive conduct going on, but also when you
 12 come to consider the agreements and you come to construe
 13 them, you have to construe them against a particular
 14 factual matrix, which is a factual matrix where it's
 15 known to both parties that Morrison's strategy is to
 16 compete aggressively on price and seeking to offer
 17 customers the lowest possible prices. That's what they
 18 say.
 19 So what you have to consider is whether it is at all
 20 likely, to put the matter at its lowest, that the
 21 retailer, here Morrisons, would tie its hands so that it
 22 was not able to compete with its rivals in accordance
 23 with its strategy. We say that is something that would
 24 be highly unlikely, unless what you found was that
 25 Morrisons were being paid such significant sums of money

1 that they were prepared to take that risk.
 2 Now, that's a point that is true particularly of
 3 Morrisons, but it's equally true of the other retailers.
 4 The trading agreements, there are two, the first one
 5 is at tab 4, which ran from 1 August 1999 to July 2001,
 6 but actually got extended, at tab 45, I think. It was
 7 then extended until such time as the parties had
 8 negotiated a new agreement. The new agreement actually
 9 is at tab 85, and that ran from 1 August 2002 for two
 10 years.
 11 Those, of course, are the written documents, but as
 12 I explained to you the other day when we were looking at
 13 the Co-op, the OFT's case is, "Well, we rely on the
 14 contacts between the parties to show what the agreement
 15 is", and so in fact I am now going to look at what these
 16 agreements say, but of course you will also be looking
 17 at the way in which the parties corresponded to see
 18 actually what the agreement was, and the points I am
 19 going to make to you I suggest are clear on the face of
 20 the agreement, but they become even clearer once you
 21 adopt the OFT's point.
 22 Now, if we look at the first agreement at tab 4, you
 23 can see there are a number of different things going on
 24 here. You have payments, a reward package -- note the
 25 words "reward package" -- and we are concerned obviously

1 in this case with the pricing, although it's fair to see
 2 that there are many other aspects. You have the
 3 distribution, the merchandising and the advertising.
 4 Now, the way the first part of the reward package
 5 works, as you can see:
 6 "ITL agreed to maintain levels of off-invoice
 7 bonuses provided ITL prices are in line with our current
 8 strategy."
 9 The next line doesn't matter, there is a change in
 10 the level of bonus on Regal and JPS.
 11 "If our pricing strategy changes, Morrisons to be
 12 notified and a new pricing sheet would take effect,
 13 Morrison to confirm in store promotional activities
 14 which may affect pricing strategy. ITL agreed to
 15 maintain bonus levels in line with appendix 1 should we
 16 elect not to respond to other manufacturers' pricing
 17 initiatives."
 18 The last line doesn't matter for present purposes.
 19 If you go to the next two pages, you will see the
 20 strategy pricing sheet is on page 5. I'll come back to
 21 that in a moment. Then appendix 1 is on page 4. You
 22 can see that there is an off-invoice bonus per outer,
 23 and sums are listed.
 24 What in fact the evidence shows is that this bonus
 25 that is being paid here is a bonus for pricing below RRP

1 as well as being related to the differentials, and the
 2 need or the fact that they are going to pay a bonus for
 3 being below RRP was something that was common with all
 4 the supermarkets.
 5 **DR SCOTT:** Just one quick question as we go to Morrisons: my
 6 recollection from page 168 --
 7 **MR HOWARD:** Sorry, page 168 of?
 8 **DR SCOTT:** This is tab 1.
 9 **MR HOWARD:** Yes.
 10 **DR SCOTT:** In Morrisons we have one tier; is that right?
 11 Although they have forecourts at petrol stations and
 12 stores which are differentiated in some ways, in
 13 relation to pricing we have just one tier here?
 14 **MR HOWARD:** I believe that is right, yes.
 15 **DR SCOTT:** So we don't have the complications of some
 16 convenience stores.
 17 **MR HOWARD:** Leaving aside the petrol forecourts because
 18 I think sometimes an issue arises about them, as
 19 I recall, but essentially, as I understand it, that's
 20 right. They were at this stage -- maybe still today --
 21 a supermarket group, ie only, I don't think they had
 22 convenience stores and things like that. They had large
 23 supermarkets in different towns in the north of England,
 24 essentially. I think that's basically what's explained
 25 actually in the profile at page 167. At this time, yes,

