Competition Act 1998

Decision of the Office of Fair Trading

Case CE/2596-03: Tobacco

15 April 2010

Confidential information in the original version of this Decision has been redacted from the published version on the public register. Redacted confidential information in the text of the published version of the Decision is denoted by 'C'.
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GLOSSARY

In this Decision, the following defined terms are frequently used throughout the document:

'2000 Order' means the Competition Act 1998 (Determination of Turnover for Penalties) Order 2000 (SI 2000/309);

'2004 Order' means the Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2004 (SI 2004/1259);

'Act' means the Competition Act 1998;

'Article 101(1)' means Article 101(1) of the Treaty on the Functioning of the European Union (‘TFEU’);

'Article 101(3)' means Article 101(3) of the TFEU;

'CAT' means the Competition Act Tribunal;

'Chapter I Prohibition' means the prohibition imposed by section 2(1) of the Act;

'Commission' means the European Commission;

'Decision' means this Decision, issued by the OFT on 16 April 2010;

'ECJ' means the European Court of Justice;

'EU' means the European Union;

'EU Council' means the Council of the European Union;

'Early Resolution agreement' means an agreement concluded by a Party with the OFT, in which a Party admitted liability in respect of all of the infringements alleged against it, and agreed to pay an individual penalty which reflected a significant reduction in the financial penalty that might otherwise have been imposed in recognition of the
procedural co-operation by that Party as set out in the Early Resolution agreement;

'Early Resolution Parties' means each of the parties that have concluded an Early Resolution agreement with the OFT;

'Infringing Agreements' means the agreements and/or concerted practices between each Manufacturer and each Retailer whereby the Retailer would apply retail pricing relativities between competing tobacco brands required by the Manufacturer (individually, 'the Infringing Agreement');

'Parties' means the undertakings listed at paragraph 1.2 of this Decision (each a Party);

'Penalty Guidance' means OFT's Guidance as to the Appropriate Amount of a Penalty (OFT 423, Edition 12/04);

'SO' means the Statement of Objections in this case, issued by the OFT on 24 April 2008;

'SSO' means the Supplementary Statement of Objections in this case, issued by the OFT on 19 June 2008;

'UK' means the United Kingdom.

ii) The following industry-specific terms appear of this Decision:

'B&H' Benson & Hedges (Gallaher cigarette brand)

'CTNs' Confectioners, tobacconists and newsagents

'EPOS' Electronic point of sale

'HRT' Hand rolling tobacco

'JPS' John Player Special (ITL cigarette brand)

'KS' King Size (cigarette size)

'L&B' Lambert & Butler (ITL cigarette brand)

'NAC' National account controller

'NAE' National account executive
iii) Annex C of this Decision contains lists of the documents relied on in this Decision, which were contained in Annexes 1-29 of the SO. For ease of reference, the lists follow the numbering of the documents at Annexes 1-29 as used in the SO, save that for the purposes of this Decision, only those documents relied on in this Decision are listed in Annex C. That means that in certain cases there are gaps in the numbering of documents.
1 INTRODUCTION

A EXECUTIVE SUMMARY

1.1 By this decision, of which Annexes A to D form an integral part ('this Decision'), the Office of Fair Trading ('the OFT') has concluded that the parties listed at paragraph 1.2 below (each a 'Party', together 'the Parties') have infringed the Chapter I prohibition imposed by section 2(1) of the Competition Act 1998 ('the Chapter I Prohibition') ('the Act') by participating in agreements and/or concerted practices which had as their object the prevention, restriction or distortion of competition in the supply of tobacco products in the UK ('the Infringing Agreements' and individually 'the Infringing Agreement'). The conduct of the Parties that is the subject of this Decision spanned different periods for different Parties between 2000 to 2003.

I The Parties

1.2 This Decision is hereby addressed to each party to which the OFT has attributed liability in respect of the agreements and/or concerted practices which the OFT has concluded constitute an infringement of the Chapter I Prohibition and for the resulting penalty in each case:

- Imperial Tobacco Group plc and Imperial Tobacco Limited (together 'ITL');
- Gallaher Group Limited and Gallaher Limited (together 'Gallaher');
- Asda Stores Limited, Asda Group Limited, Wal-Mart Stores (UK) Limited and BroadStreet Great Wilson Europe Limited (together 'Asda');
- The Co-operative Group Limited ('the Co-operative Group');
- First Quench Retailing Limited, Thresher Wines Acquisitions Limited, and Thresher Wines Holdings Limited (together 'First Quench');
- Wm Morrison Supermarkets plc ('Morrison');
- One Stop Stores Limited (formerly T&S Stores Limited ('T&S Stores'));\(^1\)

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\(^1\) This Decision is also addressed to Tesco plc by virtue of an early resolution agreement concluded with the OFT on 11 July 2008, pursuant to which One Stop Stores Limited
• Safeway Stores Limited and Safeway Limited (together 'Safeway');
• Sainsbury’s Supermarkets Limited and J Sainsbury plc (together 'Sainsbury');
• Shell U.K. Limited, Shell U.K. Oil Products Limited and Shell Holdings (U.K.) Limited (together 'Shell');
• Somerfield Stores Limited and Somerfield Limited (together 'Somerfield'); and
• TM Retail Limited and Martin McColl Retail Group Limited (together 'TM Retail').

(each a 'Retailer', together 'the Retailers').

1.3 A description of each of the Parties and the legal entities to which liability is attributed for the infringements and the resulting penalty in each case is set out at Section 2A of this Decision ('The Parties').

II Summary of the infringements

1.4 The Infringing Agreements comprised in each case an agreement and/or concerted practice between each Manufacturer and each Retailer whereby the Manufacturer co-ordinated with the Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing tobacco brands that were set by the Manufacturer, in pursuit of the Manufacturer's retail pricing strategy. The Infringing Agreement between each Manufacturer and each Retailer restricted the Retailer’s ability to determine its retail prices for competing tobacco products.

1.5 The agreements and/or concerted practices in each case had as their object the prevention, restriction or distortion of competition in the supply of tobacco products in the UK in breach of the Chapter I Prohibition.

1.6 More specifically, pursuant to each Infringing Agreement, a Retailer was to price particular brands of the Manufacturer’s tobacco products at retail prices which implemented that Manufacturer’s desired pricing relativities between its brands and the brands of a competing Manufacturer. Those requirements were commonly referred to by the Parties as the Manufacturer’s parity and differential requirements.

1.7 The Manufacturer’s parity and differential requirements were expressed in a number of ways: (i) as a parity (for example, a requirement that the relevant Manufacturer’s brand X be the same price as the competing
Manufacturer’s brand Y); (ii) as a fixed differential (for example, a requirement that the relevant Manufacturer’s brand X must be z pence less than the competing Manufacturer’s brand Y); and (iii) as a maximum differential (for example, a requirement that the relevant Manufacturer’s brand X be no more expensive than the competing Manufacturer’s brand Y, or that brand X be priced at least z pence less than brand Y). Those requirements were implemented in particular through regular communications by the Manufacturer of specific price points to the Retailer.

1.8 The Infringing Agreements involved, among other matters, a combination of the following elements (although not all of the following elements were present in each Infringing Agreement):

i) The Manufacturer’s strategy in relation to the Retailer’s retail prices (namely to achieve the parity and differential requirements between competing tobacco brands that were set by the Manufacturer).

ii) Written trading agreements between a Manufacturer and a Retailer under which the Retailer agreed that it would price a number of the Manufacturer’s brands according to the parity and differential requirements stipulated by the Manufacturer.

iii) Contacts between the Manufacturer and the Retailer regarding:
   (i) the retail prices for the Manufacturer’s brands; (ii) the retail prices for the Manufacturer’s competitors’ brands; (iii) the retail prices charged by the Retailer’s competitors.

iv) The payment or withdrawal of bonuses and other incentives (whether financial or other) by the Manufacturer to incentivise the Retailer to set its retail prices in accordance with the Manufacturer’s retail pricing strategy.

v) Frequent and detailed monitoring, complaints by the Manufacturer and subsequent alignment of the Retailer’s retail prices to ensure compliance with the Manufacturer’s retail pricing strategy.

1.9 The evidence also demonstrates that the Retailer accepted and/or indicated its willingness to implement the Manufacturer’s parity and differential requirements.

1.10 The relevant provisions of some of the written trading agreements between the Manufacturer and the Retailer where phrased in terms of parity and fixed differential requirements whereas others were phrased in terms of maximum differential requirements. In response to the OFT’s Statement of Objections (‘SO’) in this case, some Parties submitted that,
irrespective of the language used in various agreements and communications, the Manufacturer’s parity and differential requirements merely imposed an obligation on the Retailer not to set retail prices above a maximum price level and that was not consistent with and/or did not lead to the Manufacturer stipulating a fixed or minimum pricing obligation in respect of the retail price of its brands. Some Parties submitted that the notification by the Manufacturer of specified retail prices tailored to each Retailer was merely a form of suggested or recommended retail prices.

1.11 The OFT acknowledges that in certain trading agreements, parity and differential requirements were ostensibly expressed as *maximum* differential requirements and, in certain communications from a Manufacturer to a Retailer, instructions and/or requests were occasionally expressed as stipulating maximum prices or maximum differential requirements. However, taking the evidence as a whole, the OFT considers that the Infringing Agreements in fact provided for parity and fixed differential requirements which were implemented by communications from the Manufacturer to the Retailer pursuant to which the Retailer was to move to a specific retail price point. The Retailer’s compliance with such communications was induced by the grant of ongoing and tactical bonuses; and divergences from the price points communicated by a Manufacturer were detected through the Manufacturer’s monitoring of the Retailer’s retail prices. Further, the Manufacturer’s communications with the Retailer to change the retail prices as a result of the Manufacturer’s monitoring of the Retailer’s retail prices included instructions and/or requests in some instances to increase prices, which is consistent with the existence of a parity or fixed differential requirement, rather than a maximum price or a maximum differential requirement.

1.12 The restrictive nature of the Infringing Agreements resulted from the linking of the retail price of competing brands, since that restricted the Retailer’s ability to determine its retail prices for the Manufacturer’s brands and those of competing linked brands to any extent that differed from the prescribed parity or differential.

1.13 The restriction on a Retailer’s ability to determine its retail prices for competing linked brands is by its very nature, capable of restricting competition. In particular, such a requirement precluded a Retailer from favouring the brand(s) of one Manufacturer over those of another and was capable of significantly reducing uncertainty, both for a Manufacturer which imposed the parity and differential requirements and a competing Manufacturer which observed the consequences of such requirements (or had knowledge of such requirements), as regards the retail prices of the Manufacturer’s brands and those of the competing linked brands. The
long-term implementation of the Manufacturers’ parity and differential requirements would therefore reduce the incentives, both for the Manufacturer which imposed the requirements and the competing Manufacturer, to engage in inter-brand competition in relation to wholesale pricing.

1.14 Furthermore, it is clear from the nature of each of the Parties’ conduct as evidenced in this Decision, including the nature of the routine retail pricing communications between each Manufacturer and each Retailer, that the Infringing Agreements went considerably further than maximum or suggested retail pricing. It is particularly clear from the communications between each Manufacturer and each Retailer that the Retailer did not set its retail prices independently from the Manufacturer, but with the Manufacturer’s active involvement in pursuit of the Manufacturer’s parity and differential requirements.

1.15 Both Manufacturers communicated parallel and symmetrical parity and differential requirements\(^2\) to the same Retailer and there is evidence that each Manufacturer must have been aware\(^3\) of the other Manufacturer’s parallel and symmetrical parity and differential requirements.

1.16 The fact that each Manufacturer had agreed parallel and symmetrical requirements with the same Retailer provides further support for the OFT’s case that the Infringing Agreements gave rise to the observance of parity and fixed differential requirements in relation to competing brands. That is because Retailers could only implement *both* Manufacturers’ pricing relativity requirements by adhering to parity or fixed differential pricing. For example, symmetrical agreements that provided in one agreement that brand X must be no more than brand Y, and in the other agreement that brand Y must be no more than brand X, could only be satisfied by pricing brand X and brand Y at the same level.

1.17 The existence of parallel and symmetrical Infringing Agreements is part of the context of each Infringing Agreement and is relevant to how the Manufacturer and the Retailer party to an Infringing Agreement would have viewed the requirements imposed under each Infringing Agreement, since a Retailer was party to a similar Infringing Agreement with each

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\(^2\) The symmetry was in terms of the competing brands that were frequently linked by both Manufacturers and the Manufacturers’ parity and differential requirements in respect of those brands.

\(^3\) The phrase ‘must have been aware’, when used in this Decision in relation to the Manufacturers, is used in respect of situations in which the OFT has inferred from particular documents and/or the surrounding circumstances knowledge on the part of a Manufacturer of the other Manufacturer’s parallel and symmetrical parity and differential requirements.
Manufacturer and the Manufacturer was party to a similar Infringing Agreement with each Retailer.

1.18 Further, the long-term implementation of the Manufacturers' parallel and symmetrical parity and differential requirements meant that each Manufacturer could predict with even greater certainty retail price movements in relation to the Manufacturer's own brands and those of the competing Manufacturer. Where a parity requirement existed, for example, each Manufacturer could increase the price of its brand with relative certainty that its competitor (given its equivalent parity and differential requirements) would do likewise via the Retailer to restore its parity and differential requirements.

1.19 When the Infringing Agreements are viewed in the legal and economic context in which they operated (in particular, that Manufacturers, representing 90 per cent (by volume) of the relevant market at the time, had agreed parallel and symmetrical parity and differential requirements with a number of Retailers), the reduction in uncertainty on the part of each Manufacturer as regards its horizontal competitor's likely market behaviour resulting from the Infringing Agreements enabled the Manufacturers to achieve or maintain a degree of stability in relation to inter-brand competition which was similar to that which would have resulted from horizontal price co-ordination between competitors.

1.20 Accordingly, the OFT considers that the totality of the evidence addressed in this Decision demonstrates the existence of an agreement and/or concerted practice between each Manufacturer and each Retailer, which had the object of preventing, restricting, or distorting competition in the supply of tobacco products in the UK in breach of the Chapter I Prohibition, as set out more fully in this Decision.

B THE OFT'S ACTION

1.21 Each of the Infringing Agreements (save the Infringing Agreement between Gallaher and Shell, which existed from 20 August 2001), was entered into and took effect before 1 March 2000, when the Chapter I Prohibition came into force. Pursuant to paragraph 19 of Schedule 13 to the Act, the consequence of an Infringing Agreement being in existence before 1 March 2000 is that it benefitted from a one year transitional period during which the Chapter I Prohibition did not apply such that the starting date of that Infringing Agreement, for the purposes of a finding of infringement of the Chapter I Prohibition, is taken to be 1 March 2001. For the purposes of this Decision, and save in relation to the three exceptions set out below, the OFT has elected to treat the Infringing Agreements as having come to an end on 15 August 2003 when the OFT
sent out the first request for documents and information under section 26 of the Act ('a section 26 Notice'). The three exceptions are the Infringing Agreement between Gallaher and First Quench (which ended on 19 December 2002), Sainsbury and ITL (which ended on 9 March 2003) and Sainsbury and Gallaher (which ended on 9 March 2003).

1.22 In these circumstances, the OFT considers that it is not necessary to give directions under section 32 of the Act to any of the Parties to bring the infringements to an end.

1.23 However, with the exception of Sainsbury, the OFT is imposing a financial penalty on each of the Parties under section 36 of the Act in relation to the Infringing Agreements to which it was party.

1.24 Pursuant to the OFT’s leniency programme, Sainsbury has been granted total immunity from penalty and Somerfield and One Stop Stores (formerly named T&S Stores) have each been granted a partial reduction in financial penalty. Asda has been granted a partial reduction in financial penalty on the basis that it has obtained total immunity from financial penalties in respect of a completely separate infringement of the Chapter I Prohibition in relation to its activities in other, separate markets.

1.25 In addition, each of Gallaher, Asda, First Quench, One Stop Stores, Somerfield and TM Retail has been granted a further reduction in financial penalty by virtue of an agreement it concluded with the OFT on 11 July 2008, pursuant to which, among other matters, each admitted its involvement in the Infringing Agreements to which it was party in breach of the Chapter I Prohibition (an ‘Early Resolution agreement’).

1.26 A further reduction of 10 per cent to the financial penalty of each Party has been applied to acknowledge the length of time taken in the investigation in the exceptional circumstances of this case.

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4 Section 26 of the Act empowers the OFT, for the purposes of an investigation under section 25 of the Act, to require any person to produce to it a specified document, or to provide it with specified information, which the OFT considers relates to any matter relevant to the investigation.
2 FACTUAL BACKGROUND

A THE PARTIES

I The Manufacturers

ITL

2.1 The OFT is addressing this Decision to Imperial Tobacco Group plc and Imperial Tobacco Limited (together 'ITL'). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them in this Decision and for the resulting penalty that the OFT is imposing.

2.2 Imperial Tobacco Group plc is a UK-based leading international tobacco company that manufactures and sells a range of tobacco and tobacco-related products. Imperial Tobacco Limited is a wholly-owned subsidiary of Imperial Tobacco Group plc and comprises the UK division of Imperial Tobacco Group plc’s business.

2.3 During the infringement period ITL produced cigarettes, cigars, hand rolling tobacco ('HRT') and pipe tobacco. Its leading brands included: Lambert and Butler, Richmond, Superkings, Embassy, John Player Special, Regal (cigarettes); Golden Virginia, Drum (HRT); Castella (cigars); and St Bruno (pipe tobacco). In the UK, ITL also distributed Marlboro, Chesterfield and Raffles cigarettes on behalf of Philip Morris International ('Philip Morris'), and Café Crème cigars on behalf of Henri Wintermans Sigarenfabrieken BV ('Henri Wintermans').

2.4 The registered address of Imperial Tobacco Limited and Imperial Tobacco Group plc is PO Box 244, Upton Road, Bristol, Avon BS99 7UJ.

2.5 The legal entity directly engaged in the Infringing Agreements that are the subject of this Decision was Imperial Tobacco Limited (see Section 6.C: 'The Infringing Agreements'). Accordingly, the OFT has attributed liability to Imperial Tobacco Limited for the resulting infringements and for the consequential penalty that the OFT is imposing.

2.6 As set out in Section 3 below ('Legal Background'), where a parent company exerts decisive influence over a subsidiary, liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed to Imperial Tobacco

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5 Since 12 September 2001 for Marlboro and 1 January 2002 for Chesterfield and Raffles.
Group plc, on a joint and several basis, liability for the infringements attributed to Imperial Tobacco Limited and for the consequential penalty that the OFT is imposing, given its 100 per cent ownership of Imperial Tobacco Limited.

**Gallaher**

2.7 The OFT is addressing this Decision to Gallaher Group Limited and Gallaher Limited (together 'Gallaher'). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them in this Decision and for the resulting penalty that the OFT is imposing.

2.8 Gallaher Group Limited is an international tobacco manufacturing and wholesale company whose UK operations are carried out by Gallaher Limited, a wholly-owned subsidiary of Gallaher Group Limited.

2.9 During the infringement period Gallaher produced cigarettes, cigars, HRT and pipe tobacco. Its leading brands included: Benson and Hedges, Silk Cut, Mayfair, Berkeley and Dorchester (cigarettes); Hamlet (cigars); Old Holborn and Amber Leaf (HRT); and Condor (pipe tobacco). In the UK, Gallaher also distributed Camel and More cigarettes for Japan Tobacco International, and Samson HRT and Clan pipe tobacco for Theodorus Niemeyer BV.

2.10 Gallaher Group Limited was registered as a public limited company during the infringement period and was re-registered as a private limited company on 17 December 2007.

2.11 The registered address of Gallaher Limited and Gallaher Group Limited is Members Hill, Brooklands Road, Weybridge, Surrey, KT13 0QU.

2.12 The legal entity directly engaged in the Infringing Agreements that are the subject of this Decision was Gallaher Limited (see Section 6.C: 'The Infringing Agreements'). Accordingly, the OFT has attributed liability to Gallaher Limited for the resulting infringements and for the consequential penalty that the OFT is imposing.

2.13 As set out in Section 3 below ('Legal Background'), where a parent company exerts decisive influence over a subsidiary liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed to Gallaher Group Limited, on a joint and several basis, liability for the infringements attributed to Gallaher Limited and for the consequential penalty that the OFT is imposing, given its 100 per cent ownership of Gallaher Limited.
The Retailers

Asda

2.14 The OFT is addressing this Decision to Asda Stores Limited, Asda Group Limited, Wal-Mart Stores (UK) Limited and BroadStreet Great Wilson Europe Limited (together ‘Asda’). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them in this Decision and for the resulting penalty that the OFT is imposing.

2.15 Asda Stores Limited is a British supermarket chain active in the retail of food, clothing, home and leisure products.

2.16 During the infringement period Asda Stores Limited was a wholly-owned subsidiary of Asda Group Limited which was in turn a wholly-owned subsidiary of Wal-Mart Stores (UK) Limited. On 24 January 2003, BroadStreet Great Wilson Europe Limited acquired by way of a share exchange as part of a group restructuring the whole of the issued share capital of Wal-Mart Stores (UK) Limited, and became its immediate UK parent.

2.17 The registered address of Asda Stores Limited, Asda Group Limited, Wal-Mart Stores (UK) Limited and BroadStreet Great Wilson Europe Limited is ASDA House, Great Wilson Street, Leeds, LS11 5AD.

2.18 The legal entity directly engaged in the Infringing Agreements that are the subject of this Decision was Asda Stores Limited (see Section 6.C.I: ‘Agreement and/or concerted practice between ITL and Asda and between Gallaher and Asda’). Accordingly, the OFT has attributed liability to Asda Stores Limited for the resulting infringements and for the consequential penalty that the OFT is imposing.

2.19 As set out in Section 3 below (‘Legal Background’), where a parent company exerts decisive influence over a subsidiary, liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed to Asda Group Limited and in turn Wal-Mart Stores (UK) Limited and BroadStreet Great Wilson Europe Limited, on a joint and several basis, liability for the infringements attributed to Asda Stores Limited and for the consequential penalty that

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6 From 1 March 2000 until 23 January 2003, Wal-Mart Stores (UK) Limited was the ultimate UK parent of Asda Group Limited and Asda Stores Limited.

7 Since the infringement period Corinth Investments Limited has become the immediate parent of Asda Group Limited having previously been its subsidiary.
the OFT is imposing, given the 100 per cent ownership chain through these companies of Asda Stores Limited.

The Co-operative Group

2.20 The OFT is addressing this Decision to the Co-operative Group Limited ('the Co-operative Group'). The OFT finds the Co-operative Group liable for the infringements that are attributed to it in this Decision and for the resulting penalty that the OFT is imposing.8

2.21 The Co-operative Group is an Industrial and Provident Society and is involved in grocery retailing, funeral services, travel agencies, pharmacies, legal services, property, banking and insurance.


2.23 The Co-operative Group was called the Co-operative Group (CWS) Limited during the infringement period and changed its name to the Co-operative Group Limited on 3 December 2007.

2.24 The Co-operative Group’s registered address is New Century House, Manchester, M60 4ES.

2.25 The Co-operative Group is owned by its members, which consist of private individuals and independent co-operative societies. The Co-operative Group is the largest member of the Co-operative Retail Trading Group ('CRTG'), a buying group which has (nearly) all co-operative retailers in the UK as members. The Co-operative Group is CRTG’s representative member and as such it represents CRTG’s other member societies in negotiating trading terms with suppliers.

2.26 The legal entity directly engaged in the Infringing Agreements that are the subject of this Decision was the Co-operative Group Limited (see Section 6.C.II: ‘Agreement and/or concerted practice between ITL and the Co-operative Group and Gallaher and the Co-operative Group’). Accordingly, for the reasons given in Section 7.B.I below, the OFT has attributed liability for the resulting infringements and for the consequential penalty that the OFT is imposing to the Co-operative Group Limited in its capacity as a retailer and/or member of the CRTG.

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8 For the purposes of this Decision, the OFT makes a finding only in respect of the Co-operative Group’s individual liability as a retailer and/or as a member of CRTG and therefore is addressing this Decision only to the Co-operative Group.
First Quench

2.27 The OFT is addressing this Decision to First Quench Retailing Limited, Thresher Wines Acquisitions Limited, and Thresher Wines Holdings Limited (together 'First Quench'). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them in this Decision and for the resulting penalty that the OFT is imposing.

2.28 First Quench Retailing Limited was an independent specialist drinks retailer which traded under several retail brands including Threshers, Wine Rack, Victoria Wine, Bottoms Up, Drinks Cabin, The Local Huttons, Thresher plus Food and, in Scotland, Haddows.

2.29 During the infringement period, First Quench Retailing Limited was the wholly-owned subsidiary of Thresher Wines Acquisitions Limited. The immediate parent of Thresher Wines Acquisitions Limited was Thresher Wines Group Limited (a non-trading company), of which the ultimate parent in the UK with turnover was Thresher Wines Holdings Limited.9

2.30 On 29 October 2009, joint administrators were appointed for First Quench Retailing Limited.

2.31 First Quench Retailing Limited’s registered address is c/o KPMG LLP, 8 Salisbury Square, London EC4Y 8BB.

2.32 The registered address of Thresher Wines Acquisitions Limited, Thresher Wines Group Limited and Thresher Wines Holdings Limited is 5 New Street Square, London EC4A 3TW.

2.33 The legal entity directly engaged in the Infringing Agreements that are the subject of this Decision was First Quench Retailing Limited (see Section 6.C.III: ‘Agreement and/or concerted practice between ITL and First Quench and Gallaher and First Quench’). Accordingly, the OFT has attributed liability for the resulting infringements and for the consequential penalty that the OFT is imposing to First Quench Retailing Limited.

2.34 As set out in Section 3 below ('Legal Background'), where a parent company exerts decisive influence over a subsidiary, liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed to Thresher Wines Acquisitions Limited and in turn to Thresher Wines Holdings Limited, on a joint and several basis, liability for the infringements attributed to First Quench Retailing Limited and for the consequential penalty that the OFT is imposing.

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9 TFCP Holdings Limited is named as the ultimate holding company but has no turnover in the UK.
imposing, given the 100 per cent ownership chain through these companies of First Quench Retailing Limited.

**Morrisons**

2.35 The OFT is addressing this Decision to Wm Morrison Supermarkets plc (‘Morrisons’). The OFT finds Morrisons liable for the infringements that are attributed to it in this Decision and for the resulting penalty that the OFT is imposing.

2.36 Morrisons is active in the operation of retail supermarkets in the UK.

2.37 The registered address of Morrisons is Hilmore House, Gain Lane, Bradford, West Yorkshire, BD3 7DL.

2.38 The legal entity directly engaged in the Infringing Agreements that are the subject of this Decision was Wm Morrison Supermarkets plc (see Section 6.C.IV: 'Agreement and/or concerted practice between ITL and Morrisons and Gallaher and Morrisons'). Accordingly, the OFT has attributed liability for the resulting infringements and for the consequential penalty that the OFT is imposing to Wm Morrison Supermarkets plc.

**Safeway**

2.39 The OFT is addressing this Decision to Safeway Stores Limited and Safeway Limited (together ‘Safeway’). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them in this Decision and for the resulting penalty that the OFT is imposing.

2.40 The principal activity of Safeway Stores Limited is grocery retailing in the UK.

2.41 Safeway Stores plc, Stores Group Limited (a dormant holding company) and Safeway plc were acquired by Morrisons on 8 March 2004, and became wholly-owned subsidiaries of Morrisons. Morrisons therefore became the ultimate parent of Safeway Limited, Stores Group Limited and Safeway Stores Limited after the infringement period.

2.42 Safeway Limited was registered as a public limited company during the infringement period and was re-registered as a private limited company on 18 May 2004.

2.43 Safeway Stores Limited was registered as a public limited company during the infringement period and was re-registered as a private limited company on 18 May 2004.
The registered address of Safeway Stores Limited, Stores Group Limited and Safeway Limited is Hilmore House, Gain Lane, Bradford, West Yorkshire, BD3 7DL.

The legal entities directly engaged in the Infringing Agreements that are the subject of this Decision were Safeway Stores Limited and Safeway Limited (see Section 6.C.V: 'Agreement and/or concerted practice between ITL and Safeway and Gallaher and Safeway'). Accordingly, the OFT has attributed liability to Safeway Stores Limited and Safeway Limited, jointly and severally, for the resulting infringements and for the consequential penalty that the OFT is imposing.

As set out in Section 3 below ('Legal Background'), where a parent company exerts decisive influence over a subsidiary, liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed to Safeway Limited, on a joint and several basis, liability for the infringements attributed to Safeway Stores Limited and for the consequential penalty that the OFT is imposing, given its indirect 100 per cent ownership of Safeway Stores Limited.

Sainsbury

The OFT is addressing this Decision to Sainsbury’s Supermarkets Limited and J Sainsbury plc (together ‘Sainsbury’). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them in this Decision and for the resulting penalty that the OFT is imposing.

Sainsbury’s Supermarkets Limited, whose principal activity is the retail distribution of food, is a wholly-owned subsidiary of J Sainsbury plc.

The registered address of Sainsbury’s Supermarkets Limited and J Sainsbury plc is 33 Holborn, London, EC1N 2HT.

The legal entity directly engaged in the Infringing Agreements that are the subject of this Decision was Sainsbury’s Supermarkets Limited (see Section 6.C.VI: 'Agreement and/or concerted practice between ITL and Sainsbury and Gallaher and Sainsbury'). Accordingly, the OFT has attributed liability to Sainsbury’s Supermarkets Limited for the resulting infringements and for the consequential penalty that the OFT is imposing.

As set out in Section 3 below ('Legal Background'), where a parent company exerts decisive influence over a subsidiary, liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed to J Sainsbury plc, on a
joint and several basis, liability for the infringements attributed to Sainsbury’s Supermarkets Limited and for the consequential penalty that the OFT is imposing, given its 100 per cent ownership of Sainsbury’s Supermarkets Limited.

Shell

2.52 The OFT is addressing this Decision to Shell U.K. Limited, Shell U.K. Oil Products Limited and Shell Holdings (U.K.) Limited, (together ‘Shell’). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them in this Decision and for the resulting penalty that the OFT is imposing.

2.53 Shell U.K. Limited is the UK arm of the multinational company Royal Dutch Shell plc, which is one of the world’s major oil companies. The principal activities of the Shell group are the exploration, production and sale of crude oil and natural gas; and the purchasing and refining of crude oil and marketing of petroleum products and derivatives.

2.54 During the infringement period, Shell operated two types of petrol forecourts in the UK, that is, those owned by independent dealers and those owned by Shell.10 All of the Shell-owned sites operated forecourt shops under the Shell Select brand.11 (See Section 7.B.II for further details in relation to changes that took place in the operation of Shell-owned retail sites during the period under investigation).

2.55 Shell U.K. Oil Products Limited manages the downstream oil product operations and assets of Shell U.K. Limited under the terms of a management services and agency agreement.12

2.56 Both Shell U.K. Limited and Shell U.K. Oil Products Limited are wholly-owned subsidiaries of Shell Holdings (U.K.) Limited, of which Royal Dutch Shell plc has been the ultimate parent since 20 July 2005.

2.57 Royal Dutch Shell plc became the ultimate parent company of the Shell group following the unification of the two companies which jointly owned the Shell group during the infringement period. These companies were the Royal Dutch Petroleum Company, a Dutch company, and the Shell Transport and Trading Company, a UK company.

10 As at 1 August 2003, there were approximately 1000 Shell-branded forecourts in the UK. Of those, 599 sites were owned by Shell and the remaining 400 were owned by independent dealers: information provided by Shell to the OFT on 7 April 2006.
2.58 The registered address of Shell U.K. Limited, Shell U.K. Oil Products Limited and Shell Holdings (U.K.) Limited is Shell Centre, London, SE1 7NA.

2.59 The legal entities directly engaged in the Infringing Agreements that are the subject of this Decision were Shell U.K. Oil Products Limited and Shell U.K. Limited (see Section 6.C.VII: 'Agreement and/or concerted practice between ITL and Shell and Gallaher and Shell'). Accordingly, the OFT has attributed liability to Shell U.K. Oil Products Limited and Shell U.K. Limited, jointly and severally, for the resulting infringements and for the consequential penalty that the OFT is imposing.

2.60 As set out in Section 3 below ('Legal Background'), where a parent company exerts decisive influence over a subsidiary, liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed to Shell Holdings (U.K.) Limited, on a joint and several basis, liability for the infringements attributed to Shell U.K. Oil Products Limited and Shell U.K. Limited and for the consequential penalty that the OFT is imposing, given its 100 per cent ownership of both Shell U.K. Oil Products Limited and Shell U.K. Limited.

2.61 In its response to the SO, Shell submitted that Shell Holdings (U.K.) Limited did not exert decisive influence over its wholly-owned subsidiaries, Shell U.K. Oil Products Limited and Shell U.K. Limited, during the infringement period and that it should not be held liable for the actions of these subsidiaries.

2.62 As set out in Section 3 below ('Legal Background'), the European Court of Justice ('ECJ') has made clear that the exercise of decisive influence can be presumed where a subsidiary is wholly-owned by its parent, either directly or indirectly. In that situation, it is for the parent company to rebut that presumption by adducing evidence to establish that its subsidiary was sufficiently autonomous.

2.63 The OFT notes that Shell has not adduced evidence demonstrating that Shell U.K. Oil Products Limited or Shell U.K. Limited acted autonomously on the relevant market in the infringement period. The OFT therefore considers that Shell Holdings (U.K.) Limited has not rebutted the presumption of decisive influence.

Somerfield

2.64 The OFT is addressing this Decision to Somerfield Stores Limited and Somerfield Limited (together 'Somerfield'). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them.
Somerfield operates supermarkets and convenience stores in the UK. During the infringement period, Somerfield operated Somerfield and Kwik Save fascias.

The parent company of Somerfield Stores Limited was, during the period of the infringements, Somerfield Limited. On 2 March 2009 the Co-operative Group acquired Somerfield. The Co-operative Group therefore became the ultimate parent of Somerfield Stores Limited and Somerfield Limited after the infringement period.

Somerfield Limited was registered as a public limited company during the infringement period and was re-registered as a private limited company on 21 December 2005.

The registered address of Somerfield Stores Limited is Somerfield House, Whitchurch Lane, Bristol, BS14 0TJ.

The registered address of Somerfield Limited is New Century House, Corporation Street, Manchester M60 4ES.

The legal entities directly engaged in the Infringing Agreements that are the subject of this Decision were Somerfield Stores Limited and Somerfield Limited (see Section 6.C.VIII: 'Agreement and/or concerted practice between ITL and Somerfield and between Gallaher and Somerfield'). Accordingly, the OFT has attributed liability to Somerfield Stores Limited and Somerfield Limited, jointly and severally, for the resulting infringements and for the consequential financial penalty that the OFT is imposing.

As set out in Section 3 below ("Legal Background"), where a parent company exerts decisive influence over a subsidiary, liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed liability to Somerfield Limited, on a joint and several basis, for the infringement attributed to Somerfield Stores Limited and for the consequential financial penalty that the OFT is imposing, given its 100 per cent ownership of Somerfield Stores Limited.

T&S Stores

The OFT is addressing this Decision to One Stop Stores Limited (formerly named T&S Stores Limited and previously T&S Stores plc) ("T&S Stores"). The OFT finds it liable for the infringements that are attributed to T&S
Stores in this Decision and for the resulting financial penalty that the OFT is imposing. In addition, the OFT is addressing this Decision to Tesco plc in respect of T&S Stores, as explained in paragraph 2.78 below.

2.73 During the infringement period, the principal activity of T&S Stores was grocery retailing in the UK.

2.74 T&S Stores Limited was formerly T&S Stores plc. T&S Stores plc was acquired by Tesco plc on 6 January 2003.\(^\text{13}\) Tesco plc became the ultimate holding company of T&S Stores plc (as it was then known). Tesco plc therefore owned T&S Stores for the period of the infringement subsequent to 6 January 2003.

2.75 On 9 September 2005, T&S Stores Limited and One Stop Stores Limited (which was wholly-owned by Tesco plc) switched names. T&S Stores Limited became a dormant company and One Stop Stores Limited is the economic successor of the business of what was formerly named T&S Stores Limited.

2.76 The registered address of One Stop Stores Limited is Apex Road, Brownhills, Walsall, West Midlands, WS8 7TS. The registered address of Tesco plc is Tesco House, Delamare Road, Cheshunt, Hertfordshire, EN8 9SL.

2.77 The legal entity directly engaged in the Infringing Agreements that are the subject of this Decision was T&S Stores plc (see Section 6.C.IX: 'Agreement and/or concerted practice between ITL and T&S Stores and Gallaher and T&S Stores'). Accordingly, the OFT has attributed liability for the resulting infringements and for the consequential financial penalty that the OFT is imposing to T&S Stores (which is now One Stop Stores Limited).

2.78 The OFT is also addressing this Decision to Tesco plc in respect of T&S Stores on the following basis. On 11 July 2008 One Stop Stores Limited and Tesco plc concluded an Early Resolution agreement with the OFT in respect of T&S Stores. Under that agreement, Tesco plc and One Stop Stores Limited agreed to the imposition of a penalty on them, as set out in that agreement, in respect of the liability of T&S Stores for the Infringing Agreements to which it had admitted its involvement in breach of the Chapter I Prohibition.

\(^\text{13}\) Note 33 to the Tesco plc Annual Report and Financial Statements 2003.
2.79 The OFT is addressing this Decision to TM Retail Limited and Martin Mcoll Retail Group Limited (formerly TM Retail Group Limited) (together 'TM Retail'). The OFT finds these entities jointly and severally liable for the infringements that are attributed to them in this Decision and for the resulting financial penalty that the OFT is imposing.

2.80 During the infringement period TM Retail Limited was active in the operation of convenience and newsagent stores.

2.81 TM Retail Limited was a wholly-owned subsidiary of TM Group Holdings plc (now known as TM Group Holdings Limited), which itself was a wholly-owned subsidiary of Thistledove Limited. TM Retail Limited is now a dormant company.

2.82 TM Retail’s corporate structure during the infringement period is set out in Annex 25.

2.83 On 6 September 2005, TM Retail Group Limited acquired the entire share capital of Thistledove Limited. As a result of that acquisition, TM Retail Group Limited became the ultimate parent company.

2.84 On 20 June 2006, as a result of a management buyout, TM Retail Group Limited changed its name to Martin Mcoll Retail Group Limited. A change in the legal form or name of an undertaking does not create a new undertaking free of liability for the anti-competitive behaviour of its predecessor, when from an economic point of view the two are identical.14

2.85 The registered address of TM Retail Limited and Martin Mcoll Retail Group Limited is Martin Mcoll House, Ashwells Road, Pilgrims Hatch, Brentwood, Essex, CM15 9ST.

2.86 The legal entities directly engaged in the Infringing Agreements that are the subject of this Decision were TM Retail Limited15 and Martin Mcoll

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14 The OFT considers that the management buyout and change of name of some of the TM Retail group entities does not create a new undertaking. Indeed, the OFT notes that management buyouts are, as the name suggests, undertaken by the management of the company, who normally already have full knowledge of the assets and liabilities of the company that they have managed. In addition, the OFT notes that the new TM Retail structure was managed by the same individuals and operated from the same registered address. Therefore, the OFT considers that there is functional and economic continuity between the original infringer and the new undertaking.

15 See footnote 1349 which explains that the written trading agreements between Gallaher and TM Retail were signed by TM Retail Limited ‘for and on behalf of TM Retail Limited trading as Forbuoys, TM Retail, Martins, McColls and R.S. Mcoll or any other trading name that TM Retail Limited may adopt during the term of this Trading Agreement’.
Retail Group Limited\(^{16}\) (see Section 6.C.X: 'Agreement and/or concerted practice between ITL and TM Retail and Gallaher and TM Retail'). Accordingly, the OFT has attributed liability to TM Retail Limited and Martin McColl Retail Group Limited, jointly and severally, for the resulting infringements and for the consequential financial penalty that the OFT is imposing.

2.87 As set out in Section 3 below ('Legal Background'), where a parent company exerts decisive influence over a subsidiary, liability for an infringement by the subsidiary may be attributed to the parent company; decisive influence may be presumed where a subsidiary is wholly-owned by its parent. Accordingly, the OFT has attributed to Martin McColl Retail Group Limited, on a joint and several basis, liability for the infringements attributed to TM Retail Limited and for the consequential financial penalty that the OFT is imposing, given its indirect\(^ {17}\) 100 per cent ownership of TM Retail Limited.

**B THE OFT'S INVESTIGATION**

**I The origins of the investigation**

2.88 The case originated from an OFT\(^ {18}\) investigation in January 2003 under Chapter II of the Act\(^ {19}\) prompted by a complaint alleging that ITL was abusing a dominant position in the UK by foreclosing the market for cigarette papers.

2.89 In February 2003, the OFT requested documents and information from ITL and 20 major retailers\(^ {20}\) of cigarette papers in the four main multi-outlet retail distribution channels, namely multiple grocers, convenience/CTN groups and off-licences and garage forecourts, under section 26 of the Act in relation to the suspected infringement of Chapter II of the Act. In

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\(^{16}\) See footnotes 1308-1309 below which explain that the written trading agreements between ITL and TM Retail were signed by TM Retail Limited and/or Martin McColl Retail Group Limited. 

\(^{17}\) Via Thistledove Limited. 

\(^{18}\) Until 1 April 2003 the OFT's functions were carried out by the Director General of Fair Trading (DGFT), whose functions were transferred to the OFT on that date pursuant to section 2(1) Enterprise Act 2002. References in this Decision to the OFT including, for example, to the OFT leniency programme should be taken to include matters which at the time were the responsibility of the DGFT: s 2(3) Enterprise Act 2002. 