1 they had 104 stores and I think that they were
 2 essentially -- you can see -- yes. They did have petrol
 3 forecourts but essentially I think they were all similar
 4 stores.
 5 The bonus that's being paid is a bonus in fact for
 6 being below RRP as well as then -- one sees this point
 7 linking to the strategy.
 8 Now, the differentials that one sees in this
 9 agreement, the majority --
 10 **THE CHAIRMAN:** Sorry, just to be clear of the point you are
 11 making there, that this is different from the Co-op
 12 where there were lump sum payments, here the P&D reward,
 13 as it were, is factored into the cost, the net cost
 14 price of the product?
 15 **MR HOWARD:** Yes, but what you are calling the P&D reward is
 16 in fact the RRP, being below RRP reward plus the P&D
 17 reward, is what it in fact is.
 18 In other words, I think you remember in Co-op, the
 19 way they dealt with Co-op was the RRP bonus didn't
 20 feature as part of the trading agreement, but they paid
 21 them large sums of money for being below RRP. Here it's
 22 all wrapped into one, so the sum of money that's
 23 being -- the reason for paying this money was that --
 24 because otherwise you don't see that anywhere, and that
 25 was in fact an essential part of what was going on, that

1 Morrisons price below RRP, so they are being supported,
 2 if you like, in that.
 3 **THE CHAIRMAN:** But is it by way of a reduction in the net
 4 cost price rather than the payment of lump sums in
 5 a retrospective way?
 6 **MR HOWARD:** In this case, everything is done before you get
 7 to tactical bonuses by an off-invoice -- as in
 8 appendix 1 -- bonus per outer. It's just my point is
 9 that that sum is actually -- the rationale for it on
 10 both sides -- the central rationale is being below RRP.
 11 The question as to the impact of the strategy,
 12 that's an add-on and Morrison's view of that is that
 13 they were not actually binding themselves to do
 14 anything. What we see is that in fact this was just
 15 an incentive, and there is no obligation to do this, and
 16 that's actually -- the whole case doesn't turn on
 17 whether it's an incentive or obligation, but it is
 18 important just in understanding how it all fits
 19 together, as you step through the case.
 20 I'll come back to the point as to whether it's
 21 an incentive or an obligation.
 22 What you can see is that on the pricing sheet the
 23 majority of the brands are expressed as "not more than"
 24 or "at least no more expensive than". In the case of
 25 Superkings, Richmond family, and Classic, you see the

1 words have been used "level with on". So the OFT seeks
 2 to say that those are examples of fixed parities as
 3 opposed to being at least no more expensive than.
 4 We say very simply in answer to that that both
 5 parties to this understood that the purpose of this was
 6 to make Imperial competitive, and where they express
 7 themselves as "level with on", both parties would
 8 understand that that was just meant at least no more
 9 expensive than, and if Morrisons chose to price below,
 10 then that would be fantastic news. Imperial aren't
 11 going to pay them an additional reward for that, subject
 12 to the promotion bonuses, but if they want to fund
 13 something out of their margin, and occasionally we are
 14 going to see some documents where they were trying to do
 15 that then, as I think I put to one of the witnesses,
 16 then the NAM, here Mr Matthews, would have done a little
 17 jig, because he is absolutely delighted, he has
 18 absolutely no objection.
 19 I think you may remember that at one point Mr Lasok,
 20 in cross-examining one of the witnesses, sought to
 21 suggest "there was some reason why you actually wanted
 22 the fix the differential because you didn't want to
 23 damage the brand", I mean, one of the reasons -- the
 24 witness actually repudiated that, but one can see if you
 25 look at some of this that it's obvious nonsense.