\(^{19}\) Chapter II of the Act prohibits conduct by one or more undertakings which amounts to the abuse of a dominant position (within the UK or any part of it) in a market if it may affect trade within the UK. 

\(^{20}\) Those retailers included First Quench, Safeway, Sainsbury, Tesco and TM Retail.
March 2003, on-site investigations, under section 27(2) of the Act, were carried out at the premises of two additional retailers.21

2.90 The documents generated at that stage of the OFT’s Chapter II investigation contained a significant amount of information about the relationship between ITL and the retailers in respect of sales of cigarettes and tobacco products generally, in addition to information specifically about cigarette papers.

2.91 On 9 June 2004, after having analysed the evidence, the OFT informed the complainant that there were no longer reasonable grounds to suspect that the Chapter II prohibition had been infringed by ITL. The OFT therefore closed its file in relation to that matter.

II Leniency

2.92 The following addressees of this Decision applied for, and were granted, leniency pursuant to the OFT’s leniency programme applicable at the time.22 Sainsbury was granted conditional total leniency in March 2003;23 Tesco plc, including its subsidiary T&S Stores, was granted conditional partial leniency in March 2004;24 and Somerfield was granted conditional partial leniency in October 2006.25

2.93 Following an application made in October 2007, Asda obtained total immunity from financial penalties in respect of a completely separate infringement of the Chapter I Prohibition in relation to its activities in other, separate markets.26 Consequently, Asda has been granted a partial reduction in penalty in respect of the infringements to which is was party in this case.27

21 Asda and Somerfield.
22 As set out in Part 3 of the Director General of Fair Trading’s Guidance as to the Appropriate Amount of a Penalty, OFT 423 (March 2000). That was superseded by Part 3 of the ’OFT’s guidance as to the appropriate amount of a penalty’, OFT 423 (December 2004) and supplemented, most recently, by Leniency and no-action, OFT’s guidance note on the handling of applications, OFT 803 (December 2008).
23 The leniency granted was in connection with any cartel activities relating to price-fixing and/or market-sharing for tobacco and tobacco-related products.
24 The subject matter of the leniency granted was the same as for Sainsbury.
25 The leniency granted was in connection with agreements relating to the retail prices to be charged by Somerfield for tobacco and tobacco-related products.
26 Penalty Guidance, paragraphs 3.16 and 3.17; and Leniency and no-action (OFT 803), November 2006, paragraphs 6.8 to 6.10 which was applicable at the time Asda obtained total immunity in relation to its activities in the separate market. Leniency and no-action (OFT 803) was subsequently updated in December 2008.
27 See Section 8: ’The OFT’s action’. 
III The Chapter I investigation

2.94 The information provided by Sainsbury in support of its leniency application together with that received from other retailers during the OFT’s Chapter II investigation, gave the OFT reasonable grounds to suspect that the Chapter I Prohibition had been infringed. On that basis, on 10 March 2003, the OFT commenced a formal investigation under Chapter I of the Act.

IV Section 26 Notices

2.95 The OFT sent over 30 section 26 Notices28 requiring the production of relevant documents and information during the course of the investigation.

2.96 In August 2003, section 26 Notices were sent to various parties including Gallaher, ITL and 14 retailers in relation to the suspected infringements of the Chapter I Prohibition.29

2.97 In January 2005, the OFT sent out further section 26 Notices to three manufacturers and 1230 of the original retailers as well as a further four retailers31 in relation to the suspected infringements of the Chapter I Prohibition.

2.98 In January 2010, section 26 Notices were sent to ITL, Sainsbury, Morrisons, Safeway, the Co-operative Group and Shell requesting updated turnover figures to assist in the OFT’s calculation of penalties. A section 26 Notice was also sent to the joint administrators of First Quench, requesting information to assist the OFT in determining any applicable successor liability issues.

V Reduction in the number of parties

2.99 During the course of its investigation, the OFT came to the view that the considerable size of the case, in terms of the numerous parties, number of potential individual infringements and significant volume of documentation, was likely to impede the OFT’s ability to take the case

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28 Section 26 of the Act empowers the OFT, for the purposes of an investigation under section 25 of the Act, to require any person to produce to it a specified document, or to provide it with specified information, which the OFT considers relates to any matter relevant to the investigation.

29 The section 26 notices were sent on 15 August 2003 to retailers that included Morrisons, Safeway, Shell, Somerfield and Tesco. Asda was also sent a section 26 notice on 18 August 2003.

30 Those retailers included Asda, Morrisons, Safeway, Shell and Somerfield.

31 Those retailers included the Co-operative Group, First Quench and TM Retail.
forward effectively. The OFT therefore referred to its competition prioritisation framework\textsuperscript{32} at the time and concluded that in order to progress the case effectively and deliver a high impact outcome, the OFT should concentrate its limited resources by focusing on a reduced number of parties and agreements that were being investigated. Accordingly, the OFT decided to proceed with the investigation of only those parties listed in Section 2.A: 'The Parties'.

2.100 In selecting the parties that should be excluded from the OFT’s investigation, the OFT concluded that it should focus its resources on the parties whose activities would be most likely to have caused the greatest consumer detriment. In so doing, the OFT had regard both to the companies' absolute size in the UK tobacco sector overall and their importance in the relevant sector of the retail tobacco market. The OFT next considered that the most appropriate approach would be to exclude from the investigation those retailers with a share of less than 1 per cent by value of UK tobacco sales, based on figures relating to the final year of the period under investigation.

2.101 In addition, the OFT excluded two parties from the investigation on the basis of their respective limited shares of UK tobacco sales and the fact that the nature of the evidence gathered in relation to each of them was such that the OFT would have had to devote a relatively large amount of resources to determine conclusively whether each was involved in the suspected infringements of the Chapter I Prohibition.

\textbf{VI} \hspace{2em} \textbf{Types of evidence}

2.102 On 15 and 16 April 2003, the OFT conducted taped interviews with key Sainsbury employees (buyers and category managers), in the presence of Sainsbury’s legal advisers. These were given voluntarily by the employees concerned and were arranged by Sainsbury as part of its commitment to co-operate with the OFT’s investigation.

2.103 The OFT considered that the evidence of Fiona Bayley, a Sainsbury tobacco buyer from October 2000 until May 2002, was particularly relevant to the investigation. Therefore, the OFT subsequently obtained a witness statement\textsuperscript{33} from her.

\textsuperscript{32} The Competition prioritisation framework was published in October 2006 (see http://www.oft.gov.uk/shared_oft/press_release_attachments/compcriteria.pdf). That framework has been superseded, most recently, by the \textit{OFT Prioritisation Principles}, (OFT 953), October 2008 (see http://www.oft.gov.uk/advice_and_resources/publications/corporate/general/of953). \textsuperscript{33} References in this Decision to witness statements include any documents appended thereto and reliance on witness statements includes reliance on such documents.
2.104 During the subsequent course of the investigation the OFT also requested that Tesco provide statements from relevant staff identified from the documents on the OFT file. Witness statements were obtained from three Tesco staff, each in his capacity as a tobacco buyer in various periods between May 1998 until March 2004, and from Tesco’s category manager for tobacco from October 2000 until April 2002.

2.105 On 15 March 2006, the OFT received a submission from Somerfield which included a Company Statement and an unsigned draft witness Statement from Liz Smith, a tobacco buyer for Somerfield. Somerfield subsequently provided the OFT with a Supplementary Company Statement on 16 May 2006.

2.106 In the course of its investigation, the OFT uncovered documents and information in the various categories below which it considers as relevant evidence demonstrating a breach of the Chapter I Prohibition and how such a breach was implemented by the Parties:

- Written formal agreements;
- Written correspondence (that is, letters, faxes and external emails);
- Internal emails;
- Minutes of meetings;
- Internal policy documents/reports;
- Pricing information; and
- Witness statements and interview transcripts.

**VII Issue of a Statement of Objections**

2.107 The OFT issued an SO dated 24 April 2008 to the thirteen parties left in the investigation. In the SO, the OFT set out the facts (including the evidence) on which it relied, the objections it raised in terms of the alleged infringements of the Chapter I Prohibition, the action it proposed to take and its reasons for the proposed action. The SO alleged that there had been two different types of infringement.

2.108 First, in summary the SO alleged that each Manufacturer was involved in an agreement and/or concerted practice with each Retailer whereby the Retailer would apply retail pricing relativities between competing tobacco brands required by the Manufacturer. The SO alleged that each such agreement and/or concerted practice (referred to in the SO as an 'Infringing Agreement’) restricted the Retailer’s ability to determine its retail prices for tobacco products and thereby had the object and/or likely effect of preventing, restricting, or distorting competition in the supply of tobacco products in the UK in breach of the Chapter I Prohibition.
Secondly, in summary the SO alleged that some of the Parties had variously engaged in the indirect exchange of future retail pricing intentions with their competitors (referred to in the SO as 'Illegitimate Indirect Contact' or 'IIC'). The SO alleged that the Manufacturers had engaged in IIC through the intermediary of each of Asda, Shell and Somerfield on separate occasions, and that in one case Sainsbury and Tesco engaged in IIC through the intermediary of ITL. The SO alleged that each instance of IIC constituted a concerted practice which had the object and/or effect of preventing, restricting, or distorting competition in the supply of tobacco products in the UK in breach of the Chapter I Prohibition.

VIII Issue of a Supplementary Statement of Objections

On 19 June 2008, the OFT issued a Supplementary Statement of Objections ('SSO') to all the Parties in order to revise and/or supplement certain parts of the SO relating to two separate allegations of IIC (involving ITL, Gallaher and Shell).

IX Early Resolution

A covering letter dated 24 April 2008 accompanying the SO sent to the Parties provided an overview of the alleged infringements and referred, amongst other matters, to the process for access to file and for making representations on confidentiality matters. The letter also noted that a Party might obtain a reduction in the level of any financial penalty that might be imposed through co-operation with the OFT's investigation that enabled the enforcement process to be concluded more effectively and/or speedily. The letter stated that any Party interested in providing significant co-operation with a view to achieving a reduction in any potential financial penalty could contact the OFT about entering into dialogue with OFT (on a 'without prejudice' basis) for that purpose. The OFT’s letter dated 19 June 2008 accompanying the SSO noted that the above applied equally in respect of the matters that were the subject of the SSO.

A number of Parties expressed an interest in providing significant co-operation with a view to achieving a reduction in any potential financial penalty, and from May to July 2008 'without prejudice’ discussions were held with such Parties for that purpose. As a result, six of the Parties concluded Early Resolution agreements with the OFT in which each Party admitted liability in respect of all of the infringements alleged against it, and agreed to pay an individual penalty which reflected a significant reduction in the financial penalty that might otherwise have been imposed in recognition of the procedural co-operation by that Party as set out in
the Early Resolution agreement (each 'an Early Resolution Party', together, 'the Early Resolution Parties').

2.113 The Early Resolution agreements took effect on 11 July 2008 and are reproduced at Annex D to this Decision. The Early Resolution agreements are in substantially identical form, save in relation to the infringements in respect of which liability was admitted (reflecting the fact that different allegations were made against different parties), the individual penalty figures and the references, as applicable, to the leniency that had been granted to some of the Parties.

2.114 In addition to the above, and among various other provisions, the Early Resolution agreements provided that: the Early Resolution Party agreed to a streamlined administrative procedure in which it could provide a concise memorandum identifying any material factual inaccuracies in the SO or SSO rather than making full written and/or oral representations; and to account for any further developments, the OFT reserved the right: (i) to adjust the figures in applying steps 1 to 5 of its penalties guidance provided that the final penalty for the Early Resolution Party did not increase; and (ii) to make further adjustments that reduced the final penalty without further notice.

2.115 As a result of the narrower scope of this Decision compared to the SO and SSO (see Section 2.B.XII below), for example given the OFT's decision not to pursue the alleged infringements in relation to IIC, those parts of the Early Resolution agreements that pertain to aspects of the OFT's case in the SO and SSO that do not form part of this Decision have been redacted from the Early Resolution agreements reproduced at Annex D.

X Memoranda on factual inaccuracies

2.116 Of the six parties which concluded Early Resolution agreements with OFT, five parties each provided the OFT with a memorandum on factual inaccuracies. In response to further co-operation requested by the OFT pursuant to the Early Resolution agreements, Gallaher, First Quench and Asda submitted further information in relation to the commencement of some of the Infringing Agreements and other matters.

34 The Early Resolution Parties were Asda, First Quench, Gallaher, One Stop Stores (formerly named T&S Stores), Somerfield and TM Retail.
35 Asda, First Quench, Gallaher, Somerfield and TM Retail.
XI  Representations on the SO and SSO

2.117  Written representations on the matters raised by the SO and SSO were received between August 2008 to July 2009 from ITL\(^{36}\), the Co-operative Group\(^{37}\), Morrisons\(^{38}\), Safeway\(^{39}\), Sainsbury\(^{40}\), Shell\(^{41}\) and Tesco\(^{42}\). Certain parties submitted extensive representations and in some cases also provided witness evidence in support of those representations.

2.118  Only ITL and Sainsbury elected to make oral representations. In addition, both during and following the period for the submission of representations, ITL, Morrisons and Safeway engaged in extensive correspondence with the OFT on a number of procedural issues.

XII  Decision not to pursue certain alleged infringements set out in the SO and SSO

2.119  The OFT reviewed the whole of the case in the light of the substantial representations received in response to the SO and the SSO, the memoranda submitted by certain parties pursuant to the Early Resolution

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\(^{40}\) Written response to the SO, dated 23 July 2008 and supplementary written response to the SO dated 3 April 2009.

\(^{41}\) Written response to the SO dated 30 September 2008 ('Shell’s response to the SO'), and supplementary written response to the SO dated 21 April 2009 ('Shell’s supplementary response to the SO').

\(^{42}\) Written response to the SO, dated 1 October 2008 and supplementary written response to the SO dated 7 April 2009.
agreements agreed with the OFT in July 2008, as well as supplementary written representations and information received.

2.120 Following that review, in particular having re-assessed the evidence in the light of all the representations received, the OFT concluded that in relation to the alleged infringements made in the SO and SSO listed below, the evidence in its possession was ultimately insufficient to sustain a finding that there had been an infringement of the Act in the terms set out in the SO and the SSO. Accordingly, the OFT has decided not to make an infringement finding in relation to:

- Each of the alleged instances of IIC;
- The alleged Infringing Agreements relating to each of (i) ITL and Tesco, and (ii) Gallaher and Tesco; and
- The allegation that the Infringing Agreements had the likely effect of preventing, restricting or distorting competition.

2.121 As regards the last allegation, it is important to recall that in the SO the OFT alleged that the Infringing Agreements had an anti-competitive object and/or likely effect. In that connection, it is only the allegation as to the likely effect of the Infringing Agreements that the OFT is no longer pursuing. The OFT considers that each of the Infringing Agreements was, by its very nature, capable of restricting competition and therefore had as its object the prevention, restriction or distortion of competition, in breach of the Chapter I Prohibition.

XIII Addressing representations on the matters raised by the SO

2.122 As set out above, certain of the Parties provided detailed representations to the OFT in response to the SO and the OFT has reviewed these representations in detail and has taken them into account in reaching this Decision.

2.123 Given the volume of written representations received, the OFT has not set out in this Decision a response to every point made in the representations. Rather, the OFT has grouped and addressed key representations from different Parties according to their substance (rather than by reference to a particular heading or section in the relevant Party’s representations).
3 LEGAL BACKGROUND

A INTRODUCTION - THE CHAPTER I PROHIBITION

1.1 This part of the Decision sets out the legal framework within which the OFT has considered the evidence in this case.

3.1 Section 2(1) of the Act prohibits agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the UK and have as their object or effect the prevention, restriction or distortion of competition within the UK.\(^{43}\) Such agreements, decisions or concerted practices are prohibited unless exempted or excluded in accordance with the provisions of Part I of the Act. The prohibition imposed by section 2(1) of the Act has been defined in paragraph 1.1 of this Decision as 'the Chapter I Prohibition'.

3.2 Section 2(2)(a) of the Act provides that the Chapter I Prohibition applies, in particular, to agreements, decisions or practices that 'directly or indirectly fix purchase or selling prices … '. The list of matters set out in section 2(2) is illustrative and not exhaustive.\(^{44}\)

3.3 In order to find an infringement of the Chapter I Prohibition in the present case, the OFT must establish that the Parties entered into an agreement or engaged in a concerted practice that may affect trade within the UK and which had as its object or effect the appreciable prevention, restriction or distortion of competition.\(^{45}\)

B APPLICATION OF SECTION 60 OF THE ACT – CONSISTENCY WITH EUROPEAN UNION LAW

3.4 Section 60(1) of the Act sets out the principle that, so far as it is possible (having regard to any relevant differences between the provisions concerned), questions arising in relation to competition within the UK are dealt with in a manner which is consistent with the treatment of corresponding questions arising in European Union ('EU') law in relation to competition within the EU. In particular, under section 60(2) of the Act,

\(^{43}\) 'The UK' means, in relation to an agreement, decision or concerted practice which operates or is intended to operate only in part of the UK, that part: section 2(7) and 2(5) of the Act.

\(^{44}\) OFT Competition Law Guideline Agreements and concerted practices (OFT 401, Edition 12/04), at paragraph 2.3.

\(^{45}\) As to the requirement for appreciability, see the OFT Competition Law Guideline on Agreements and Concerted Practices (OFT 401, Edition 12/04), at paragraphs 2.15-2.21 and in Section 3.1: 'Appreciability' below.
The OFT must act (so far as it is compatible with the provisions of Part I of the Act) with a view to securing that there is no inconsistency with the principles laid down by the Treaty on the Functioning of the European Union (‘TFEU’) and the European Court\(^{46}\) and any relevant decision of the European Court in determining any corresponding questions arising in Community law. Under section 60(3) of the Act, the OFT must, in addition, have regard to any relevant decision or statement of the European Commission (‘the Commission’).

3.5 The provision in EU competition law closely corresponding to the Chapter I Prohibition is Article 101 TFEU, on which the Chapter I Prohibition is modelled. Accordingly, the case law of the European Court and the decisional practice of the Commission concerning Article 101 TFEU are relevant when applying the Chapter I Prohibition.

C APPLICATION OF ARTICLE 101 TFEU – EFFECT ON INTER-STATE TRADE

3.6 Following the entry into force of Council Regulation (EC) No 1/2003\(^{47}\) on 1 May 2004, the OFT is required, when applying national competition law to agreements and concerted practices between undertakings which may affect trade between Member States, also to apply Article 101 TFEU.\(^{48}\)

3.7 In view of the fact that the OFT has limited its investigation to the period up to 15 August 2003 (see Section 7.G: ‘Duration of the infringements and the involvement of each Party’), and therefore prior to 1 May 2004, the OFT does not consider it is under a duty to apply Article 101 TFEU to the particular circumstances of this case. Accordingly, the OFT has not considered whether trade between Member States may have been appreciably affected, and this Decision relates solely to whether the Chapter I Prohibition has been infringed.

D UNDERTAKINGS

3.8 The Chapter I Prohibition applies to, among other matters, agreements or concerted practices between ‘undertakings’. However, the term ‘undertaking’ is not defined in the Act or the TFEU. It is a wide term that the ECJ has held to cover ‘any entity engaged in an economic activity,

\(^{46}\) The European Court is defined in section 59 of the Act as meaning the Court of Justice of the European Communities (now the Court of Justice of the European Union) and including the Court of First Instance (now the ‘General Court’).

\(^{47}\) OJ 2003 L1/1.

\(^{48}\) Article 3, Regulation 1/2003.
regardless of the legal status of the entity or the way in which it is financed.49

3.9 Accordingly, the key consideration in establishing whether an entity is an undertaking is whether it is engaged in an ‘economic activity’. The ECJ has described economic activities as being ‘of an industrial or commercial nature by offering goods and services on the market’.50

3.10 The term ‘undertaking’ includes any natural or legal person that is capable of carrying on commercial or economic activities. This has resulted in a variety of legal forms of organisation being captured by this definition, including companies,51 partnerships,52 individuals acting as sole traders,53 trade associations,54 and (in some circumstances) public entities that offer goods or services on a given market.55 The fact that an organisation does not make a profit,56 or lacks profit motive,57 or does not have an economic purpose, does not disqualify it as an undertaking provided that it is carrying out some form of commercial or economic activity.

E ATTRIBUTION OF LIABILITY FOR INFRINGEMENTS

3.11 Where a legal entity was directly involved in the conduct that is the subject of this Decision, liability for the resulting infringement and any consequential financial penalty imposed by the OFT has been attributed to it.58

3.12 Where a parent company exerts decisive influence on the policy of a subsidiary such that the latter does not enjoy real autonomy in determining its own course of action on the market, liability may be

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51 In all their corporate forms, including a limited partnership (Case 258/78 Nungesser v Commission [1982] ECR 2015, [1983] 1 CMLR 278; or a trust company, see Fides, OJ 1979 L57/33, [1979] 1 CMLR 650.
54 For example, Case 71/74 FRUBO v Commission [1975] ECR 563, [1975] 2 CMLR 123.
attributed to the parent company for the actions of the subsidiary. As recently confirmed by the ECJ in *Akzo Nobel*, the exercise of decisive influence can be presumed where a subsidiary is wholly-owned by its parent, either directly or indirectly. A 100 per cent shareholding in a subsidiary therefore gives rise to a rebuttable presumption that a parent company exercises decisive influence over the conduct of its subsidiary. Where the presumption of decisive influence arises, the OFT is entitled to attribute liability for an infringement by the subsidiary to the parent company, unless the parent company has proved that the subsidiary acted autonomously on the relevant market.

3.13 Additional indicia of decisive influence, other than the parent’s shareholding in the subsidiary, may also be relied on. Such indicia have been found to include a parent being active on the same or adjacent markets to its subsidiary, direct instructions being given by a parent to a subsidiary or the two entities having shared directors.

3.14 A change in the legal form or name of an undertaking does not create a new undertaking free of liability for the anti-competitive behaviour of its predecessor when, from an economic point of view, the two are identical; the determining factor is whether there is functional and economic continuity despite the change in legal form or name.

3.15 Where the original legal entity responsible for an infringement still exists, liability remains with it and a new parent company will usually not be liable for infringements which pre-date its acquisition. In certain circumstances, a parent company may be held responsible for the unlawful conduct of an undertaking which it has acquired, even where the

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64 *Sepia Logistics Limited v OFT* [2007] CAT 13, at [77] to [80].
legal person responsible for the operation of that undertaking at the time of the infringement continues to exist.

3.16 For example, if one undertaking involved in an infringement becomes the parent of another undertaking which is also involved in the same infringement, the former may be held liable for the conduct of the latter, to the extent that the latter continues its involvement in the infringement after the date of its acquisition.66

3.17 Where, however, the original legal entity responsible for an infringement no longer exists, it is necessary to consider whether there is functional and economic continuity between the original entity and any new successor entity.67 That involves considering whether the physical and human assets which contributed to the commission of the infringement have been acquired by another entity.68

3.18 In Suiker Unie, the ECJ upheld a fine on a company in respect of activities carried out before its incorporation by an association of four co-operatives, all of which had been dissolved by the time of the Commission’s decision. As the company had assumed the rights and liabilities of the co-operatives and was operated by the same persons at the same address, the ECJ held that it was the economic successor of the dissolved undertakings.69

3.19 The ECJ has confirmed that events such as organisational changes should not enable liabilities for competition law breaches to be evaded:70

‘...it must be noted that if no possibility of imposing a penalty on an entity other than the one which committed the infringement were foreseen, undertakings could escape penalties by simply changing their identity through restructurings, sales or other legal or organisational changes. This would jeopardise the objective of suppressing conduct that infringes the competition rules and preventing reoccurrence by means of deterrent penalties...[T]he legal forms of the entity that committed the infringement and the entity that succeeded it are irrelevant. Imposing a penalty for the infringement on the successor can therefore not be excluded simply because...the successor has a different legal status and is operated differently from the entity that it succeeded.'

3.20 Financial penalties that are imposed both on a parent and a subsidiary may be imposed jointly and severally.\textsuperscript{71}

\section*{F RELEVANT CASE LAW IN RELATION TO AGREEMENTS OR CONCERTED PRACTICES}

3.21 This Section 3 sets out relevant legal principles. The application of those principles to the infringements particularised in this Decision is set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements'.

\textit{Agreement 'and/or' concerted practice}

3.22 The Chapter I Prohibition applies to 'agreements' as well as to 'concerted practices'.\textsuperscript{72}

3.23 The ECJ has confirmed that it is not necessary, for the purpose of finding an infringement, to characterise conduct exclusively as an agreement or as a concerted practice.\textsuperscript{73} The concepts of agreement and concerted practice are not mutually exclusive and there is no rigid dividing line between the two. They are intended:\textsuperscript{74}

\begin{quote}
'to catch forms of collusion having the same nature and are only distinguishable from each other by their intensity and the forms in which they manifest themselves.'
\end{quote}

3.24 The ECJ further expressed this in \textit{Anic} as follows:\textsuperscript{75}

\begin{quote}
'The list in Article [101(1)] of the [TFEU] is intended to apply to all collusion between undertakings, whatever form it takes... The only
\end{quote}


\textsuperscript{72} Section 2(1) of the Act.


\textsuperscript{75} Case C-49/92P \textit{Commission v Anic Partecipazioni} [1999] ECR I-4125, at paragraph 108. See also \textit{JJB Sports plc v OFT and AllSports Ltd v OFT} [2004] ("Replica Kit") CAT 17, at [153].
essential thing is the distinction between independent conduct, which is allowed, and collusion, which is not, regardless of any distinction between types of collusion.

3.25 That is particularly, but not exclusively, so in the case of complex infringements of long duration. Indeed, the same principle will apply even where the infringement is of short duration. As the Competition Appeal Tribunal (‘the CAT’) has confirmed in its judgments in both the Replica Kit\(^77\) and Argos/ Littlewoods\(^78\) cases:

‘it is not necessary for the OFT to characterise an infringement as either an agreement or a concerted practice: it is sufficient that the conduct in question amounts to one or the other.’

3.26 It is not, therefore, necessary for the OFT to come to a conclusion as to whether the conduct of the Parties should be specifically characterised as an agreement or as a concerted practice in order to demonstrate an infringement of the Chapter I Prohibition. The OFT considers that it is, however, able to demonstrate in the present case that the conduct of each of the Parties did amount to agreements and/or concerted practices.

**Agreement**

3.27 An agreement does not have to be a formal written agreement to be covered by the Chapter I Prohibition. It may be constituted simply by way of an 'understanding', even where there is nothing to prevent either party going back on, or disregarding, the understanding. The Chapter I Prohibition is intended to catch a wide range of agreements, including oral agreements and 'gentlemen's agreements' as, by their nature, anti-competitive agreements are rarely in written form.\(^79\)

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\(^76\) See Commission decision in Citric Acid, OJ 2002 L239/18.


\(^79\) See the OFT Competition Law Guideline on Agreements and Concerted Practices (OFT 401, Edition 12/04), at paragraph 2.7. See also the judgment of the ECJ regarding gentlemen’s agreements in Case C-42/69 ACF Chemiefarma NV v European Commission [1970] ECR 661 (in particular, at paragraphs 106-114). See also the European Commission’s decision in Citric Acid dated 5 December 2001, OJ 2002 L239/18, at paragraph 137.
3.28 There is no requirement for an agreement to be legally binding, or for it to contain any enforcement mechanisms. 80 An agreement may be express or inferred from conduct of the parties, 81 including conduct that appears to be unilateral. 82 An agreement may consist not only of an isolated act, but also of a series of acts or a course of conduct. 83 As held by the General Court, for an agreement to exist: 84

‘[I]t is sufficient if the undertakings have expressed their joint intention to conduct themselves on the market in a specific way’.

3.29 An agreement within the meaning of the Chapter I Prohibition exists in circumstances in which there is a concurrence of wills, in that a group of undertakings intend to adhere to a common plan that limits, or is likely to limit, their commercial freedom by determining the lines of their mutual action, or abstention from action. 85

3.30 Although it is essential to show the existence of a joint intention to act on the market in a specific way in accordance with the terms of the agreement, it is not necessary to establish a joint intention to pursue an


83 Case C-49/92P *European Commission v Anic Participazioni* [1999] ECR I-4125, at paragraph 81.

anti-competitive aim as such.\textsuperscript{86} The form in which the parties’ intention to behave on the market is expressed is irrelevant.\textsuperscript{87}

3.31 An agreement can also come into existence through tacit acquiescence. Tacit acquiescence requires an express or implied ‘invitation’ from one party to the other party to fulfil an anti-competitive goal ‘jointly’, which may be inferred from conduct. For example, where a manufacturer adopts certain measures in the context of its ongoing contractual relations with its retailers, such measures will amount to an agreement if there is express or implied acquiescence or participation by the retailers in those measures.\textsuperscript{88}

3.32 The fact that a party does not abide fully by an agreement which is anti-competitive, does not relieve that party of responsibility for it. \textsuperscript{89} Equally, the fact that a party may come to recognise that in practice it can ‘cheat’ on an anti-competitive agreement, or does not observe the terms of the particular agreement in practice, does not preclude a finding that an anti-competitive agreement existed.\textsuperscript{90}

\textbf{Concerted practice}

3.33 The Chapter I Prohibition also applies in respect of a concerted practice. A concerted practice does not require an actual agreement (whether express or implied) to have been reached. Rather, as the ECJ held in Dyestuffs: \textsuperscript{91}

\begin{quote}
\textquote{Article [101] draws a distinction between the concept of \textquote{concerted practices} and that of \textquote{agreements between undertakings} or \textquote{decisions by associations of undertakings}; the object is to bring within the prohibition of that Article a form of co-ordination between undertakings which, without having reached the stage where an agreement properly so called has been
\end{quote}

\begin{footnotes}
\item[90] Case C-246/86 \textit{Belasco v Commission} [1989] ECR 2117, at paragraphs 10 to 16.
\item[91] Case 48/69 \textit{ICI Ltd. v European Commission} [1972] ECR 1969, at paragraph 64.
\end{footnotes}
concluded, knowingly substitutes practical co-operation between them for the risks of competition.\footnote{92}

3.34 The concept of a concerted practice must be understood in light of the principle that each economic operator must determine independently the policy it intends to adopt on the market.\footnote{93} In particular, as the ECJ held in \textit{Suiker Unie}:\footnote{94} 

‘Although it is correct to say that this requirement of independence does not deprive economic operators of the right to adapt themselves intelligently to the existing and anticipated conduct of their competitors, it does however strictly preclude any direct or indirect contact between such operators, the object or effect whereof is either to influence the conduct on the market of an actual or potential competitor or to disclose to such a competitor the course of conduct which they themselves have decided to adopt or contemplate adopting on the market.’

3.35 The fact that concerted practices do not arise only as between competitors has been confirmed by the CAT, which held in \textit{Argos Ltd & Littlewoods} that:\footnote{95}

‘…the underlying idea of ‘concerted practice’ is equally applicable to the vertical relationship between a supplier and a retailer.’

3.36 The Court of Appeal expressed the same view, stating that:\footnote{96}

‘The Chapter I prohibition catches agreements and concerted practices whether between undertakings at different levels or between those at the same level of commercial operation.’

\footnotesize{\begin{itemize}
\item[92] Case 48/69 \textit{ICI Ltd. v European Commission} [1972] ECR 1969, at paragraph 64. This has been followed in: Cases 40/73 etc. \textit{Suiker Unie v Commission} [1975] ECR 1663, at paragraph 26; Cases C-89/85 etc. \textit{Ahlström Osakeyhtiö v Commission} [1993] ECR I-1307 (‘Woodpulp II’), at paragraph 63; Case C-49/92P \textit{European Commission v Anic Participazioni} [1999] ECR I-4125, at paragraph 115; and Case C-199/92 P \textit{Hüls} [1999] ECR I-4125, at paragraph 158. See also \textit{Replica Kit} at [151] and \textit{Apex Asphalt and Paving Co Limited v OFT} [2005] CAT 4, at [206 (iii)].
\item[95] \textit{Argos Ltd & Littlewoods Ltd v Office of Fair Trading} [2004] CAT 24, at [703].
\item[96] \textit{Argos Limited and Littlewoods Limited v OFT} and \textit{JJB Sports plc v OFT} [2006] EWCA Civ 1318, at paragraph 28.
\end{itemize}}
G PREVENTION, RESTRICTION OR DISTORTION OF COMPETITION

3.37 As noted above, the Chapter I Prohibition prohibits, among other things, ‘agreements between undertakings…or concerted practices which…have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom.’

The law on anti-competitive object

3.38 In considering whether an agreement or concerted practice has as its object the prevention, restriction or distortion of competition, it is necessary to consider the precise purpose or objectives of the agreement or concerted practice and the specific economic and legal context of which it forms part.

3.39 The Commission’s Guidelines on the application of Article 101(3) TFEU confirm that:

‘The assessment of whether or not an agreement has as its object the restriction of competition is based on a number of factors. These factors include, in particular, the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which it is (to be) applied and the actual conduct and behaviour of the parties on the market. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction of competition by object. The way in which an agreement is actually implemented may reveal a restriction by object even where the formal agreement does not contain an express provision to that effect. Evidence of subjective intent on the part of the parties to restrict competition is a relevant factor but not a necessary condition.’

3.40 In considering whether an agreement or concerted practice has as its object the prevention, restriction or distortion of competition, the OFT has

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97 Section 2(1), Competition Act 1998.
98 Cases C-501/06 P etc. GlaxoSmithKline Services Unlimited v Commission, judgment of 6 October 2009, at paragraphs 55 and 58; Case C-8/08 T-Mobile Netherlands BV and others v NMa, judgment of 4 June 2009, at paragraph 27 and 28.
considered the objective aims of the agreement or concerted practice in the economic and legal context in which it operates.\textsuperscript{100}

3.41 The ECJ stated in its recent \textit{T-Mobile Netherlands} judgment that agreements or concerted practices which have as their object the prevention, restriction or distortion of competition are those which can be regarded, \textit{‘by their very nature’}, as being injurious to the proper functioning of normal competition.\textsuperscript{101}

3.42 The ECJ went on to state that in order for an agreement or concerted practice to be regarded as having an anti-competitive object:\textsuperscript{102}

\textit{‘… it is sufficient that it has the potential to have a negative impact on competition. In other words, the concerted practice must simply be capable in an individual case, having regard to the specific legal and economic context, of resulting in the prevention, restriction or distortion of competition’.} [Emphasis added]

3.43 Further, an agreement or concerted practice can have an anti-competitive object independently of whether or not the parties to the agreement or concerted practice have considered the anti-competitive nature of their conduct and appreciated that it might be anti-competitive; and independently of whether the agreement or concerted practice has the sole aim of restricting competition or simultaneously pursues other legitimate objectives.\textsuperscript{103}

3.44 Although proof of subjective intention is not a necessary condition in finding that an agreement has an anti-competitive object, there is nothing to prevent the OFT from taking the intention of the relevant parties into account in reaching such a finding.\textsuperscript{104}


\textsuperscript{101} Case C-8/08 \textit{T-Mobile Netherlands BV and others v NMa}, judgment of 4 June 2009, at paragraph 29. At paragraph 24 of its judgment, the ECJ stated that: ‘the criteria laid down in the Court’s case law for the purpose of determining whether conduct has as its object or effect the prevention, restriction or distortion of competition are applicable irrespective of whether the case entails an agreement, a decision or a concerted practice’.

\textsuperscript{102} Case C-8/08 \textit{T-Mobile Netherlands BV and others v NMa}, judgment of 4 June 2009, at paragraph 31.

\textsuperscript{103} Case T-450/05 \textit{Automobiles Peugeot SA and another v Commission}, judgment of 9 July 2009, at paragraphs 55 to 56 (and the cases cited there).

3.45 In its judgment in *Irish Beef*, the ECJ confirmed that the scope of object infringements should not be restricted unnecessarily. Responding to a suggestion that the concept of infringement by object should be interpreted narrowly so as to apply only to 'hardcore' agreements such as horizontal price fixing and market sharing, the ECJ stated that, on the contrary, '*...the types of agreements covered by Article [101](1)(a) to (e) do not constitute an exhaustive list of prohibited collusion*.\(^\text{105}\)

No need to prove anti-competitive effect where an anti-competitive object is established

3.46 In the context of Article 101 TFEU, the ECJ has held that:\(^\text{106}\)

>'there is no need to take account of the concrete effects of an agreement once it has as its object the prevention, restriction or distortion of competition'.

3.47 Equally, where the conduct in question is a concerted practice, the ECJ has held that, although the concept of an 'object infringement' presupposes conduct of the participating undertakings on the market, it does not necessarily imply that the conduct should produce the concrete effect of preventing, restricting or distorting competition.\(^\text{107}\) Concerted practices are therefore prohibited regardless of their effect, when they have an anti-competitive object.\(^\text{108}\)

3.48 The CAT confirmed in *Argos Ltd & Littlewoods Ltd v OFT* that the OFT is not, as a matter of law, obliged to establish that an agreement or concerted practice has an anti-competitive effect where it is found to have as its object the prevention, restriction or distortion of competition.\(^\text{109}\)

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\(^{105}\) Case C-209/07 Competition Authority v Beef Industry Development Society Ltd, judgment of 20 November 2008, at paragraphs 22 and 23.

\(^{106}\) Joined Cases 56/64 and 58/64 *Consten & Grundig v Commission* [1966] ECR 299, at page 342; and more recently, see Case C-8/08 *T-Mobile Netherlands BV and others v NMa*, judgment of 4 June 2009, at paragraph 29.

\(^{107}\) Case C-49/92P *Commission v Anic Partecipazioni* [1999] ECR I-4125, at paragraphs 122-123. See also *Apex Asphalt and Paving Co Limited v OFT* [2005] CAT 4, at [206(xii)]; followed in *Makers UK Limited v OFT* [2007] CAT 11, at [103(xii)].


\(^{109}\) *Argos Ltd & Littlewoods Ltd v Office of Fair Trading* [2004] CAT 24, at [357].
'It is trite law that once it is shown that such agreements or practices had the object of preventing restricting, or distorting competition, there is no need for the OFT to show what the actual effect was: see Cases 56 and 58/64 Consten and Grundig v Commission [1966] ECR 299, 342 and many subsequent cases'.

3.49 The ECJ has made clear that, in order to find an 'object' infringement, an agreement or concerted practice need only be capable in an individual case, having regard to the legal and economic context, of preventing, restricting or distorting competition. The OFT is not therefore required to conduct a competitive analysis to demonstrate an actual prevention, restriction or distortion of competition in any particular case. Moreover, the ECJ has also made clear that an impact on consumer prices is not a pre-requisite to the finding of an 'object' infringement, as the competition rules are 'designed to protect not only the immediate interests of individual competitors or consumers but also to protect the structure of the market and thus competition as such'.

3.50 A finding that an agreement or concerted practice has an anti-competitive object does not amount to a presumption which is rebuttable by an analysis of the actual effects of the agreement or concerted practice.

3.51 Further, where an agreement has the object of restricting competition, parties cannot escape liability for the resulting infringement by arguing that the agreement was never put into effect.

H RESTRICTION OF THE BUYER’S ABILITY TO DETERMINE ITS RESALE PRICE

3.52 The OFT considers that an agreement or concerted practice which restricts a buyer’s ability to determine its resale price of any product has, as a result of its very nature, the 'object' of preventing, restricting or distorting competition, in breach of the Chapter I Prohibition. The foregoing is without prejudice to the possibility of a supplier imposing a maximum resale price or recommending a resale price to the reseller.

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110 Case C-8/08 T-Mobile Netherlands BV and others v NMb, judgment of 4 June 2009, at paragraph 29.
111 Case C-8/08 T-Mobile Netherlands BV and others v NMb, at paragraph 38. See also Cases C-501/06 P etc. GlaxoSmithKline Services Unlimited v Commission, judgment of 6 October 2009, at paragraph 63.
112 Case C-8/08 T-Mobile Netherlands BV and others v NMb, judgment of 4 June 2009, at paragraph 29.
provided that this does not amount to a fixed or minimum resale price as a result of pressure from, or incentives offered by, any party.\footnote{114}

3.53 There are many ways in which a buyer’s ability to determine its resale price may be restricted. For example, an agreement may directly fix resale prices or impose minimum resale prices, or prices may be fixed by indirect means, for example in the form of an agreement to adhere to published price lists or not to charge less than any other price in the market.

3.54 An agreement or concerted practice which indirectly affects the prices to be charged may nevertheless restrict a buyer’s ability to determine its resale price. For example, the OFT considers that a buyer’s ability to determine its resale price is restricted if the agreement or concerted practice with a supplier prescribes the resale price of the supplier’s products as a fixed or variable differential to the retail price of the products of a competing supplier that the buyer also sells.