1 Take Richmond, Richmond is in the ultra low cheap,
 2 whatever we wanted to call it, sector. So if Morrisons
 3 want to sell it -- let's say it was at £3.50 to match
 4 Dorchester, if Morrisons want to sell it for £3.45, why
 5 would Imperial be in the least bit upset about that?
 6 They are just going to get even more sales of Richmond.
 7 That's the point on fixed. If you go to the second
 8 trading agreement, that's at tab 85, and there the
 9 position is actually unambiguous, at page 464, and they
 10 are all no more expensive than and so on.
 11 You may remember, I think Mr Lasok -- I think either
 12 in opening the case or in cross-examining -- I think the
 13 OFT is essentially saying "Oh, well, this is all a sham
 14 in this agreement because there were prior drafts which
 15 didn't express it in this way and the signed agreement
 16 is in this form and therefore that's a sham, that's not
 17 the true agreement".
 18 Now, there is a well known case called Snook in
 19 which the -- I think it was the Court of Appeal, and
 20 I think it was Lord Justice Diplock, considered what we
 21 mean by a sham, but it's a pretty hard test, but
 22 obviously we will see whether the OFT seeks to
 23 cross-examine the parties to this as to whether this was
 24 a sham. We say it certainly wasn't.
 25 Now, going back to agreement number 1, back at

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1 tab 4, if one just thinks about how this agreement is to
 2 operate for a moment, I think in his opening Mr Lasok
 3 focused attention on the word "maintain", and I think he
 4 sought to say: well, because ITL is agreeing to maintain
 5 the levels of off-invoice bonuses, that somehow means
 6 that this agreement continues to apply even where there
 7 are changes in the either Imperial's prices, wholesale
 8 prices or Gallaher's wholesale prices.
 9 In fact, it's perfectly clear that this agreement
 10 doesn't work in the way that's being suggested. What
 11 the agreement as a whole is recognising is that
 12 Morrisons are free to implement other promotions,
 13 because it actually says "Morrisons to confirm in store
 14 promotional activities which may affect pricing. ITL
 15 agree to maintain bonus levels in line with appendix 1,
 16 should we elect not to respond to other manufacturers'
 17 pricing initiatives."
 18 So if you ask yourself: is there some restriction
 19 here on Morrisons indulging in other promotional
 20 activities, the agreement certainly doesn't say
 21 Morrisons must not indulge in promotional activities;
 22 what the agreement is simply doing, it's working on the
 23 premise that Morrisons may do that, but it's then
 24 considering what the position will be vis-a-vis
 25 Imperial. What it's saying is, in a certain particular

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1 situation, if you are having a promotion which is as
 2 a result of a competitor funding it, we may choose to
 3 respond or we may not.
 4 What it is actually saying is: if in that event we
 5 choose not to respond, your bonus levels won't be
 6 affected, in other words, because I am not going to take
 7 some action. What the agreement is not saying is:
 8 Morrisons, you are not to do this. And self-evidently,
 9 we say, you can't imply a term. It would be very
 10 difficult to see how you could do that. And therefore,
 11 just looking at this agreement, there is nothing in it
 12 which is actually imposing any restraint of any relevant
 13 type on to Morrisons, and all it is in fact is
 14 an incentive to Morrisons that, all other things being
 15 equal, if they choose to (a) price below RRP -- and that
 16 has not been explicitly stated, but that's the common
 17 understanding -- and they adhere to the pricing
 18 strategy, which is that the relevant ITL brands are
 19 priced as we see set out on the pricing sheet, then they
 20 will receive their bonus. But they don't have to do it,
 21 and what's more, what the agreement recognises is that
 22 if it suits them, ie because Gallaher are funding it or
 23 they themselves are funding it, then they may go below.
 24 So there are two, basically situations where they
 25 may not bother with this. One is Gallaher have come

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1 along and basically cut their price, and I'll come back
 2 to what I mean by that in a moment, or they benchmarked
 3 against Tesco or whoever it is, Tesco have a price
 4 reduction on the brand, and Morrisons have decided to
 5 meet them. There is nothing to stop them doing that,
 6 and they certainly didn't regard themselves as being
 7 inhibited.
 8 In relation to -- I said I wanted to come back to
 9 this point about what happens if Gallaher price cut and
 10 how does all of this work. You have to remember, what
 11 does Imperial know? Imperial knows what the RRP
 12 differentials are. It also knows what the wholesale
 13 prices are, because although each manufacturer
 14 distributes their price list and essentially it's
 15 impossible to imagine in the market that they don't each
 16 know what is in the wholesale price list because they
 17 are distributed around something like 10,000 retailers,
 18 so it's inevitable people are going to have a pretty
 19 good idea of what the wholesale price is.
 20 They also know what the bulk drop discounts are,
 21 because those again are effectively set out in the terms
 22 of dealing anyway.
 23 The only thing you don't know is what individual
 24 discount, further discount, has been negotiated by
 25 a retailer, in other words to reduce his net wholesale

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1 price.
 2 So what Imperial is inferring is that their
 3 wholesale cost in fact is lower than Gallaher's, where
 4 their RRP is lower. They may not be right about that,
 5 but what they are hoping is, under this agreement, that
 6 Morrisons will find that that is so, and that therefore
 7 they will not discriminate against Imperial, ie let's
 8 assume Imperial's Richmond is the same or cheaper than
 9 Dorchester, that therefore they will price Richmond
 10 either at the same level or cheaper than Dorchester.
 11 But that's a matter for Morrisons as to whether actually
 12 it has turned out that they have or haven't been able to
 13 secure a lower price from Gallaher. Because if they get
 14 a lower price from Gallaher, then they will price
 15 Dorchester below Richmond, and then they will say to
 16 Imperial, "Well, that's as a result of Gallaher making
 17 Dorchester cheaper" and then Imperial responds or not by
 18 reducing the bonus.
 19 That's essentially what really is going on in this
 20 market, which is you have one manufacturer here trying
 21 to get the prices of his goods in the shop lower, but he
 22 is trying to do it by getting his wholesale prices lower
 23 and feeding that through to the consumer.
 24 I think you were asking at one point: how is it that
 25 the P&Ds, whatever one wants to call them, feed through

1 into lower prices to the consumer, what's the
 2 relationship? It is in fact quite simple. It's not
 3 actually really any different to the tactical bonuses.
 4 It's just in the case of a tactical bonus, it's much
 5 easier for the manufacturer to control the position
 6 because if he sees the price of his goods at £3.50 on
 7 Day 1, and he sees his competitor at Day 1 at £3.50 and
 8 Day 2 at £3.45, he knows that he can go to the retailer
 9 and say "I'll give you 5p to get me down to £3.45" and
 10 he can see that passing through. Whereas at this stage,
 11 before, at a sort of the anterior stage, it's much more
 12 difficult for him to be absolutely certain. That's in
 13 other words that he is necessarily at a lower wholesale
 14 cost. But that's what he is trying to achieve. (a) he
 15 believes because his RRP is less and he can see his
 16 wholesale price, list price is less, he believes that he
 17 therefore should be positioned at a cheaper level in the
 18 supermarket. If he is not, he infers it's because his
 19 competitor is actually undercutting him, and so he has
 20 to respond by undercutting.
 21 So that's actually how it all operates.
 22 Now, in the second agreement, if we turn to that,
 23 the wording is slightly different, but it is in fact
 24 still operating in the same way. If you go to tab 85,
 25 the relevant paragraph is on the second page at 463 and

1 it's the passage under "Pricing". You can see what it
 2 says is:
 3 "Morrison agree to continue supporting Imperial's
 4 pricing strategy and accept that Imperial make pricing
 5 investments based on two fundamental criteria:
 6 achievement of the natural price list differentials that
 7 exist between the manufacturers and the absolute levels
 8 of those shelf prices."
 9 Stopping there for a moment, that again comes back
 10 to the point that the absolute level is the level below
 11 RRP. Again, it is dangerous to proceed on the basis
 12 that there is no interest in the absolute levels. There
 13 are, and particularly in the supermarkets, there is
 14 a great interest in their being below RRP, not least
 15 because you are trying to get your product sold, and so,
 16 as I say, there are these two things going on.
 17 Then if you go to the next paragraph:
 18 "Based on the continued achievement of those
 19 differentials and the shelf prices highlighted in the
 20 ongoing schedule of costs, bonuses and margins
 21 documents, Imperial will pay all of these bonuses
 22 off-invoice subject to the following conditions: should
 23 our competitors reduce their shelf prices, Imperial
 24 should be allowed to respond in order to realign with
 25 the price list differentials. Should any additional