3.55 An agreement or concerted practice may restrict price competition even if it does not entirely eliminate it.\footnote{115}

3.56 It is instructive to note that Article 4 of the Commission’s Vertical Block Exemption Regulation (‘VBER’)$^{\text{116}}$ provides that the block exemption\footnote{117} provided by the VBER shall not apply to vertical agreements:

\[ \text{\textit{(a)} the restriction of the buyer’s ability to determine its sale price, without prejudice to the possibility of the supplier’s imposing a maximum sale price or recommending a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties.} \]

\[\text{[Emphasis added]}\]

3.57 Moreover, it is also instructive to note that paragraph 47 of the Commission’s Notice Guidelines on Vertical Restraints (‘Vertical Guidelines’) refers to resale price maintenance (RPM) as a hardcore restriction, in Article 4(a) of the VBER, and states the following:

\footnote{114 The OFT Competition Law Guideline on Agreements and concerted practices (OFT 401, Edition 12/04), at paragraph 3.8, footnote 14.}
\footnote{115 The OFT Competition Law Guideline on Agreements and concerted practices (OFT 401, Edition 12/04), at paragraph 3.6.}
\footnote{117 Article 2(1) provides, that subject to the provisions of the VBER, Article 101(1) shall not apply to agreements or concerted practices entered into between two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain and relating to the conditions under which the parties may purchase, sell or resell certain goods or services.}
'In the case of contractual provisions or concerted practices that directly establish the resale price, the restriction is clear cut. However, RPM can also be achieved through indirect means. Examples of the latter are an agreement fixing the distribution margin, fixing the maximum level of discount the distributor can grant from a prescribed price level, making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level, linking the prescribed resale price to the resale prices of competitors, threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level.

Direct or indirect means of achieving price fixing can be made more effective when combined with measures to identify price-cutting distributors, such as the implementation of a price monitoring system, or the obligation on retailers to report other members of the distribution network who deviate from the standard price level. Similarly, direct or indirect price fixing can be made more effective when combined with measures which may reduce the buyer’s incentive to lower the resale price, such as the supplier printing a recommended resale price on the product or the supplier obliging the buyer to apply a most-favoured-customer clause. The same indirect means and the same ‘supportive’ measures can be used to make maximum or recommended prices work as RPM.'

3.58 In Pronuptia, it was made clear that the mere provision by a supplier or manufacturer of price guidelines or suggestions will not infringe competition law, so long as there is no concerted practice between the parties to the agreement or between competitors themselves in relation to the actual application of the recommended prices.

I APPRECIABILITY

3.59 An agreement or concerted practice will infringe the Chapter I Prohibition if it has as its object or effect an appreciable prevention, restriction or distortion of competition within the UK.

3.60 Where the agreement is made between, or the concerted practice involves, non-competing undertakings, such as between a supplier and a

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118 Commission Notice Guidelines on Vertical Restraints OJ 2000 C291/1 at paragraph 47.
120 From 1 May 2004, the OFT has regard to the EU thresholds on appreciability in determining whether there is an appreciable effect on competition: see the European Commission’s Notice on Agreements of Minor Importance (OJ [2001] C368/13) and the OFT Competition Law Guideline on Agreements and Concerted Practices (OFT 401, Edition 12/04), at paragraphs 2.16-2.19.
retailer, the OFT will not generally consider competition to be appreciably restricted if the market share of each of the parties on any of the relevant markets affected by the agreement or concerted practice does not exceed 15 per cent. However, that approach does not apply to agreements or concerted practices that limit a buyer’s ability to determine its resale price.\textsuperscript{121} Such agreements or concerted practices are regarded as being capable of having an appreciable effect even where the market shares fall below the relevant thresholds, provided that such agreements do not have only insignificant effects.\textsuperscript{122}

\section*{J EFFECT ON TRADE WITHIN THE UK}

3.61 By virtue of Section 2(1)(a) of the Act, the Chapter I Prohibition applies only to agreements or concerted practices which:

\textit{‘may affect trade within the United Kingdom’}.

3.62 For the purposes of the Chapter I Prohibition, the UK means any part of the UK in which an agreement or concerted practice operates or is intended to operate.\textsuperscript{123}

3.63 By their very nature, agreements or concerted practices that restrict price competition are likely to affect trade. It should be noted that, to infringe the Chapter I Prohibition, an agreement and/or concerted practice does not actually have to affect trade as long as it is capable of affecting trade.\textsuperscript{124} Moreover, effect on trade within the UK is a purely jurisdictional test to demarcate the boundary line between the application of Community competition law and national competition law. The test is not read as importing a requirement that the effect on trade should be appreciable.\textsuperscript{125}

\begin{flushright}
\textsuperscript{121} The OFT Competition Law Guideline on \textit{Agreements and Concerted Practices} (OFT 401, Edition 12/04), at paragraph 2.17.
\textsuperscript{123} Section 2(7) of the Act.
\textsuperscript{125} \textit{Aberdeen Journals v Director General of Fair Trading} [2003] CAT 11, at [459] and [460].
\end{flushright}
K  BURDEN AND STANDARD OF PROOF

3.64 The burden of proving an infringement of the Chapter I Prohibition lies upon the OFT. The CAT held in Napp that:126

‘As regards the burden of proof, the Director127 accepts that it is incumbent upon him to establish the infringement, and that the persuasive burden of proof remains on him throughout. However, that does not necessarily prevent the operation of certain evidential presumptions …

In our view it follows from Article 6(2) [of the European Convention on Human Rights] that the burden of proof rests throughout on the Director to prove the infringements alleged.’

3.65 As the CAT pointed out in Napp, that burden does not preclude the OFT from relying, where appropriate, on evidential presumptions. The CAT stated:128

‘That approach does not in our view preclude the Director, in discharging the burden of proof, from relying in certain circumstances, on inferences or presumptions that would, in the absence of any countervailing indications, normally follow from a given set of facts, for example … that an undertaking’s presence at a meeting with manifestly anti-competitive purpose implies, in the absence of explanation, participation in the cartel alleged.’

3.66 As regards the standard of proof, the CAT held that: 129

‘...formally speaking, the standard of proof in proceedings under the Act involving penalties is the civil standard of proof, but that standard is to be applied bearing in mind that infringements of the Act are serious matters attracting severe financial penalties. It is for the Director to satisfy us in each case, on the basis of strong and compelling evidence, taking account of the seriousness of what is alleged, that the infringement is duly proved, the undertaking being entitled to the presumption of innocence, and to any reasonable doubt there may be.’

126 Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading, [2002] CAT 1, at [95] and [100]. The CAT confirmed this approach in the Replica Kit judgment JJB Sports PLC v Office of Fair Trading [2004] CAT 17, at [164]. See also at [928] and [931].

127 References to the 'Director' are to the Director General of Fair Trading. As from 1 April 2003, section 2(1) of the Enterprise Act 2002 transferred the functions of the Director General of Fair Trading to the OFT.

128 Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading, [2002] CAT 1, at [110].

129 Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading, [2002] CAT 1, at [109].
3.67 That statement has been further clarified by the CAT in its ruling in the Replica Kit appeals, where the CAT stated that:\textsuperscript{130}

'It also follows that the reference by the Tribunal to 'strong and compelling' evidence at [109] of Napp should not be interpreted as meaning that something akin to the criminal standard is applicable to these proceedings. The standard remains the civil standard. The evidence must however be sufficient to convince the Tribunal in the circumstances of the particular case, and to overcome the presumption of innocence to which the undertaking concerned is entitled.'\textsuperscript{131}

3.68 In other words, the standard of proof is the civil standard (that is, the balance of probabilities). In using the term 'strong and compelling' to describe the evidence in relation to the Parties to whom this Decision is addressed, the OFT has followed the same principle. That is consistent with recent decisions of the Supreme Court, in other contexts but of general application,\textsuperscript{132} confirming that there is only one civil standard of proof, that being on the preponderance or balance of probabilities. Most recently in \textit{Re S-B}, Baroness Hale said:

'... there is no necessary connection between the seriousness of an allegation and the improbability that it has taken place. The test is the balance of probabilities, nothing more and nothing less.'\textsuperscript{133}

3.69 The OFT considers that the evidence set out in this Decision is sufficient to overcome the presumption of innocence to which the Parties are entitled.

3.70 The CAT has acknowledged that in cases involving a possible infringement of the Chapter I Prohibition the nature of the evidence may be fragmentary or circumstantial.\textsuperscript{134}

3.71 The CAT has expanded on this in its \textit{Replica Kit} and \textit{Argos and Littlewoods} judgments.\textsuperscript{135}

\textsuperscript{130} \textit{Replica Kit} at [204]. See also \textit{Argos Limited and Littlewoods Limited v Office of Fair Trading} [2004] CAT 24, at [164] and [165].

\textsuperscript{131} See also \textit{Replica Kit} at [188]: '...facts are required to be proved on the balance of probability, that is to say that the court must be satisfied on the evidence, that the occurrence of the events is more likely than not. However, the principle is that the more serious the allegation, the stronger the evidence should be before the court concludes that the allegation is established on the balance of probabilities. Hence the civil standard provides for flexibility as to the cogency of the evidence required to satisfy the court of the facts...'


\textsuperscript{133} \textit{Re S-B} [2010] 2 WLR, at paragraph 34. See also \textit{Re B} [2009] 1 AC 11, at paragraph 69.

\textsuperscript{134} \textit{Claymore Dairies Ltd and Express Dairies plc v. OFT} [2003] CAT 18, at [3] (Observations of the Tribunal upon staying the appeal).
'As regards price fixing cases under the Chapter I prohibition, the Tribunal pointed out in Claymore Dairies that cartels are by their nature hidden and secret; little or nothing may be committed to writing. In our view even a single item of evidence, or wholly circumstantial evidence, depending on the particular context and the particular circumstances, may be sufficient to meet the required standard: see Claymore Dairies at [3] to [10].'

And, on the specific facts of Argos and Littlewoods, it held that:

'EVEN IF, for example, particular documents or particular pricing patterns may appear inconclusive standing alone, nonetheless in our judgment the overall picture convincingly establishes the OFT’s case.'

3.72 In addition to the comment on a single piece of evidence, or wholly circumstantial evidence, set out in the above extracts, the CAT also made the following observations:

'In Chapter I cases, however, in the light of the factors we have already identified, we think it important to underline that the Napp standard should not be interpreted in a way that leads to the absence of prosecution of Chapter I infringements that ought to be prosecuted. In our view, there is no rule of law that, in order to establish a Chapter I infringement, the OFT has to rely on written or documentary evidence. The oral evidence of a credible witness, if believed, may in itself be sufficient to prove an infringement, depending on the circumstances of a particular case.'

And:

'[that] the OFT may well be entitled to draw inferences or presumptions from a given set of circumstances, for example, that the undertakings were present at a meeting with a manifestly anti-competitive purpose, as part of its decision-making process.'

3.73 In addition, the General Court has recently confirmed that the evidence demonstrating an infringement:

'may consist of direct evidence, taking the form, for example, of a written document [...] or, failing that, indirect evidence, for example in the form of conduct [...].'

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137 Claymore Dairies Ltd and Express Dairies plc v. OFT [2003] CAT 18, at [8].

138 Claymore Dairies Ltd and Express Dairies plc v. OFT [2003] CAT 18, at [10].

L RELEVANCE OF EVIDENCE PRE-DATING 1 MARCH 2000

3.74 The Chapter I Prohibition came into force on 1 March 2000 and any infringement can be established from no earlier than that date. However, the OFT takes the view that evidence relating to facts existing before that date may be important as relevant background context in relation to the facts and matters at issue on and after 1 March 2000.\textsuperscript{140}

3.75 Evidence relating to facts existing before 1 March 2000 may also be relevant for the purpose of determining whether an agreement benefits from a transitional period under Schedule 13, paragraph 19 of the Act, by virtue of which the Chapter I Prohibition did not apply until 1 March 2001.

\textsuperscript{140} Evidence pre-dating 1 March 2000 was taken into account by the CAT in \textit{Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading} [2001] CAT 1, at [217] and in \textit{JJB Sports PLC and Others v. OFT} [2004] CAT 17, at among other places [324-332] and [369-393]. See also \textit{Claymore Dairies Limited and Arla Foods UK plc v Office of Fair Trading} [2005] CAT 30, at [181].
4 ASSESSMENT OF THE RELEVANT MARKET

A INTRODUCTION

4.1 In a case under Chapter I of the Act, it is necessary to define the relevant market only where it would be impossible, without such a definition, to determine whether the agreement may affect trade in the UK and whether it has as its object or effect the prevention, restriction or distortion of competition within the UK. Therefore, in a case under Chapter I of the Act, market definition is neither intrinsic to, nor normally necessary for, a finding of infringement. However, market definition is relevant to assessing penalties, and for this purpose the OFT must identify the market affected by the infringements on a reasonable and properly reasoned basis.

4.2 Central to market definition is the consideration of whether consumers can and will switch their purchases to substitute products in response to relative price changes, and identification of those substitute products which may exert a price-constraining effect. Evidence on substitution from a number of different sources may be considered. Other factors important in defining the relevant market include the objective characteristics of the products, their intended use, the competitive conditions, the structure of supply and demand, and the attitudes of consumers and users.

4.3 The OFT’s approach to market definition is set out in its guideline on market definition which follows a similar approach to the Commission’s Notice on market definition. As stated in this guidance and in accordance with the case law on defining the relevant market in a Chapter I case for the purposes of penalty assessment, the OFT does not follow

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143 The OFT Guideline Market definition (OFT 403, December 2004), at paragraph 3.7.
144 Aberdeen Journals Limited v DGFT [2002] CAT 4, at [96].
145 The OFT Guideline Market definition (OFT 403, December 2004), at paragraph 1.2.
146 European Commission Notice on the definition of the relevant market for the purposes of Community competition law (OJ 1997 C372/3).
mechanically every step described but will instead look at evidence that is reasonably attainable and relevant to the present case.

4.4 The OFT is not bound by market definitions adopted in previous cases, either by itself or by other competition authorities, although earlier definitions can sometimes be informative when considering the appropriate market definition. Equally, although previous cases can provide useful information, the relevant market must be identified according to the particular facts of the case in hand.147

B THE RELEVANT PRODUCT MARKET

I Focal products

4.5 The process of defining a market generally begins with identifying the focal product, which is the product under investigation.148 The focal products in this case are cigarettes, HRT, pipe tobacco, and cigars/cigarillos. The OFT considers that there are no other products that are substitutable with these products. Hence, the relevant market is not wider than these products. For market definition purposes the OFT has analysed below the degree of substitutability within and between these product groups. The level of the analysis below is consistent with the purpose of the market definition in this Decision as set out in paragraph 4.1 above.

Cigarettes

4.6 Cigarettes are by far the largest component of tobacco sales, accounting for around 90 per cent by value of total tobacco sales in the UK in 2003.149 Cigarettes exhibit a high degree of apparent similarity in their main external product characteristics and intended use (that is, a roll of tobacco that is wrapped in paper and can be smoked as it is). Nevertheless, product differentiation exists in relation to such matters as cigarette brands, cigarette size, pack size, tar levels, tobacco blend, flavour, and price category.

4.7 The majority of UK cigarette sales (around 70 per cent) are of 'King Size' (85mm) cigarettes, with most of the remainder accounted for by

147 Aberdeen Journals Limited v Director General of Fair Trading (No. 1) [2002] CAT 4 at [139], and the OFT Guideline Market definition (OFT 403, December 2004), at paragraph 5.7.
148 See paragraph 2.9 of the OFT Guideline Market definition (OFT 403, December 2004).
149 Key Note Market Report – 'Cigarettes & Tobacco'; August 2004 (page 15).
'Superkings' (100mm). The most popular pack size is the 20-cigarette format, which accounts for nearly 70 per cent by value of UK cigarette sales.\(^{150}\)

4.8 In relation to tar levels (also referred to as cigarette 'strength'), identified categories are high-tar (10+mg), mid-tar (7-10mg), low-tar (4-6mg) and ultra low-tar (1-3mg). There is a trend in UK consumption towards lower tar varieties. All the major manufacturers offer cigarettes across the range of tar levels, including through variations in strength within a brand family (for example, Lambert & Butler King Size and Lambert & Butler Lights; Benson & Hedges Special Filter and Benson & Hedges Lights). This may imply significant potential for supply-side substitutability between cigarettes of different strength.

4.9 Each major cigarette manufacturer supplies a number of cigarette brands, positioned across the various price categories (premium, mid, low and ultra-low). Retailer private label cigarettes also have a small UK presence.\(^{151}\) Brand loyalty is traditionally stronger in the premium price sector. However, there is evidence of UK consumers 'trading down' to cheaper cigarette categories in response to cumulative price increases (see Table 4.2 below). The virtual disappearance of brand-related advertising, as a consequence of the UK ban on tobacco advertising (see Section 5.E: 'Regulations'), may also be a factor.

4.10 Table 4.1 below illustrates the increase in tobacco retail prices across all pricing categories over the period of infringement. It shows that the lowest increase was observed in the 'ultra-low' price category. The second table, Table 4.2 below, illustrates that the 'premium' and 'mid' price categories lost over ten percentage points of share of volume sales between 1999 and 2003, and that the great majority of net share gain accrued to the 'ultra-low' price category.


\(^{151}\) Private label accounted for less than two per cent of total retail sales of cigarettes (Euromonitor – 'Market report: Food – Cigarettes: Part 2' April 2004 (page 50)).
Table 4.1: Typical UK retail prices of cigarettes per pack of 20, by price category\textsuperscript{152}

<table>
<thead>
<tr>
<th>Price category</th>
<th>October 1999 (£)</th>
<th>October 2003 (£)</th>
<th>per cent change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>3.88</td>
<td>4.65</td>
<td>+19.8 per cent</td>
</tr>
<tr>
<td>Mid</td>
<td>3.63</td>
<td>4.39</td>
<td>+20.9 per cent</td>
</tr>
<tr>
<td>Low</td>
<td>3.42</td>
<td>4.13</td>
<td>+20.8 per cent</td>
</tr>
<tr>
<td>Ultra-low</td>
<td>3.25</td>
<td>3.69</td>
<td>+13.5 per cent</td>
</tr>
</tbody>
</table>

Table 4.2: Share of UK retail volume sales of duty-paid cigarettes, by price category\textsuperscript{153}

<table>
<thead>
<tr>
<th>Price category</th>
<th>1999 (per cent)</th>
<th>2003 (per cent)</th>
<th>per cent change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>39.1</td>
<td>33.3</td>
<td>-5.8</td>
</tr>
<tr>
<td>Mid</td>
<td>17.1</td>
<td>12.7</td>
<td>-4.4</td>
</tr>
<tr>
<td>Low</td>
<td>35.3</td>
<td>35.6</td>
<td>+0.3</td>
</tr>
<tr>
<td>Ultra-low</td>
<td>8.4</td>
<td>18.4</td>
<td>+10.0</td>
</tr>
</tbody>
</table>

4.11 The major companies have reacted to consumer demand for cheaper cigarettes by launching brands in the low and ultra-low price categories (for example, ITL’s Richmond brand; and Gallaher’s Dorchester brand) and repositioning existing ones into a lower-price category (for example, ITL’s Lambert & Butler brand).

4.12 The Commission has previously considered the argument for further segmenting cigarettes.\textsuperscript{154} The Commission noted that ‘the investigation

\textsuperscript{152} Source: Mintel – ‘Cigarettes’, Market Intelligence, April 2004 (page 22). This trend continued after this period: the typical UK retail price of a pack of 20 cigarettes was £5.61, £5.25, £4.97 and £4.36 for the premium, mid, low and ultra-low price categories respectively in January 2006, which equates to retail price increases since October 1999 of 44.6%, 42.3%, 45.3% and 34.15% respectively (Mintel – ‘Cigarettes and Smoking Cessation Aids’, Market Intelligence, April 2006, page 24 (percentage changes calculated by the OFT)).

\textsuperscript{153} Source: Mintel – ‘Cigarettes’, Market Intelligence, April 2004 (page 21). This trend has continued in 2004 and 2005, with shares for the premium, mid, low and ultra-low price categories at 30.9%, 11.1%, 34.7% and 23.4% respectively in 2005 (Mintel – ‘Cigarettes and Smoking Cessation Aids’, Market Intelligence, April 2006, page 23).

\textsuperscript{154} Case No IV/M.1415 BAT/Rothmans, Article 6(1)(b) Non-Opposition Decision, 17 March 1999, available at:
carried out by the Commission shows that a sub-division of the manufactured cigarette market along with a particular criterion (or combination of them) would in most cases be arbitrary and not meaningful.\textsuperscript{155} This view was restated by the Commission in its recent decisions in \textit{Imperial Tobacco/Altadis}\textsuperscript{156}, and \textit{BAT/Skandinavisk Tobakscompagni}.\textsuperscript{157}

4.13 On the basis of the evidence available, the OFT concurs with the Commission’s findings in this respect. Moreover, given that the Infringing Agreements covered a wide range of cigarette brands across different possible market segments, the OFT considers that it is not necessary for the purposes of this Decision to examine further the extent to which different segments or categories of cigarettes could be regarded as separate relevant product markets.

\textbf{HRT / Roll your own (‘RYO’)}

4.14 HRT is fine-cut hand rolling tobacco sold in packets or pouches. In 2003 HRT accounted for around seven per cent of total tobacco sales.\textsuperscript{158} The potential for substitution between (factory manufactured) cigarettes and HRT arises through the ability of consumers to roll their own cigarettes using HRT and cigarette papers. Purchasing of HRT is biased towards men, the relatively young and lower income groups.\textsuperscript{159}

4.15 Product differentiation tends to focus on texture, aroma and colour (light, medium and dark tobacco). Leading brands are Golden Virginia and Drum (ITL brands) and Amber Leaf and Old Holborn (Gallaher brands). The average price of a hand-rolling cigarette is approximately a third of that of a factory manufactured cigarette.\textsuperscript{160}

\textsuperscript{155} \textit{BAT/Rothmans}, paragraph 12; confirmed in \textit{Imperial Tobacco/Reemtsma Cigarettenfabriken}, paragraph 11.

\textsuperscript{156} Case No COMP/M.4581 \textit{Imperial Tobacco/Altadis}, Article 6(2) Non-Opposition Decision 18 October 2007, available at: http://ec.europa.eu/comm/competition/mergers/cases/decisions/m4581_20071018_20212_en.pdf.


\textsuperscript{158} Key Note Market Report – ‘Cigarettes & Tobacco’; August 2004 (page 16).

\textsuperscript{159} Idem (page 47).

\textsuperscript{160} Idem (page 16).
Published market intelligence points to some evidence of UK consumers switching from cigarettes to HRT. For example:

‘In 2002 and 2003, hand-rolling tobacco (HRT) performed strongly as high duties drove consumers to seek cheaper alternatives to manufactured cigarettes. The average price of [an HRT] cigarette can almost amount to a third of that of a ready-made one and this type of cost differential is a considerable incentive.’

Indeed, the rate of growth in duty paid HRT sales by value (at the recommended retail price (‘RRP’)) between 2002 and 2003 was three times that of cigarettes, and more than twice that of total tobacco sales.

However, any inferences about consumer switching from cigarettes to HRT may well be subject to the ‘cellophane fallacy’. At some large price differential (inflated because of the high proportion of duty), consumers will switch to an alternative product, even if it would not be considered a good substitute given the ‘competitive’ (i.e. lower) price levels and a smaller price differential (that would exist absent the duty). Tax-driven price increases that have resulted in a larger price differential between cigarettes and HRT may well therefore have resulted in circumstances where consumer demand elasticities (and propensity to switch their purchases) are higher than those previously applicable.

The Commission found that ‘[t]he smokers of [HRT] seem to form a distinct type of smokers separated from the mainstream of [cigarette] smokers.’ The Commission has previously concluded that HRT/RYO constitutes a separate and distinct product market from factory manufactured cigarettes.

Pipe tobacco

Pipe tobacco accounts for only a small proportion of total tobacco sales (less than one per cent in 2003). Pipe tobacco is a different preparation
to HRT (for example, in texture and taste) such that there is little possibility for demand-side substitution.

4.21 All major tobacco manufacturers produce pipe tobacco. They differentiate their HRT brands from their pipe tobacco brands (Condor and Clan for Gallaher and St Bruno for ITL).

4.22 Sales of pipe tobacco are in long-term decline as the number of pipe smokers within the population continues to fall.\(^\text{167}\) The Commission has previously concluded that pipe tobacco constitutes a separate product market from RYO/HRT.\(^\text{168}\)

**Cigars and cigarillos**

4.23 Cigars and cigarillos are rolls of tobacco with an outer wrapper of either natural or reconstituted tobacco. Like pipe tobacco, cigars and cigarillos account for a small proportion of total tobacco sales (around two per cent in 2003).\(^\text{169}\) Cigar and cigarillo consumption has been in slow decline for a number of years.

4.24 Unlike cigarettes and other tobacco products which tend to be smoked on a habitual basis, cigars and cigarillos are often reserved for smoking on special occasions, as evidenced by the rise in sales around the Christmas period. Furthermore, cigars and cigarillos are often smoked on an occasional basis by existing tobacco users in addition to their usual product.\(^\text{170}\)

4.25 The Commission has previously concluded that cigars constitute a separate product market, but has left open the question of whether the cigar market should be further segmented.\(^\text{171}\)

**II Distribution channels**

**Retail outlets**

4.26 When defining markets for products which are sold through various different distribution channels, it is necessary to consider whether

\(^{167}\) Key Note Market Report – ‘Cigarettes & Tobacco’; January 2006 (page 22).


\(^{169}\) Key Note Market Report – ‘Cigarettes & Tobacco’; August 2004 (page 17).

\(^{170}\) Idem.

different channels could constitute separate markets. This may be the case if differences between channels facilitate significant price discrimination between groups of customers.172

4.27 UK consumers have a wide choice of retail outlets for tobacco products. These include supermarkets, convenience stores, petrol forecourts, newsagents, kiosks, specialist tobacconists, off licences and licensed premises (often in the form of vending machines).

4.28 As shown in Table 5.3 below, grocers and confectioners, tobacconists and newsagents (‘CTNs’) accounted for the bulk of retail sales in cigarettes (around 50 and 27 per cent respectively in 2003, most of which was in multiples). These stores sold products in multipacks as well as individual cartons. Around 13 and 7 per cent of cigarettes respectively were sold in garage forecourts and off licences.173

4.29 Whilst there was some price variation between these various types of retail outlet, the OFT does not consider that this price variation implies separation of markets by different retail channels. Thus while it is noted that multiple grocers typically charged discounted prices, and petrol forecourts typically charged premium prices, within those categories of retail channel there is also significant price variation. For example, in terms of multiple grocers, the retail price can vary considerably according to the format of the store within a particular retailer.174 In addition, it is difficult to generalise about the pricing strategies for other types of retail outlet, for example off licences, or CTNs.175

4.30 ITL submitted that the Competition Commission (‘the CC’), in its 2008 report on the Supply of Groceries, considered that the product market for the supply of groceries could be delineated by store size. Although the CC did not include tobacco in its definition of groceries,176 ITL submitted that a similar delineation between size and types of retailer could apply in

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172 For further explanation of why price discrimination may affect market definition see the OFT Guideline Market definition (OFT 403, December 2004), at paragraphs 3.8 to 3.10.
174 ITL notes that ‘even multiple grocers are prepared to engage in different variations of premium pricing.’ ITL’s response to the SO, paragraph 2.57.
175 For example, in their representations, ITL show a wide variation in the selling prices of its Richmond King Size 20 cigarettes as between different Thresher stores (off licence) during the period of infringement. ITL’s response to the SO, paragraph 2.74.
176 In addition, while the CC considered that large grocery stores were not constrained by competition from medium or small sized grocery (convenience) stores, it found that convenience stores were constrained by medium sized and large sized grocery stores. ‘The supply of groceries in the UK’ market investigation, Competition Commission report, 30 April 2008, paragraph 4.145.
relation to the sale of tobacco products. However, the OFT notes there are important differences between grocery retailing and tobacco retailing. Indeed, as ITL notes, convenience remains a key driver of retailing competition in relation to tobacco products which suggests that proximity, rather than size or format of retail store, is often a more relevant consideration for consumers in considering their choice of outlet for their cigarette purchases.

4.31 Given the above, the OFT does not consider that there is a basis for delineating the relevant product market between different types of retail outlet. Furthermore, given that the Infringing Agreements covered a wide range of different possible types of retail outlet, the OFT considers that it is not necessary for the purposes of this Decision to examine further the extent to which different retail distribution channels could be regarded as separate relevant product markets.

**Duty paid and non-duty channels**

4.32 All tobacco products sold through UK retail outlets are 'duty paid' (that is, subject to UK excise duty and VAT). 'Non-duty' channels by which UK consumers can obtain tobacco products include legal personal imports and illegal smuggled products from non-authorised sources. Demand for non-duty supplies is driven by the substantial price differential between the UK and other EU countries, largely caused by the relatively high level of UK excise duty. One measure taken to combat tobacco smuggling has been the introduction of 'UK duty paid' pack markings, and in July 2001 it became a criminal offence to trade in tobacco without a duty paid pack mark.

4.33 The degree to which consumers can switch their purchases from duty paid to non-duty products is constrained by physical restrictions on legal imports (both the need to travel abroad in person, and 'personal use' quantity restrictions enforced by Customs and Excise), and the illegal nature of UK-sourced non-duty purchases.

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177 ITL’s response to the SO, paragraph 2.11.
178 ITL’s response to the SO, paragraph 2.30.
179 As ITL notes, the importance of convenience for consumers of tobacco products is reflected by the fact that in 2003 only some 30 per cent of both UK cigarette sales and RYO tobacco sales were made by multiple grocers as a whole, while 80 per cent of all UK grocery sales were accounted for by the top six supermarkets. ITL’s response to the SO, paragraph 2.30.
4.34 Whilst the availability and realised volume of non-duty supplies will clearly affect the level of demand for duty paid products, they cannot be considered to represent a reliable substitute and a genuine competitive pricing constraint due to the legal restrictions on the volume of this supply channel. Therefore, the relevant product markets in this case are limited to UK duty paid supplies.

4.35 In summary, for the purposes of this Decision, the OFT is therefore of the view that on balance the relevant product markets may be treated as each of UK duty paid cigarettes, HRT, pipe tobacco, and cigars and cigarillos. This is without prejudice to the OFT’s discretion to adopt a wider or narrower definition in any subsequent case, in particular where further evidence becomes available.

C THE RELEVANT GEOGRAPHIC MARKET

4.36 The geographic scope of the Infringing Agreements was the UK. The Manufacturers and Retailers operate on a national basis. There are no significant differences in the products sold, or in pricing, at a regional or local level. Hence there is no apparent reason to define a geographic market narrower than the UK.\(^\text{182}\)

4.37 There are substantial differences between countries in the tax and regulatory systems applicable to tobacco products, and in the resulting range of prevailing retail prices.\(^\text{183}\) Furthermore, the manner and quantity in which tobacco products can be imported into the UK is subject to explicit legal restrictions.\(^\text{184}\)

4.38 Cross-border trade flows are generated since some cigarettes and other tobacco products are produced only in specific countries and then delivered to their country of retail sale. However, this does not imply a

\(^{182}\) ITL submitted that the convenience nature of consumer purchases of tobacco products means that markets are local (ITL’s response to the SO, paragraph 2.31). In support of this argument, ITL draws a parallel with the CC’s finding that grocery markets are local (’The supply of groceries in the UK market investigation’, Competition Commission report, 30 April 2008, paragraph 15). However, as noted above, tobacco products were not included in the CC’s definition of groceries, and there are important differences between the two categories. In addition, the contemporaneous marketing and trade reports that ITL submitted with its representations (ITL’s response to the SO, Volume 2: Annexes) do not indicate that ITL differentiated between local or regional markets within the UK in its assessment of competitive conditions.

\(^{183}\) See also the note of the meeting between ITL and the OFT of 10 February 2005(Document 4, Annex 13 (page 4)).

\(^{184}\) The legal restrictions on the import of tobacco products can be viewed as having similar effects to quotas, see the OFT Guideline Market definition (OFT 403, December 2004), at paragraph 4.6.
wider market if final demand conditions remain substantially different between countries.

4.39 In summary, for the purposes of this Decision, the OFT is therefore of the view that the relevant geographic market may be regarded as the UK. This is without prejudice to the OFT’s discretion to adopt a wider or narrower definition in any subsequent case, in particular where further evidence becomes available.

D THE RELEVANT MARKET - CONCLUSION

4.40 The OFT concludes that there appears to be a sound basis for defining UK duty paid cigarettes, HRT/RYO, pipe tobacco, and cigars and cigarillos as comprising separate product markets, but not for making further subdivisions in relation to other characteristics. In relation to the geographic markets, it seems appropriate to consider these as national.

4.41 For the purposes of this Decision, and in particular for the purpose of assessing the level of penalties, the OFT has defined the relevant markets as:

- UK duty paid cigarettes;
- UK duty paid HRT/RYO;
- UK duty paid pipe tobacco; and
- UK duty paid cigars and cigarillos.

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185 See also the note of the meeting between ITL and the OFT of 10 February 2005, (Document 4, Annex 13 (pages 3 and 4)).
5 THE UK TOBACCO INDUSTRY

A INTRODUCTION

5.1 Annual worldwide consumption of tobacco was estimated at 6.6 million tonnes in 2003\(^{186}\) and, with the exception of the Chinese state tobacco monopoly,\(^{187}\) the vast majority of tobacco sales both worldwide and in the UK were accounted for by major international tobacco manufacturers such as Philip Morris, British American Tobacco (BAT), ITL, Japan Tobacco Inc. and Gallaher. Although, during the infringement period, both ITL and Gallaher manufactured and marketed a large range of cigarettes, cigars and hand rolling and pipe tobacco in the UK, the manufacture and distribution of tobacco products was a global industry and both companies obtained significant revenues from sales in countries other than the UK.

5.2 In the UK, the value of total sales of cigarettes and tobacco in 2003 has been estimated at around £15.27 billion.\(^{188}\) Sales of cigarettes accounted for around 90 per cent of this figure, HRT around 7 per cent and cigars and pipe tobacco around 3 per cent.\(^{189}\) The UK tobacco industry was and is characterised by high levels of concentration, regulation and taxation.

B INDUSTRY CONCENTRATION

5.3 In terms of their share by volume of the total UK duty paid cigarette sales during the infringement period, ITL and Gallaher products (including distributed brands, see Section 6.D: 'Role of ITL and Gallaher in relation to brands distributed for third parties') have been estimated to have accounted for 90 per cent of total sales by volume in 2003.

\(^{186}\) Keynote Market Report 2004: *Cigarettes & Tobacco*.

\(^{187}\) China’s National Tobacco Company (CNTC) is the largest tobacco company and state monopoly in the world.

\(^{188}\) Keynote Market Report 2004: *Cigarettes & Tobacco*. It should be noted that this is an estimate of total sales of cigarettes and tobacco products in the UK and therefore includes an estimate, by HMRC, of sales of illegal non-duty paid sales in the UK. It is therefore not an estimate of the size of the relevant market as defined in Section 4: 'Assessment of the relevant market' above.

\(^{189}\) Keynote Market Report 2004: *Cigarettes & Tobacco*. 
Table 5.1: Manufacturer shares of UK duty paid cigarette sales (including distributed brands) by volume in 2003190

<table>
<thead>
<tr>
<th>Manufacturer</th>
<th>Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ITL</td>
<td>51.5</td>
</tr>
<tr>
<td>Gallaher</td>
<td>38.5</td>
</tr>
<tr>
<td>BAT</td>
<td>6.1</td>
</tr>
<tr>
<td>Other</td>
<td>3.9</td>
</tr>
</tbody>
</table>

C PRODUCTS

5.4 As described above in Section 4: ‘Assessment of the relevant market’, during the infringement period, Gallaher and ITL supplied a number of different cigarette brands, in 10, 20 or multi-pack formats, positioned across various price categories. In some cases different cigarette formats were available within a ‘parent’ or main brand title with variants differing in terms of cigarette size or tar content. For example, the Dorchester [Gallaher] and Richmond [ITL] brands were available in different cigarette sizes such as the Kingsize (‘KS’) and Superking (‘SK’) formats and the Silk Cut [Gallaher] brand was available in a lower tar version and an ultra low tar version.

5.5 Table 5.2 below sets out the leading Gallaher and ITL brands (based on parent / main brand) distributed in the UK in 2002 together with the price category in which they were located: Premium (P), Mid-Range (M) or Low (L).

Table 5.2: Leading ITL and Gallaher (including distributed) Cigarette Brands in the UK by percentage of duty paid retail volume 2002 \(^{191}\)

<table>
<thead>
<tr>
<th>Brand</th>
<th>Manufacturer</th>
<th>Share (%) of all cigarettes</th>
<th>Price Cat.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lambert &amp; Butler KS</td>
<td>ITL</td>
<td>16.1</td>
<td>L</td>
</tr>
<tr>
<td>Richmond</td>
<td>ITL</td>
<td>10.9</td>
<td>L</td>
</tr>
<tr>
<td>Benson &amp; Hedges</td>
<td>Gallaher</td>
<td>9.4</td>
<td>P</td>
</tr>
<tr>
<td>Mayfair</td>
<td>Gallaher</td>
<td>7.5</td>
<td>L</td>
</tr>
<tr>
<td>Silk Cut</td>
<td>Gallaher</td>
<td>6.6</td>
<td>P</td>
</tr>
<tr>
<td>Marlboro Lights</td>
<td>ITL(^{192})</td>
<td>5.6</td>
<td>P</td>
</tr>
<tr>
<td>Superkings</td>
<td>ITL</td>
<td>4.9</td>
<td>M</td>
</tr>
<tr>
<td>Regal</td>
<td>ITL</td>
<td>4.1</td>
<td>P</td>
</tr>
<tr>
<td>Berkeley</td>
<td>Gallaher</td>
<td>4.0</td>
<td>M</td>
</tr>
<tr>
<td>Dorchester</td>
<td>Gallaher</td>
<td>3.7</td>
<td>L</td>
</tr>
<tr>
<td>Sovereign</td>
<td>Gallaher</td>
<td>3.3</td>
<td>L</td>
</tr>
<tr>
<td>Embassy No.1</td>
<td>ITL</td>
<td>2.9</td>
<td>P</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td>79</td>
<td></td>
</tr>
</tbody>
</table>

5.6 Although they were not as important to the manufacturers in terms of absolute turnover, sales of HRT increased in the UK over the course of the infringement period as smokers looked for cheaper alternatives to manufactured cigarettes. Both Gallaher (Old Holborn and Amber Leaf) and ITL (Golden Virginia and Drum) manufactured and distributed a number of leading brands in the UK which, although available from some outlets in


\(^{192}\) ITL distributes Marlboro cigarettes for Philip Morris (see Section 6.D: 'Role of ITL and Gallaher in relation to brands distributed for third parties').
multi-pack formats, were typically sold in single packs or tins with weights of 12.5g, 25g and 50g.

5.7 In contrast to HRT, the cigar sector has been described as being 'in long term decline, with sales having fallen 25.1 per cent between 2000 and 2004'.\textsuperscript{193} Once again, both Gallaher (Hamlet, Sobraine and King Six) and ITL (Café Crème, Castella, Classic and Panama) manufactured and distributed a number of leading brands in the UK which although available from some outlets in multi-pack formats, were usually supplied in single packs of 5, 6 or 10.

5.8 Sales of pipe tobacco have also been described as being in 'long-term decline as the number of pipe smokers within the population continues to fall'.\textsuperscript{194} As with HRT, the main brands manufactured and distributed by Gallaher (Condor and Clan) and ITL (St Bruno) in the UK were also typically sold in individual packs with weights of 25g or 50g.

### D DISTRIBUTION

5.9 Table 5.3, which illustrates the distribution of sales of duty-paid cigarettes by value in the UK in 2003, demonstrates that a significant proportion of all tobacco products’ retail sales were accounted for by multiple and independent grocers. Multiple grocers often sold cigarettes and tobacco products in multi-packs as well as individual packs. CTNs and garage forecourts tended to sell individual rather than multi-packs but still accounted for a significant percentage of total retail sales.

#### Table 5.3: Retail distribution of duty-paid cigarettes by value in the UK 2003\textsuperscript{195}

<table>
<thead>
<tr>
<th>Retail distribution</th>
<th>Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple grocers</td>
<td>32.7</td>
</tr>
<tr>
<td>Independent CTNs</td>
<td>17.9</td>
</tr>
<tr>
<td>Independent grocers</td>
<td>17.0</td>
</tr>
</tbody>
</table>

\textsuperscript{193} Keynote Market Report 2006: Cigarettes & Tobacco.
\textsuperscript{194} Idem.
\textsuperscript{195} Source: Mintel Market Intelligence April 2006: Cigarettes and Smoking Cessation Aids. Data may not sum to 100 due to rounding.
<table>
<thead>
<tr>
<th>Retailer</th>
<th>Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Co-operative Group(^{197})</td>
<td>6.20</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>4.36</td>
</tr>
<tr>
<td>Somerfield</td>
<td>4.01</td>
</tr>
<tr>
<td>Asda</td>
<td>3.73</td>
</tr>
<tr>
<td>Safeway</td>
<td>3.30</td>
</tr>
<tr>
<td>T&amp;S Stores</td>
<td>2.99</td>
</tr>
<tr>
<td>First Quench</td>
<td>2.08</td>
</tr>
<tr>
<td>TM Retail</td>
<td>1.90</td>
</tr>
<tr>
<td>Morrisons</td>
<td>1.52</td>
</tr>
</tbody>
</table>

\(^{196}\) The OFT calculation was based on data provided by ITL, Gallaher and [another manufacturer] for the year to August 2003, confirmed by figures from the retailers. The sales of other manufacturers, which accounted for 4 percent of UK duty paid cigarette sales in 2003 (see Table 5.1 above), are not included in these figures.

\(^{197}\) See Section 2.A.II: ‘The Retailers’ for a description of this entity’s organisation. The equivalent share of the Co-operative Group is 3.35 per cent.
5.10 ITL and Gallaher both had strong distribution networks in the UK. Tobacco products were either supplied directly to retailers in the various distribution channels or they were supplied via independent distribution and wholesale companies such as Palmer & Harvey McLane Limited (‘P&H’) (see paragraphs 6.299 and 6.343). Pricing data collected by the OFT during its investigation confirmed that pricing strategies tailored to retailer channels and/or locations were common across retailers. The contrast in strategies is most apparent when the typically discounted prices charged by the multiple grocers are compared with the typically premium prices charged by petrol forecourt retailers.

5.11 Data provided to the OFT during the investigation also confirms that ‘tiered pricing’ strategies, which involved classifying individual outlets as sellers of discount or premium priced cigarettes and tobacco products in relation to published RRPs applied across some multiple and independent grocers, off-licence chains and CTN groups. As confirmed by Gallaher, these strategies allowed certain retailers to take into account factors such as customer demographics and their proximity to competing outlets and differentiate their pricing accordingly.

E REGULATIONS

5.12 Within the UK, the tobacco manufacturers and the retailers of their products operated within an increasingly regulated market during the infringement period. Certain restrictions, for example the banning of all television commercials for cigarettes in 1965 and the 1971 introduction of health warnings printed on packs, had been in place for decades. Developments during the infringement period included:

- Health warnings – in line with EU Directive 2001/37/EC all cigarette packs were required to include health warnings covering 30 per cent of the front surface and 40 per cent of the back.
- Duty markings - the Tobacco Product Regulations 2001 (SI 2001/1712) required tobacco products to carry a ‘UK Duty Paid’ marking and any retailers failing to comply were liable to a fine up to £5000.

The Tobacco Advertising and Promotion Act 2002 – following the implementation of which almost all tobacco advertising, including 'flash' and 'pence off' packs\(^1\), in the UK became illegal. The exception was at point of sale but even here regulations limited advertising to a single advertisement not exceeding A5 size.

5.13 These measures were followed after the infringement period by moves towards banning smoking in public places and workplaces.\(^2\) Despite these and other restrictions, the UK tobacco industry has been described as having demonstrated 'resilient characteristics' and, although overall consumption levels have been on a downward trend for decades, it remains the case that 'tobacco is of vital importance to a retailer's business, it acts as a primary footfall driver in store'.\(^3\)

F TAXATION

5.14 During the infringement period, cigarettes and tobacco were, and continue to be, subject to high rates of taxation in the UK. Hand rolling and pipe tobaccos were taxed at a fixed rate by weight plus VAT. Cigars were taxed at a fixed rate for every five plus VAT.

5.15 By contrast, the imposition of tax on cigarettes in the UK had three distinct elements:

- A flat rate tax on every single cigarette expressed per thousand sticks;\(^4\)
- An ad valorem element calculated as a percentage (22 per cent throughout the period under investigation) of the manufacturer's RRP for the product in question or, where no RRP was set, 'the highest price at which cigarettes of that description are normally sold by retail at that time in the UK';\(^5\) and

\(^1\) In contrast to ‘flash’ or ‘pence off’ pack markings which highlighted a price reduction, Price Marked Packs, where a specific price is printed on the pack, can still be used by manufacturers of cigarettes and tobacco products and, although their use is less frequent and widespread in the Multiple Grocer channel, their use can be observed across a variety of retail outlets.

\(^2\) A ban on smoking in all enclosed public places in Scotland came into effect in Spring 2006. In England smoking has been banned in all enclosed public spaces and workplaces including clubs, pubs and restaurants from 1 July 2007. Similar measures were adopted in Wales in April 2007 and in Northern Ireland on 30 April 2007.

\(^3\) The Grocer, September 2006: 'Guide to Tobacco.'

\(^4\) This was applied at £90.43 per 1000 in March 2000. The figure was increased to £92.25 in March 2001 and it has been set at £94.24 since April 2002. Source: Action on Smoking and Health Tax Calculator: [http://www.ash.org.uk/html/smuggling/html/cigtax.html](http://www.ash.org.uk/html/smuggling/html/cigtax.html)

• VAT imposed as a 17.5 per cent sales tax levied on the retail price.

5.16 Under this regime it was in the interest of manufacturers to set RRPs for cigarettes, as a failure to do so might be expected to have resulted in a higher tax liability. Further, from 1 June 2001 tobacco manufacturers were required to determine RRPs for tobacco products (Regulation 15 of the Tobacco Products Regulations 2001 (SI 2001/1712)).

5.17 Increases in tobacco taxation are used to encourage people to reduce smoking\textsuperscript{204} and have led to smokers switching between brand segments. In particular, prior to and during the infringement period, consumers switched to low priced brand segments, and away from premium priced brand segments as a result of the upward movement in Manufacturer’s prices and taxes forcing customers to gravitate to cheaper brands (see Table 4.2 above).

G MANUFACTURERS’ PRICE INCREASES

5.18 In addition to increases in retail prices that are directly attributable to increases in levels of taxation, prices of cigarettes and other tobacco products have also increased due to Manufacturers’ Price Increases (‘MPIs’). Published analysis of changes in the average price of a packet of 20 cigarettes between February 2002 and January 2006 concluded that ‘\textit{while rising duty has been a factor in these increases, price rises by manufacturers have far exceeded the extra duty that has been added}’.\textsuperscript{205}

5.19 During the infringement period, both Gallaher and ITL regularly introduced MPIs at least once and, on occasions, twice a year. These MPIs were usually preceded by written notice one month in advance of their specified date and the MPIs of Gallaher and ITL would typically be announced and introduced within a few days of each other. Both Manufacturers typically communicated the details of MPIs in terms of increases in RRPs. A typical MPI communication from Gallaher and ITL would therefore set out for each brand the absolute increase in the retail price to be applied (for single and multi-packs), together with the new RRPs for each brand.\textsuperscript{206} In some cases MPI details were communicated more briefly with a communication such as an e-mail informing the Retailer concerned of the absolute increase being applied and an attachment providing a list of revised cost prices and RRPs.

\textsuperscript{204} The Rt Hon. John Healey MP has stated that ‘\textit{successive Governments, including this one, have used the high price of cigarettes to encourage people to reduce smoking}’. Hansard 14 Oct 2004: Column 415.

\textsuperscript{205} Mintel Market Intelligence April 2006: ‘\textit{Cigarettes and Smoking Cessation Aids}’, p.24.

\textsuperscript{206} For example, see Document 61, Annex 11.
6 ANALYSIS OF THE INFRINGING AGREEMENTS

A OVERVIEW

I The anti-competitive object of the Infringing Agreements

Introduction

6.1 The salient factual elements of the Infringing Agreements are set out below in the sections of this Decision evidencing each bilateral vertical Infringing Agreement between a Manufacturer and a Retailer (see Section 6.C: 'The Infringing Agreements'). The evidence demonstrates that under the Infringing Agreements, each Manufacturer co-ordinated with each Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing tobacco brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy.

6.2 Pursuant to each Infringing Agreement, a Retailer was to price competing tobacco products at retail prices which implemented the Manufacturer’s parity and differential requirements between its brands and the linked brands of a competing Manufacturer (referred to in this Decision as 'competing linked brands'). In that way, the Infringing Agreement between each Manufacturer and each Retailer restricted the Retailer’s ability to determine its retail prices for competing linked brands.

6.3 The Manufacturer’s parity and differential requirements were expressed in a number of ways: (i) as a parity (for example, a requirement that the relevant Manufacturer’s brand X be the same price as the competing Manufacturer’s brand Y); (ii) as a fixed differential (for example, a requirement that the relevant Manufacturer’s brand X must be z pence less than the competing Manufacturer’s brand Y); and (iii) as a maximum differential (for example, a requirement that the relevant Manufacturer’s brand X be no more expensive than the competing Manufacturer’s brand Y, or that brand X be priced at least z pence less than brand Y). Those requirements were implemented in particular through regular communications by the Manufacturer of specific retail price points to the Retailer.

6.4 The Manufacturers’ parity and differential requirements were frequently specified in written trading agreements and were implemented in particular through regular contacts between each Manufacturer and each
Retailer, including routine notification and/or confirmation by the Manufacturer of specific retail prices and/or through instructions to set retail prices in accordance with parity and differential requirements.

6.5 Taking the evidence in relation to each Infringing Agreement as a whole, the OFT considers that the Infringing Agreements in fact provided for parity or fixed differential requirements which were implemented by communications from a Manufacturer to a Retailer that the Retailer move to a specific retail price point. The Retailer’s compliance with such communications was induced by the grant of ongoing and tactical bonuses; and divergences from the price points communicated by a Manufacturer were detected through the Manufacturer’s monitoring of a Retailer’s retail prices. Further, the Manufacturer’s communications with the Retailer to change the retail prices as a result of the Manufacturer’s monitoring of the Retailer’s retail prices included instructions and/or requests in some instances to increase prices.

6.6 There is evidence that the Manufacturers’ retail price strategies took into account the Retailer’s pricing policies and commercial requirements by:

- ensuring that the Retailer’s margins were not significantly affected by changes in the retail prices communicated by the Manufacturer;
- ensuring, in some cases, that the communicated retail prices took into account the Retailer’s desired pricing position relative to its retail competitors; and
- providing reassurance to the Retailer that it would not be out of step with its retail competitors if the Retailer set its retail prices in accordance with the Manufacturer’s retail pricing strategy.

6.7 As explained further in Section 6.A.I.(d) below, the restriction on a Retailer’s ability to determine its retail prices for competing tobacco products imposed by each of the Infringing Agreements was, by its very nature, capable of restricting competition. In particular, the Manufacturer’s parity and differential requirements precluded a Retailer from favouring the brand(s) of one Manufacturer over the brand(s) of the other Manufacturer and would significantly reduce uncertainty, both for the Manufacturer which imposed the parity or differential requirement and the competing Manufacturer, as regards the retail prices of the Manufacturer’s own brands and those of the competing linked brands. The long-term implementation of each Manufacturer’s parity and differential requirements would therefore reduce the incentives, both for the Manufacturer which imposed the requirement and the competing Manufacturer which observed the consequences of such a requirement (or had knowledge of such a requirement), to engage in inter-brand competition in relation to wholesale pricing.
6.8 Both Manufacturers communicated parallel and symmetrical parity and differential requirements to the same Retailer and there is evidence that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements.

6.9 The fact that each Manufacturer had agreed parallel and symmetrical parity and differential requirements with the same Retailer provides further support for the OFT’s case that the Infringing Agreements gave rise to the observance of parity and fixed differential requirements in relation to competing brands. That is because Retailers could only implement both Manufacturers’ pricing relativity requirements by adhering to parity or fixed differential pricing. For example, symmetrical agreements that provided in one agreement that brand X must be no more than brand Y, and in the other agreement that brand Y must be no more than brand X, could only be satisfied by pricing brand X and brand Y at the same level.

6.10 Further, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to the same Retailers and that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements with the Retailer (as explained further in this section) also reinforced and increased the restrictive nature of each Infringing Agreement, because each Manufacturer could predict with even greater certainty retail price movements in relation to the Manufacturer’s own brands and those of the competing Manufacturer. The long-term implementation of each Manufacturer’s parallel and symmetrical parity and differential requirements meant that each Manufacturer could predict with even greater certainty retail price movements in relation to the Manufacturer’s own brands and those of the competing Manufacturer. Where a parity requirement existed, for example, each Manufacturer could increase the price of its brand with relative certainty that its competitor (given its equivalent parity and differential requirements) would do likewise via the Retailer to restore its parity and differential requirements.

6.11 Given that the Manufacturers entered into Infringing Agreements with a number of Retailers and those Infringing Agreements ensured in practice that the retail prices of competing linked brands of tobacco products would be priced at either parity or at a fixed differential, the reduction in uncertainty on the part of each Manufacturer as regards its horizontal competitor’s likely market behaviour resulting from the Infringing Agreements enabled the Manufacturers to maintain or achieve a degree of stability in relation to inter-brand competition which was similar to that which would have resulted from horizontal price co-ordination between competitors.
The analysis of the objective aims of the Infringing Agreements, in the legal and economic context in which they operated, shows that each of the Infringing Agreements had as its 'object' the prevention, restriction, or distortion of competition, in breach of the Chapter I Prohibition.

The remainder of this section is structured as follows: an overview of the evidence of the Infringing Agreements is set out at Sections 6.A.I.(a)-(c) below; the restrictive nature of the Infringing Agreements is analysed at Section 6.A.I.(d) below; and the legal and economic context in which the Infringing Agreements operated is summarised at Section 6.A.I.(e) below.

(a) Elements of the Infringing Agreements

Under each of the Infringing Agreements, a Manufacturer co-ordinated with a Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. The Infringing Agreements between each Manufacturer and each Retailer restricted the Retailer’s ability to determine its retail prices for competing linked brands.

The Infringing Agreements involved, among other matters, a combination of several of the following elements (although not all of the following elements were present in each Infringing Agreement):

i) The Manufacturer’s strategy in relation to the Retailer's retail prices (that is, to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer).

ii) Written trading agreements between a Manufacturer and a Retailer under which the Retailer agreed that it would price a number of the Manufacturer’s brands according to the parity and differential requirements stipulated by the Manufacturer.

iii) Contacts between the Manufacturer and the Retailer regarding: (i) the retail prices of the Manufacturer's brands; (ii) the retail prices of the Manufacturer's competitors' brands; (iii) the retail prices charged by the Retailer's competitors.

iv) The payment or withdrawal of bonuses and other incentives (whether financial or other) by the Manufacturer to incentivise the Retailer to set its retail prices in accordance with the Manufacturer's retail pricing strategy.

v) Frequent and detailed monitoring or complaints by the Manufacturer and subsequent alignment of the Retailer's retail prices.
prices to ensure compliance with the Manufacturer's retail pricing strategy.

6.16 The paragraphs below contain a summary of the elements of the Infringing Agreements. It should be noted that the various elements which form part of each Infringing Agreement are not identical in every respect across the various Infringing Agreements and it is not necessary for all of the elements listed below to be present for a breach of the Chapter I Prohibition to be found. Moreover, for the purposes of the present summary, the examples of evidence that are set out below are illustrative of the nature of the commercial dealings between the specific Manufacturer and Retailer in each case and are relied on by the OFT only as regards the Parties in each example given. Further evidence upon which the OFT relies in respect of each Infringing Agreement between each Manufacturer and each Retailer is set out or otherwise referred to in Section 6.C: 'The Infringing Agreements'.

6.17 The trading agreements and/or contacts between a Manufacturer and a Retailer summarised below have been assessed in the context of the Manufacturer's strategy in relation to the Retailers' retail prices (namely to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer).

6.18 As each of ITL and Gallaher had similar Infringing Agreements with the same Retailers, there was a prevalence of similar vertical agreements across the tobacco retail sector. The OFT has treated the Infringing Agreements as a series of bilateral vertical agreements between each Manufacturer and each Retailer and concluded that each of the Infringing Agreements between a Manufacturer and a Retailer amounts to a breach of the Chapter I Prohibition in its own right.

6.19 It is, however, clear that the Infringing Agreements had characteristics in common. Certainly they pursued a common aim, namely to enable the Manufacturers to specify the relativities between the retail prices of competing tobacco brands, thereby restricting price competition between those brands (see Section 6.A.I.(e) below).

6.20 The evidence relating to the existence of a vertical Infringing Agreement between a Manufacturer and a Retailer is supported by documents which are similar in content, tone and nature, which concern relationships between the same Manufacturer and other Retailers or the same Retailer and another Manufacturer.

6.21 The OFT considers that the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to the same
Retailer and that each Manufacturer must have been aware\textsuperscript{207} of the other Manufacturer’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. In addition, the existence of parallel and symmetrical Infringing Agreements is relevant to how the Manufacturer and the Retailer party to an Infringing Agreement would have viewed the requirements imposed under each Infringing Agreement, since a Retailer was party to a similar Infringing Agreement with each Manufacturer and a Manufacturer was party to a similar Infringing Agreement with each Retailer. Further, as explained in Section 6.A.I.(d), the existence of an Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements with the Retailer reinforced and increased the restrictive nature of each Infringing Agreement.

\textit{i} The Manufacturer’s strategy in relation to the Retailer’s retail prices

6.22 Each Manufacturer’s retail pricing strategy becomes clear from a number of documents, which are referred to in greater detail in Section 6.B: ‘The Manufacturers’ retail pricing strategies’.

6.23 For example, ITL outlined its strategy to Somerfield in its Trade Development Programme for 2001:\textsuperscript{208}

\begin{quote}
‘I have pleasure in confirming our proposal for developing our mutual business during 2001. The key factors to the development of our business are:-

.....

Maintaining our Strategic Pricing Requirements which are designed to maintain price list differentials.

.....’
\end{quote}

6.24 In relation to Gallaher’s strategy, an example is demonstrated in its response to a section 26 Notice dated 27 January 2005:

‘Under a Parities and Differentials Clause, a retailer would be required to maintain the differential between a Gallaher brand and

\textsuperscript{207} See paragraph 1.15 and footnote 3 as to the meaning of the phrase ‘must have been aware’.
\textsuperscript{208} ITL/Somerfield (Document 15, Annex 20). The 2002 Trade Development Programme between Somerfield and ITL re-stated the purpose of ITL’s retail pricing requirements.
6.25 In order to determine its parity and differential requirements, each Manufacturer generally selected a tobacco brand and paired that brand with a brand of a competing Manufacturer in the relevant price segment of the market. The parity and differential requirements would generally link the price of a premium brand with the price of a competing premium brand, and the price of a 'value for money' ('VFM') brand with the price of a competing VFM brand. The Manufacturers typically paired the leading competing brands in the relevant price sector. Within each brand pair, competing brands were also paired in terms of equivalent pack sizes (for example, 20s, 100s, 200 for cigarettes, or 12.5g, 25g and 50g for RYO brands), equivalent cigarette sizes (for example, King Size, Superkings), or equivalent strengths (for examples, Lights, Mild). Lists of the brands frequently paired by ITL and Gallaher for the purposes of each Infringing Agreement are set out in Tables 6.1 and 6.2 below.

6.26 Each Manufacturer’s specified parity and differential requirements for competing linked brands were based on the differences between the RRP of the Manufacturer’s brand and the RRP of the competing linked brand. Where there was a difference between the respective RRPs of two competing linked brands, that was regarded as a price 'differential' and where the RRPs of two competing linked brands were the same, that was regarded as a 'parity'.

6.27 The OFT considers that the evidence as a whole demonstrates that each Manufacturer sought to achieve, via the Retailer, retail prices for the Manufacturer’s brands which were set either at parity with, or at a fixed price differential to, competing linked brands supplied by the other Manufacturer (as explained further in Section 6.A.I.(c) below). As is clear from the documents in Section 6.B: 'The Manufacturers' retail pricing strategies', the Manufacturer’s parity and differential requirements were central to its retail pricing strategy, and significant resources were invested by the Manufacturer in securing a Retailer’s compliance with that strategy.

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209 Gallaher’s response to the OFT’s section 26 notice dated 27 January 2005 (Document 17, Annex 3 (paragraph 1.8)).
ii Written trading agreements

6.28 An element of most of the Infringing Agreements is the existence of a written trading agreement between the relevant Manufacturer and the relevant Retailer which formed part of the ongoing commercial dealing between the Manufacturer and the Retailer and formalised the basis for certain aspects of the trading relationship between them. The OFT has assessed these trading agreements in light of how the trading relationship between the Manufacturer and Retailer operated in practice.

6.29 Pursuant to these written trading agreements, the Retailer concerned agreed to price the Manufacturer’s leading brands at parity with, or at a specified differential to, competing linked brands. The relevant parity and differential requirements were often included on a list that was either appended to a trading agreement or communicated separately from time to time. In addition, updates of such lists were often sent separately by a Manufacturer to a Retailer. The lists would generally contain a variety of the Manufacturers’ leading brands, including cigarettes, hand-rolling tobacco, cigars and pipe tobacco.

6.30 ITL had written trading agreements providing for parity and differential requirements with all of the Retailers. Gallaher had written trading agreements with each of the Co-operative Group, First Quench, Shell, T&S Stores and TM Retail, which had explicit reference to parity and differential requirements. In the case of Sainsbury and Somerfield, the Gallaher trading agreements did not make explicit reference to parity and differential requirements. Gallaher did not have formal written trading agreements with Asda, Morrisons or Safeway. However, Gallaher’s parity and differential strategy was an implicit part of the trading relationship between Gallaher and the Retailers. As set out in each of Sections 6.C.I-X below, whether as part of a formal written agreement or otherwise, the Infringing Agreement in each case involved each Manufacturer co-ordinating with the relevant Retailer the setting of the Retailer’s retail prices for competing tobacco brands, in order to achieve the parity and differential requirements sought by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy.

6.31 In some trading agreements, the Manufacturer’s requirements were phrased as fixed price differential requirements. For example: (i) Gallaher’s

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210 As set out in Section 6.C.V.(a), the OFT does not have a copy of the trading agreement between ITL and Safeway. However, the OFT has copies of correspondence between ITL and Safeway which refer to trading agreements between these two parties.

trading agreement with TM Retail required TM Retail to observe parity and 'agreed' differentials; (ii) Gallaher's trading agreement with First Quench provided that First Quench was obliged to observe a specific parity or differential that reflected the differences between the RRP's of the relevant competing brands; and (iii) ITL's trading agreement with Sainsbury required Sainsbury to observe parity and fixed differential requirements.

6.32 In other trading agreements, the Manufacturer’s requirements were phrased as maximum price differential requirements, in that the Manufacturer requested that its brands be priced at no more than a competitor brand, or at no more than a given differential relative to a competitor brand. For example, in its trading agreement with CRTG (entered into by the Co-operative Group on CRTG's behalf), Gallaher required that CRTG's members set retail price relativities that were no less favourable to its brands than those implied by the RRP differentials. In its trading agreements with Asda, Shell and Somerfield, ITL's requirements were expressed as maximum price differential requirements. In some cases, the trading agreements contained a mixture of parity and maximum differential requirements.

6.33 Some written trading agreements provided that the Retailer would notify the Manufacturer of reductions or 'pricing activity' in the Retailer’s retail prices for a competing Manufacturer’s brands, in order to give the Manufacturer an opportunity to respond. These were the trading agreements between (i) ITL and each of Sainsbury, Morrisons, TM Retail, T&S Stores and Shell; and (ii) Gallaher and each of the Co-operative Group, First Quench, Sainsbury, Shell, Somerfield, T&S Stores and TM Retail.

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212 Gallaher/TM Retail, 29 October 2001 (Document 9, Annex 12); Gallaher/First Quench, 8 November 1999 (Document 1, Annex 6).
213 ITL/Sainsbury, 16 August 2000 and 23 August 2002 (Documents 17 and 61, Annex 18 respectively);
214 Gallaher/Co-operative Group, 2 October 2000 (Document 7, Annex 5).
215 ITL/Asda, 5 June 2002 and 28 August 2003 (Documents 53 and 80, Annex 14 respectively); ITL/Shell, Documents 27 and 40, Annex 19 respectively; ITL/Somerfield, Documents 5, 20 and 48, Annex 20 respectively.
216 For example, ITL/Morrisons, 26 June 2000 (Document 4, Annex 17).
6.34 For example, the trading agreement between Gallaher and Shell provided the following:\textsuperscript{218}

‘1. PRICING

…..

Where Account is involved in the promotion of a brand by a competitor of Gallaher, Gallaher shall be offered the opportunity to conduct similar promotional activity on a brand to be selected by mutual agreement with Account as soon as reasonably requested by Gallaher following that competitor’s promotion.’

6.35 Similarly, the trading agreement dated 20 December 2001 between ITL and TM Retail stated the following:\textsuperscript{219}

‘TM agrees to retail Imperial Tobacco products in line with agreed pricing differentials in all tiers, provided it is noted and agreed that should any other manufacturer activity negate the current pricing differentials, Imperial Tobacco shall be given the opportunity to adjust the differentials to ensure parity is maintained (see appendix 2).’

6.36 In their responses to the SO, ITL, Shell and Morrisons submitted that the written trading agreements provided incentives to Retailers which were contingent on the Retailer promoting the Manufacturer’s brands and ensuring that competing tobacco products were priced within a competitive range of each other.\textsuperscript{220} ITL, Shell and the Co-operative Group submitted that the trading agreements did not amount to an ‘agreement’ between the Manufacturer and the Retailer pursuant to which the Retailer was required to observe the Manufacturer’s retail pricing strategy –

\textsuperscript{218} Gallaher/Shell, Document 9, Annex 9.

\textsuperscript{219} ITL/TM Retail, Document 19, Annex 22.

\textsuperscript{220} ITL’s response to the SO, for example at paragraphs 4.40-4.54. Shell’s response to the SO, paragraphs 111-125. (It is noted that Shell’s submissions relating to the period from June 2001 to August 2003 when Shell-owned sites were operated by Contractors are dealt with in Section 7.B.II.) Morrisons’ response to the SO paragraphs 325-334. At paragraphs 410-468 of its response to the SO, Morrisons submitted that it was not aware of Gallaher’s parity and differential requirements and that the evidence cited by the OFT in the SO did not demonstrate such an awareness. Morrisons submitted that the correspondence between Morrisons and Gallaher related to circumstances where Morrisons received a bonus to price at or below a maximum price. At paragraphs 321-400 and 401-453 of its response to the SO, Safeway submitted that it was not aware of ITL’s or Gallaher’s parity and differential requirements and that the evidence cited by the OFT in the SO did not demonstrate such an awareness. Safeway submitted that the correspondence between ITL and Safeway and Gallaher and Safeway cited by the OFT in the SO related to each Manufacturer stipulating a maximum price in respect of its products. The Co-operative Group’s response to the SO, paragraph 5.4. Further, the Co-operative Group stated that the OFT had not provide evidence to demonstrate that the parity and differential terms were incorporated into its trading relationship with ITL.
rather, the Retailer unilaterally chose to accept a bonus from the Manufacturer in return for pricing in line with the Manufacturer’s requirements.221

6.37 Further, ITL, Morrisons and the Co-operative Group submitted that the written trading agreements provided for maximum prices only and Retailers were free at all times to set retail prices at a level that was lower than the maximum (relative) price levels specified in the trading agreements.222

6.38 In this respect, ITL and Morrisons referred to the provisions in the trading agreements summarised at paragraphs 6.33-6.35 above as demonstrating that each Manufacturer sought to match the price promotions (not price increases) of another competing Manufacturer and the trading agreements would not have required any action on the part of a Retailer in the event that a competing Manufacturer’s brand increased in price. 223

6.39 The OFT considers that the evidence taken as a whole is not consistent with these submissions. The OFT considers that pursuant to each Infringing Agreement, the Manufacturer coordinated with the Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. Both the trading agreements and contacts between the Manufacturer and the Retailer demonstrate that the Retailer accepted and/or indicated its willingness to implement the Manufacturer’s parity and differential requirements, when setting its retail prices.

6.40 Further, although the parity and differential requirements contained in certain of the written trading agreements purportedly provided that the

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221 ITL’s response to the SO, paragraphs 4.40-4.154. Shell’s response to the SO, paragraph 117. The Co-operative Group’s response to the SO, for example at paragraphs 5.4-5.10.

222 ITL’s response to the SO, paragraphs 4.40-4.154. Morrisons’ response to the SO, paragraphs 325-334 (in respect of the trading relationship between ITL and Morrisons). In respect of the trading relationship between Gallaher and Morrisons, see footnote 220 above. In respect of Safeway, see footnote 220 above. The Co-operative Group’s response to the SO, at Annex 4 and see also footnote 220 above. Shell stated at paragraphs 113-114 of its response to the SO that Shell was required, under the trading agreements with each Manufacturer, to price a specified product at either a maximum differential (for example ‘at least [x] ‘less’)) or a fixed differential (for example, ‘minus xp’ or at parity (‘at the same price as’) a competing product. Shell stated that it could set the price of one product, which would act as a ceiling for the price of the other product. Shell further stated that it was free to set the price of two products at whatever level it wished.

Retailer was to maintain maximum differential requirements between competing linked brands, the OFT considers that such provisions were in fact implemented as parity or fixed differential requirements (see Section 6.A.I.(c) below).

6.41 The implementation of the Manufacturer’s parity and differential requirements was assisted by the obligation in some written trading agreements for the Retailer to afford the Manufacturer the opportunity to respond to a retail price cut or retail ‘pricing activity’ instigated by a competing Manufacturer. The parity and differential requirements created the expectation that either the Retailer would seek, and be granted permission, from a Manufacturer to move the price of its product in line with the parity and differential requirement, or that the Manufacturer would instigate the price alignment itself in order to maintain its parity and differential requirements. That is demonstrated by contacts between a Manufacturer and a Retailer where the Manufacturer gave instructions and/or requests regarding retail prices in order to maintain or realign its parity and differential requirements (which included instructions to increase retail prices, see, for example, at paragraphs 6.56-6.60 and 6.94-6.98 below) or in other cases where the Manufacturer expressly suspended its parity and differential requirements (for example, where Gallaher implemented an MPI which was not followed by ITL, see for example, at paragraphs 6.82-6.84 below).

iii Contacts between a Manufacturer and a Retailer regarding retail prices

6.42 A further element of the Infringing Agreements was the series of contacts between the Manufacturer and the Retailer, which either related to: (i) the Retailer’s retail prices for the Manufacturer’s brands; (ii) the Retailer’s retail prices for the Manufacturer’s competitors’ brands; and/or (iii) the retail prices of other Retailers for the Manufacturer’s brands and/or the Manufacturer’s competitors’ brands.

6.43 The evidence of such contacts, together with the context of each Manufacturer’s retail price strategy set out at Section 6.A.I.(a).i above, demonstrates that each Manufacturer’s retail price strategy was for the Retailer to maintain specified parities and differentials between the Manufacturer’s brands and competing linked brands. The contacts between the Manufacturer and the Retailer assisted the implementation of that strategy, and ensured that the Manufacturer’s desired parity and differential requirements were maintained or realigned.

6.44 The contacts between the Manufacturer and the Retailer also demonstrate that the Retailer accepted and/or indicated its willingness to implement
the instructions and requests contained in communications from the Manufacturer to the Retailer in that connection.

6.45 Furthermore, the OFT has found almost no evidence of correspondence where a Retailer explicitly refused to make the requested amendments, or contested the Manufacturer’s requests.224

6.46 There is also additional evidence in many cases of the Retailer’s general adherence to the Manufacturer’s parity and differential requirements (see further Section 6.A.III below: ‘The Retailer’s adherence to the Manufacturer’s retail pricing strategy’).

6.47 The OFT notes that it was in the Retailer’s interest to implement the prices communicated by the Manufacturer because: (i) implementation meant that the Manufacturer’s desired parity and differential requirements were adhered to (which, for each Retailer, was linked to the payment of a bonus (see Section 6.A.I.(a).iv and Section 6.C.I-X); (ii) the Manufacturer ensured that the prices communicated reflected the Retailer’s desired retail pricing position relative to the Retailer’s competitors, and (iii) the Retailer’s margin was not significantly affected by the communicated retail price changes by virtue of the application of the Manufacturer’s tactical and ongoing bonuses.

6.48 To secure the Retailer’s compliance with its parity and differential strategy, each Manufacturer devoted significant resources to communicating the required price points to the Retailer in order to ensure that the Manufacturer’s desired parity and differential requirements were maintained or realigned.

6.49 The features of the Infringing Agreements described above resulted in a significant and exceptional degree of control by the Manufacturer over retail prices.

6.50 This is demonstrated by an internal ITL email relating to Kwiksave225, dated 11 January 2002, in which ITL reported a conversation with a market researcher employed by Kwiksave on the legitimacy of strategic

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224 The OFT notes, for example, that there is evidence in certain documents that First Quench (see paragraph 6.673) rejected a Manufacturer’s pricing instructions and/or requests in certain documents. However, the OFT considers that there is sufficient evidence over a period of time of the Retailer’s compliance, or intention to comply, with the Manufacturer’s retail pricing strategy, consistent with the existence of an agreement and/or concerted practice between the Manufacturer and the Retailer (see Section 6.C.I-X).

225 As noted in Section 2.A.II: ‘The Retailers’, throughout the infringement period, Somerfield operated Kwiksave fascias.
pricing requirements and his concern that the retailer should be free to charge whatever the retailer wanted. ITL noted that: 226

‘Eventually he accepted that if the manufacturer is paying bonuses and offering an incentive for strategy pricing then the retailer should be prepared to run with it although he continued to express some reservations about the price fixing aspect!’ [Emphasis added]

6.51 This is also demonstrated by an email dated 12 June 2002 between Gallaher and Shell, in which Gallaher advised Shell:227

‘All manufacturers look to achieve price list differentials between competitor brands, and also their own price list. If you move one product to a price point, and not the competitor brand also because it is already at a favourable price point, then obviously parities and differentials will be affected.

6.52 As already suggested at this stage, increase only by MPI (recommendations emailed on Monday), as the current Shell prices are correct at this stage. Once all MPIs are in place I will look at the whole picture, and carefully move prices bearing in mind other brands.’

6.53 That the Manufacturer took such control for granted is demonstrated by the Manufacturers’ reaction when Sainsbury terminated its trading agreements in 2003 and made it clear to the Manufacturers that they could not determine its retail prices (see also at paragraph 6.188 below for the changes in ITL’s and Gallaher’s conduct after they became aware of the OFT investigation in the course of 2003). For example, the degree of frustration evident on the part of ITL when Sainsbury terminated its agreement with ITL suggests that a major Retailer (in this case Sainsbury) refusing to accept direct pricing instructions was an exceptional situation. The OFT notes, in particular, the following statements made by ITL to Sainsbury in a letter dated 2 May 2003:228

‘There is a de facto relationship between the majority of the investment that I make in Imperial brands and their prices on Sainsbury’s shelves.’

[quoting from the trading agreement between the parties] ‘SSL accept that ITL make investments in their brands based on two fundamental criteria: shelf price relativities and the absolute levels of those shelf prices’ …

I know that nothing lasts forever, I have no objection to mutually acceptable moderation to reflect your sensibilities but the response

to every pricing enquiry – we are the guardians [of shelf prices] etc. – is making me feel distinctly uncomfortable. ...'if I am to have absolutely no input or influence into the relative, or absolute shelf price of Imperial brands why would I continue to invest nearly £[C] per year?'

Contact between the Manufacturer and the Retailer regarding the Retailer’s retail prices for the Manufacturer’s brands

6.54 Each Manufacturer regularly communicated to a Retailer what the Retailer’s retail prices should be for the Manufacturer’s brands, sometimes by reference to the Retailer’s retail price for a competing linked brand and sometimes by reference to other Retailers’ prices for the Manufacturer’s brands.

Communications from the Manufacturer relating to price changes

6.55 Each Manufacturer co-ordinated with the Retailer the setting of the Retailer’s retail prices for competing tobacco products through communications by letter, fax or email, in meetings or by telephone. As set out in more detail in Sections 6.C.I-X below, the communications from the Manufacturer referred to price increases, reductions or price holds or required the Retailer to maintain or realign the Manufacturer’s parity and differential requirements generally. The vast majority of those communications set out a specific price point that was to be observed by the Retailer.

6.56 For example, in an email dated 22 March 2001 from Gallaher to Asda, Gallaher stated:229

‘..., can you please arrange to increase Dorchester [Gallaher brand] retails in line with the MPI increase from 1st April. I believe that Richmond [ITL brand] will be increasing on this date as well?
Please advise if this is not the case

Therefore:-

Dorchester KS 20’s should therefore be £3.39

Dorchester SK 20’s should therefore be £3.40’. [Emphasis added]

6.57 In a letter dated 12 October 2001 from Gallaher to First Quench, Gallaher confirmed various points which were discussed at a meeting the previous day, in particular, Gallaher noted:230

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229 Gallaher/Asda (Document 3, Annex 4).
'I will continue to track JPSK [ITL brand] with my Superking brands. Please advise of any change to your current JPSK [ITL brand] pricing initiative.'

6.58 In an e-mail dated 11 November 2002 from Gallaher to Somerfield, Gallaher stated:231

‘…Old Holborn [Gallaher brand] (Kwik Save) - 25g needs to be reduced to £4.41 to match Golden Virginia [ITL brand] (retro bonus being paid) and to maintain parity with Asda’.

6.59 Similarly, in a fax from ITL to Sainsbury dated 15 November 2000, ITL stated:232

‘I understand that you have increased the shelf price of Dorchester KS brands [Gallaher brands] form 329 to 334 […]

You may remember from my presentation on the price repositioning of Richmond KS (and launch of Richmond Superkings) [ITL brands] that our strategy is parity with Dorchester KS. In light of this, and not to hold the market up, I would be grateful if you could increase the shelf price of Richmond KS and Lights 20s from 329 to 334.

In order to maintain your cash margin position, the bonus levels at 334 should be as follows:

Current shelf price £3.29'.

[C]

6.60 In a fax from ITL to Safeway dated 20 March 2002, ITL communicated that:233

1. From Sunday, 24th March please reduce the price of Richmond Superkings [ITL brand] in Supermarkets and PFS234 by 1p to match Dorchester Superkings [Gallaher brand] at £3.47…

2. In PFS please reduce the price of all Superkings [ITL brand] variants by 2p to £4.18 to match Berkeley 20s [Gallaher brand].

3. …Please reduce Drum [ITL brand] by 4p to £4.09/£4.10 to match A.L. [Amber Leaf, a Gallaher brand] Parity is the policy on the 25gm and also with Drum Milde [ITL brand].

4. Golden Virginia [ITL brand] is currently some 1p or 8p more expensive than Old Holborn [Gallaher brand] 12.5gm when we are

230 Gallaher/First Quench Threshers (Document 10, Annex 6).
234 The OFT considers that ‘PFS’ refers to petrol filling stations.
paying for parity at 10p/20p/40p more than Drum [ITL brand]/Amber Leaf [Gallaher brand].

I recommend that you move into line with other Grocers, but not [another retailer], Asda and Kwiksave and move both G.V. [Golden Virginia, an ITL brand] and O.H. [Old Holborn, a Gallaher brand] up to the common price of £2.28, and the equivalent on 25/50 gm.

The current bonus on G.V. [Golden Virginia, an ITL brand] will cease from this date of implementation. Can you please advise Gallaher of this move.’ [Emphasis as in source document]

6.61 Communications between a Manufacturer and a Retailer regarding retail prices were often very detailed, as demonstrated by the example of an exchange of emails between Shell and Gallaher and Shell and ITL around the Gallaher MPI of 25 June 2002, which, exceptionally, was not followed by ITL until September 2002 (see further paragraph 6.82). After Shell had sent Gallaher its ’pricing proposals’, Wes Feeney, Gallaher’s account manager for Shell, made the following comment in a response to Shell in an e-mail dated 8 July 2002:235

’I note you are proposing to increase some ITL prices even though they are not having an MPI yet, I would think their agreement also stipulates parities and differentials to be maintained, and with this in mind I have moved their prices in the attached as well as mine. Breda [ITL’s account manager for Shell] will be on the phone I would think if the above is not maintained’.

6.62 The spreadsheet with retail prices that Gallaher attached to its e-mail included increases in the prices of some ITL brands. Shell responded on the same day to Gallaher as follows:236

’Thanks, Wes. I appreciate your time on this and your thoughts. I will run through them and the margin mix tomorrow morning taking into consideration your comments re differentials and parities.’

6.63 The next day, Breda Hughes, ITL’s account manager for Shell, sent an email to Shell confirming her agreement with Gallaher’s changes in Shell’s retail prices, which the OFT infers from the earlier communications between Gallaher and Shell must have included Gallaher’s changes to the prices of ITL’s brands:237

’As per our telephone conversation this morning I agree with Wes’ [Gallaher account manager] recommendations for the price file.’

235 Gallaher/Shell, 8 July 2002 (Document 31, Annex 9).
236 Gallaher/Shell, 8 July 2002 (Document 32, Annex 9).
subsequently, when itl announced its mpi on 5 august 2002 it sent shell an amended list of its parity and differential requirements. shell forwarded the email from itl to gallaher with the following covering email:

‘… fyi. could you please check the proposed price points and provide any feedback.’

the oft infers that the amended list of itl’s parity and differential requirements attached to itl’s email to shell was also forwarded by shell to gallaher, given gallaher’s reply which appears below:

Gallaher responded:

‘the ‘price requirements’ (parities/differentials) are in order.’

another example of detailed communications between a manufacturer and a retailer regarding retail prices is an exchange of emails between gallaher and somerfield in april and may 2002.

in an email dated 30 april 2002 from gallaher to somerfield, gallaher stated:

‘old holborn [gallaher brand] and golden virginia [ITL brand] 12.5g should be = (as for 25g & 50g) … suggest you have both at £2.31’.

in a later email on 30 april 2002, gallaher stated:

‘… what i have recommended to resolve this means you putting up gv (which is ITL’s product) …… if you are matching somerfield with js then that is the way to go but if you want to be competitive with asda / [another retailer] then it’s reduce to old holborn to £2.25’

somerfield responded:

‘ok i will wait for mr hall [the ITL account manager] and then let you know.’

later on 30 april 2002 somerfield responded:

‘right …. gv 12.5g is at and will remain at £2.25 in both fascias. do you want to match if yes, please confirm by return and complete new pricing schedule confirming new bonuses.’

later on 30 april 2002 gallaher responded:

238 Gallaher/Shell (Document 35, Annex 9).
239 Gallaher/Shell (Document 35, Annex 9).
'As previously confirmed there is no extra bonus for OH, both GV [Golden Virginia, ITL brand] and OH [Old Holborn, Gallaher brand] are sold at PL (price list), terms, neither manufacturer pay[s] bonuses. Both have same costs hence why the same retail applies in all other multiples.....'