1 funding be agreed to support a response to competitor
 2 activity should be removed once that activity has
 3 ended."
 4 What that is showing, again, firstly, it's
 5 anticipated that Morrisons is free to cut prices of
 6 competitor products, here it's in response to the
 7 competitor -- it must be the competitor funding is
 8 what's meant -- and Imperial in that event wants to be
 9 free to respond. Then the next paragraph:
 10 "With the exception of the application of either
 11 Budget or manufacturer price increases, Imperial
 12 Tobacco's investment should reduce in line with any
 13 upward movement in shelf price."
 14 Now, what that's talking about is it's trying to
 15 capture two things: it's trying to say "We don't want
 16 you, Morrisons, to move up our prices absent there being
 17 a Budget or manufacturer price increase, so if you
 18 moreover up our prices then that is going to cause
 19 a reduction in the bonus", and so it's meant to -- this
 20 is actually again, in the agreement what you actually
 21 see is disincentivising the retailer from increasing
 22 Imperial's prices. It's trying to keep the prices down.
 23 So the first point we make on these agreements is
 24 that that paragraph would cover also a situation, we
 25 suggest as a matter of sensible construction, where what

1 Morrisons seeks to do is to put up the price of
 2 Imperial's product as a result of an MPI by Gallaher.
 3 But the other point, of course -- I'll come back to
 4 that in a moment.
 5 So the first point is that we say there is nothing
 6 in these agreements to stop Morrisons from entering into
 7 more favourable arrangements with Gallaher; indeed, they
 8 expressly contemplate it. So if you are saying there is
 9 a restriction on favouring Gallaher, it's very odd if
 10 you actually contemplated as part of the agreement that
 11 would happen, and how Imperial might respond.
 12 We say once you bear that in mind, it's clear
 13 actually this is an incentive and not a commitment to do
 14 this, come what may. So Mr Lasok, in his opening, said
 15 that these agreements represented a clear commitment by
 16 Morrisons to subscribe to the ITL pricing strategy, when
 17 properly construed, they do not. Clearly ITL is hoping
 18 that Morrisons is going to follow it, but the extent to
 19 which Morrisons does depends (a) on its own interests,
 20 (b) on its benchmarking, and (c) the extent to which
 21 Gallaher takes competitive action.
 22 **DR SCOTT:** Mr Howard, just at that point, as we look at
 23 page 463, it gives the impression that ITL is not by way
 24 of paying money any old how, because it has to justify
 25 payments to its auditors.

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1 **MR HOWARD:** Yes.
 2 **DR SCOTT:** In that way, were they treating Morrisons
 3 differently to their relationship with the Co-op, or was
 4 this a general policy that ITL didn't pay money?
 5 **MR HOWARD:** I am not sure that I understand the question.
 6 **DR SCOTT:** Well, we have been hearing earlier in the day
 7 that the Co-op expected money to be paid by ITL
 8 regardless of any performance. On page 463 you have
 9 a rather different position, that ITL are concerned that
 10 they do have to justify these payments.
 11 **MR HOWARD:** What you will hear from Mr Matthews is -- and to
 12 some extent maybe this explains some of what we are
 13 hearing about the Co-op -- what historically the various
 14 bonuses, whatever one wants to call it, have been paid
 15 to the supermarkets, and I think particularly in the
 16 case of Co-op what you were hearing was "we regarded
 17 this as basically the terms of trading; in other words,
 18 to get into our shops, basically we expect you to pay
 19 this sum of money".
 20 Now, on the other hand, you have Imperial
 21 recognising in part that they are going to have to pay
 22 whatever you want to call it, a sweetener, terms of
 23 trading, whatever it is, but they are trying to extract
 24 a price, as you would expect. So in this case, you can
 25 see that an agreement has been drawn up which has,