6.71 In addition, the Manufacturer regularly provided the Retailer with detailed, bespoke matrices that set out the cost price (including the 'ongoing' and 'tactical' bonuses that are discussed below), the retail price that the Retailer should charge taking into account both its own pricing position and the Manufacturer's desired parity and differential requirements, and the resulting retail margin.241

6.72 The pricing communications by the Manufacturer were customised and took into account the Retailer's position in the market (that is, whether the Retailer positioned itself as a 'premium' or 'discount' retailer), the Retailer's desired position relative to its competitors and retailer-specific characteristics (such as the adoption of different price tiers for the Retailer's premises). Parity and differential requirements could accommodate a Retailer's own competitive position and strategy (for example, to price match another retailer). By way of example, where a Retailer was under an obligation to maintain parity pricing between Richmond (an ITL brand) and Dorchester (a Gallaher brand), provided these two brands were priced at the same level, the Retailer could decide how it wanted to place the two brands relative to the pricing of its retail competitors.

6.73 For example, in an email chain between ITL and Somerfield dated 12 August 2003, ITL sent a price file to Somerfield with some amendments on Kwiksave pricing. The Somerfield Assistant Buyer replied stating:242

'Is this to make us in ASDA prices?'

The ITL NAM replied stating:

'Yes and to also meet the Strategy Pricing Requirement of the Trade Development Programme we have with you.'

6.74 Even though the Retailer took account of its own commercial objectives, it did not set its retail prices independently from the Manufacturer. Indeed, as in the email between ITL and Somerfield dated 12 August 2003, referred to in paragraph 6.73 above, the pricing communications were often designed to accommodate the Retailer's pricing policy so that there

241 See for example ITL/Shell (Documents 32 and 39, Annex 19); ITL/Somerfield (Document 73, Annex 20); ITL/Sainsbury (Document 64, Annex 18); ITL/Morrisons (Documents 17 and 26, Annex 17).
was no inconsistency between the Retailer’s objectives and the Manufacturer’s parity and differential requirements.

6.75 As set out in Sections 6.C.I-X below, the evidence contains examples where the Retailer accepted and/or complied with pricing instructions from the Manufacturer. Further evidence of a Retailer’s compliance or intention to comply with the Manufacturer’s parity and differential requirements is provided, among other things, by email replies where the Retailer agreed to the pricing instruction or confirmed when it would be implemented, manuscript annotations on pricing requests or price files or invoices for, and receipt of, bonus payments.

6.76 A further example of a Retailer’s compliance with a Manufacturer’s parity and differential requirements is set out in the witness evidence of a Somerfield buyer:243

’[ITL] dictates price in some sense because of the pricing strategy within the agreement and the fact that the agreement was signed by Somerfield. In that way, maybe it was right for [ITL] to ring and say change price x, because otherwise the agreement would have been breached. I confirm that if [ITL] rang and suggested that a price be changed (up or down), Somerfield would generally do so as they had signed the contract and did not want to risk losing bonus payments. …

Across the board with all suppliers, I advise that I generally changed price when it was suggested or at least it was my intention even if my inefficiency meant it didn’t happen straight away.’

6.77 Other examples of a Retailer complying with a Manufacturer’s parity and differential requirements are demonstrated in correspondence where some Retailers (for example the Co-operative Group, Shell and Somerfield in various periods) provided lists with their current or proposed retail prices to the Manufacturers, in some cases to ITL and Gallaher simultaneously, to check and confirm their acceptance.244


244 For example, ITL/the Co-operative Group, 24 July 2001 (Document 9, Annex 15); Gallaher/the Co-operative Group, 15 May 2000 (Document 1, Annex 5); Gallaher/Shell, 13 May 2002 (Document 24, Annex 9); ITL/Somerfield, 30 April 2002 (Document 40, Annex 20); Gallaher/Somerfield, 30 April 2002 (Document 29, Annex 10). See also paragraph 3.21 of Somerfield’s Company Statement of 15 March 2006, in which Somerfield acknowledges that its request to confirm that its retail prices were 'correct' related also to compliance with ITL’s parity and differential requirements; the notes of the interview Somerfield’s solicitors had with Liz Smith, Somerfield’s tobacco buyer, who said that 'the driver’ for sending the retail price lists was to ensure that Somerfield met ITL’s parity and differential requirements (page 5, sixth paragraph under the heading...
6.78 For example, in an email exchange dated 5, 9 and 12 August 2002 ITL sent details of a price increase and a revised price file to Shell. Shell then forwarded that to Gallaher for the latter to check that its parities and differentials were correct:

‘Subject: FW: ITL Price Increase – September 2002’

‘Thanks for your assistance, could you please check price list diffs, and parities, and please detail any queries …’

Gallaher responded on 12 August 2002 stating:

‘The 'Price Requirements' (parities/differentials) are in order.’

Interaction between parity and differential requirements and retail price changes

6.79 In practice, after the retail price of a competing brand had changed, the Manufacturer decided whether to ask the Retailer to follow the price change in order to maintain its parity and differential requirements. That was assisted by the obligation in some written trading agreements for the Retailer to afford the Manufacturer the opportunity to respond to a retail price cut or retail 'pricing activity' in relation to a competing linked brand (see above at Section 6.A.I.(a).ii).

6.80 On occasion, a Manufacturer expressly informed a Retailer that a parity and differential requirement was suspended, for example after a competing Manufacturer’s promotion, or that the parity and differential requirement had temporarily changed, for example after an MPI. Fiona Bayley, Sainsbury’s tobacco buyer, noted that:

‘It was their [the manufacturers’] ideal strategy to have price relativities. Probably for 99% of the time those relativities were in place, but there would be the odd couple of weeks between MPIs where they would be out of parity. If, say, [ITL] had a MPI and they were the first one to go and they put Marlboro up 5p, I would not stick Benson & Hedges [Gallaher’s competing linked brand] up 5p if Gallaher had not announced a price increase, even though [ITL]’s strategy was to have parity between Marlboro and Benson & Hedges. It was [ITL]’s decision to go first and they would expect somebody to follow them. They would not come to me and say ’Gallaher have not had a price increase but we expect you to

‘Supercigs Tier’); and the notes of the interview Somerfield’s solicitors had with Stephen Clarke, another Somerfield tobacco buyer (page 6, third paragraph under the heading ‘Price Files’).


increase all their shelf prices’. If Gallaher or [another manufacturer] did not follow [ITL]’s MPI, [ITL] would have to reduce its own prices to realign the price differential – but it would be up to [ITL] to do so. This would apply equally to Gallaher …’

6.81 As noted below in paragraphs 6.94 to 6.98 below (and as further set out in Sections 6.C.I-X) the evidence suggests that, in contrast to some of the points made in Fiona Bayley’s witness evidence, on some occasions the Manufacturer did ask the Retailer to change the price of a competing brand.

6.82 On one occasion,247 ITL and Gallaher implemented an MPI at different dates, with Gallaher’s MPI taking effect on 25 June 2002 and ITL’s MPI taking effect on 2 September 2002.248 That resulted in letters from ITL to various retailers, explaining that the differentials would widen until such time as ITL introduced its own MPI. By way of example, a letter from ITL to Morrisons dated 11 June 2002 stated:

‘As you are already aware, one of our competitors has already announced a price increase, effective June 25 2002. This means that the differentials that exist naturally between our brands and our competitor’s will widen; this means, I would expect to see the following example disparities from June 25, or from the date you implement our competitor’s price increase:

<table>
<thead>
<tr>
<th>Premium Price</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Embassy No. 1 KS vs. B&amp;H KS</td>
<td>moving from -3p to -9p per 20</td>
</tr>
<tr>
<td>Regal KS vs. B&amp;H KS</td>
<td>moving from -5p to -11p per 20</td>
</tr>
<tr>
<td>Marlboro KS/Lts vs. B&amp;H KS</td>
<td>moving from parity to -6p per 20</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Mid price</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Superkings vs. Berkeley</td>
<td>moving from parity to -6p per 20</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Low Price</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>L&amp;B KS vs. Sovereign KS</td>
<td>moving from +10p to +6p per 20</td>
</tr>
</tbody>
</table>

| Ultra low price |   |

247 Other examples are ITL/Somerfield, 10 March 2000 (Document 3, Annex 20); and ITL/First Quench, 8 November 2000 (Document 6, Annex 16).
248 See also witness statement of Fiona Bayley, 2 September 2005 (Document 2, Annex 2 (paragraph 56)).
Richmond KS vs. Dorchester KS moving from parity to -4p per 20

Richmond SKS vs. Dorchester SKS moving from parity to -6p per 20

... 

Pro rata increases in 10s, 100 and 200 multi-packs.\(^{249}\)

6.83 ITL sent similar communications to Asda, First Quench, Shell and Somerfield on or around the same date.\(^{250}\)

6.84 When ITL announced the date of its own MPI, it informed these Retailers that its parity and differential requirements had changed again. For example, in a letter from ITL to Morrisons dated 5 August 2002, ITL stated:\(^{251}\)

'As you will see from our new Price List, the RSP differentials between our Embassy and Regal families and those of our competitor's [comparable] brands have narrowed. Specifically:

Embassy No.1 KS from -3p vs. B&H KS skus to -2p vs. B&H KS skus;
Embassy Filter from -6p vs. B&H KS skus to -5p vs B&H KS skus;
Regal KS from -5p vs. B&H KS skus to -4p vs. B&H KS skus;
Regal Filter from -8p vs. B&H KS skus to -7p vs. B&H KS skus.'

Contact between the Manufacturer and the Retailer regarding the retail prices for the Manufacturer's competitors' brands

6.85 The Manufacturer not only communicated to the Retailer the retail price for the Manufacturer's brands, as discussed above, but in some cases the Manufacturer also discussed with the Retailer, and occasionally asked the Retailer to change, the price of the competing Manufacturer's brands to ensure that the first Manufacturer's parity and differential requirements were met.

\(^{249}\) ITL/Morrisons, 11 June 2002 (Document 58, Annex 17).
\(^{251}\) ITL/Morrisons, 5 August 2002 (Document 63, Annex 17). ITL sent similar notices to First Quench, ITL/First Quench, 5 August 2002 (Document 30, Annex 16); ITL/Sainsbury, 5 August 2002 (Document 59, Annex 18); ITL/Shell, 5 August 2002 (Document 52, Annex 19) and ITL/TM Retail, 5 August 2002 (Document 28, Annex 22). In addition, it can be inferred from notes of meetings between ITL and Asda and ITL and Somerfield that ITL informed Asda and Somerfield in a similar way, ITL/Asda, 13 August 2002, under heading 'Price increase' (Document 56, Annex 14); ITL/Somerfield, 14 August 2002, under heading 'Price increase' (Document 52, Annex 20).
The Manufacturer would often discuss with the Retailer, or ask the Retailer for information about, future intended retail prices for the Manufacturer’s competitors’ brands. For example in an email from ITL to Somerfield dated 15 January 2001, ITL stated:252

‘Finally, I would welcome confirmation regarding your plans to implement the new selling prices. In particular will you be planning to increase Gallaher brands at the same time as you increase ours and [C]?’

In a letter dated 5 October 2000 from ITL to Asda, ITL stated:253

‘Subsequent to our meeting you have advised that Dorchester King Size [Gallaher brand] will move to £3.34 on 29th October and we agreed that Richmond King Size 20s and Richmond Lights 20s will move to £3.34 on 29th October.’

In an email dated 16 June 2003 from Gallaher to the Co-operative Group, Gallaher stated: 254

‘Will you be holding the price Cafe Crème & Cafe Crème Blue [ITL brands] until August 1st as is stated in their price list or has a decision been made to go up in June?’

The Retailer regularly provided notification of the competing Manufacturer’s price changes.255 That happened because, where a Retailer’s prices were in line with parity and differential requirements, any new pricing communication by one Manufacturer that was not immediately replicated by the other Manufacturer would have resulted in the Manufacturer’s desired parity and differential requirements being out of line. As a result of such notifications by the Retailer, in circumstances where one Manufacturer had communicated a pricing instruction and/or request that by implication affected the pricing relativities between the competing linked brands, the competing Manufacturer was able to ensure that the desired pricing relativity was restored.

As set out in Section 6.A.I.(a).ii above, in some cases, the Retailer was obliged to provide notification to the Manufacturer of a competing Manufacturer’s price promotions or pricing activity, pursuant to its written trading agreement with the Manufacturer.

Where the Retailer was not obliged or failed to inform the Manufacturer of specific changes to retail prices which affected the Manufacturer’s desired

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253 ITL/Asda, 5 October 2000 (Document 9, Annex 14).
255 The Retailer also occasionally provided advance warning of a Manufacturer’s price change: see, for example, ITL/Asda, Documents 8-10, 40 and 49, Annex 14.
pricing relativities, the Manufacturer was nonetheless able to react to the changes because in any event it would perform its own monitoring of retail prices to ensure that deviations from the desired pricing relativities were corrected (see Section 6.A.I.(a).v below).256

The OFT considers that although the Retailer may not have automatically changed the retail price of one Manufacturer’s brand in response to a change in the price of the competing linked brand in every case, the parity and differential requirements created the expectation that either the Retailer would seek, and be granted permission, from the Manufacturer to move the price of its product in line with the parity and differential requirement, or the Manufacturer would instigate the price alignment itself in order to maintain its parity and differential requirements. That is demonstrated by contacts between a Manufacturer and a Retailer relating to periods where the Manufacturer’s parity and differential requirements were either suspended (see, for example, paragraphs 6.82-6.84 above), or where the Manufacturer gave instructions and/or requests regarding retail prices in order to maintain or realign its parity and differential requirements (which included instructions to increase retail prices, as set out, for example, at paragraphs 6.56-6.60 above and 6.94-6.98 below). It is evident from the communications between each Manufacturer and each Retailer that the Retailer did not set its retail prices independently from the Manufacturer, but with the Manufacturer’s active involvement in pursuit of the Manufacturer’s parity and differential requirements.

Further, the context in which the Infringing Agreements operated was that each Retailer had entered into a symmetrical Infringing Agreement with each Manufacturer. In such circumstances, a Retailer would have been aware that if there was a retail price change which resulted in the parity and differential requirements of either Manufacturer being out of line, the other Manufacturer would be likely to instigate a price change in order to realign its parity and differential requirements.

On some occasions, a Manufacturer instructed or requested the Retailer to change the price of one of its competing Manufacturer’s brands to ensure that its parity and differential requirements were met, including instructions and/or requests to increase the retail price of a competitor’s brand (see also paragraph 6.198 below).257 That is illustrated, for example, by the following correspondence.

256 See for example, Fiona Bayley’s witness statement, Document 2, Annex 2 (paragraph 55).
257 See for example, ITL/Shell, 4 October 2001 (under heading 'Price File'); ITL/Shell, 13 December 2001, 14 May 2002, 9 July 2002 and 12 August 2002 (Documents 35, 39, 46, 50 and 53, Annex 19 respectively); ITL/Somerfield, 30 April 2002 (email Graham
6.95 In a fax from ITL to Safeway dated 24 April 2001, ITL asked Safeway to increase the retail prices of two Gallaher brands:258

‘There is still an error in the pricing of both Mayfair and Sovereign [Gallaher brands] in all Safeway stores. The differential between L&B/JPS [ITL brands] should be -16p and -9p respectively. Currently, the differentials are -18p and -11p. Can you please increase the prices of both Mayfair and Sovereign [Gallaher brands] by +2p … Many thanks.’

6.96 In an email dated 8 June 2001 from ITL to First Quench, ITL stated:259

‘With regard to the price of Dorchester [Gallaher brand] and Richmond [ITL brand], we would like to move Richmond up in price to £3.45 as soon as possible. Other Accounts are moving in a similar direction and, if you are speaking with Gallaher in the next few days, should be grateful if you would encourage them to move Dorchester to £3.45 on, say 18th or 26th June.’

6.97 In a later email dated 5 August 2002 to First Quench, ITL stated:260

‘At the MPI we wish to move the market up on Richmond [ITL] brands and bring greater profitability to this end of the market. Therefore, on 2nd September please increase Richmond brands by 4p for KS and 6p for SKSs. We would encourage you to follow on Dorchester [Gallaher brand] and, as a guideline across the trade, anticipate shelf prices as below:-

Richmond KS/SKS, Dorchester KS/SKS £3.54/£3.58’.

6.98 In an email dated 21 September 2001 from Gallaher to Somerfield, Gallaher stated:261

‘… both Old Holborn (-3p) [Gallaher brand] and Golden Virginia (+1p) [ITL brand] need adjusting to £2.22.


258 ITL/Safeway (Document 34, Annex 28).

259 ITL/First Quench, 8 June 2001 (Documents 15 of Annex 16); similarly, 24 August 2001 (Documents 17, Annex 16 respectively).

260 ITL/First Quench, 5 August 2002 (Document 30 of Annex 16). Similarly, see also Documents 15-17 of Annex 16.

Contact between the Manufacturer and the Retailer regarding the retail prices charged by the Retailer’s competitors

6.99 In some cases, the implementation of parity and differential requirements was facilitated by contacts between the Manufacturer and the Retailer in which the Manufacturer and Retailer informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for the Manufacturer’s brands and/or the Manufacturer’s competitors’ brands.

6.100 In particular, such communications provided assurance to the Retailer that its prices would not be out of step with its retail competitors and would be consistent with what the Manufacturer was achieving (or said it was achieving) with other retailers.

6.101 For example, the correspondence dated 12 August 2003 between ITL and Somerfield at paragraph 6.73 above demonstrates that ITL’s price communication had taken into account Somerfield’s desired pricing position vis-à-vis a competitor. Similarly, when Gallaher asked Asda on 7 January 2003 to increase the price of one of its brands, Asda replied (on the same date):262

‘Have our friends … [another supermarket retailer] been told the same’

Gallaher responded:

‘As regards competitors, we have taken this action across all retail accounts without exception.’

6.102 In addition, the Manufacturer would often check whether a particular Retailer’s prices were in line with that Retailer’s desired pricing position relative to the Retailer’s competitors and would communicate that information to the Retailer. For example, in an email dated 13 August 2002 from Somerfield to Gallaher, Somerfield stated:263

‘Please find attached this weeks price file. Please confirm that all prices are correct and are still in line with the competition.’

Gallaher responded to Somerfield (on the same date):

‘… there have been no moves by Asda / JS to impact on KS / Somerfield pricing.’

262 Gallaher/Asda, 7 January 2003 (Document 10 of Annex 4).  
ITL also informed Somerfield about price developments in Asda, for example, in an email dated 9 September 2002:

'In answer to your query on Asda as far as I am aware they have not moved any prices since last week. However, I am seeing them tomorrow and will hopefully get some answers then.'

Further, there is evidence that some of the Retailers were aware that their competitors were party to agreements with the Manufacturers, similar to those to which they were themselves a party.

For example, in a letter dated 25 June 2002 from ITL to Somerfield, ITL stated:

'The ITL Strategy Pricing Requirements apply across all trade channels. In some instances we offer an incentive within Trade Development Programmes to meet these requirements as is the case for both Somerfield and Kwik Save.'

In their responses to the SO, ITL, Morrisons, Safeway, the Co-operative Group and Shell submitted that communications between the Manufacturer and the Retailer regarding the Retailer’s retail prices were suggestions which the Retailer was not obliged to follow and that the Retailer set its retail prices independently of the Manufacturer.

ITL, Shell, Morrisons and the Co-operative Group also submitted that there were frequent occasions where a Retailer either did not implement, did not implement fully, or delayed the implementation of instructions and/or requests in the Manufacturer’s pricing communications.

Notwithstanding that certain communications from a Manufacturer to a Retailer were phrased as requests or suggestions to the Retailer, the OFT considers that viewed as a whole, the evidence demonstrates that the Retailer understood that it was to set its retail prices in accordance with the Manufacturer’s parity and differential requirements. Both the trading agreements and contacts between the Manufacturer and the Retailer

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265 ITL/Somerfield (Document 49, Annex 20).
267 That is, where a Retailer increased or decreased the retail price following a price instruction and/or request from a Manufacturer but not by the exact amount instructed and/or requested.
demonstrate that the Retailer accepted and/or indicated its willingness to implement the Manufacturer’s parity and differential requirements. It is particularly clear from the communications between each Manufacturer and each Retailer that the Retailer did not set its retail prices independently from the Manufacturer, but with the Manufacturer’s active involvement in pursuit of the Manufacturer’s parity and differential requirements.

6.109 It is clear from the nature of each of the Parties’ conduct as evidenced in this Decision, including the nature of the routine retail pricing communications between each Manufacturer and each Retailer, that the Infringing Agreements went considerably further than maximum or suggested retail pricing.

6.110 The OFT considers that isolated instances of a Retailer not implementing, not implementing fully or delaying the implementation of instructions and/or requests in the Manufacturer’s pricing communications, do not negate the existence of the Infringing Agreement between the Manufacturer and the Retailer, as there is sufficient evidence over a period of time of each Retailer’s compliance, or intention to comply, with the Manufacturer’s retail pricing strategy (see Sections 6.C.I-X), which is consistent with the existence of an agreement and/or concerted practice between the Manufacturer and the Retailer.

6.111 Further, the OFT also notes that it is possible that where a pricing instruction and/or request from a Manufacturer was not implemented, or not implemented fully by a Retailer, it may have been the case that the Retailer was continuing to comply with the Manufacturer’s parity and differential requirements during that period, because the price of the competing linked brand had not changed.

6.112 Further, in their responses to the SO, ITL, Morrisons, Safeway and the Co-operative Group also submitted that communications from a Manufacturer to a Retailer stipulated maximum price levels only.269

6.113 The OFT acknowledges that a limited number of instructions or requests were framed in terms of a specific maximum price level (that is, an ‘absolute’ maximum price which was not linked to a competing brand). For example, in an email dated 21 August 2001 from ITL to T&S Stores, ITL stated:270

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270 ITL/T&S Stores (Document 34, Annex 29).
Following the MPI effective from 3 September will you please implement the following price changes ... Move to a maximum price of £2.65 in all stores and in all tiers, rather than the 'natural' price of 2.68'.

6.114 The OFT considers that the evidence, viewed as a whole, demonstrates that each Manufacturer’s retail pricing strategy was based on the Retailer maintaining a specified price relativity between competing linked brands. Whether such a requirement was phrased as a parity or fixed differential requirement, or as a maximum differential requirement, it restricted the Retailer’s ability independently to determine its resale price for competing linked brands and was, by its very nature, capable of restricting competition (as explained further in Section 6.A.I.(d) below).

6.115 In any event, for the reasons set out in Section 6.A.I.(c), the OFT considers that each Manufacturer sought to achieve, via the Retailer, retail prices for the Manufacturer’s brands which were set either at parity or at a fixed differential to competing linked brands of another Manufacturer.

iv Bonus payments from the Manufacturer to the Retailer linked to adherence with the Manufacturer’s retail pricing strategy

6.116 Each Manufacturer paid bonuses to the Retailer, on an ongoing and/or ad hoc basis, which were linked to the Retailer’s compliance with the Manufacturer’s parity and differential requirements.

Standard or ‘ongoing bonuses’

6.117 The evidence demonstrates that, in a number of cases, the Manufacturer paid ‘standard’ or ‘ongoing’ bonuses to the Retailer. These standard or ongoing bonus payments were generally provided for in the formal trading agreements and/or as part of the ongoing trading relationship between the Manufacturer and the Retailer.271 As discussed in the sections below relating to each of the Infringing Agreements (see Section 6.C.I-X below), the evidence demonstrates that part of the standard or ongoing bonus payments from the Manufacturer to the Retailer were linked to adherence with the Manufacturer’s retail pricing strategy.

271 Gallaher/the Co-operative Group, Gallaher/First Quench; Gallaher/T&S Stores, Gallaher/Sainsbury, Gallaher/Shell, Gallhaer/Somerfield and Gallaher/TM Retail (see Sections 6.C.II.(b), 6.C.III.(b), 6.C.IX.(b), 6.C.IV.(b), 6.C.VII.(b), 6.C.VII(b) and 6.C.X.(b) below), and ITL/Asda through to ITL/TM Retail (see Sections 6.C.I.(a), through to 6.C.X(a) below). Somerfield has confirmed the importance of these payments in view of the fact that retail margins on tobacco products were small (Company Statement of 15 March 2006, paragraph 3.8).
was frequently linked to and contingent upon the Retailer’s compliance with the parity and differential requirements.\textsuperscript{272}

Tactical/retro bonuses

6.118 In addition to the payment of ‘ongoing’ bonuses, each Manufacturer also paid ‘tactical’ or ‘retro’ bonuses to most of the Retailers.\textsuperscript{273}

6.119 These ‘bonuses’ can be characterised as reductions off the standard cost price that the Retailer paid to the Manufacturer or a wholesaler and were in general directly linked to a specific absolute price level for a specified period of time. Such bonuses should therefore be distinguished from the ‘ongoing’ bonuses that the Manufacturer paid for compliance with the parity and differential requirements stipulated in the written trading agreements, as discussed at paragraphs 6.117 above. The ‘tactical’ bonuses were used to incentivise the Retailer to price according to the Manufacturer’s retail price strategy by ensuring that its margins were adjusted to reflect the requested changes to retail prices. For example, a Sainsbury tobacco buyer noted:

6.120 ‘The level of bonuses had a direct impact on the shelf prices of the brands and was one way the tobacco companies maintained the price differential between its brands and those of its competitors’.\textsuperscript{274}

6.121 Tactical bonuses were paid to support a specific movement in the retail price of a brand. Generally, the tactical bonuses were granted or increased when a Retailer reduced the price of a Manufacturer’s brand at the Manufacturer’s request (or held the price at the prevailing level after a Budget duty increase or an MPI) and withdrawn or reduced when a Retailer increased the price at the Manufacturer’s request. These bonuses thus broadly maintained the Retailer’s cash margin when it implemented the changes in its retail prices requested by the Manufacturer. The tactical bonuses therefore ensured that the Retailer’s margin was unaffected by

\textsuperscript{272} For particular examples, see ITL/the Co-operative Group, Document 14, Annex 15 and the terms of the signed trading agreement between ITL and Morrisons dated 4 April 2003 (Document 85, Annex 17) whereby Morrisons agreed to ‘continue supporting ITL’s pricing strategy and accepts that ITL makes pricing investments based on two fundamental criteria: achievement of natural price list differentials that exist between the manufacturers and the absolute level of those shelf prices….’. See also Gallaher/First Quench (Document 1, Annex 6) in which Gallaher agreed to pay First Quench an ongoing bonus, provided that First Quench maintained price parity and differential requirements between Gallaher’s brands and their immediate competitors.

\textsuperscript{273} With the exception of Shell, who did not receive tactical bonuses from the Manufacturers (but did receive an ‘ongoing’ bonus – see Section 6.C.VII below).

\textsuperscript{274} Witness statement of Fiona Bayley, 2 September 2005 (Document 2, Annex 2 (paragraph 39)).
the changes to retail prices instructed or requested by the Manufacturer to achieve its retail pricing strategy.

6.122 The evidence demonstrates that the tactical bonuses were frequently linked to the Manufacturer’s strategy to maintain specified parities and/or differentials between its brands and competing linked brands. A Manufacturer frequently paid or withdrew tactical bonuses to a Retailer in order to encourage a retail price change which would maintain or realign its parity and differentials strategy. That link is clear from correspondence between a Manufacturer and a Retailer. For example, in emails to the Retailer, the Manufacturer would emphasise the link between tactical and ongoing bonus payments and parity and differential requirements.

6.123 An example is an email dated 27 May 2002 from Gallaher to Somerfield, in which Gallaher stated:275

‘we have in place off invoice support for price cutting and to maintain strategically Gallaher v Competitor brands at price list differentials. This has been confirmed in writing by me several times … .’

6.124 In a number of cases, when sending pricing instructions or requests to change prices to the Retailer, the Manufacturer would detail the change in tactical bonus required to bring about the required price move. For example, in a letter dated 9 October 2000 from Gallaher to Safeway, Gallaher stated:276

‘From the 29th October we would like to increase the retail price of Dorchester King Size to £3.34 and Dorchester Superking [Gallaher brands] to £3.35, provided that this does not leave us out of line with Richmond [ITL brand]......

From the 29th October, therefore, the following bonus levels will apply:-’ [details of new bonus levels then followed].

6.125 In an email dated 27 June 2002 from Gallaher to T&S Stores, Gallaher stated:277

‘In the light of some excellent performances on Hamlet [Gallaher brand], we would now like to implement a ’price hold’ on 5′s, 10′s, and MP′s, and hold the price or reduce the price to the same level as Classic [ITL brand] ... I propose to pay you a retro.’

6.126 Similarly, in a letter dated 16 March 2001 from ITL to Morrisons, ITL stated:278

276 Gallaher/Safeway (Document 11, Annex 26).
'iii) Drum 12.5g to be at parity with Amber Leaf: a shelf price of 196p. This represents a 10p reduction per SKU, necessitating an additional bonus of \( \text{[C]} \)p/outer; although not discussed yesterday, I would also be grateful for a parity position on 25g: a shelf price of 384p. This would represent a 22p reduction per SKU, necessitating an additional bonus of \( \text{[C]} \)p/outer….

v) Please allow the shelf prices of L&B/JPS brands [ITL brands] to increase by 7p (pro-rate on multi-packs) which brings to an end our support (\( \text{[C]} \)p/1000) for the pre-budget shelf position of 369.’

6.127 In an email dated 20 March 2000 from ITL to Asda, ITL communicated its desired retail price points as follows:279

> 'Following yesterday’s increase in the retail prices of Amber Leaf [Gallaher brand], I would like to increase the retail prices of ITL’s RYO range as follows:

<table>
<thead>
<tr>
<th></th>
<th>From (£)</th>
<th>To (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drum 12.5g</td>
<td>1.95</td>
<td>2.09</td>
</tr>
<tr>
<td>Drum 25g</td>
<td>3.80</td>
<td>4.10</td>
</tr>
<tr>
<td>...</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Golden Virginia 12.5g</td>
<td>2.05</td>
<td>2.19</td>
</tr>
<tr>
<td>Golden Virginia 25g</td>
<td>3.99</td>
<td>4.31</td>
</tr>
<tr>
<td>...</td>
<td></td>
<td></td>
</tr>
<tr>
<td>[All ITL brands]</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

These prices will be achieved by withdrawing the bonus support. Could you confirm a date for this change (Monday 26th March?)'.

6.128 The witness statement provided by a Sainsbury tobacco buyer also confirmed the link between adherence to the Manufacturer’s desired parity and differential requirements and financial incentives:280

\[278 \text{ITL/Morrisons (Document 26, Annex 17).} \]
\[279 \text{ITL/Asda (Document 30, Annex 14).} \]
\[280 \text{Witness statement of Fiona Bayley, 2 September 2005 (Document 2 of Annex 2, paragraphs 39 and 41b).} \]
‘The level of the bonuses had a direct impact on the shelf prices of the brands and was one way the tobacco companies maintained the price differential between its brands and those of its competitors ….

The tactical bonus was offered by the tobacco companies to supermarkets to fund any further price cuts needed to enable the tobacco companies to reposition their brands’ prices relative to others, so as to maintain the price differentials or to keep the brand at a suitable price point (for example following a budgetary price rise).’ [Emphasis added]

6.129 The OFT therefore considers that, in the context of the Infringing Agreements, tactical bonuses were used in fact mainly as a means for the Manufacturer to micromanage retail prices and, in particular, to ensure that its parity and differential requirements were maintained or realigned. The payments demonstrate the importance that ITL and Gallaher attached to the Retailers’ compliance with the parity and differential requirements provided for in the trading agreements and in their wider communications.

6.130 Further, there is evidence of bonuses being withdrawn, or of threats to withdraw a bonus, by a Manufacturer where a Retailer did not comply with its parity and differential requirements.

6.131 An example is in a letter from Gallaher to First Quench dated 14 August 2000, which stated that Gallaher did not pay a bonus to First Quench for 'price parity' for the period from January to June 2000 as price parity was 'not achieved'.

6.132 In a fax dated 7 December 2000 from ITL to Somerfield, ITL pointed out various price differential errors in Somerfield stores and stated:

‘These price differential errors will of course impact on the Pricing Payments under the Trade Development Programme and I trust therefore that this information will enable you to make the necessary corrections.’

6.133 In addition, the ‘Draft Witness Statement of Liz Smith 27 February 2004’ stated:

‘I confirm that if Imperial rang and suggested that a price be changed (up or down), Somerfield would generally do so as they

281 Gallaher/First Quench (Document 3, Annex 6).
282 ITL/Somerfield (Document 10, Annex 20).
had signed the contract and did not want to risk losing bonus payments.'

Stock allocation

6.134 On occasion, the allocation of stock to a Retailer prior to a Budget increase or MPI was linked to adherence to a Manufacturer’s parity and differential requirements. Such stock allocation allowed Retailers to make additional profit, because they could purchase the stock at the old cost prices and sell it, after the Budget increase or MPI had taken effect, at the new, higher retail prices. For example, in a letter dated 3 August 2000, from ITL to Shell, ITL stated:284

'Shell agree that ITL will store the 'pre-buy' stock on our behalf at no additional cost to Shell on condition that: … 2) The current differentials against other manufacturers will be maintained.'

6.135 In their responses to the SO, ITL and the Co-operative Group submitted that the OFT had not demonstrated a link between the payment of an ongoing bonus and the Manufacturer’s parity and differential requirements and some parties argued that the Retailer continued to receive such a bonus in circumstances where it did not comply with the Manufacturer’s parity and differential requirements.285

6.136 ITL, Morrisons, Safeway and the Co-operative Group also submitted that tactical bonuses were paid to Retailers to support price reductions (that the Retailer would not have otherwise been willing to make due to the low margins made on tobacco products) and that the prices that the Retailers had to charge as a condition for receiving those bonuses were by reference to a maximum price level. Therefore, a Retailer was free to charge lower prices without forfeiting the bonuses, by funding a further promotion from its margin.286 Further, ITL stated that there were no examples where a Manufacturer withdrew or threatened to withdraw a tactical bonus where a Retailer set its retail prices at a level below the

285 ITL’s response to the SO, for example at paragraph 4.377. The Co-operative Group’s response to the SO, at paragraphs 5.12-5.29 and 5.69-5.102. Shell’s response to the SO, paragraph 116. Morrisons’ response to the SO, for example at paragraph 273. Safeway’s response to the SO, for example at paragraph 271.
286 ITL’s response to the SO, paragraphs 4.55-4.444. Morrisons’ response to the SO, paragraphs 399-405 and 463. Safeway’s response to the SO, paragraphs 392-396 and 462. Shell stated that it did not receive retro/tactical bonuses from the Manufacturers, see footnote 109 of its response to the SO. Annex 4 of the Co-operative Group’s response to the SO.
'maximum' price communicated to the Retailer (for example, as a result of an own-initiative price promotion).  

6.137 The OFT considers that, viewed in isolation, a bonus linked to an absolute maximum price (as opposed to a parity, fixed differential or maximum differential requirement, which is expressed by reference to a competing linked brand) would generally not be objectionable.

6.138 It is clear from the terms of the trading agreements between a Manufacturer and a Retailer that part of the ongoing bonus was linked to and contingent upon the Retailer’s compliance with the Manufacturer's parity and differential requirements.  

6.139 Further, the contacts between a Manufacturer and a Retailer demonstrate that tactical bonuses were linked to the Retailer’s adherence to the Manufacturer’s parity and differential requirements, rather than being linked to absolute maximum price instructions or requests. For example, it is clear from the correspondence between a Manufacturer and a Retailer referred to above (in particular, the frequent references to the Manufacturer’s desired pricing relativity with a competing linked brand in correspondence regarding the payment withdrawal of a tactical bonuses) that a Manufacturer made it clear, and a Retailer understood, that such payments were conditional on the Retailer’s compliance with the Manufacturer’s retail pricing strategy (see Section 6.A.I.(a).iii).

6.140 Further, there are numerous examples of the Manufacturer withdrawing a tactical bonus in order to bring about an increase in retail price which would maintain or restore a parity or fixed differential between competing linked brands (see Section 6.A.I.(a).iii). These communications between the Manufacturer and the Retailer, that the Infringing Agreements went considerably further than maximum or suggested retail pricing.

6.141 The retail prices to which tactical bonuses were linked were only extremely rarely referred to as absolute maximum prices – rather, the Manufacturer used specific price points to communicate its desired pricing position.

6.142 Although Retailers retained a discretion as to the absolute level at which paired brands were priced (for example, a parity requirement would not of itself prevent a retailer from choosing to price a Manufacturer’s brand and

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287 ITL’s response to the SO, for example at paragraph 4.360.
288 For particular examples, see ITL/Co-operative Group (Document 14, Annex 15) and the terms of the signed trading agreement between ITL and Morrisons, ITL/Morrisons, dated 4 April 2003 (Document 85, Annex 17) whereby Morrisons agreed to 'continue supporting ITL’s pricing strategy and accepts that ITL makes pricing investments based on two fundamental criteria: achievement of natural price list differentials that exist between the manufacturers and the absolute level of those shelf price.'
a competing brand each at £4.10 rather than £4.20, provided they were priced at the same level), the Infringing Agreements nonetheless constituted a restriction of the Retailer’s ability to determine its retail prices for the Manufacturer’s brands and those of competing linked brands to any extent that differed from the prescribed parity or differential.

6.143 Moreover, it is relevant to note, as part of the context as to how the Infringing Agreements operated in practice, that, Gallaher stated that the Retailer nearly always raised or lowered retail prices by reference to the tactical bonuses being withdrawn or given and that it was rare for the Retailer to set retail prices below the level instructed or requested by a Manufacturer in correspondence, because margins on tobacco products were too low.289

6.144 There was general adherence to the Manufacturer’s parity and differential requirements and the parties have not provided evidence to substantiate the argument that there were numerous one-off promotions on the Manufacturer’s brands during the infringement period. The OFT notes that this assertion is inconsistent with the retail price data for certain of the Manufacturers’ competing linked brands, which shows that promotions involving price reductions on those brands during the infringement period was rare (see Annex B).

6.145 This is also supported by the witness statement of, a Somerfield tobacco buyer, who stated that:290

‘I confirm that if [ITL] rang and suggested that a price be changed (up or down), Somerfield would generally do so as they had signed the contract and did not want to risk losing bonus payments.’

Monitoring of the Retailer’s retail prices to ensure compliance with the Manufacturer’s desired pricing policy

6.146 The Manufacturer monitored the Retailer’s retail prices to spot deviations from the prices it had communicated to the Retailer (and thereby from its parity and differential strategy). That resulted in communications by the Manufacturer to the Retailer of price ‘errors’. In some cases, the Retailer participated in and facilitated such monitoring by providing the Manufacturer with details of its current or proposed retail prices for the

Manufacturer’s brands and/or the Manufacturer’s competitors’ brands and by forwarding complaints about divergent prices in other retailers.

6.147 The Manufacturers had systems of detailed price monitoring and used these to ask Retailers to change their retail prices. The Manufacturers’ monitoring of their price requirements took a variety of forms. In a number of cases, as already referred to above at paragraph 6.75, the Retailer sent price files to the Manufacturer that outlined its current or proposed retail prices for that Manufacturer’s, and sometimes the Manufacturer’s competitors’, brands. The Manufacturer would then communicate the necessary changes to the Retailer. Other Retailers provided Electronic Point of Sale (‘EPOS’) data to the Manufacturer, sometimes using third parties such as P&H or external consultants, such as TMD.291 Other relationships were characterised by systems whereby the Manufacturer monitored the implementation of its requirements292 by surveying in-store prices before then communicating any necessary changes to the Retailer.293

6.148 The evidence suggests that the Manufacturer routinely targeted and applied pressure on the Retailer where such monitoring showed that the Manufacturer’s parity and differential strategies or specific pricing instructions or requests had not been correctly implemented, and that a failure or refusal of a Retailer to adhere to a given price was sufficiently anomalous as to be a matter of discussion internally within the Manufacturer. Where the Manufacturer found that a Retailer’s price was out of line, it asked the Retailer to adjust the price.294 Such requested adjustments included requests to increase retail prices which were below the prices indicated by the Manufacturer in its pricing instructions or requests.

6.149 For example, in correspondence with Somerfield dated 2 November 2002, ITL stated:295

291 See for example, ITL/Asda (Document 64, Annex 14); Gallaher/Shell, (Documents 28 and 34, Annex 9) and ITL/Somerfield (Document 52, Annex 20).
292 See for example, the notes of the interview Somerfield’s solicitors had on 23 February 2006 with Stephen Clarke, a Somerfield tobacco buyer, ITL/Somerfield, Document 82, Annex 20 (paragraph 2.1.6).
293 For more details on the Manufacturers’ monitoring systems, see Section 6.B: ‘The Manufacturer’s retail pricing strategy’.
295 ITL/Somerfield (Document 24, Annex 20).
'Amber Leaf 12.5g [Gallaher brand] appears to have been increased to £2.18 whilst Drum 12/5g [ITL brand] is still priced at £2.12. Amber Leaf 25g pouch is priced at £4.26 and Drum 25g pouch only £4.15. If Amber Leaf has increased in price as it appears to have done then ITL would wish to increase the price of Drum to match Amber Leaf and achieve parity pricing. Please advise your intentions.'

6.150 In their responses to the SO, some of the Parties submitted a number of explanations for the Manufacturer's monitoring of the Retailer's retail prices. Shell and the Co-operative Group contended that the regular provision of detailed cost and retail pricing information to the Retailer (for example, as set out in a price matrix) was merely part of a service performed by the Manufacturer at the Retailer's request in order to assist with the complicated and frequently changing pricing structure of many different brands. ITL argued that this monitoring and related communications were part of a service they provided to the Retailer to identify prices that were inconsistent with the Retailers' pricing policies.

6.151 Further, ITL, Morrisons and Safeway submitted that the Manufacturer's monitoring of prices and communications to the Retailer, in which the Manufacturer pointed out 'price anomalies', were partly meant to identify prices that were higher than the maximum price the Retailer could charge to be entitled to the Manufacturer's ongoing or tactical bonuses.