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1 expresses this in terms of incentives, and as far as
 2 Imperial is concerned, it is hoping that Morrisons is
 3 going to take some notice of this, but it recognises
 4 that Morrisons might just put this in the drawer and do
 5 nothing about it. And that's actually Morrison's
 6 evidence, that they basically, and I think you will find
 7 that that's the evidence of all the supermarkets, they
 8 all say, "We didn't actually take any notice of this
 9 whatsoever" and actually the interesting thing is going
 10 to be that's actually true of Sainsbury's as well, we
 11 will hear that when we hear their witness, the one
 12 witness the OFT is going to call.
 13 The supermarkets seem to -- almost to a man or
 14 a woman -- be saying that this is, we recognise that
 15 Imperial had these aspirations but we didn't regard
 16 ourselves as in any way bound by this.
 17 The reason that's the binding/incentive point is
 18 important is that you are looking for a restriction, and
 19 if actually all that you have is an incentive
 20 arrangement, it's less likely that that of itself is
 21 giving rise to any restriction, still less the type of
 22 restriction that the OFT is talking about.
 23 **THE CHAIRMAN:** Well, we may have to have a debate in due
 24 course as to whether the existence of a restriction
 25 depends on an objective or a subjective assessment of

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1 the intentions of the parties looking at the documents.
 2 **MR HOWARD:** Yes. We may have to, but that's actually
 3 a slightly different debate, in the sense that there can
 4 be one debate where one could have an argument where
 5 what one sees is the agreement appears to create on its
 6 face a restriction, and then there is an issue as to:
 7 well, if the parties to it did not so understand it, how
 8 is that relevant in relation to whether you then have
 9 an anticompetitive agreement? But I am on a different
 10 point, which is actually that not only did the parties
 11 not see this as creating a restriction, but actually the
 12 agreement itself, even properly construed, doesn't
 13 create a restriction that -- if what you are saying is
 14 "Well, I'm giving you an incentive" and they are free to
 15 take it or not and to price their goods as to how they
 16 see fit, then it's very difficult to see there is
 17 a restriction whereby they are prevented from favouring
 18 Gallaher, which is what you have to remember, that's the
 19 point of all this.
 20 **THE CHAIRMAN:** Yes, but where we have a situation where the
 21 agreement says one thing, the retailers say "Well, we
 22 just put it in a drawer and ignored it" but still ITL
 23 paid the bonuses, year on year, then we do have a rather
 24 puzzling set of facts which may give rise to those sort
 25 of legal considerations.

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1 **MR HOWARD:** Yes, but you still have to come back. I am not
 2 running away from that, seeing that there is
 3 an interesting conundrum, potentially, but in fact on
 4 our analysis there isn't really any conundrum at all,
 5 for this reason: that if the agreement said "You,
 6 Morrisons, must not give Gallaher the opportunity to
 7 undercut us", let's say that's what it said, because
 8 that's really in part what the OFT's case is amounting
 9 to. We say they don't say that. But let's assume it
 10 said that in terms and we said "We will pay you
 11 £1 million a year not to ever allow Gallaher to
 12 undercut", and then the evidence was they put that in
 13 the drawer and we pay them the £1 million a year, and
 14 they say they didn't take any notice of it. You would
 15 then have to decide, well, there is an agreement which
 16 explicitly says this, you were paid £1 million, what do
 17 I do with this evidence where you say "Well, I wasn't
 18 actually applying it"?
 19 I'm on a different point, which is: well, what
 20 actually was it that the agreement says? All the
 21 agreement actually properly construed is saying is, "You
 22 can take Gallaher's money, but if you do, then I would
 23 like an opportunity to respond to it; in other words
 24 I am not stopping you, I am not stopping Gallaher having
 25 price promotions, not in any way disincentivising you