6.152 However, the OFT considers that the evidence referred to above demonstrates that the Manufacturer's monitoring and related pricing communications to the Retailer exceeded these purposes and were aimed at securing the Retailer's compliance with the Manufacturer's parity and differential strategy (as indeed acknowledged by ITL and Shell).

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296 The OFT considers that, viewed in context, the reference to 'Please advise your intentions' was a polite reminder that Gallaher expected Shell to comply with its parity and differential requirements, either by reducing the price of Amber Leaf or increasing the price of Drum.

297 The Co-operative Group's response to the SO, paragraphs 5.52-5.55 and 5.114-5.117. Shell's response to the SO, paragraph 118. See also Document 2, Annex 13 (paragraphs 4.31 and 4.32), ITL's Explanatory Memorandum of 24 October 2003.

298 ITL's response to the SO, for example at paragraph 4.450. See also ITL's Explanatory Memorandum of 11 April 2005 (Document 5, Annex 13, paragraphs 8.1 to 8.4).


300 ITL's response to the SO, paragraph 4.459 and see also ITL's Explanatory Memorandum of 11 April 2005, paragraph 8.1 (Document 2, Annex 13) and Shell's response to the SO, paragraph 118. The OFT's case relating to the Infringing
6.153 The OFT considers that the provision of information in this form, in the context of the existence of the Infringing Agreements, facilitated the Retailer’s implementation of the parity and differential requirements sought by the Manufacturer and can therefore be properly characterised as an element that assisted the implementation of the Infringing Agreements.

(b) The existence of the Manufacturers’ parallel and symmetrical parity and differential requirements

6.154 Although each Infringing Agreement between each Manufacturer and each Retailer amounted to a breach of the Chapter I Prohibition in its own right, the existence of parallel and symmetrical Infringing Agreements is part of the context of each Infringing Agreement. In addition, the existence of parallel and symmetrical Infringing Agreements is relevant to how the Manufacturer and the Retailer party to an Infringing Agreement would have viewed the requirements imposed under each Infringing Agreement, since the Retailer was party to a similar Infringing Agreement with each Manufacturer and a Manufacturer was party to a similar Infringing Agreement with each Retailer.

6.155 As set out above, both Manufacturers had similar retail pricing strategies and sought to ensure that Retailers observed retail prices for competing linked brands that replicated the parities and differentials that existed between the RRPs of those competing brands. An illustrative list of the brands frequently linked by both ITL and Gallaher is set out at Tables 6.1 and 6.2 below.

6.156 As explained further in Section 6.B: ‘The Manufacturer’s retail pricing strategy’, each Manufacturer sought to achieve, via the Retailer, retail prices for the Manufacturer’s brands which were set either at parity with or at a differential to competing linked brands. The Manufacturer’s parity and differential requirements reflected the differences in the RRPs for leading brands in key segments of the tobacco market (for example, value for money cigarettes, premium cigarettes, cigars). The competing brands that were frequently linked by each Manufacturer, as set out in Tables 6.1 and 6.2 below, and as evidenced by the Manufacturers’ written trading agreements, the contacts between each Manufacturer and each Retailer and documents regarding each Manufacturer’s retail pricing strategy, demonstrate that the Manufacturers often paired the same leading competing brands within these segments of the tobacco market.

Agreements operating in fact as parity or fixed differential requirements is set out at Section 6.A.I.(c) below.
Further, each Manufacturer’s parity and differential requirements for competing linked brands was compatible with those of the other Manufacturer (for example, where both Manufacturers specified that the same competing linked brands should be priced at parity) and the Retailer was therefore able to satisfy the requirements of both Manufacturers.

On occasion, each Manufacturer expressed its parity and differential requirements for the same Retailer using different parameters which were nonetheless compatible. For example, in their respective trading agreements with Shell, ITL required that its brand be priced at a ceiling up to parity with Gallaher’s competing brand, whereas Gallaher required that the two brands be priced at parity with one another.

Shell’s trading agreements with ITL and Gallaher included the following requirements:\(^{301}\)

*Richmond* [ITL brand] and *Dorchester*, [Gallaher brand] (both value for money cigarette brands):

'Richmond King Size; Richmond Lights: All packings at least no more than the price of the same Dorchester King Size packing’ [ITL Agreement]

'Parities …DORCHESTER KING SIZE HOUSE Vs RICHMOND KING SIZE HOUSE’ [Gallaher Agreement]

*Classic* [ITL brand] and *Hamlet*, [Gallaher brand] (both cigar brands):

'Classic: All packings at least no more than the price of the same Hamlet packing’ [ITL Agreement]

'Parities HAMLET Vs CLASSIC’ [Gallaher Agreement]

*Golden Virginia* [ITL brand] and *Old Holborn* [Gallaher brand] (both roll-your-own tobacco brands):

'Golden Virginia: All packings at least no more than the price of the same Old Holborn packing’ [ITL Agreement]

'Parities: OLD HOLBORN Vs GOLDEN VIRGINIA’ [Gallaher Agreement]

Further, the fact that a Retailer had entered into an Infringing Agreement with a Manufacturer that was similar to the Infringing Agreement it had entered into with the other Manufacturer, and that there was symmetry between the Manufacturers’ parity and differential requirements meant

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[^301]: ITL/Shell (Document 27, Annex 19) and Gallaher/Shell, 2 October 2001 (Document 4, Annex 9).
that the Retailer was able to satisfy both Manufacturers’ requirements by pricing at parity or a fixed differential (as applicable in each case). So, for example, in the trading agreements between Shell and respectively, ITL and Gallaher, Shell was effectively bound in relation to Richmond and Dorchester to price both competing brands at parity in order to comply with each Manufacturer’s requirements.

6.161 The Manufacturers’ knowledge of one another’s parity and differential requirements can also be inferred from their correspondence with Retailers. For example, in correspondence with Shell, Gallaher noted that it (and ITL) sought to ‘achieve price list differentials between competitor brands’.302

6.162 For example, in an email dated 8 July 2002 from Gallaher to Shell, Gallaher explained its reasons for making changes to Shell’s prices for ITL brands:303

‘1) … the Gallaher agreement is for price list parities and differentials to be maintained.

2) I note you are proposing to increase some ITL prices even though they are not having an MPI yet, I would think their agreement also stipulates parities and differentials to be maintained, and with this in mind I have moved their prices in the attached as well as mine. Brenda [ITL] will be on the phone I would think if the above is not maintained.’


‘I expect CWS Retail to challenge the strategy pricing differentials during this year. They believe that the manufacturers are restricting promotion and activity by demanding strategic differentials. This will affect all manufacturers over the coming year.’

6.164 As explained in Section 6.A.I.(a).iii above, there were in some cases contacts between the Manufacturer and the Retailer regarding the retail prices of the Manufacturer’s competitor’s brands. In certain instances, the Manufacturers encouraged such transparency.305 In some cases, both

302 Gallaher/Shell (Document 30, Annex 9).
303 Gallaher/Shell (Document 31, Annex 9).
304 ITL/Co-operative Group (Document 11, Annex 15 (page 8)).
305 For example, Gallaher stated to Somerfield in an email dated 4 March 2002: ‘given the nature of the market (I would guess) that probably we think it’s fair to take a more relaxed view and that unless either say ‘please keep this confidential’ assume that the
Manufacturers actively cooperated with a given Retailer to resolve discrepancies in the pricing files and maintain their differentials, as acknowledged by ITL in a National Account Business Development Plan dated 1 February 2003 from ITL to Shell:306

Under the previous Category Manager the price file was in a state of disrepair with many differentials out of line. Under the new Category Manager and the aid of both Gallaher and ITL this has been resolved and in the main differentials between manufacturers comparable brands are now maintained.’ [Emphasis added]

6.165 The above email demonstrates ITL’s understanding of Gallaher’s parity and differential requirements.

6.166 In an email dated 12 June 2002 to Shell, Gallaher acknowledged its understanding of ITL’s parity and differential requirements. Gallaher explained that, because of the parity and differential requirements sought by both Gallaher and ITL, any price change implemented by Shell to one Manufacturer’s brand would necessitate a change to the competing linked brand if it were not to affect the prescribed parity and differential requirements:307

All manufacturers look to achieve price list differentials between competitor brands, and also their own price list. If you move one product to a price point, and not the competitor brand also because it is already at a favourable price point, then obviously parities and differentials will be affected.308

6.167 Moreover, in correspondence dated 30 April 2002 with Somerfield and dated 14 February 2003 with T&S Stores, Gallaher’s detailed understanding of ITL’s requirements is illustrated via discussion of the retail pricing of Golden Virginia (an ITL brand) and Old Holborn (a Gallaher brand):309

As previously confirmed there is no extra bonus for OH, both GV and OH are sold at PL (price list) terms, neither manufacturers pay

information will be discussed in the context of ’pricing/normal trading‘. See Gallaher/Somerfield (Document 22, Annex 10).

307 See also, for example ITL/Shell, 13 December 2001 (Shell to ITL, Gallaher and [another manufacturer]), 13 December 2001, 9 January 2002 and 14 May 2002 (ITL to Shell) (Documents 38, 39, 41 and 46, Annex 19 respectively); Gallaher/Shell, 13 December 2001, 8 July 2002 and 12 August 2002 (Documents 12, 31-33 and 35, Annex 9 respectively); ITL/Sainsbury, 15 October 2002 (Document 92, Annex 18). See also, ITL/Somerfield, the notes of the interview Somerfield’s solicitors had with Stephen Clarke, a Somerfield tobacco buyer, and Somerfield’s Company Statement, dated 15 March 2006, (Document 82, Annex 20 (paragraph 3.20)).
bonuses. Both have same cost's hence why the same retail applies in all other multiples.'

And: \(^{310}\)

'Just to point out that the RRP on OH is 4p above GV, and on 25p is 6p above. Your price files show the same pricing, which is good for us, but not for you or ITL!! All we are after is Price List parity (i.e. same price differential). I'm surprised ITL hasn't picked this up.'

6.168 Further, in the event that Gallaher required a differential that conflicted with one required by ITL, or vice versa, the relevant Retailer could not have entered into such agreements with both parties. For example, had Gallaher requested that Gallaher's brand A be no more than 5p more than ITL's brand B, whereas ITL had requested that ITL's brand B be at least 6p less than Gallaher's brand A, the Retailer could not have satisfied both Manufacturers' requirements. No documentation has been identified in which a Retailer suggests to a Manufacturer that its parity and differential requirements conflict with those of the Manufacturer's competitor, and the OFT infers from this that ITL and Gallaher must have been aware of each other's parallel and symmetrical parity and differential requirements.

6.169 Similarly, it is in any event implausible that the symmetry in the pricing relativities required by the Manufacturers could have emerged without the Manufacturers having a mutual understanding of each other's retail pricing strategies.

6.170 The OFT therefore considers that Gallaher and ITL must have been aware of each another's parallel and symmetrical parity and differential requirements, since otherwise the Infringing Agreements entered into by each Manufacturer could not have been implemented successfully.

6.171 In its response to the SO, ITL stated that its parity and differential requirements were 'benchmark maxima' based on the differences between the RRP's of the relevant ITL brands and the respective benchmark competing brands. ITL stated that this did not require any 'inside knowledge' of Gallaher's strategy on ITL's part. \(^{311}\) However, the OFT does not accept that submission for the reasons set out above.

6.172 Further, ITL, the Co-operative Group, Morrisons and Safeway contended that the OFT had not demonstrated that a Retailer had agreed parallel and symmetrical parity and differential requirements with both Manufacturers, or that only a small proportion of the relevant market was covered by

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\(^{310}\) See Gallaher/T&S Stores, 14 February 2003 (Document 57, Annex 27).

\(^{311}\) ITL's response to the SO, paragraphs 5.109 to 5.111.
parallel and symmetrical parity and differential requirements of both Manufacturers.\textsuperscript{312}

6.173 The OFT notes, however, that these Parties’ analysis of the symmetry between the Manufacturers’ parity and differential requirements excludes circumstances in which: (i) a Retailer had not entered into written trading agreements with both Manufacturers; and (ii) periods of time in which the duration of the relevant written trading agreements of each Manufacturer did not overlap.\textsuperscript{313}

6.174 As stated above, the OFT considers that although written trading agreements were an element of certain Infringing Agreements, the existence of an Infringing Agreement is also evidenced by other elements, such as contacts between the Manufacturer and the Retailer regarding the Retailer’s retail prices, the monitoring of retail prices by the Manufacturer and evidence of the Manufacturer’s retail pricing strategy, as set out in Sections 6.C.I-X. Therefore, it is necessary to view the evidence as a whole, rather than a more limited part.

6.175 The evidence demonstrates that many competing ITL and Gallaher brands were ‘paired’ by both Manufacturers and their parity and differential requirements were generally compatible. For example, both ITL and Gallaher generally had compatible parity and differential requirements in respect of B&H (Gallaher brand) / Embassy (ITL brand), Berkeley (Gallaher brand) / Superkings (ITL brand), Dorchester (Gallaher brand) / Richmond (ITL brand), Old Holborn (Gallaher brand) / Golden Virginia (ITL brand) and Hamlet (Gallaher brand) / Classic (ITL brand). These brands were also frequently the subject of communications between Manufacturers and the Retailer.

6.176 In view of the foregoing, the OFT considers that, in respect of a Retailer, the Manufacturers implemented parallel and symmetrical parity and differential requirements in relation to a large number of competing linked brands.

6.177 Some of the Parties submitted that even if symmetry existed in relation to particular product pairs, the Manufacturers’ parity and differential requirements would not amount to a fixed or minimum price, because the Retailer was free to reduce, hold or increase the retail price of both linked


\textsuperscript{313} ITL’s supplementary response to the SO, Annex 2. Report by Oxera for the Co-operative Group, paragraph 3.14
brands or play Manufacturers off against each other to obtain funding to reduce retail prices.

6.178 In response to this point, the OFT notes that although under the Infringing Agreements, Retailers retained a discretion as to the absolute level at which paired brands were priced (for example, a parity requirement would not of itself prevent a retailer from choosing to price a Manufacturer’s brand and a competing brand each at £4.10 rather than £4.20, provided they were priced at the same level), the Infringing Agreements nonetheless constituted a restriction of a Retailer’s ability to determine its retail prices for the Manufacturer’s brands and those of competing linked brands to any extent that differed from the prescribed parity or differential. The OFT describes the restrictive nature of the Infringing Agreements in greater detail at Section 6.A.I.(d) below.

(c) The Infringing Agreements implemented the Manufacturers’ retail pricing strategies, which aimed to achieve parity or a fixed differential between competing linked brands

6.179 As set out above, in their responses to the SO, ITL, the Co-operative Group, Morrisons and Safeway submitted that the Manufacturer’s strategic pricing requirements required a Retailer to observe maximum price levels and that the Retailer was free at all times to set retail prices at a level that was lower than the maximum price levels specified in the trading agreements and/or communications between the Manufacturer and the Retailer.314

6.180 The OFT acknowledges that in certain trading agreements, parity and differential requirements were ostensibly expressed as maximum differential requirements and, in certain communications from Manufacturers to Retailers, instructions or requests were occasionally expressed as stipulating maximum prices or maximum differential requirements. However, taking the evidence as a whole, the OFT considers that the Infringing Agreements in fact provided for parity or fixed differential requirements which were implemented by communications from a Manufacturer to a Retailer that the Retailer move to a specific retail price point. The Retailer’s compliance with such communications was induced by the grant of ongoing and tactical bonuses; and other incentives and pressure were applied if divergences

314 ITL’s response to the SO, paragraphs 4.74 to 4.83 and paragraphs 4.288 to 4.329, the Co-operative Group’s written representations, paragraph 6.49, Morrisons’ response to the SO, paragraphs 321-409 and 410-468. Safeway’s response to the SO, paragraphs 321-400 and 401-467.
from the price points communicated by a Manufacturer were detected through the Manufacturer’s monitoring of a Retailer’s retail prices.

6.181 The OFT has reached this conclusion, in particular, given that:

(i) the language and nature of the communications from a Manufacturer to a Retailer regarding resale prices was commonly not indicative of the prices being a maximum price (or maximum differential price) requirement and was instead indicative of the Manufacturer communicating specific price instructions or requests which were necessary to maintain or realign parity and fixed differential requirements;

(ii) the Manufacturer’s communications with a Retailer to change the retail prices as a result of monitoring included instructions or requests to increase prices (which is consistent with the existence of a parity or fixed (rather than a maximum) differential requirement); and

(iii) even where one Manufacturer’s pricing requirement was expressed as a maximum differential requirement in a trading agreement with a particular Retailer, such a requirement, when viewed in the context of the symmetrical requirement that the Retailer had with the other Manufacturer, and vice versa, meant that the Retailer could only price the relevant brands at parity or at a fixed differential in order to comply with both Manufacturers’ requirements (see Section 6.A.I.(b)).

6.182 The OFT considers that the language used by the Parties in pricing communications, and set out in the evidence in Section 6.A.I.(a) and Sections 6.C.I-X below, is reflective of instructions and/or requests for the Retailer to move to specific price points, not absolute maximum prices. References to pricing in correspondence were only very rarely expressed as maxima.

6.183 Moreover, communications referred to prices being ‘corrected’ and ‘amended’, for example after price monitoring by the Manufacturer. It is clear from the context of these communications that they frequently related to the Manufacturer’s parity and differential requirements. Further, the use of specific price points in a Manufacturer’s communications to a Retailer was consistent with the Manufacturer maintaining or realigning parity and/or fixed differential requirements, rather than stipulating an absolute maximum price level or requiring the Retailer to observe a maximum differential.
6.184 For example, in an email dated 16 April 2002, ITL pointed out to Somerfield that a number of Somerfield stores had been found to be pricing Richmond at £3.45, whereas 'the correct price should of course be £3.47.'

6.185 Similar language was also used by Gallaher. For example, in an email dated 19 December 2002 from Gallaher to First Quench entitled 'pricing anomalies', Gallaher stated:

>'Please find attached details from our Price Audit fieldwork carried out yesterday.

>‘You will see that there are a number of £3.54 prices appearing for Dorchester [Gallaher brand], Richmond [ITL brand] and Mayfair KS [Gallaher brand]. The price increase seems to have been implemented correctly in most stores but it appears that maybe one group of stores have been overlooked? ....Hopefully you will be able to identify the problem on your system.'

6.186 In addition, it is instructive to note that of the ITL written trading agreements submitted to the OFT, those that commenced in or before 2000 (except for the trading agreement between ITL and T&S Stores relating to the period 1 October 1996 to 30 September 1997\(^{317}\)) included a detailed outline of their strategic pricing requirements and also included a requirement on the part of the Retailer to implement parities and/or fixed differentials. \(^{318}\) For example, a written trading agreement between ITL and T&S Stores relating to the period 1 October 1999 to 30 September 2000 included the following 'relative pricing' requirements:

>...  

\[
\text{JPS Lights 20s} \quad = \quad \text{Berkeley Superkings / B&H Superkings}
\]

\(^{315}\) ITL/Somerfield, 16 April 2002 (Document 35, Annex 20). Liz Smith, the Somerfield tobacco buyer, forwarded this email from ITL to her assistant, copied to ITL’s account manager, and asked 'Why? Can you remember when moving any of [ITL] products pricing to match that you double check with Graham [ITL’s account manager] first.’ In the notes of Liz Smith’s interview with Somerfield’s solicitors, she links ITL’s email with ITL’s differentials strategy being out of line (Document 82, Annex 20, page 60). ITL sent a similar email directly to the assistant of Somerfield’s tobacco buyer on 11 July 2002, in response to which the assistant apologised and stated that he had changed the prices from the following day (Document 50, Annex 20). A similar example ITL/Sainsbury, 16 November 2001 (Document 50, Annex 18).

\(^{316}\) Gallaher/First Quench (Document 28, Annex 6).

\(^{317}\) ITL/T&S Stores (Document 1, Annex 29).

\(^{318}\) The agreements are as follows: ITL/Morrisons (Document 4, Annex 17); ITL/Sainsbury (Document 17, Annex 18) and ITL/TM Retail (Document 1, Annex 22).

\(^{319}\) ITL/T&S Stores (Document 1, Annex 29).
6.187 From 2001 onwards, ITL’s written trading agreements were modified such that, ostensibly, the Retailer was required to adopt maximum parity and differential requirements (that is, amounting to a ceiling at parity or to a ceiling at a differential). Such a requirement can itself be distinguished from a maximum price, as it links the relative prices of competing brands (the restrictive nature of such a requirement is set out in Section 6.A.I.(d) below). In any event, despite this change to the way that ITL’s parity and differential requirements were expressed in its written trading agreements with a Retailer, the language that was in fact used in pricing communications from ITL to the Retailer which facilitated the implementation of those trading agreements did not alter. In that connection, it is relevant to note that specific pricing points continued to be communicated by each Manufacturer as described above, which the OFT considers to be evidence of the continuation of ITL’s strategy as well as Gallaher’s strategy to maintain parity or fixed differentials between competing linked brands.

6.188 Indeed, the only significant change in the approach and language used by the Manufacturers, in particular Gallaher, in their communications with the Retailer occurred during 2003, apparently reflecting an awareness of the OFT’s investigation\(^{320}\) and an awareness of the fact that the prices being communicated to the Retailer may not have been understood by the Retailer as being maximum prices (see also paragraph 6.53 to above).\(^ {321}\)

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\(^{320}\) The OFT’s investigation had begun in March 2003 when Sainsbury applied for and was granted conditional leniency from financial penalties. The OFT did not send section 26 Notices to the Manufacturers until 15 August 2003, but they became aware of striking changes in the attitude of Sainsbury before that time (Section 2.B.II above).

\(^{321}\) See, for example, Gallaher/Asda, 30 July 2003 and 28 August 2003 (explicit reference to ‘maximum resale price’) (Documents 14 and 15, Annex 4, respectively); Gallaher/Morrisons, 8 August 2003 (explicit reference to ‘maximum selling price’) (Document 20, Annex 7); ITL/Asda, 14 August 2003 (Document 79, Annex 14), email from Graham Hall to Guy Mason and others sent at 10.06am. Gallaher also started
For example, one such email dated 15 August 2003 from Gallaher to Somerfield, included the following note:322

‘The purpose of the agreed off invoice support is to assist Somerfield to sell Gallaher products at a rate below RRP. Somerfield is at all times free to sell its products at a price lower than that which is supported by any Gallaher bonus payment’.

6.189 The OFT notes that nevertheless Gallaher informed Somerfield that ‘[t]he proposed retails’ [that is, the retail prices Gallaher notified to Somerfield for its Hamlet brand] should retain parity with the equivalent Café Crème packings [ITL’s brand]’.

6.190 Somerfield’s Tobacco Buyer also noted in her witness statement that:323

‘Since September 2003 Imperial correspondence has included a generic paragraph in respect of pricing and suggest such suggestions be for guidance only.’

And:

‘There were no disclaimers on Gallaher emails until around August 2003’.

6.191 In their response to the SO, ITL, Morrisons, Safeway and the Co-operative Group submitted to the OFT that references to specific price points in correspondence between a Manufacturer and a Retailer were only a form of commercial shorthand, which was properly understood as referring to a maximum price level by the commercial employees who wrote and received them, or that these communications were instructions that were frequently ignored by the Retailer.324

6.192 The OFT considers explanation provided by some of the Parties regarding the use of specific price points in a communication between a Manufacturer and a Retailer to be implausible, in particular given the tone and nature of the communications, the evidence of the Manufacturer’s retail pricing strategy, and given the fact that many of these

adding a note to the price files it sent to Retailers to clarify the purpose of the bonuses it paid to Retailers (for example, Gallaher/Somerfield, 15 August 2003 (Document 64, Annex 10)).

323 ITL/Somerfield (Document 82, Annex 20 (page 55)). The draft witness statement of Liz Smith (Somerfield) at fourth page, second paragraph under the heading 'Imperial' and fourth paragraph under the heading 'Gallaher', fifth page, fourth to seventh paragraph, and seventh and eighth page under point 8.
324 ITL’ response to the SO, for example at paragraph 4.290. Morrisons’ response to the SO, paragraphs 335-384 and 415-449 Safeway’s response to the SO, paragraphs 333-380 and 405-445. The Co-operative Group’s response to the SO, paragraphs 5.43-5.59 and 5.106-5.121.
communications explicitly referred to the objective of restoring a specific parity or differential with a competing linked brand, both in the context of a price decrease or price increase (see below).

ii Communications between a Manufacturer and a Retailer to increase retail prices

6.193 In numerous communications, the Manufacturer gave an instruction or request that a Retailer’s price for the Manufacturer's brand or the linked brand of a competing Manufacturer should be increased to a specific price point, in order to maintain or realign a parity or differential requirement. Such communications cannot be considered compatible with an agreement designed to implement a maximum price.

6.194 The examples cited at paragraphs 6.56-6.60, 6.94-6.98, 6.124 and 6.127 and 6.149 and also below each illustrate instances in which ITL and Gallaher requested that a Retailer increase a price to a specified level to ensure that a given parity or differential requirement was restored.325

6.195 A further example is in a letter dated 15 November 2000 from ITL to Morrisons entitled 'Richmond KS and Richmond Superkings [ITL brands]', ITL stated:326

'Regarding our earlier telephone conversation on the above. You are probably aware that the broad marketplace has moved from 329/330 to 334/335 on Dorchester KS and Dorchester Superkings [Gallaher brands]. You may remember from my presentation on the Richmond repositioning (and launch of Richmond Superkings) that our strategy is parity with Dorchester. In light of this we are moving Richmond KS and Richmond Superkings up to 334/335.'

6.196 In an email dated 29 March 2001 from ITL to Asda, ITL stated:327

'On the basis that both Sterling and Dorchester [Gallaher brands] will increase by 5p/20s [i.e. 5p on a pack of 20 cigarettes] on the 1st April 2001, I can confirm that Richmond prices will increase by the same amount on this date.'

6.197 In an email dated 11 October 2001 from ITL to TM Retail, ITL stated:328

325 See also, for example, ITL/Asda, 5 October 2000 (letter from ITL to Asda; regarding Lambert & Butler, JPS and Richmond) (Document 9, Annex 14); ITL/Sainsbury, 26 September 2000 (regarding Lambert & Butler and JPS), 16 February 2001 (regarding Embassy) 4 September 2001 (regarding Embassy/Regal), 2 October 2001 (regarding Richmond products) and 4 March 2002 (regarding Richmond) (Documents 20, 29, 44, 45 and 54, Annex 18 respectively)

326 ITL/Morrisons (Document 16, Annex 17).

327 ITL/Asda. 29 March 2001 (Document 32, Annex 14).

'...we agreed to raise the retail price of the Richmond KS 20s and Richmond Superkings 20s by 10p per pack. This applies to all tiers. ... I understand this move in price will be in line with competing brands. Please let me know should this position change.'

6.198 In addition, both Manufacturers on occasion required the retail price of a competitor’s brand to be increased in order to maintain or realign the relevant parity or differential requirement.329

6.199 ITL, Morrisons and Safeway argued that communications to a Retailer to increase the price of ITL’s brands were also commercial 'shorthand' employed by the ITL NAM to inform the Retailer that a temporary promotion was ending in relation to a particular brand and the Retailer would therefore no longer benefit from a tactical bonus or constituted a price recommendation that the Retailer was free to ignore.330 These parties argued that those communications served as advice to the Retailer that it would need to raise its retail price in order to preserve its margin on the brand, but not that the Retailer was required to increase its retail price to that level.

6.200 However, there are numerous examples of a Manufacturer withdrawing tactical funding in order to bring about an increase in a retail price which would maintain or restore a parity or fixed differential between competing linked brands, or requesting that a Retailer increase the price of a competing linked brand. Those examples are not consistent with the arguments advanced above by ITL, Morrisons and Safeway.

6.201 Moreover, it is relevant to note, as part of the context as to how the Infringing Agreements operated in practice, that Gallaher stated that the

329 See, for example, ITL/Somerfield, 30 April 2002 (Document 40, Annex 20); Gallaher/Shell, 8 July 2002, (Document 31, Annex 9); Gallaher/Somerfield, 21 September 2001, 6 March 2002 and 30 April 2002 (Documents 13, 23 and 29, Annex 10); ITL/Safeway (Document 34, Annex 28); ITL/First Quench (Documents 15-17, Annex 16); and Gallaher/Somerfield (Document 13, Annex 10). See also paragraphs Annexe(s)6.94-6.98 above.

330 ITL’s response to the SO, for example paragraphs 4.240-4.287. Morrisons’ response to the SO, paragraphs 335-384 and 404. Safeway’s response to the SO, paragraphs 364 and 433. Shell acknowledged that correspondence from Manufacturers to Shell included requests to increase prices, but stated that it could have remedied a pricing 'error' identified by a Manufacturer regarding its implementation of the Manufacturer’s parity and differential requirements by reducing the price of one product rather than increasing the price of the other, linked product. The Co-operative Group submitted in its response to the SO that the OFT had not produced evidence of requests by Manufacturers for the Co-operative Group to increase retail prices, see for example paragraph 5.44 (in respect of the trading relationship between ITL and the Co-operative Group).
Retailers rarely set retail prices below the level instructed or requested by a Manufacturer, because margins on tobacco brands were too low.\textsuperscript{331}

\textit{iii) The Manufacturers’ symmetrical parity and differential requirements}

6.202 As set out in paragraphs 6.21 to 6.154 above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to the same Retailer and that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement.

6.203 Therefore, even in circumstances in which one Manufacturer’s retail pricing strategy (or both Manufacturers’ retail pricing strategies), or instructions or requests to a Retailer, was or were ostensibly expressed as a maximum differential requirement, the fact that a Retailer had entered into similar Infringing Agreements with both Manufacturers, and that there was symmetry between the Manufacturers’ parity and differential requirements meant that the Retailer was bound to price both Manufacturers’ competing linked brands at a parity or fixed differential, as applicable (see Section 6.A.I.(b)).

6.204 Moreover, from the evidence set out in Section 6.A.I.(b) above, the OFT considers that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements.

\textbf{(d) The restrictive nature of the Infringing Agreements}

6.205 As set out in detail in Section 6.C.I-X, under each of the Infringing Agreements, a Manufacturer co-ordinated with a Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. As a result of the Manufacturer’s parity and differential requirements, each Infringing Agreement restricted the ability of the Retailer to determine its retail prices for competing linked brands.

6.206 The Manufacturer’s parity and differential requirements involved linking the retail price of a particular brand to the price of a competing brand and

\textsuperscript{331} Note of the OFT’s meeting with Gallaher, 23 January 2006 (Document 18 of Annex 3, paragraphs 11 and 12).
precluded a Retailer from making price changes that fostered inter-brand competition, within the Retailer’s premises. As described in further detail below, the OFT considers that each of the Infringing Agreements was, by its very nature, capable of restricting competition and therefore had as its 'object' the prevention, restriction or distortion of competition.

6.207 ITL, the Co-operative Group, Shell, Morrisons and Safeway submitted that the parity and differential requirements had a pro-competitive objective to ensure that competing tobacco brands were priced competitively against the rival Manufacturer’s brands within each Retailer’s premises. These Parties further submitted that the requirements merely encouraged Retailers not to set retail prices above a maximum price level. They submitted therefore that parity and differential requirements facilitated inter-brand competition between the Manufacturers.332

6.208 In order to respond fully to these arguments, the OFT has set out in detail how the Manufacturers’ requirements (whether phrased as a parity, fixed differential or maximum differential requirement) were, by their very nature, capable of restricting competition.

6.209 Subsection (i) below examines the restrictive nature of a parity or fixed differential requirement, examining first how a parity or differential requirement imposed by one manufacturer is capable of restricting competition, when considered in isolation. The section subsequently considers how the restrictive nature of a parity or fixed differential requirement imposed by one manufacturer is reinforced and increased where a competing manufacturer has knowledge of the other Manufacturer’s parity and differential requirements; and where the competing Manufacturer has symmetrical parity and differential requirements.

6.210 Subsection (ii) below examines the restrictive nature of a maximum differential requirement when viewed in isolation. Although the OFT considers that the manufacturers maintained parity or fixed differentials in relation to competing linked brands, (as opposed to imposing maximum differential requirements), the OFT has nonetheless explained why it considers that a maximum differential requirement is also capable of restricting inter-brand competition. The section subsequently considers how the restrictive nature of a maximum differential requirement imposed by one manufacturer is reinforced and increased where a competing

332 ITL’s response to the SO, paragraphs 4.47 to 4.60. The Co-operative Group’s response to the SO, paragraph 8.2. Morrisons’ response to the SO, paragraphs 218 to 219. Safeway’s response to the SO, paragraphs 321-400 and 401-467. Shell’s response to the SO, paragraphs 123 to 125.
manufacturer has knowledge of the other manufacturer’s parity and
differential requirements and where the competing manufacturer has
symmetrical parity and differential requirements.

6.211 Subsection (iii) responds to arguments by some of the Parties in response
to the SO regarding recommended/maximum pricing and sets out the
distinction between the restrictive nature of the Infringing Agreements
and the consequences of a supplier stipulating an absolute maximum retail
price level without linking that to the retail price of a competitor’s brand.

i. The restrictive nature of a Manufacturer’s retail pricing strategy
   operating as a parity or fixed differential requirement

A parity or fixed differential requirement viewed in isolation

6.212 An example of a parity requirement is a requirement by manufacturer A
for a retailer to price manufacturer A’s brand X at the same price as the
competing manufacturer’s brand Y. An example of a fixed differential
requirement is a requirement to price manufacturer A’s brand X at zp less
than the competing brand Y.

6.213 As stated in the SO,333 a parity or fixed differential requirement restricts a
retailer’s ability to determine the retail prices of competing linked brands,
because the relative prices of competing brands are fixed on the basis of
the required parity or differential. If a parity or fixed differential
requirement is implemented, an increase or reduction in the retail price of
one brand leads to a corresponding increase or reduction in the retail price
of the competing linked brand by an equivalent amount.

6.214 A parity or fixed differential requirement is capable of giving rise to
significantly increased certainty for a manufacturer imposing the
requirement (in this hypothetical scenario, manufacturer A) that any
change in the retail price of its brand, brand X, will be matched by a
 corresponding change in the retail price of the linked, competing brand,
brand Y.

6.215 In the absence of a parity or differential requirement, manufacturer A can
expect that if it raises the wholesale price of its brand X, the retail price
of that brand will increase relative to the competing brand Y, assuming
that other factors remain constant. As a result, it will expect to suffer a
loss of sales volume as consumers switch to the relatively cheaper,
competing brand Y of manufacturer B. Conversely, manufacturer A would
expect that if it lowers the wholesale price of its brand X, the retail price

333 SO, paragraphs 585 and 586.
of that brand will decrease relative to that of competing brand Y, assuming that other factors remain constant, and it will enjoy an increase in sales volume as consumers switch away from the relatively more expensive, competing brand.

6.216 In contrast, if manufacturer A has a requirement that a retailer’s price for brand X is linked to the retail price of competing brand Y by virtue of a required parity or fixed differential, that requirement is capable of giving rise to a significant degree of certainty that the retail prices of the two competing, linked brands will move in parallel. The loss in sales volume that manufacturer A would normally expect to suffer by increasing its wholesale price - as a result of an adverse shift in its retail price relative to that of the competing brand - is therefore significantly reduced by virtue of the retail prices for both brands increasing in parallel. As a result, manufacturer A would enjoy the gain in revenue from increasing its wholesale price without suffering the loss in sales volume that would normally result from its brand having a more expensive retail price relative to that of the competing brand Y.

6.217 Similarly, a manufacturer which does not operate a parity and differential strategy (manufacturer B) would observe, over time, that any change in the retail price of its brand, brand Y, is very likely to be matched by a corresponding change of the same magnitude in the price of the competing, linked brand X and infer the existence of a relationship between the retail price of its brand Y and the price of the competing brand X. In that situation, manufacturer B’s incentive to reduce its wholesale price is capable of being significantly reduced by manufacturer A’s parity or differential requirement. That is because manufacturer B would suffer the loss in revenue from reducing its wholesale price without enjoying the gain in sales volume that would normally result from its brand having a cheaper retail price relative to that of the competing brand X. Therefore, manufacturer B’s incentive to increase its wholesale price is capable of being significantly increased by manufacturer A’s parity or differential requirement.

6.218 For example where, pursuant to an Infringing Agreement with ITL, a Retailer was required to price Gallaher’s brand Dorchester at parity with ITL’s brand Richmond, that requirement would have significantly increased ITL’s certainty that any change in the retail price of Richmond would be matched by a change of equivalent direction and magnitude in the retail price of Dorchester, Gallaher’s brand. Similarly, Gallaher would have been likely to observe, over time, that on each occasion there was a decrease in the retail price of Dorchester, there was a corresponding decrease for

334 SO, paragraph 653.
both brands and, on each occasion that there was an increase in the retail price of Dorchester, there would be a matching increase on ITL’s Richmond brand.

6.219 Equally, where manufacturer B has knowledge of manufacturer A’s parity and differential requirements with a retailer, that knowledge enables manufacturer B to predict with an even greater degree of certainty the response of manufacturer A (via the retailer) in relation to brand X to any change in the retail price of manufacturer B’s brand Y.

6.220 It is also possible that such a parity or fixed differential requirement would restrict intra-brand competition. Notwithstanding that retailers would remain able to determine the absolute level of retail prices (in particular, by reference to their preferred pricing position compared to their retailer competitors), manufacturers would have a reduced incentive by virtue of the parity or differential requirement (as the case may be) to seek or pay for retail price promotions on their brands given the knowledge that any retail price promotion on their brands would be matched by an equivalent reduction in the price of the competing linked brand. In that way, retailers would be less able to negotiate price promotions with manufacturers, which could otherwise facilitate both intra-brand and inter-brand competition.

6.221 For example, in an internal memo, ITL noted the Co-operative Group’s concerns that the Infringing Agreements restricted the Co-operative Group’s ability to use price promotions:

‘I expect CWS Retail to challenge the strategy pricing differentials during this year. They believe that the manufacturers are restricting promotion and activity by demanding strategic differentials.’

6.222 The long-term implementation of such parity and differential requirements would therefore significantly reduce each manufacturer’s uncertainty regarding the retail pricing of its competitor’s brand and is capable of creating mutually consistent expectations between competing manufacturers. The restriction of a retailer’s ability to determine its retail prices for competing linked brands is therefore capable of restricting inter-brand competition by distorting the incentives of both manufacturers of the competing linked brands to engage in inter-brand competition in relation to wholesale pricing. Specifically, the long-term implementation of a parity and differential requirement would give rise to significant incentives for both manufacturers to raise their wholesale prices, and significant disincentives for them to lower their wholesale prices. A parity

or fixed differential requirement is also capable of restricting intra-brand competition by reducing the incentive for manufacturers to seek or pay for retail price promotions on their brands.

6.223 In its response to the SO, ITL submitted that the Infringing Agreements did not impose an obligation on the Retailers to adjust the prices of one Manufacturer’s brand in response to a reduction or increase in the price of the other Manufacturer’s competing linked brand. As noted in the SO, the OFT recognises that the Manufacturer’s uncertainty regarding the retail price movement of a competing linked brand was not completely eliminated as a consequence of an Infringing Agreement. If the retail price of one brand changed, for example as a result of a temporary promotion instigated by a Manufacturer, the Retailer was frequently under an obligation to inform the other Manufacturer of that promotion or price change, and afford it a chance to respond (see Section 6.A.I.(a).ii). The Manufacturer of the competing linked brand would then decide whether to ask the Retailer to follow the price change in order to maintain or realign the parity or differential requirement. On certain occasions, a Manufacturer would accept or would inform a Retailer that a parity and differential requirement was suspended (see for example paragraph 6.82 above).

6.224 However, the OFT considers that although the Retailer may not have automatically changed the retail price of a brand in response to a change in the price of the competing linked brand, the evidence indicates that either the Retailer would seek, and be granted, permission from the Manufacturer of that brand to move the price of its brand in line with the parity and differential requirement, or that the Manufacturer would instigate the price alignment by contacting the Retailer.

6.225 Moreover, the OFT considers that the evidence of contacts between each Manufacturer and the Retailers shows that there was a clear expectation on the part of Manufacturers and an acceptance on the part of Retailers that retail prices would be moved in line with the parity and differential requirements. That is demonstrated by contacts between a Manufacturer and a Retailer where the Manufacturer gave instructions and/or requests regarding retail prices in order to maintain or realign its parity and differential requirements (see Section 6.A.I.(a).iii above). The limited number of communications from a Manufacturer to a Retailer to suspend or temporarily disregard a parity and differential requirement indicate that the normal expectation on the Retailer’s part would be to move retail prices in line with the requirement.

336 ITL’s response to the SO, paragraph 4.229.
337 SO, paragraph 655.
The consequences of symmetrical parity or fixed differential requirements

6.226 The preceding analysis has focused on the impact of each Infringing Agreement in isolation. However, as set out in Section 6.A.I.(b) above, each Manufacturer was party to a parallel and symmetrical Infringing Agreement with the same Retailer.

6.227 In a situation where manufacturers have symmetrical parity or fixed differential requirements, the restrictive nature of each requirement is reinforced and increased. In such a context, the potential uncertainty that a rise in the retail price of one brand might not be followed by a rise in the retail price of the linked competing brand, for example as a result of the suspension of the parity and differential requirement, or an oversight by the retailer, is even further reduced by the existence of the other manufacturer’s symmetrical requirement. As a result, each manufacturer could observe, over time, an even greater uniformity in retail price movements in relation to the linked brands and therefore observe with an even greater degree of predictability, the retail price movements of the linked brands.

6.228 In addition, as noted in the SO, the restrictive nature of a parity or fixed differential requirement is further reinforced and increased where the manufacturers are aware of the each other’s symmetrical parity and differential requirements. This awareness would mean that each manufacturer could predict with an even greater degree of certainty the response of its competitor to a change in the retail price of the manufacturer’s brand.

6.229 In the present case, for the duration of the Infringing Agreements and given ITL’s understanding and knowledge of Gallaher’s pricing parity and differential requirements (and vice versa), ITL’s incentive to instigate a price increase on competing linked brands would have been heightened by the knowledge that such an increase was very likely to be mirrored by Gallaher via a corresponding change made by Gallaher to the price of its competing linked brands (and vice versa). For the same reason, ITL’s incentive to decrease its wholesale prices would have been significantly reduced as a result of its knowledge that Gallaher’s parity and differential requirements were very likely to result in it implementing a corresponding decrease in the competing Gallaher brands (and vice versa).

338 SO, paragraph 647.
ii The restrictive nature of a Manufacturer’s retail pricing strategy operating as a maximum differential requirement

A maximum differential requirement viewed in isolation

6.230 An example of a parity or differential requirement phrased as a maximum differential requirement is a requirement by manufacturer A for a retailer to price its brand X at a retail price no higher than that of a competing manufacturer’s brand Y, or at least z pence less than the retail price of brand Y.

6.231 As examined in Section 6.A.I.(c) above, the OFT considers that, when viewed in the context of the evidence as a whole in this case, the Manufacturer’s parity and differential requirements operated as parity or fixed differential requirements, rather than maximum differentials requirements. However, in view of the arguments of some of the Parties that the Manufacturers’ requirements were in fact maximum differential requirements and that these requirements were pro-competitive, the OFT considers that it is instructive to set out how a maximum differential requirement is, by its very nature, capable of restricting competition. See also Section 6.A.II: ‘The OFT’s response to arguments that the Infringing Agreements had a pro-competitive nature’.

6.232 As stated in the SO, a maximum differential requirement restricts the ability of a retailer to determine its resale prices. Specifically, the retailer is obliged to ensure that the difference in the retail price of two competing brands does not exceed a certain level (such that the retail price of brand X is not at a level which exceeds the relative price ceiling determined by the relevant differential requirement). Thus, in the example where the retail price of brand X must be no higher than that of brand Y, once the retailer has determined the price of brand X, it could in principle still choose to set the price of the competing brand Y at a higher level, but it is restricted in its freedom to set it at a lower level relative to brand X. If a retailer wants to increase the price of brand X and that brand’s retail price is at the relative price ceiling, it could only do so if it increased the price of brand Y at the same time. Conversely, if the retailer wanted to reduce the retail price of the competing manufacturer’s brand Y, and brand X was already at its price ceiling relative to brand Y, the retailer could only do so if it reduced the price of brand X at the same time. Therefore, a maximum differential requirement imposes as a corollary a minimum retail price on brand Y, relative to the retail price of brand X.

6.233 By analogy with the scenarios in Section 6.A.I.(d).i above, a maximum differential requirement is capable of giving rise to significantly increased
certainty that, when the retail price of brand X is priced at the relative price ceiling in relation to the retail price of brand Y, any increase in the retail price of brand X would be matched by a corresponding increase in the price of brand Y.

6.234 Therefore, a maximum differential requirement is capable of giving rise to an increased incentive on the part of manufacturer A to raise the wholesale price of its brand X, as it would be aware that once the retail price of its brand X is priced at the relative price ceiling in relation to the retail price of brand Y, any further increase in the retail price of brand X would result in at least a corresponding increase in the retail price of brand Y.

6.235 Conversely, manufacturer B would observe, over time, that on the occasions where it sought to instigate a reduction in the retail price of brand Y, for example by lowering its wholesale price or funding a temporary retail price promotion, the retailer would not price brand Y at a lower level than brand X, or within a particular differential in relation to brand X. Therefore, manufacturer B’s incentive to instigate a reduction in the retail price of its brand Y is capable of being significantly reduced by manufacturer A’s parity or differential requirement.

6.236 Equally, where manufacturer B had actual knowledge of manufacturer A’s parity and differential requirements, that would enable manufacturer B to predict with an even greater degree of certainty the response of its competitor manufacturer A (via the retailer) in relation to brand X to a reduction in the retail price of manufacturer B’s brand Y.

6.237 The long-term implementation of a maximum differential requirement would therefore reduce the incentives of each manufacturer to engage in inter-brand competition in relation to wholesale prices.

The consequences of symmetrical maximum differential requirements

6.238 As set out in Section 6.A.I.(b) above, both Manufacturers were party to a parallel and symmetrical Infringing Agreement with the same Retailer.

6.239 In a situation in which both manufacturers have parallel and symmetrical maximum differential requirements (for example, where manufacturer A requires that brand X must be priced no higher than brand Y, and manufacturer B requires that brand Y must be priced no higher than brand X), the combination of the two symmetrical requirements means that the retailer would price the competing linked brands at either a parity or at a fixed differential (as applicable) (see Section 6.A.I.(b)), thereby further
restricting the ability of the retailer in its ability independently to determine its retail prices for competing linked brands.

6.240 Symmetrical maximum differential requirements are therefore capable of distorting the incentives of each manufacturer to engage in inter-brand competition in relation to wholesale prices, in a similar way to parity or fixed differential requirements (see Section 6.A.I.(d).i above).

iii Response to arguments regarding maximum/recommended pricing

6.241 In their responses to the SO, ITL, the Co-operative Group, Morrisons, Safeway, and Shell submitted that the Manufacturer’s parity and differential requirements related to maximum suggested retail prices and therefore did not restrict the Retailer’s ability to determine its resale prices, as the Retailer could determine the actual level of retail prices for tobacco products.339

6.242 These Parties submitted, in particular, that the Manufacturer’s requirements/communications to the Retailer did not result in RPM regarding the Manufacturer’s products because:

- they did not result in the Manufacturer stipulating a fixed or minimum price in respect of the Retailer’s price for its products; and
- the Manufacturer stipulated recommended resale prices only and these did not amount to fixed or minimum resale price requirements in practice.340

6.243 In its written representations, the Co-operative Group submitted that it retained at all times an absolute discretion in relation to the level at which its prices should be set.341 Likewise, Morrisons and Safeway submitted that each had complete freedom to set its own retail prices, save that these retail prices could not exceed stated maxima without potentially jeopardizing their bonuses from the Manufacturer.342 ITL further submitted that there was no evidence that it withdrew ongoing bonuses as a result

339 ITL’s response to the SO, paragraphs 1.76 to 1.81. Morrisons’ response to the SO, paragraphs 244 and 245. Safeway’s response to the SO, paragraphs 242 and 243. The Co-operative Group’s response to the SO, paragraph 6.51 to 6.52. Shell’s response to the SO, paragraph 257.
340 ITL’s response to the SO, section 4.J. Morrisons’ response to the SO, section V.A. Safeway’s response to the SO, section V.A. The Co-operative Group’s response to the SO, paragraph 6.8 to 6.28. Shell’s response to the SO, paragraphs 111 to 122.
341 The Co-operative Group’s response to the SO, paragraph 5.101.
342 Morrisons’ response to the SO, paragraphs 324 and 413. Safeway’s response to the SO, paragraphs 324 and 404.
of a Retailer reducing its retail price, and that there was a 'constant round of one-off promotions (which would have thrown the differentials out of line)' which ITL submitted as demonstrating that there was no restriction upon Retailers reducing the price of its own or another Manufacturer’s brands.343

6.244 It was submitted that, on this basis, the Manufacturer’s parity and differential requirements did not constitute a 'hardcore' restriction of competition and did not have as their object the restriction of competition.344

6.245 First, it is clear from the nature of each of the Parties’ conduct as evidenced in this Decision, including the nature of the routine retail pricing communications between each Manufacturer and each Retailer, that the Infringing Agreements went considerably further than suggested or recommended retail pricing.

6.246 The OFT considers that viewed as a whole, the evidence demonstrates that the Retailer understood that it was to set its retail prices in accordance with the Manufacturer's parity and differential requirements.

6.247 The OFT considers that pursuant to each Infringing Agreement, the Manufacturer coordinated with the Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. Both the trading agreements and contacts between the Manufacturer and the Retailer demonstrate that the Retailer accepted and/or indicated its willingness to implement the Manufacturer’s parity and differential requirements. The Retailer did not set its retail prices independently from the Manufacturer, but with the Manufacturer’s active involvement in pursuit of the Manufacturer’s parity and differential requirements.

343 ITL’s response to the SO, for example at paragraph 4.782.
344 In this respect, some of the Parties referred to the Commission’s Guidelines on Vertical Restraints OJ 2000 C291/1 at paragraph 47 which states that 'the hardcore restriction set out in Article 4(a) of the Block Exemption Regulation concerns resale price maintenance (RPM), that is agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer’. The paragraph in question describes the hardcore restriction contained in article 4(a) of the Vertical Agreements Block Exemption (Commission Regulation (EC) No 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ 1999 L336/21).
6.248 Second, the OFT considers that in the present case the Manufacturer’s parity and differential requirements (whether operating as a fixed parity or differential requirement, or a maximum differential requirement) can be distinguished from a seller stipulating a maximum resale price, on the basis that parity and differential requirements involved linking the retail price of a particular brand to the price of a competing brand, whereas a maximum resale price instruction would stipulate a price ceiling in relation to one brand only.

6.249 In relation to ITL’s argument that it never withdrew an ongoing bonus in response to a Retailer initiating an own-initiative price cut on ITL’s brands or a competing brand (which would cause its parity and differential requirements to be out of line), the OFT notes that there are numerous examples of ITL paying or withdrawing tactical bonuses in order to ensure a parity or differential requirement was maintained or realigned (see Section 6.A.I.(a)iv above). In addition, ITL has not provided evidence to substantiate its claim that there were numerous one-off promotions on its brands during the period of the Infringing Agreements. The OFT notes that the analysis of retail price data for certain competing linked brands during the infringement period contained at Annex B indicates that promotions involving price reductions on these brands were rare.

6.250 Although under the Infringing Agreements, Retailers retained a discretion as to the absolute level at which paired brands were priced (for example, a parity requirement would not of itself prevent a retailer from choosing to price a Manufacturer’s brand and a competing brand each at £4.10 rather than £4.20, provided they were priced at the same level), the Infringing Agreements nonetheless constituted a restriction of the Retailer’s ability to determine its retail prices for the Manufacturer’s brands and those of competing linked brands to any extent that differed from the prescribed parity or differential.

6.251 The restrictive nature of the Infringing Agreements resulted from the link between the retail price of competing brands, as described in subsections (a) and (b) above: it is the fact that the requirement itself had created a link between the price of brand A and the price of the competing linked brand B that was capable of restricting competition.

6.252 By contrast, ceilings imposed by manufacturers on the maximum 'absolute' retail price that retailers can charge for brands (for example, an instruction that the resale price of a particular brand must be no more than £x) and which do not involve a link with the retail price of competing brands, are not generally regarded as being restrictive of competition and may result in enhanced inter-brand competition and consumer benefits, provided that those maximum prices do not actually amount to fixed or minimum prices in practice.
For example, an efficiency resulting from an absolute maximum pricing requirement is the manufacturer’s ability to limit the double-mark up problem. This is caused when a retailer with market power sets a retail price above the level that would be set otherwise, were the manufacturer and retailer integrated. As explained further in Section 7.I: ‘Exemption’, the Manufacturer’s parity and differential requirements did not limit the double mark-up problem since the Manufacturer’s requirement did not impose a limit on the absolute level of price and hence margin applied by the Retailer.

In response to the Parties’ submissions that the Infringing Agreements did not constitute RPM, the OFT would note that the Infringing Agreements shared a key element of RPM, to the extent that each Infringing Agreement restricted the ability of the buyer (in this case, the Retailer) to determine its retail prices. In the present case, such a restriction resulted from the linking of the retail price of one brand to the retail price of a competing brand. Moreover, it is instructive to note paragraph 47 of the Vertical Guidelines which specifically refers to ‘linking the prescribed resale prices to the resale price of competitors’ as an example of a so-called ‘hardcore’ restriction of competition.

(e) Legal and Economic Context in which the Infringing Agreements are assessed

As discussed above in Section 3: ‘Legal Background’, to determine whether an agreement or concerted practice has as its object the prevention, restriction or distortion of competition, its legal and economic context must be considered. This section summarises those aspects of the market context – which are dealt with in more detail in other parts of this Decision – that are relevant to the assessment of the Infringing Agreements.

In assessing the Infringing Agreements, a number of general market characteristics (including legal requirements) are relevant. In particular, the impact of the Infringing Agreements upon the relevant market must be considered with reference to the following observations, discussed further below, which relate to the market as it was during the period of the infringement:

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345 Commission Notice Guidelines on Vertical Restraints OJ 2000 C291/1 at paragraph 47.
a) the UK tobacco manufacturing markets were highly concentrated and in 2003 the two Manufacturers accounted for 90 per cent of cigarette sales (by volume);\textsuperscript{346}

b) the existence of a series of similar Infringing Agreements, involving both Manufacturers and the same Retailers, which related to a significant proportion of the tobacco market at both the manufacturing and retailer level;

c) advertising and promotion of tobacco brands was restricted by law,\textsuperscript{347} resulting in a so-called ‘dark market’, meaning that price competition was especially important;\textsuperscript{348}

d) the UK tax regime encouraged tobacco manufacturers to publish representative RRP\textsuperscript{s} and from 2001 manufacturers were required to set RRP\textsuperscript{s};\textsuperscript{349}

e) the fact that around 80 per cent of the retail price of tobacco brands was accounted for by tax meant that an apparently small increase in the retail price as a result of a tobacco manufacturer’s price increase represented a relatively large increase in the cost price charged by the manufacturer; \textsuperscript{350} and

f) tobacco brands were sold across a broad range of retail outlets characterised by various pricing strategies.\textsuperscript{351}

6.257 ITL and Gallaher together accounted for 90 per cent (by volume) of the UK cigarettes market in 2003 (see also Table 5.1 above). As the market leaders, both had significant brands in each major category of the relevant

\textsuperscript{346} The UK tobacco industry is discussed in more detail in Section 4: ‘Assessment of the relevant market’ and Section 5: ‘The UK tobacco industry’.

\textsuperscript{347} See the Tobacco Advertising and Promotion Act 2002, which was in force at the end of the period of the infringement. Prior to that Act, television and certain other forms of advertising were already restricted by law and limited voluntary codes of practice, although to a lesser extent than is now the case.

\textsuperscript{348} See also Section 5 above, ‘The UK Tobacco Industry’. ITL’s response to the SO, paragraphs 2.40 to 2.41. The Co-operative Group’s response to the SO, paragraphs 7.64 to 7.70. Morrisons response to the SO, paragraphs 210 to 217. Safeway’s response to the SO, paragraphs 208 to 215. See also ITL’s Explanatory Memorandum of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003, paragraphs 2.4 and 3.2 (Document 1, Annex 13), and Gallaher’s response of 17 March 2005 to the OFT’s section 26 notice of 27 January 2005, page 26, second paragraph of response to point 016 (Document 17, Annex 3).

\textsuperscript{349} See also section 5 above, ‘The UK Tobacco Industry’. ITL’s response to the SO, paragraphs 2.103. Morrisons response to the SO, paragraph 175. Safeway’s response to the SO, paragraph 175.

\textsuperscript{350} See also section 5 above: ‘The UK Tobacco Industry’.

\textsuperscript{351} See also section 5 above: ‘The UK Tobacco Industry’. See also ITL’s response to the SO, paragraphs 2.29 to 2.35.
markets and these brands were covered by the Infringing Agreements (see Section 6.B: 'The Manufacturer’s retail pricing strategy'). That meant that the majority of tobacco brands sold by the Retailers were affected by the Manufacturers' parity and differential requirements.

6.258 The tobacco market’s advertising restrictions meant that tobacco brands were denied one component of competition that is typically of great significance to consumer goods where brand image is important. The absence of this component of competition was likely to be of relevance to the 'stability' that may have arisen as a result of the Infringing Agreements. Where the components of competition are limited, strategies designed to co-ordinate prices are more likely to be sustainable. That makes it all the more important that the price competition that would ordinarily exist is not restricted by restrictive pricing arrangements such as those contained in the Infringing Agreements.

6.259 The tobacco tax regime also represented an important part of the context in which the Infringing Agreements operated. As outlined in Section 5: 'The UK tobacco industry', it was in tobacco manufacturers' interests to publish RRPs for each of their brands, as a failure to do so might be expected to result in a higher tax liability. In addition, from 1 June 2001 tobacco manufacturers were required to set RRPs. The RRPs therefore provided the Manufacturers with a means of observing the outcome of the pricing relativities required by one another.

6.260 Around 80 per cent of the retail price of tobacco brands was accounted for by taxes (see paragraphs 5.14-5.15 above). These taxes, with the exception of VAT charged at the retail level, were collected by the tobacco manufacturers and hence were reflected in the wholesale price paid by the retailers to the manufacturers. This meant that another consequence of the tax regime, specific to tobacco brands, was that an apparently small increase in the retail price as a result of a manufacturer’s price increase represented a relatively large increase in the cost price (wholesale price minus taxation) charged by the manufacturer. For example, for a brand with an RRP of £5, when the manufacturer increased its cost price by 10 pence and a retailer charging RRP passed that increase on to consumers in the form of an increase in the retail price to £5.12 (including VAT), that resulted in a retail price increase for the consumer of 2.4 per cent. However, assuming that the manufacturer’s cost price was £1 (that is, 20 per cent of the RRP of £5), its 10 pence cost price increase represented ten per cent of its cost price, a much greater percentage than the retail price increase to the consumer. Since tobacco products were, and continue to be, relatively price inelastic at the

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352 Regulation 15 of the Tobacco Products Regulations 2001 (SI 2001/1712).
industry level, meaning that a 1 per cent rise in the retail price will result in a fall in demand of significantly less than 1 per cent, this implies that there were strong incentives and rewards for Manufacturers to achieve industry-wide price increases, and strong disincentives for them to see industry-wide price decreases.353

6.261 When seen in the legal and economic context in which they operated, the Infringing Agreements were capable of distorting the incentives of the Manufacturers to engage in wholesale price competition. Further, given that the Manufacturers entered into Infringing Agreements with the Retailers and those agreements and/or concerted practices ensured in practice that the retail prices of competing linked brands would be set at either a parity or a fixed differential, the Manufacturers were able to maintain or achieve a degree of stability in relation to inter-brand competition which was similar to that which would have resulted from horizontal price co-ordination between competitors.

6.262 That is further demonstrated by communications from the Manufacturer to the Retailer where each Manufacturer appears to be concerned with preserving pricing 'stability', a situation akin to that in which manufacturers are party to collusion. For example, on 15 October 2002, when Sainsbury asked ITL if it would support it with a multi-buy promotion, ITL responded:354

‘I thought I should write to confirm my support for a multi-buy promotion. … My only two caveats are that other manufacturers should be aware that we are not doing this to subvert their position, but to support you; and that we should not be disadvantaged by a competing offer.’

6.263 Similarly, on 14 February 2003, Gallaher pointed out to T&S Stores that it was charging a lower price for Gallaher’s brand than it should have been relative to ITL’s competing brand:355

‘Just to point out that the RRP on OH [Old Holborn, Gallaher’s brand] is 4p above GV [Golden Virginia, ITL’s brand], and on 25p is 6p above. Your price files show the same pricing, which is good for us, but not for you or ITL!! All we are after is Price List parity (i.e. same price differential). I’m surprised ITL hasn’t picked this up.’

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353 In the RBB report for ITL at paragraphs 35 and 36, RBB cited research that put the overall demand elasticity of tobacco products at between minus 0.4 and minus 0.9 based on retail prices (including tax). From that it calculated that the degree of price elasticity facing manufacturers was even lower, between minus 0.15 and minus 0.27. That meant, it submitted, that a 1 per cent rise in manufacturers' cost price, not including tax, would result in a fall in sales of between only 0.15 and 0.27 per cent.


In their response to the SO, ITL, the Cooperative Group, Morrisons, and Safeway submitted that the OFT’s analysis of the relevant context failed to take into account the low likelihood that retailers would themselves have initiated price reductions for tobacco products. As a result, they submitted that it was a feature of the tobacco sector that Retailers’ prices were generally reduced by the Manufacturer’s bonuses. ITL pointed to the thin margins available to retailers on tobacco products, a reluctance on health and reputation grounds to be seen to promote tobacco products, and the limited scope to engage in promotions due to advertising restrictions as reasons why retailers were unlikely to initiate and fund price reductions on tobacco products. Morrisons and Safeway submitted that thin margins on tobacco products resulted from heavy taxation and the intense competition between retailers. They submitted that bonuses paid by manufacturers were a ‘key parameter for negotiations between manufacturers and retailers’. 

ITL, Morrisons and Safeway also pointed to the significance of the obligation on Manufacturers to publish RRPs under the tax regime. In its response to the SO, ITL stated that this obligation created a legitimate interest in the Manufacturer understanding retailers’ pricing strategies given that, when setting the RRP, the Manufacturer needed to be confident that it broadly reflected actual selling prices on the market.

The OFT does not accept these submissions. First, where retail margins are expressed as a percentage of the retail sale price, they will seem low for tobacco products in comparison to other retail products because of the large element of tax in the retail price of tobacco products. That does not however mean that retail sales of tobacco products had low profitability for retailers. Second, a full analysis of retail margins on tobacco products would need to be on the basis of the net wholesale price paid by the Retailer which would include all ongoing and tactical bonuses. As the analysis by Morrisons and Safeway shows, there can be a significant difference between the gross wholesale price (excluding bonuses) and the net wholesale price (including ongoing bonuses). Furthermore, given
that Morrisons, Safeway and the Co-operative Group all highlighted in their representations the strength of competition between retailers for tobacco products,\textsuperscript{362} it is not clear that Manufacturer bonuses were necessary to induce the Retailers to lower their retail prices.

6.267 Furthermore, the Manufacturers elected to subsidise indirectly the margins earned by Retailers through ongoing and tactical bonuses, rather than simply directly lower their gross wholesale prices to Retailers by an equivalent amount. That was, in the OFT’s view, a matter of choice on the Manufacturer’s part, rather than an inherent feature of the tobacco sector. The advantage of a system of bonuses from the Manufacturer’s viewpoint was that it enabled the Manufacturers to micromanage retail prices and, in particular, to ensure that its parity and differential requirements were implemented.

6.268 Moreover, even if there was a reluctance on the part of Retailers to initiate reductions in the retail prices of tobacco products, such a situation would not justify the Infringing Agreements under which each Manufacturer co-ordinated with each Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. As noted in Section 6.A.I.(d).iii, price promotions could have been achieved by the Manufacturer stipulating absolute maximum prices.

6.269 In relation to the requirement that the RRPs published by Manufacturers broadly reflected the actual selling prices on the market, the OFT does not dispute that such a stipulation may have required a degree of knowledge and understanding of the retail selling prices by the Manufacturers. However, the OFT does not consider that an obligation on a Manufacturer to publish RRPs would require the Manufacturer’s active involvement in the setting of the Retailer’s retail prices in order to achieve its parity and differential requirements regarding competing linked brands, which occurred under the Infringing Agreements.

\textsuperscript{362} Morrisons’ response to the SO, paragraph 199(b). Safeway’s response to the SO, paragraph 199(b). The Co-operative Group’s response to the SO, paragraph 3.18. ITL also noted that large multiples and supermarkets were competitive with each other on the price of tobacco products. Report by RBB Economics for ITL, paragraphs 52 and 53.
II The OFT’s response to arguments that the Infringing Agreements had a pro-competitive nature

6.270 In its response to the SO, ITL submitted that the Manufacturer’s parity and differential requirements had a pro-competitive objective, that was to ensure that competing tobacco brands were priced competitively against the rival Manufacturer’s brands within each Retailer’s premises, and therefore to facilitate inter-brand competition.\(^{363}\) The Co-operative Group also submitted that parity and differential requirements were pro-competitive.\(^{364}\) Morrisons and Safeway submitted that the bonuses paid in support of the Manufacturer’s strategy, seen in the context of the industry, were also pro-competitive.\(^{365}\) Shell submitted that the parity and differential arrangements had a pro-competitive object in seeking to ensure that competing tobacco product brands remained within a certain competitive range of each other.\(^{366}\)

6.271 The key arguments made by these Parties in this connection can be summarised as follows:

(a) The objective of the parity and differential requirements was to ensure that retailers passed on the benefit of bonuses and wholesale price reductions to consumers given that the context was that retailers had little incentive to pass on the benefit of such bonuses in the form of lower shelf prices, or where they were prone to ‘premium price’ certain brands. Parity and differential requirements enabled Manufacturers to achieve lower retail prices in order to compete better with rival brands. In that way, the Infringing Agreements incentivised Retailers to pass on wholesale price discounts to consumers, and thus promoted inter-brand competition between Manufacturers within the Retailer’s premises.\(^{367}\)

(b) The Infringing Agreements afforded the Manufacturer the opportunity to respond to competitors’ pricing promotions, thereby stimulating inter-brand competition.\(^{368}\)

(c) The parity and differential requirements were maximum differential requirements, and the communications between the Manufacturer and

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\(^{363}\) ITL’s response to the SO, paragraph 1.27 to 1.38.

\(^{364}\) The Co-operative Group’s response to the SO, paragraph 6.67.

\(^{365}\) Morrisons’ response to the SO, paragraphs 218 to 219. Safeway’s response to the SO, paragraphs 216 to 217.

\(^{366}\) Shell’s response to the SO, paragraphs 123-124.

\(^{367}\) ITL’s response to the SO, paragraphs 2.116 to 2.138.

\(^{368}\) ITL’s response to the SO, paragraph 1.37. Morrisons response to the SO, paragraph 329(b).
the Retailer specified maximum prices. See references to Parties’ responses to the SO in this regard in Section 6.A.I.(a) above.

6.272 In relation to paragraph 6.271(a) above, ITL submitted that the parity and differential requirements were introduced in the mid 1990s, with the objective of countering a situation in which retailers would price certain ITL brands above competing Gallaher brands despite, it was submitted, the ITL brands having had lower wholesale prices and RRP s than the competing Gallaher brands.\(^{369}\) It contended that the introduction of parity and differential requirements was therefore designed to ‘win sales from competing manufacturers of brands in a proactive attempt to build ITL’s market share.’\(^{370}\) ITL further submitted that the strategy was first developed to promote its Embassy No1 brand, which despite having an RRP of 1p less than Gallaher’s competing Benson & Hedges brand, and being offered to retailers at a wholesale price which ITL considered to be less than Benson & Hedges, was nevertheless set at the same retail price as Benson & Hedges by retailers.

6.273 ITL did not adduce evidence to support its argument regarding the extent of the competitive disadvantage that it faced in relation to the pricing practices of retailers at the time, nor did it specify (other than \([C]\)) the brands which it perceived were being priced at a competitive disadvantage to competing Gallaher brands. Moreover, the OFT notes that none of the contemporaneous documentary evidence that ITL has cited in its representations under a heading entitled ‘Competitive context of the tobacco market prior to 1999’ indicates that ITL perceived that it was being placed at a competitive disadvantage as a result of retailer pricing practices.\(^{371}\)

6.274 As set out above, the OFT considers that there is unlikely to be an infringement of the Chapter I Prohibition where a manufacturer provides support to a retailer who agrees to sell the manufacturer’s brand up to an agreed maximum price that is not linked to the price of a competing brand. However, in the present case the Infringing Agreements went well beyond what was necessary for the Manufacturers to ensure that ‘competitive’ discounts would be properly passed on to consumers and focused instead on ensuring that the retail prices for competing linked brands were within the Manufacturer’s prescribed parities and differentials. The Infringing Agreements restricted each Retailer’s ability to

\(^{369}\) First Witness Statement of Geoff Good, August 2008, submitted as part of ITL’s response to the SO.

\(^{370}\) First Witness Statement of Geoff Good, August 2008, paragraph 5.

\(^{371}\) ITL’s response to the SO, paragraph 2.221.
determine its retail prices for competing linked brands on an ongoing basis.

6.275 In that context, it is particularly difficult to reconcile an argument that the Infringing Agreements had a pro-competitive object with the frequent examples of an instruction and/or request by a Manufacturer for a Retailer to increase a retail price (either in relation to the retail price of the Manufacturer’s own brand or the brand of a competing Manufacturer), as referred to, by way of example, in paragraphs 6.56-6.60, 6.94-6.98, 6.124, 6.127 and 6.149 and as further set out in Section 6.C.I-X.

6.276 Furthermore, the argument that the Infringing Agreements were pro-competitive is also inconsistent with the fact that each Manufacturer had parallel and symmetrical parity and differential requirements with a Retailer (and that situation was replicated across a number of Retailers), which enabled the Manufacturers to maintain or achieve a degree of stability in relation to inter-brand competition within a Retailer’s premises which was similar to that which would have resulted from horizontal price co-ordination between competitors.

6.277 In response to the argument at paragraph 6.271(b) above, the OFT considers that even if the Infringing Agreements did on some occasions facilitate a price reduction by one Manufacturer in response to a retail price reduction instigated by another Manufacturer, the long term implementation of the parity and differential requirements was capable of restricting inter-brand competition and does not negate the anti-competitive object of the Infringing Agreements. In addition, the OFT considers that there are less restrictive means for the Manufacturers to have ensured that wholesale price reductions or promotional funding were passed on to customers by a retailer, which do not entail parity and differential requirements. This issue is considered further in Section 7.I: 'Exemption'.

6.278 In response to the argument at paragraph 6.271(c) above, and as explained in more detail at Section 6.A.I.(c) above, the OFT considers that the Infringing Agreements operated as a parity or a fixed differential requirement between competing linked brands, not a maximum differential requirement.

6.279 Moreover, even if one accepted the argument at paragraph 6.271(c) above, the OFT considers that a maximum differential requirement would have as its object the restriction of competition. As explained in Section 6.A.I.(d),ii. above, the long-term implementation of a maximum differential requirement would reduce the incentives of competing manufacturers to engage in inter-brand competition in relation to wholesale prices.
Moreover, given that the Manufacturers’ parity and differential requirements were implemented in respect of many of the same brands and with the same Retailers over a long period, it cannot be the case that the Manufacturers were competing with one another to persuade Retailers to favour a Manufacturer’s brand(s) over those of the other Manufacturer.

In their responses to the SO, ITL and the Co-operative Group also presented pricing and margin evidence as a ‘counterfactual analysis’ which they submitted was not consistent with the Infringing Agreements leading to a restriction of competition, and/or demonstrated that the Infringing Agreements had pro-competitive effects. That evidence consisted of the following:

- Graphs showing retail price increases implemented by Asda for certain tobacco brands. The graphs show weekly Asda national selling prices (excluding increases in excise duty, ad valorem tax and VAT) for certain brands during the infringement period, and compare those with weekly Asda national selling prices for the same brands for an equivalent period of time commencing at the end of the infringement period (‘ITL’s counterfactual period’). ITL claimed that this data showed that retail prices rose by a smaller percentage during the period of the Infringing Agreement between ITL and Asda than they did during ITL’s counterfactual period.

- Graphs showing an inflation adjusted monthly index of ITL’s list prices (Q5 selling prices) for Richmond KS 20, L&B KS 20 and Embassy No1 20 excluding excise duty and ad valorem duty. The graphs compared the rise in the index during the infringement period with the rise during ITL’s counterfactual period. ITL claimed that, in the case of Richmond, the list price rose by less during the infringement period than during ITL’s counterfactual period, and submitted that this was evidence that the pricing differential schedules were pro-competitive.

- A graph showing an index of ITL’s manufacturer list price (inflation adjusted) calculated by applying a weighted average of the list prices of Embassy, Regal, Superkings, L&B and Richmond between

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372 Figures 11, 12, 13 and 14 in the Report by RBB Economics for ITL, pages 53 to 56. The brands are: Richmond and Dorchester KS, Lambert and Butler and Sovereign KS, Superkings and Berkeley Superkings, and Embassy No1 and Benson and Hedges Gold.

373 ITL did not specify the dates it had taken for the two periods, although it would appear that it took the period 1 March 2000 to 31 August 2003 as the infringement period. An equivalent duration (182 weeks) starting on 1 September 2003 would last until 2 March 2007 (ITL’s counterfactual period).

374 Figures 15, 16 and 17 in the Report by RBB Economics for ITL, pages 58 to 61.
January 2000 to December 2007. ITL claimed that this demonstrated that there was very little real inflation in ITL’s list prices during the infringement period, whereas list price increases were substantially greater during ITL’s counterfactual period which followed.  

- A graph showing the Co-operative Group’s margin on tobacco brands showing that its margins had [C] since the end of the infringement period, and a graph submitted by the Co-operative Group but derived from the Manufacturer’s annual reports, showing ITL’s and Gallaher’s operating margins on tobacco for their UK sales and for their European sales. The Co-operative Group claimed that the latter graph demonstrated that the Manufacturer’s operating margins continued to increase from the end of the infringement period.

6.282 ITL also submitted that the evidence of the pro-competitive nature of the Infringing Agreements ‘is supported by the fact that ITL gained significant market share during the [infringement] period’.  

6.283 The OFT considers that the submissions made as to the alleged pro-competitive nature of the Infringing Agreements do not undermine or negate the OFT’s finding as to their anti-competitive object in law. In any event, arguments about pro-competitive effects fall to be addressed in relation to the issue of exemption (see Section 7.1. ‘Exemption’).

6.284 Moreover, it is not clear that the counterfactual analysis presented by ITL and the Co-operative Group demonstrates that prices increased following the period of the Infringing Agreements or indeed that any increase that may have taken place was attributable solely to the move from a period of infringement to a period of ‘no infringement’. In that regard, the OFT would make a number of observations in relation to the pricing and margin evidence adduced.

6.285 First, some of the graphs presented by ITL seem to be selective in their choice of price data. For example, it is not clear why ITL has chosen to present only Asda’s retail prices for its comparisons of retail price trends during and following the infringement period. From the data it appears that Asda had a significant price increase across all of its tobacco brands right at the end of ITL’s counterfactual period that could distort any comparison of price trends over the two periods.

6.286 Second, the graph showing an index of ITL’s monthly list price for its Richmond brand during the infringement period will have been affected by

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376 ITL’s response to the SO, paragraph 4.677(c).
ITL’s decision to reposition its Richmond brand in September 2000 to a new lower price point in the value and economy segment of the market which will distort any comparison of list price increases over the two periods. Similarly, ITL’s graph comparing the rise in a weighted average of ITL’s list prices during the infringement period with the rise during ITL’s counterfactual period is likely to have been distorted by the rapid growth of the economy and value segments of the cigarette market during the infringement period and the decision to reposition the Richmond brand. These factors, neither of which provide evidence of the pro-competitive effects of the Infringing Agreements, are likely to have pushed down the weighted average of list prices during the infringement period.

6.287 In addition, it is not clear how, and to what extent, ITL and the Co-operative Group attribute any differences in pricing and margin trends across the two periods to a pro-competitive effect arising from the Infringing Agreements. Differences in pricing and margin trends across the two periods may have arisen for a variety of factors including differences in cost trends. Restrictions on the advertising of tobacco products, which entered into force towards the end of the infringement period, may also have had an impact on price trends across the two periods.

6.288 Furthermore, although the OFT has elected to take 15 August 2003 as the cut-off point for the period of infringement, it is quite possible that the expectations generated by the Infringing Agreements would have persisted beyond that date and would have had an impact on retail pricing. In that respect, the period immediately following the end of the infringement period may not provide a robust counterfactual for assessing how prices and margins would evolve in the absence of the Infringing Agreements.

6.289 Finally, in relation to ITL’s argument that shifts in market share in ITL’s favour during the infringement period demonstrate vigorous inter-brand price competition, ITL submitted market share data showing that its share of all segments rose from 38 per cent in 1999 to 44 per cent in 2003, while the share of Gallaher remained roughly constant over the same period. To the extent that this evidence shows that ITL won market share from manufacturers other than Gallaher during the infringement period, the OFT does not consider that demonstrates a pro-competitive effect of the Infringing Agreements which linked ITL and Gallaher brands. Equally, the OFT does not consider that ITL’s increase in market share is necessarily evidence of a strategy of vigorous inter-brand price competition by ITL during the infringement period. Other factors, such as

377 ITL’s response to the SO, paragraph 1.26.
378 ITL’s response to the SO, paragraph 2.16 and figure 2.1.
the structural shift in demand to the lower priced segments of the market (where ITL was comparatively strong and where it repositioned its Richmond brand) as a result of tax increases may explain ITL’s market share performance. In addition, the OFT notes that the market shares of Gallaher and ITL were broadly static during the mid to late 1990s, when ITL stated that its parity and differential strategy was introduced (as noted in paragraph 6.272 above).380

III  The Retailer’s adherence to the Manufacturers’ retail pricing strategies

6.290 As noted in Section 3: ‘Legal Background’, for the purposes of establishing an infringement of the Chapter I Prohibition, it is not necessary for the OFT to demonstrate that the Infringing Agreements had any anti-competitive effects on the market. Nonetheless and although it is not necessary to do so in order to prove that the Infringing Agreements had an anti-competitive object, the OFT has set out in Annex B below the available evidence regarding Retailers’ adherence to the Manufacturers’ retail pricing strategies, as it is noteworthy that such adherence is generally consistent with the existence and nature of the Infringing Agreements found by the OFT.

6.291 In the course of its investigation, the OFT received pricing data from Retailers covering a number of the linked brands. The OFT undertook a limited analysis of this pricing data. Specifically, the OFT considered the pricing trends for those linked brands between which both Manufacturers sought pricing parity. That enabled the analysis to focus on a consistent

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379 The OFT notes that excluding the value and economy segments, ITL’s market share increased from 48.6 per cent to 49.2 per cent over the infringement period. ITL’s supplementary response to the SO, Annex 1B.
380 ITL’s response to the SO, figure 2.1, page 45.
382 The OFT sent a section 26 Notice to Retailers on 28 January 2005 requesting inter alia that they provide the daily price for a list of brands between the dates 1 March 2000 and 31 August 2003. A number of Retailers were not able to provide pricing data for all of the brands and/or for all of the period requested. Some Retailers provided pricing data for a shorter period between the two dates specified. The dates for which the OFT had data are specified in the table at Annex B. The OFT did not receive data for Safeway, Shell, or T&S Stores. First Quench supplied pricing data for certain individual stores. However, the OFT did not consider that there was a basis on which to compare these with data from the other Retailers.
383 The OFT selected the linked brands set out in Annex B by identifying which brands were ‘paired’ or linked by both Manufacturers, as set out in the written trading agreements of Retailers who agreed written parity and differential requirements with each Manufacturer. The OFT considers that other Retailers which did not have written
and straightforward parity requirement, and avoided the need for the analysis to identify precisely when, for each Retailer, a requirement may have changed. In addition, the OFT considers that absent the Infringing Agreements, price competition would otherwise have been at its most intense between brands in respect of which the Manufacturers sought parity pricing under the Infringing Agreements.

6.292 The relevant competing linked brands in respect of which both Manufacturers sought price parity are Richmond and Dorchester; Berkeley and Superkings; Café Crème and Hamlet Miniatures; Hamlet and Classics; and Golden Virginia and Old Holborn.

6.293 Annex B sets out the OFT’s calculation of:

- The percentage of days during the period for which the Retailer supplied data on which the Retailer was pricing the relevant linked brands at parity. The evidence at Annex B shows that this percentage was usually high or very high; and
- The number of retail price increases and price decreases for either of the relevant linked brands that occurred for that Retailer during the period for which they were able to supply data. The evidence shows that there were numerous price increases and very few price decreases for the cigarette and cigar brands.

6.294 It is important to stress that the OFT is not relying on this evidence to demonstrate the effect of the Infringing Agreements on retail prices. The OFT also acknowledges that the evidence is not presented by reference to a relevant counterfactual for the period that could be used to compare it with the Retailers’ pricing behaviour in the absence of the Infringing Agreements. Instead, the OFT simply notes that the evidence is consistent with: (i) the existence and nature of the Infringing Agreements found by the OFT; and (ii) the restrictive nature of the Infringing Agreements insofar as it shows that the retail prices for the relevant competing linked brands regularly increased, but rarely decreased, during the periods of analysis.

6.295 The OFT also notes, by way of a cross-check on its analysis of the restrictive nature of the Infringing Agreements, that the data does not demonstrate that the linked brands were regularly the subject of price trading agreements with both Manufacturers also agreed similar requirements with both Manufacturers on the basis that the same brand pairings were frequently referred to in correspondence between the Manufacturer and the Retailer.

384 Only price changes that were sustained for a significant period were recorded as price increases or decreases. Where price changes returned to their previous level within a matter of days, they were assumed to have been made in error.

385 This point is made in the Report by RBB Economics for ITL, paragraphs 102 to 106.
promotions. Indeed, as noted above, reductions in the price of any of the brands analysed were rare during the periods for which the OFT had data, whereas there were frequent price increases.386

386 The same conclusion can be drawn from retail price data contained in charts 1 and 4 in the Report by Chris Decker and George Yarrow for Morrisons and Safeway. Figures 11, 12, 13 and 14 in the Report by RBB Economics for ITL, pages 53 to 56, also show that Asda’s pricing of certain competing linked brands exhibited a degree of parallelism consistent with adherence to parity and differential requirements. These figures also show a preponderance of price increases on the brands compared to price decreases. However, a few temporary price reductions are evident in these graphs due to the fact that they show Asda’s retail prices excluding excise duty and ad valorem tax. It is therefore possible that on occasions where these taxes have risen, but there has been a short delay in the corresponding rise in retail price, that this shows up in the graph as a temporary price reduction even though retail prices have not in fact been reduced.
B MANUFACTURERS’ RETAIL PRICING STRATEGIES

6.296 This section examines the nature of the trading relationship between each of ITL and Gallaher on the one hand and the Retailers on the other, and the retail pricing strategies adopted by the Manufacturers in relation to the pricing of their tobacco products by Retailers. The section analyses the situation as it existed during the period of the infringements that are the subject of this Decision.