1 from taking Gallaher's price promotions".
 2 That is actually a sort of a rather different point.
 3 Now, I do not want to go back over Co-op, but just
 4 hearing that evidence, obviously there will be
 5 a question as to whether in the light of that, looking
 6 at the true agreement, whether any restriction could
 7 have been accepted, but that's really a battle that
 8 Co-op is running. For my part, my essential point is:
 9 we are starting from the premise that there are the
 10 agreements, but we say those agreements don't on their
 11 face give rise to any restriction.
 12 So in other words we are not -- Co-op may be
 13 right --
 14 **THE CHAIRMAN:** Do I understand your position may differ from
 15 Co-op's?
 16 **MR HOWARD:** So the first point is: what are these agreements
 17 doing, and we say they are providing an incentive but
 18 they are not providing for a restriction. As I say,
 19 I do apologise for, as it were, repeating the point, but
 20 it is central to the case: how are Morrisons restricted?
 21 You did hear at one stage, I think, that they are
 22 restricted, it's said, because they cannot themselves
 23 independently do price reductions. Let's leave that on
 24 one side for a moment. The decisions were based on
 25 Morrisons not being able to favour Gallaher. In our

1 submission, that is an impossible argument based on
 2 these trading agreements. We will look in the morning
 3 at the correspondence, but based on the trading
 4 agreements, that doesn't arise.
 5 Insofar as it's said there is a restriction on
 6 Morrisons themselves, again, there is nothing in these
 7 agreements which actually says Morrisons, if they so
 8 choose, cannot fund price reductions, and indeed
 9 Morrison's case, and you will see in the documents, that
 10 they did. One of the reasons is of course -- I mean,
 11 that's price reductions for Imperial or for Gallaher.
 12 One of the things again that is important to bear in
 13 mind is if Morrisons -- if what they choose to do, is if
 14 we take Richmond and Dorchester, let's say they put
 15 Dorchester 1p below Richmond, what then happens in
 16 reality? In reality what happens is ITL pay them some
 17 more money to get the price of Richmond down.
 18 **THE CHAIRMAN:** When you say "Oh, it's an incentive, it's not
 19 an obligation", absent any particular tactical
 20 promotion, how would you describe the incentive?
 21 An incentive to do or not to do what, exactly?
 22 **MR HOWARD:** On Day 1?
 23 **THE CHAIRMAN:** At a time when there is no promotion going on
 24 in relation to one of the brands in the pricing sheet,
 25 what are you trying to incentivise them to do?

1 **MR HOWARD:** You are trying to incentivise them to do exactly
 2 what actually you see on the piece of paper. If you
 3 take Richmond, that it should be no more expensive than
 4 Dorchester and the premise for that is that you believe
 5 you are selling them Richmond at a price which makes
 6 that worthwhile for them, and so you are trying to
 7 incentivise them not to discriminate against Richmond
 8 whereby you have it at an RRP which is equivalent to
 9 Dorchester, your wholesale price is equivalent or better
 10 than Dorchester, and you believe that the price at which
 11 you are actually selling it to Morrisons is equivalent
 12 or better than Dorchester, and so what you are trying to
 13 do is make sure they don't upset your strategy, which is
 14 to gain market share for Richmond, by their putting
 15 Richmond a penny above Dorchester.
 16 That's what manufacturers all the time are trying to
 17 do, that's what Coca-Cola/Pepsi in their price wars,
 18 they are trying to ensure that retailers reflect on the
 19 shelf prices a lower price that they are trying to give
 20 or an equivalent price. They have a keen interest in
 21 how they are priced by the retailer as against the
 22 competition. They have two interests. One is ensuring
 23 that the retailer is -- that's why they are keen on
 24 selling below RRP -- going to maximise the sales of the
 25 product and, because that gets them market share. So if

1 they published an RRP of, say, £4, the public who smoke
 2 know that, and that's out there in the public domain, so
 3 people who -- other than convenience stores where people
 4 may be prepared, because it's convenient, to pay more,
 5 but they are concerned not to have their cigarettes
 6 being sold at prices above RRP. So they want to get the
 7 price down below RRP and then to be competitive with the
 8 competing brand. So that's what they are incentivising.
 9 **DR SCOTT:** But also, as we understand it, they want to be
 10 able to change things when, as we see with Richmond,
 11 Dorchester and Mayfair, they decide on some
 12 repositioning or introducing Superking size or whatever.
 13 **MR HOWARD:** The OFT says it's all in the context of these
 14 agreements, but in fact it isn't. A lot of that is
 15 operating outside. Most of the promotional discounts
 16 are operating just in a market environment where you see
 17 one manufacturer -- your rival has moved. Now, you may
 18 say to the retailer, and we see this obviously lots of
 19 times in the correspondence, you see them say "I see
 20 that Dorchester has gone down to 3.34, I want to match
 21 it". But the thing is, there is no secret about the
 22 fact that Richmond and Dorchester are competing brands.
 23 They are in the ultra low price sector.
 24 **THE CHAIRMAN:** One of the issues we will have to decide is
 25 whether the tactical bonuses are, as the OFT say, one of

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1 the mechanisms by which the parities and differentials
 2 are maintained or enforced, or however you want to
 3 describe it, or whether as you say they are
 4 a manifestation of strong price competition and brands
 5 repositioning quite apart from the P&Ds.
 6 **MR HOWARD:** The thing is, it's actually quite a simple point
 7 in reality. They are not -- I don't know how anybody
 8 can say you are enforcing the strategy, but if, for
 9 instance, it's known "I want to price Richmond at no
 10 more expensive than Dorchester", that's known from the
 11 RRP or is just known because that's your strategy, you
 12 don't have to necessarily have the retailer being
 13 incentivised at all. So that when you see Richmond more
 14 expensive than Dorchester in his shops, you will go to
 15 him and say "What can I do to get the price down?" And
 16 that's an absolutely normal thing to do, how much will
 17 it cost me to do it, and you can see how much you infer
 18 it costs. When you see the price of Dorchester is
 19 a penny below, it will cost you a penny. Obviously
 20 there may be a calculation with the VAT and so on. What
 21 you see actually -- actually this file, again, I am
 22 sorry, I will tomorrow morning want to go through the
 23 documents, because it's a helpful file in that
 24 Mr Matthews very often when he writes the letters
 25 actually records how it's -- what is happening in terms

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1 of the bonuses, and so you see when he says it's coming
 2 down, the price is to come down 5p in order to match
 3 somebody else, he then sets out the revised bonus, and
 4 sometimes you have the two different prices, so you can
 5 see explicitly what is happening; in other words, there
 6 is less of the shorthand that you sometimes see in the
 7 other files. So it's a helpful one for that purpose.

8 **THE CHAIRMAN:** Is that a convenient moment to break?

9 **MR HOWARD:** Yes.

10 Discussion re timetable

11 **THE CHAIRMAN:** Now, as far as tomorrow is concerned, you are
 12 going to continue, and then Mr Saini, are you going to
 13 say something before Mr Matthews is called?

14 **MR SAINI:** I was going to actually wait until after
 15 Mr Matthews.

16 **THE CHAIRMAN:** Okay. Are we still confident that we will
 17 finish Mr Matthews on Friday, and if not, what does that
 18 mean about what we do with Mr Eastwood for Tuesday?
 19 It's my understanding that, do we have to make sure we
 20 can finish Mr Eastwood on Tuesday?

21 **MR SAINI:** No, he can come on Wednesday as well.

22 **THE CHAIRMAN:** Okay. Yes, Mr Williams?

23 **MR WILLIAMS:** Madam, it did just occur to me that given that
 24 Mr Matthews has travelled from the United States, there
 25 will obviously be a real advantage in being able to

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1 release him tomorrow if that's at all possible. One
 2 can't anticipate how quickly the cross-examination would
 3 go, but a 10 am start would give us a better chance of
 4 being able to release him at the end of the day and you
 5 have probably already seen there is quite a lot of
 6 material in relation to Morrisons.

7 I think we have a full day ahead of us at least, but
 8 if the Tribunal could sit at 10 o'clock that would
 9 improve the prospect of being able to release him before
 10 the weekend.

11 **THE CHAIRMAN:** Is that convenient for everyone? Yes, well,
 12 we will start at 10 o'clock tomorrow morning. Thank you
 13 very much.

14 (4.45 pm)

15 (The court adjourned until 10.00 am on
 16 Friday, 14 October 2011)

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