I ITL

(a) Supply and distribution

6.297 ITL is a leading British tobacco company and manufactures and sells a range of tobacco and tobacco-related products through different retail distribution channels. ITL’s sales and distribution in the UK focused upon four principal types of accounts:387

- National accounts: national multiple retailers and wholesalers;
- Regional/key accounts: sizeable accounts;
- Direct independent accounts: small independent retailers; and
- Other accounts: other independent retailers throughout the UK who purchased their stock through third parties such as buying groups, ‘cash and carry’ wholesalers or other wholesale operators.

6.298 This Decision concerns only national accounts.

6.299 National accounts were administered by a National Account Controller (‘NAC’) and a National Accounts Operations Manager (‘NAOM’). National Account Managers (‘NAMs’) reported to the NAC, whilst National Account Executives (‘NAEs’) reported to various NAMs.388 As in the case of Gallaher, many of the major multiple retailers, for example Sainsbury, purchased their supplies of tobacco and tobacco-related products through independent wholesalers such as P&H. Invariably in such relationships, the wholesaler was responsible for receiving the order from the retailer, picking and delivering the product, as well as invoicing and ultimately receiving payment from the retailer. The price at which a wholesaler purchased a product from ITL was determined by the ITL Standard Price

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387 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraphs 1.8-1.12)).
388 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraphs 1.5-1.6, 1.8)).
List (see paragraph 6.300 below). The price at which the wholesaler sold the product to the retailer was negotiated independently between it and the retailer. Other multiple retailers, including Morrisons, Safeway and Somerfield, ordered directly from ITL, in which case ITL delivered the product directly to the retailers’ regional distribution centres, usually using a third party haulier.

6.300 All of ITL’s customers were required to purchase cigarettes, tobacco and tobacco-related products from ITL at the ex-manufacturer price specified in ITL’s Standard Price List (‘the ITL Standard Price List’); this price was known as the ‘Gross Cost Price’. The ITL Standard Price List, which was published at every MPI and Budget (i.e. two to three times per year), set out ITL’s RRP for its products inclusive of VAT. It also set out a series of ex-manufacturer prices per ’outer’ of product, which varied according to the volume purchased (known as the 'Q prices' or 'Prompt Settlement Prices’). An ‘outer’ referred to the packaging in which individual products were sold (for example, an outer would usually contain 200 cigarettes in individual packs of 10 or 20 cigarettes).

6.301 Specific additional discounts from the ex-manufacturer price, in the form of bonus payments paid by ITL to the customer in respect of each unit of product sold (known as a 'stock keeping unit' or 'SKU’), could be negotiated directly by customers with ITL (see ‘Bonuses paid to Retailers by ITL’, below). Bonuses applicable to a Retailer were generally agreed directly between the ITL NAM or NAE and the relevant Retailer’s national category buyer. ITL stated that these bonuses were generally conditional upon ITL’s parity and differential provisions being observed by the Retailer (see Section 6.B.I.(c) below).

(b) Bonuses paid to Retailers by ITL

6.302 As stated at paragraph 6.301 above, specific discounts in the form of bonus payments paid by ITL to the customer, could be negotiated from the ex-manufacturer price. ITL informed the OFT that it operated two formalised price support bonus schemes – ‘Standard Dealing’ and

389 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.3)). ITL’s response dated 15 August 2008 to the SO (paragraphs 2.85 to 2.87).
390 ITL presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraphs 4.1-4.6 of ITL script and accompanying slide no. 48).
391 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraphs 4.3-4.8)). ITL’s response dated 15 August 2008 to the SO (paragraph 2.86).
392 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.8)).
ITL submitted that the purpose of these payments was to fund lower on-shelf retail prices in the Retailer’s premises, to ensure that its products were priced competitively when compared with other competing manufacturers’ products.  

ITL informed the OFT that the policy of shelf-price support in the form of retrospective bonus payments to retailers was part of industry custom and practice and had evolved since the mid 1970s.

ITL informed the OFT that the policy of shelf-price support in the form of retrospective bonus payments to retailers was part of industry custom and practice and had evolved since the mid 1970s. Standard Dealing support was available to any UK retailer and, according to ITL, was on the understanding that the bonus payment made to the retailer was passed on to the consumer in the form of a shelf price reduction of at least the same amount below the RRP. As stated above, the payment of these bonuses was also conditional on the Retailer observing ITL’s parity and differential requirements. Standard Dealing support was available on certain brands up to £C per outer (Cigarettes) and other brands up to £C per outer (200 cigarettes). ITL has informed the OFT that retailers that applied premium pricing in certain outlets (selling above RRP) did not generally receive this bonus. Similarly, retailers that operated a system of different price tiers in respect of on-shelf retail prices in their various outlets might only receive this bonus for the part of their volume sold at a discount to RRP. However, certain Retailers received additional bonus payments in order to respond to promotions by other manufacturers and for observance of parity and differential requirements (see Section 6.B.I.(c) below). Evidence relating to the payment of such bonuses by ITL to the Retailer (referred to as 'ongoing' bonuses in this Decision) is set out in Section 6.A.I.(a).iv and Section 6.C.I-X.

Tactical Dealing support was a form of additional temporary margin support available to UK retailers and were generally directly linked to a specific absolute price level for a specified period of time. Tactical Dealing

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394 ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 2.2 of ITL script)).
395 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.9)).
396 Although the Retailers retained the ability to choose, for example, to be a 'premium' or 'discount' retailer of tobacco products, or to adopt price tiers, the Infringing Agreements nevertheless restricted the Retailer’s ability, within that context, to set retail prices independently from the Manufacturer.
397 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraphs 4.10-4.14)).
support was available on certain brands up to \([C]\)p per outer (200 cigarettes) and on other brands at up to \([C]\)p per outer (200 cigarettes). 398

6.306  Further, ITL also offered other additional short-term bonus payments in addition to or instead of Standard Dealing and Tactical Dealing payments to support particular price initiatives, such as price marked packs or as part of an introductory offer to launch a new product onto the market. 399  Price marked packs could be marked at specific price points below RRP and also below the Retailer’s normal selling price. The retailer was, according to ITL, at all times free to sell the price marked product for a price lower than that indicated. 400  These additional short-term bonus payments, referred to in the previous paragraph, would be on top of or instead of the Standard Dealing and Tactical Dealing support and were negotiated individually by ITL account managers and retailers. 401  ITL informed the OFT that these promotional payments related to retailers charging prices below RRP, and were not generally available to retailers charging premium prices. 402

6.307  According to ITL, when any bonus payment was likely to be withdrawn, ITL might suggest to the retailer that it returned to its ‘natural’ or ‘normal’ prices for the product - usually the pre-initiative price – so that the retailer’s margin was not reduced. 403

6.308  The OFT considers that tactical bonuses were paid or withdrawn in order to maintain or realign ITL’s parity and differential requirements. Evidence relating to the payment of tactical bonuses by ITL to the Retailer is set out in Section 6.A.I.(a).iv and Section 6.C.I-X.

6.309  The link that margin support bonuses had to ITL’s parity and differential pricing strategy (described below in Section 6.C.I.(c)) is highlighted, for

398 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.14)).
399 ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 2.11 of ITL script)) and ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraphs 4.15-4.16)).
400 ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 3.4 of ITL script)).
401 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.15)) and ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 3.1-3.6 of ITL script and accompanying slide nos. 43, 44 and 46)).
402 ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 3.5 of ITL script)).
403 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.16)).

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example, in the trading agreement for the period 1 April 2002 to 31 March 2003 between ITL and Sainsbury which stated:  

`SSL accept that ITL make investments in their brands based on two fundamental criteria: shelf price relativities and the absolute levels of those shelf prices.

ITL’s pricing strategy is to replicate the differentials that exist naturally between our brands and those of our competitors.

Based on SSL’s current shelf prices and the achievement of the Price List Differentials detailed in appendix 5, ITL will continue to pay those bonuses framed in the example price file in appendix 3.

These investments comprise of two elements: 'on-going' and 'tactical' bonuses; both of which will be paid retrospectively.

On-going bonuses will be paid, based on SSL’s shelf prices remaining at their current levels and should be reduced in line with any upward movements (excluding MPI or budget increases); 'tactical' bonuses are paid to reflect additional investment, usually in response to temporary or sustained competitor activity, and should also be reduced once that activity has ended."

(c) ITL’s retail pricing strategy – parity and differential requirements

6.310 According to ITL, the policy of adopting price parity and differential requirements relative to competing manufacturers’ brands was introduced in the mid 1990s. ITL stated that the reason for the introduction of these requirements was that retailers frequently sold ITL’s brands at a higher retail price than, or at the same retail price as, Gallaher’s competing brands despite the ITL brands having a lower RRP and being offered to retailers at a lower cost price than the competing Gallaher brands. Starting with its Embassy brand, which was benchmarked against Gallaher’s Benson and Hedges brand, ITL informed the OFT that it decided, from then on, to benchmark the retail prices of its brands against certain competitor brands to ensure that lower RRPs and lower cost prices for its brands were reflected in lower retail prices.

6.311 In order to determine its parity and differential requirements, ITL benchmarked its brands with a brand of a competing manufacturer in the

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406 Although these clauses were later removed from the final version of the trading agreement (see Section 6.A.C.IV.(a) below), the OFT considers that the clauses provide a good description of the link between the use of bonuses and ITL’s pricing parity and differential strategy.

406 ITL’s response dated 15 August 2008 to the SO (paragraph 2.116).
relevant price segment of the market (for example, premium, mid-price, VFM brands). Therefore, the parity and differential requirements would generally link the price of an ITL premium brand with the price of a competing premium brand and the price of a VFM brand with the price of a competing VFM brand. Within each brand pair, competing brands were then also paired in terms of equivalent pack sizes (for example, 20s, 100s, 200s for cigarettes, or 12.5g, 25g and 50g for RYO brands), equivalent cigarette sizes (for example, King Size, Superkings) or equivalent strengths (for example Lights, Mild). Thus, for example, within the Embassy brand, the ITL product Embassy No 1 King Size 20s was paired with the Gallaher product Benson and Hedges King Size 20s. ITL brands were typically linked with the leading competing brands in the relevant price sector, and these were generally Gallaher brands.

6.312 Examples of ITL’s parity and differential requirements were contained in a number of ITL’s agreements with Retailers, and also in the ‘ITL Strategy Pricing Requirements’ documents which were sent periodically to Retailers (for example, following an MPI when the differentials between RRPs of competing linked brands had varied). Such documents typically required that ITL’s products were ‘at least [x]p less expensive than’, or ‘not more than [xp] more expensive than’, or ‘no more expensive than’ the competing linked brand. The OFT considers how the trading agreements operated in practice at Section 6.A.I.(a) above.

6.313 ITL’s parity and differential requirements in respect of these competing, linked brands were based on the difference between the RRP of the competing product and the RRP of the ITL product. Where there was a difference between the respective RRPs, this was known as a price differential, and when the RRPs were the same, this was known as a ‘parity’.

6.314 In respect of the Philip Morris and Henri Wintermans brands, ITL was notified of the RRP, and any MPIs affecting the RRP, by the manufacturer,

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407 ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 5.3 of ITL script)).
408 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.34)).
410 ITL’s covering submission of 24 October 2003 (Document 1, Annex 13, paragraph 4.34) in response to the OFT’s section 26 Notice of 15 August 2003. ITL’s response to the SO, paragraph 2.124.
and the parity and differential requirements were calculated by comparing these RRPs with the current RRPs for the benchmark brands.\footnote{ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.40)).}

6.315 The following table sets out an illustrative list of the competing brands of Gallaher that were frequently linked by ITL.\footnote{A list of the competing brands that were frequently linked by Gallaher is set out in Table 6.2.} This table was submitted to the OFT as part of ITL’s response of 24 October 2003 to the OFT’s section 26 Notice of 15 August 2003,\footnote{ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.39 and table 7)).} and many of these brands are referred to in ITL’s trading agreements with Retailers, contacts with Retailers regarding the Retailer’s retail prices, and strategy documents.

**Table 6.1: Illustrative list of brands linked by ITL**

<table>
<thead>
<tr>
<th>ITL brand\footnote{ITL distributed Marlboro cigarettes on behalf of Philip Morris and distributed Café Crème cigars on behalf of Henri Wintermans.}</th>
<th>Gallaher brand linked by ITL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cigarette Brands</strong></td>
<td></td>
</tr>
<tr>
<td>Embassy No 1 KS</td>
<td>Benson &amp; Hedges KS</td>
</tr>
<tr>
<td>Regal KS</td>
<td>Benson &amp; Hedges KS</td>
</tr>
<tr>
<td>Marlboro KS</td>
<td>Benson &amp; Hedges KS</td>
</tr>
<tr>
<td>Marlboro Lights KS</td>
<td>Silk Cut KS</td>
</tr>
<tr>
<td>Superkings</td>
<td>Benson &amp; Hedges SK</td>
</tr>
<tr>
<td></td>
<td>Berkeley SK</td>
</tr>
<tr>
<td>Raffles SK</td>
<td>Benson &amp; Hedges SK</td>
</tr>
<tr>
<td></td>
<td>Berkeley SK</td>
</tr>
<tr>
<td>John Player Special</td>
<td>Sovereign</td>
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<tr>
<td>Lambert &amp; Butler</td>
<td>Mayfair</td>
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<tr>
<td>Richmond</td>
<td>Dorchester</td>
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<tr>
<td></td>
<td>Mayfair</td>
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<tr>
<td></td>
<td>Sterling</td>
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<td>----------------</td>
<td>------------------------------</td>
</tr>
<tr>
<td>Maxim</td>
<td>Sterling</td>
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<tr>
<td>RYO Tobacco</td>
<td></td>
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<tr>
<td>Golden Virginia</td>
<td>Old Holborn</td>
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<tr>
<td>Drum</td>
<td>Amber Leaf</td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cigars</strong></td>
<td></td>
</tr>
<tr>
<td>Café Crème/Café Crème Mild</td>
<td>Hamlet Miniatures</td>
</tr>
<tr>
<td>Small Classic</td>
<td>Hamlet Miniatures</td>
</tr>
<tr>
<td>Panama</td>
<td>King 6</td>
</tr>
<tr>
<td>King Edward Coronets</td>
<td>Hamlet</td>
</tr>
<tr>
<td>Classic</td>
<td>Hamlet</td>
</tr>
</tbody>
</table>

6.316 Examples of the parity and differential requirements were contained in a number of ITL's trading agreements with Retailers, and also in the 'ITL Strategy Pricing Requirements' documents which were sent periodically to Retailers (for example, following an MPI when the differentials between the RRPs of competing brands had varied).

6.317 Before 2004, parity and differential requirements existed in ITL’s trading agreements with all national accounts.415 ITL informed the OFT that since late 2003, ITL has no longer included such provisions in new trading agreements.416

6.318 As stated above, the parity and differential requirements specified in these documents reflected the comparative RRP of ITL’s brand and the RRP of the linked brand of a competing manufacturer. ITL submitted that if the RRP of the linked brand of a competing manufacturer, varied (for example, as a result of a temporary promotion), ITL would have the opportunity to respond with a similar initiative. Should ITL choose not to fund a reduction on its own product, the retail price differentials might change temporarily.417

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415 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.29)).
416 ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 5.4 of ITL script)).
417 ITL’s Explanatory Memorandum of 11 April 2005 (Document 5, Annex 13 (paragraphs 4.3-4.5)).
6.319 When the differential between the RRP of an ITL brand and the competing, linked brand of a competitor manufacturer changed exceptionally as a result of each manufacturer having an MPI at different times, this might require a change in the price differential strategy on a longer term basis. A provision for this was contained in certain trading agreements, of which the following written trading agreement between ITL and Sainsbury is an example:

'From time to time, ITL's competitors may reduce the shelf prices of their brands. SSL should allow ITL the opportunity to respond, in order to realign with the differentials highlighted in Appendix 5. Should ITL choose not to respond, those differentials may widen.'

6.320 There was one occasion on which ITL and Gallaher implemented an MPI at different dates, with Gallaher’s MPI taking effect on 25 June 2002 and ITL’s MPI taking effect on 2 September 2002. As set out at paragraph 6.82, this resulted in letters from ITL to various Retailers, explaining that the differentials would widen until such time as ITL introduced its own MPI. By way of example, a letter from ITL to Morrisons dated 11 June 2002 stated:

'As you are already aware, one of our competitors has already announced a price increase, effective June 25 2002. This means that the differentials that exist naturally between our brands and our competitor’s will widen; this means, I would expect to see the following example disparities from June 25, or from the date you implement our competitor’s price increase: ... [There followed a list of parity and differential requirements].'

6.321 In its response to the SO, ITL claimed that the Retailers were:

'free to reduce the shelf price of ITL’s product. In particular, the promotional bonus offered under the price differentials was unaffected if the retailer chose to reduce the shelf prices of ITL’s products further of its own volition, perhaps by funding reductions in the price of ITL’s products from its own margin. This reflected the objective of the provisions, which was to seek to incentivize the retailers not to increase the prices of ITL’s products and thereby render ITL’s products less competitive to the consumer in price terms.'

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420 ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 5.3(b) of ITL script)).
In contrast to ITL’s statement that the purpose of tactical bonuses was to support lower retail prices, the OFT considers that the payment and withdrawal of tactical bonuses was in fact used to ensure that ITL’s parity and differential requirements were maintained. The OFT also responds to this point in Section 6.A.I and 6.A.II above.

(d) ITL’s retail pricing strategy—internal documentation

Examples of the importance to ITL of Retailers adhering to its parity and differential strategy are contained in its internal Business Development Plans and its internal Account Briefs. For example, a National Accounts Business Development Plan concerning TM Retail, dated March 2000, stated:\(^{421}\)

‘Account Objective and Strategy … PRICING – Maintain pricing in line with agreed current ITL policy. Monthly payment by store provided prices are in line with strategy.’

Similarly, a Business Development Plan concerning Morrisons dated March 2001, stated under the heading ‘Strategy for the financial year 1.10.01-30.09.02’ that:\(^{422}\)

‘Morrison accept Imperial’s pricing strategy of reflecting current price list differentials between the manufacturers’ brands; and that levels of on-going and tactical support are also based on absolute shelf prices’.

This document also demonstrates a further link between the bonuses, described at Section 6.A.I.(a).iv, ITL’s parity and differential requirements and the Retailer’s actual shelf prices.

A later TM Retail Business Development Plan, dated November 2002 provides evidence of the link between payments made by ITL to the Retailer for adhering to its retail pricing strategy and reductions in payment for failing to adhere to that strategy:\(^{423}\)

‘PRICING – Maintain pricing in line with agreed current ITL policy. Monthly payment by store, provided prices are in line with strategy. A weekly check is run each Tuesday by T/A showing actual pricing and differentials. Reductions in payment are made for non-adherence to policy’.

\(^{421}\) Document 8(a), Annex 13 (page 4).
\(^{422}\) Document 23, Annex 17.
\(^{423}\) Document 8(g), Annex 13 (page 6).
6.327 It is also clear from the TM Business Development Plan above that the strategy also applied to the Philip Morris brands.424 Under the heading ‘Philip Morris’, the plan stated: 425

‘The objective for the new trading agreement is to increase current influence on pricing … PRICING – Maintain pricing in line with agreed current ITL policy. A weekly check run each Tuesday by T/A showing actual pricing and differentials’.

6.328 Another example is an Accounts Brief concerning Southern Co-op, dated 24 June 2002, which stated on the third page:426

‘the prices shown on this brief are only a guide. We are prepared to accept variation from the prices shown, provided that the agreed differentials are maintained between our brands and those of our competitors’.

(e) Monitoring of the Retailer’s retail prices

6.329 As outlined above, ITL monitored the Retailer’s retail prices to spot deviations from the prices communicated to the Retailer and thereby from the ITL’s parity and differential requirements and communicated ‘errors’ to the Retailer. In some cases, the Retailer participated in and facilitated this monitoring by providing ITL with details of its current or proposed retail prices for its brands and/or for ITL’s competitor’s brands.

6.330 In order to monitor the prices of its products in the Retailer’s stores, ITL employed a Multiple Trade Representative (‘MTR’) team. The MTR’s job was to visit stores operated by multiple retailers to record and report the prices at which tobacco and tobacco-related products were sold, and to ensure that products were available.427

6.331 The accounts which were covered by the MTR team comprised all of the ITL national and regional accounts. Not all stores operated by these accounts were visited every week, but over the course of either four or

\[\text{\footnotesize 424 Philip Morris is not an addressee of this Decision. See Section 6.D: ‘The Role of ITL and Gallaher in relation to brands distributed for third parties’.}\\\text{\footnotesize 425 Document 8(g), Annex 13 (page 9), Documents 7(d) to (g), Annex 13 which include Philip Morris brands in ITL’s ‘Strategy Pricing Requirements’ lists, provide further evidence that the strategy also applied to Philip Morris.}\\\text{\footnotesize 426 Document 9 (e), Annex 13.}\\\text{\footnotesize 427 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraphs 4.43-4.48)). ITL’s response dated 15 August 2008, to the SO (paragraphs 2.203 to 2.205).}\]
eight weeks every store of the relevant retailers would have been expected to have been visited by a representative of the MTR team.428

6.332 According to ITL, in order to keep track of bonus structures across the range of brands and products, ITL maintained bonus schedules and price files which recorded and audited, amongst other things, the bonus amounts being paid vis-à-vis individual Retailers, and the (ostensibly) maximum on-shelf retail prices against which they were being paid. ITL informed the OFT that, in the majority of instances, a 'price file' was required by a Retailer, and was produced and maintained by ITL as part of the Retailer’s desire to keep the Retailer’s systems up to date. Price files referred to the Retailer’s on-shelf retail prices and margins.429

6.333 EPOS data was generated automatically by a number of Retailers from the Retailer’s sales data. The data related to actual weekly sales volumes as well as pricing and products sold at each specific store by various Retailers. In addition, as stated above, ITL’s price monitoring was undertaken by the MTR team which visited retail outlets and compared the on-shelf retail prices it found in store with those set out in ITL’s internal ‘Account Briefs’.430 The data were inputted by the MTR team into hand-held terminals and downloaded onto ITL’s IT system. ITL stated that the data were used to monitor Retailer compliance with the criteria set out in the trading agreement, as well as specific bonuses agreed between the NAC, NAM, or NAE and the customer.431

6.334 The Account Briefs were used as a guidance note to assist the MTR team in its monitoring. Reports were compiled on an account basis and where discrepancies occurred, these would be reported to the relevant ITL NAC etc.

6.335 Another example of pricing ‘discrepancies’ cited by ITL was where there were differences between the on-shelf retail prices which the Retailer had told ITL were its in-store retail prices, and the actual on-shelf prices found in-store by the MTR team on store visits. ITL stated that there may also have been errors on the part of the Retailer in implementing a pricing

428 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.45)).
429 ITL’s presentation to the OFT of 10 February 2005 of ITL script (Document 3, Annex 13 (paragraph 2.22)). ITL’s response to the SO, (paragraphs 2.164 to 2.177).
430 ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.44-4.46)).
431 ITL’s presentation to the OFT of 10 February 2005 (Document 3, Annex 13 (paragraph 6.2 to 6.6 of ITL script)) and ITL’s covering submission of 24 October 2003 in response to the OFT’s section 26 Notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.45-4.46)).
policy across their store network; for example, if the Retailer’s outlets did not operate EPOS equipment.\(^{432}\)

6.336 ITL stated that the relevant NAM would usually report pricing discrepancies to the Retailer and, according to ITL, the Retailer generally expected ITL to provide this service, since the Retailer might not have the resources to monitor in-store prices and because such errors could lose the Retailer money.\(^{433}\) The OFT notes that some of the Account Briefs suggest a more rigorous approach to dealing with Retailers’ pricing ‘anomalies’; for example the first page of a Kwik Save Account Brief of 19 February 2001 provided the following instruction to the MTR:\(^{434}\)

> *NB Normal differentials between ITL brand and competitors should be maintained at all times. If shelf prices do not show correct differentials, ask for the packs in question to be scanned, and for new price tickets to be printed if necessary.***

6.337 A later Account Brief, also concerning Kwik Save, dated 9 September 2002, has an identical instruction.\(^{435}\)

6.338 ITL has acknowledged that it might use such information to advise the Retailer to re-align its retail prices in accordance with the parity and differential requirements, and the Retailer might make price adjustments as a result of this. ITL informed the OFT that it did not tell Retailers to change their prices of other Manufacturers’ products although it might ‘explain the position to the retailer’ on retail prices for ITL’s products. Sometimes, ITL submitted, the Retailer subsequently made price changes as a consequence of viewing its position in the market. ITL stated that if a differential was out of line ITL could either allow it to widen or fund a bonus for the Retailer. In the documents submitted, there were some instances where ITL would decide to ‘live with’ a price anomaly, however, rather than pay an extra bonus to re-adjust prices.\(^{436}\)

6.339 The OFT considers that through such monitoring, ITL would usually be in a position to react quickly in order to maintain parity and differential requirements between ITL brands and competing linked brands and to observe occasions where a Retailer was not complying with its requirements. The link between ITL’s monitoring of the Retailer’s retail

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\(^{432}\) ITL’s Explanatory Memorandum of 11 April 2005 (Document 5, Annex 13 (paragraphs 8.1-8.2)).

\(^{433}\) ITL’s Explanatory Memorandum of 11 April 2005 (Document 5, Annex 13 (paragraph 8.4)). ITL’s written response to the SO (paragraph 2.161).

\(^{434}\) Document 9(b), Annex 13

\(^{435}\) Document 9(f), Annex 13

\(^{436}\) ITL’s note of its meeting with the OFT on 10 February 2005 (Document 4, Annex 13 (page 7)).

6.340 Further evidence of ITL’s monitoring of the Retailer’s adherence to its parity and differential requirements is provided in other examples of ITL’s internal Business Development Plans and Account Briefs.\textsuperscript{437} In an internal ITL ‘National Accounts Business Development Plan’ for Sainsbury, dated January 2002 ITL stated:\textsuperscript{438}

‘Pricing: Sainsbury have supported our strategy e.g. Richmond [ITL brand] repositioning, every PMP incarnation and have responded quickly to every shelf price move.’

6.341 A Business Development Plan concerning Asda, dated 15 January 2002 noted that:\textsuperscript{439}

‘Almost all stores continue to achieve strategy pricing on all of our brands. The most frequent exception to this is where the price of leading brands is reduced to match local competition and either Regal or Embassy [ITL brands] are not supported locally, due to a result of a lack of local demand’.

6.342 As noted above, certain clauses in trading agreements, such as the clause referred to at paragraphs 6.33 and 6.319 above, gave ITL further scope for monitoring the Retailers’s retail prices in that the Retailer was required to notify ITL about competitor promotions or 'pricing activity' in order than ITL may respond.

IV **Gallaher**

(a) Supply and distribution

6.343 Gallaher manufactures and markets a range of cigarettes, cigars and hand rolling and pipe tobacco products. Throughout the period of the infringements that are the subject of this Decision, Gallaher’s tobacco products were either supplied directly to Retailers in the four distribution channels described below, or they were supplied via the distribution and wholesale company P&H or other companies within the P&H Group.

6.344 Gallaher managed its UK sales operations through four retail channels:\textsuperscript{440}

\textsuperscript{437} Documents 8 and 9, Annex 13  
\textsuperscript{438} Document 8(e), Annex 13 (page 8).  
\textsuperscript{439} Document 8(f), Annex 13 (page 8).  
\textsuperscript{440} Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 7)).
• Independent and Distributive (smaller retail outlets, wholesalers, cash and carry operators);
• Multiple Grocer (major supermarkets);
• Convenience (confectionery, tobacco and newsagents stores, petrol forecourts, travel outlets, off licences); and
• Leisure (pubs, clubs, hotels, restaurants, vending machines).

6.345 Of the addressees of this Decision, Asda, Morrisons, Safeway, Sainsbury, Somerfield and the Co-operative Group were managed through the multiple grocer channel and First Quench, Shell, T&S Stores and TM Retail were managed through the convenience channel.

6.346 Gallaher supplied directly to all of the Retailers apart from Sainsbury. As with accounts supplied directly, Gallaher has confirmed that it entered into trading agreements with retailers supplied by P&H covering matters such as marketing, advertising (to the extent legally permitted), resale price support and other commercial issues in respect of which the retailer liaised directly with Gallaher.\textsuperscript{441}

6.347 Gallaher also entered into a variety of trading agreements with Retailers which contained provisions for some or all of the following: maintaining price parity and price differentials with competitor brands; providing Gallaher the opportunity to offer bonus payments, resulting in retail price reductions, in respect of its brands in reaction to a competitor’s promotional activity; compliance with contractual terms relating to merchandising units; agreeing to list Gallaher products and ensuring a percentage of the Retailer’s stores are stocked with defined Gallaher brands; and agreeing not to de-list Gallaher brands without Gallaher’s agreement.

6.348 Gallaher has stated that within the company, ‘\textit{instructions relating to retail prices are determined by UK senior management}\textsuperscript{442} and that ‘\textit{strategy and policy decisions are taken by management at a level above that of individual account managers}.\textsuperscript{443}

\textsuperscript{441} Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 29)).
\textsuperscript{442} Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 32)).
\textsuperscript{443} Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 31)).
(b) Bonuses paid to Retailers by Gallaher

6.349 Gallaher made specific discounts available to customers in the form of bonus payments termed a Promotional Contribution Payment ('PCP'). Such bonus payments were paid by Gallaher to multiple retailers, some convenience retailers and some independent retailers. Bonus payments were paid to all of the Retailers.

6.350 Bonus payments were either paid to the Retailers via a lower cost price which reflected the amount of the bonus or retrospectively via a company cheque for the amount due.

6.351 Gallaher distinguished between 'ongoing' and 'tactical' PCP bonus payments. To qualify for an ongoing bonus a Retailer would be required to sell a Gallaher product to which the bonus related at a discount from its published RRP. Gallaher informed the OFT that:

‘An ongoing bonus payment is agreed between Gallaher and each retailer before or around the time a new product or SKU is launched by Gallaher onto the UK market. Once the level of ongoing bonus is set for that product, it generally remains payable to the retailer at that agreed level as long as that retailer chooses to sell the product to which it relates at a discounted price, the discount being at least the amount of the bonus’.

6.352 As the name suggests, ongoing bonuses were long-term payments which were paid continuously from the time they were agreed onwards. Gallaher stated that:

‘the retailer decides at what price they want to sell the brand and then looks to Gallaher to fund as much of the 'discount' as possible’.

6.353 Ongoing bonus payments were also paid by Gallaher to retailers for maintaining parity and differential requirements against competing brands. Gallaher’s trading agreements/strategy documents also make clear that the payment of an ongoing bonus was conditional on the Retailer’s compliance with Gallaher’s parity and differential requirements (see Section 6.C.I-X below).

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444 Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 40)).
445 Gallaher’s response to the OFT’s section 26 notice dated 27 January 2005 (Document 17, Annex 3 (paragraph 2.2)).
446 Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 46)).
6.354 Gallaher described tactical bonuses as:447

'Short term payments aimed at encouraging retailers to lower the price of specific brands'

Whereby:

'Gallaher agrees to pay a certain amount on condition the retailer does not price above a particular level, i.e. they operate solely as a maximum retail price'.

6.355 Gallaher stated that where a bonus was being paid to a Retailer with whom a trading agreement including a parity and differential clause had been entered, the parity and differential clause would cease to apply for the brand to which the bonus applied.448 As in paragraphs 6.33 above and 6.367 below, Gallaher’s trading agreement with seven retailers specified that Gallaher be given the opportunity to respond to any price promotion by one of its competitors. As noted in paragraph 6.342 above, this was also a stipulation in ITL’s trading agreements with retailers. As such, in contrast to Gallaher’s statement that parity and differential requirements would cease to apply to a brand that was subject to a promotion, the OFT considers that the payment and withdrawal of tactical bonuses was in fact used to ensure that Gallaher’s parity and differential requirements were maintained.

6.356 Evidence relating to the payment of bonuses by Gallaher to the Retailer (referred to as ‘tactical’ bonuses in this Decision) is set out in Section 6.A.I.(a).iv and Section 6.C.I-X.

6.357 Gallaher provided an example449 of how a tactical bonus might work in practice where the ‘normal selling price’ of a particular brand is £4.55 and Gallaher agrees to pay 5p per packet on that particular brand so long as the retail price does not exceed £4.50. In such a case the retailer has the choice of pricing up to and including the £4.50 price point before the 5p payment is automatically withdrawn in its entirety for pricing above £4.50.

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447 Gallaher’s response to the OFT’s section 26 notice dated 27 January 2005 (Document 17, Annex 3 paragraph 2.6 and 2.7)).
448 Gallaher’s response to the OFT’s section 26 notice dated 27 January 2005 (Document 17, Annex 3 (paragraph 1.9))).
449 Gallaher’s response to the OFT’s section 26 notice dated 27 January 2005 (Document 17, Annex 3 (paragraphs 2.8 and 2.9))).
(c) Gallaher’s retail pricing strategy - parity and differential requirements

6.358 Gallaher informed the OFT that it has no record of when or why price parity and differential clauses were introduced into written trading agreements. Gallaher stated that:450

’It seems that at some stage one head of channel began introducing a Parities and Differentials clause into written trading agreements. The driver for this is not clear but it seems the thinking was that it would do no harm’.

6.359 Gallaher is however clearer on how such clauses were supposed to work in practice:451

’Under a Parities and Differentials Clause, a retailer would be required to maintain the differential between a Gallaher brand and a competitor brand(s) in the same price segment (i.e. premium price or economy price) – as set out in the published list of RRPs... For example, if the RRP for Dorchester [Gallaher brand] was 2p lower than the RRP for Richmond [ITL brand], the clause would require the retailer to price Dorchester 2p below Richmond, whatever retail price it set for Richmond’.

6.360 Where clauses requiring the Retailer to maintain parity and differential requirements with competing linked Brands were included in a trading agreement (usually as clause 1(a)) the actual parities, differentials and linked brands covered would be listed as an appendix (usually Appendix 1). Such clauses were included in trading agreements with five of the Retailers: the Co-operative Group,452 First Quench,453 Shell,454 T&S Stores455 and TM Retail.456 The relevant clauses of these agreements are set out in greater detail in Section 6.C.I-X below. According to Gallaher, all such clauses were removed from Gallaher’s written trading agreements following a competition law compliance review initiated in June 2003.457

450 Gallaher’s response to the OFT’s section 26 notice dated 27 January 2005 (Document 17, Annex 3 (paragraph 1.5)).
451 Gallaher’s response to the OFT’s section 26 notice dated 27 January 2005 (Document 17, Annex 3 (paragraph 1.8)).
452 Document 7, Annex 5
453 Documents 1 and 21, Annex 6
454 Documents 9 and 10, Annex 9
455 Document 18, Annex 27.
456 Documents 9 and 33, Annex 12
457 Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 16)).
6.361 Gallaher informed the OFT that the brands subject to specified parity and differential requirements within such clauses were:458

‘to an extent, a matter for individual negotiation with the retailer concerned and also at the discretion of the Gallaher contract manager responsible for that account’.

6.362 However, a number of brands were frequently paired by Gallaher for the purposes of each Infringing Agreement, as demonstrated by the brands listed in the appendices to Gallaher’s trading agreements, the brands listed in internal Gallaher communications setting out strategies for retail channels (see Section 6.B.II.(e)), and the contacts between Gallaher and the Retailer, as set out in Section 6.C.I-X below.

6.363 The linked brands were most often competing brands of ITL in the relevant price sector (for example, premium, mid-price, low-price bands). Within each brand pair, competing brands were then also paired in terms of equivalent pack sizes (for example, 20s, 100s, 200s for cigarettes, or 12.5g, 25g and 50g for RYO brands), equivalent cigarette or cigar sizes (for example, King Size, Superkings) or equivalent strengths (for example, Lights, Mild).459

6.364 Table 6.2 below sets out an illustrative list of the competing brands of ITL that were frequently paired by Gallaher:

<table>
<thead>
<tr>
<th>Gallaher brand</th>
<th>ITL brand linked by Gallaher</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cigarette brands</td>
<td></td>
</tr>
<tr>
<td>Benson and Hedges</td>
<td>Embassy No1</td>
</tr>
<tr>
<td></td>
<td>Regal</td>
</tr>
<tr>
<td></td>
<td>Marlboro</td>
</tr>
<tr>
<td>Silk Cut</td>
<td>Embassy No1/Embassy Mild</td>
</tr>
<tr>
<td></td>
<td>Marlboro Lights</td>
</tr>
</tbody>
</table>

458 Gallaher’s response to Question 8 of the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 57)).
459 Gallaher’s response to Question 8 of the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 57 to 61)).
6.365 The importance that Gallaher attached to its parity and differential requirements is illustrated by the fact that such clauses continued to be included when trading agreements were re-negotiated and this would not have been the case if they were not expected to have an effect upon Retailer behaviour. These requirements were linked to specific payments and failure to adhere to them was often the subject of penalty clauses.\(^{461}\)

6.366 Gallaher has confirmed to the OFT that the parity and differential requirements in trading agreements were linked to published RRP\(s\)\(^{462}\), and that where:\(^{463}\)

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\(^{460}\) Gallaher’s parity and differential schedules often refer to John Player Superkings, but the OFT understands this to be a reference to ITL’s Superkings brand. See the supplementary response of ITL to the SO, Annex 2 (paragraph 2.21).\(^{461}\)

\(^{461}\) Document 7, Annex 5 in relation to the Co-operative Group.

\(^{462}\) Gallaher’s response to the OFT’s section 26 notice dated 27 January 2005 (Document 17, Annex 3 (paragraph 1.8)).
'the publication of price lists [resulted] in a change in the differentials between the two RRPs, then the differential required under the trading agreement would also change, to reflect the new differential between the RRPs'.

6.367 In practice, Gallaher would also seek to respond to any observed or reported changes in the actual retail prices of its competitors' brands. To help ensure Gallaher could achieve its objective of maintaining parity and differential requirements, clauses providing Gallaher the opportunity to offer bonus payments in respect of its brands in reaction to a competitor’s promotional activity were included in trading agreements with seven of the Retailers: the Co-operative Group, Sainsbury, Shell, First Quench, Somerfield, T&S Stores and TM Retail.

6.368 In addition, maintaining parity and differential requirements with the competing, linked brands of competing manufacturers was a key objective within internal Gallaher planning documents and the subject of regular monitoring to ensure compliance.

(d) Gallaher’s retail pricing strategy – internal documentation

6.369 In addition to the communication of instructions and/or requests to Retailers regarding its retail prices, internal Gallaher correspondence included strategy and policy statements regarding the achievement of retail price points and parity and differential requirements. Internal documents confirm that the strategy of communicating retail pricing objectives and/or retail pricing instructions to Retailers was driven by senior management within Gallaher. Instructions relating to retail prices within Gallaher were communicated to channel team members by senior management, including the heads of channels.

6.370 Certain internal Gallaher documents, relating to all or specific retail channels, contained retail pricing objectives regarding the achievement of parity and differential requirements. For example, an internal Gallaher document headed 'Promotional Policy - Retail Promotion Contributions – March 2000' listed the following 'pricing objectives':

'Came [Gallaher brand] – Parity with Marlboro [competitor brand]

Camel Lights/Ultra Lights – Parity with Marlboro Lights [competitor brand]

463 Gallaher’s response to Question 8 of the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 57)).
464 Documents 1 to 17, Annex 3.
465 Document 1, Annex 3 (page 2).
B&H – 5p above Regal [ITL brand], 3p above Embassy No 1 [ITL brand]
Club [Gallaher brand] 14p below Regal [ITL brand]
Sovereign [Gallaher brand] 10p below L&B [ITL brand]
Mayfair [Gallaher brand] 7p below Sovereign [Gallaher brand] and at least at parity with Richmond [ITL brand]
Dorchester K/S [Gallaher brand] 10p below Mayfair [Gallaher brand]
Dorchester Superkings 1p above Dorchester KS
Dickens & Grant 4p above Mayfair
West 6p below L&B [ITL brand]

More – should not normally be promoted.

6.371 A number of these objectives were repeated and others added in internal Gallaher documents headed 'Promotional Policy - Retail Promotion Contributions – March 2001' and 'Promotional Policy - Retail Promotion Contributions – October 2001'. The first of these documents also listed a number of retail pricing objectives for cigars and tobacco:


6.372 Certain Gallaher planning documents had general as well as retail channel specific objectives. Gallaher devoted an entire Channel Marketing Plan to an initiative called ‘Project Kew Gardens’ which had the stated objective of ‘Re-pricing of the Mayfair House to achieve parity with Richmond [ITL brand]’. Included within this Channel Marketing Plan were a ‘Multiple Grocer Channel Execution Plan’ which set out a channel retail pricing strategy to ‘reduce the maximum selling price of Mayfair KS and SK by 6p

466 Document 4, Annex 3 (page 1 and 2).
467 Document 9, Annex 3 (page 2).
468 Document 4, Annex 3 (pages 2 and 3).
469 Document 13, Annex 3 (page 3).
per 20 (and pro-rata on other pack sizes), with the intention of achieving parity with Richmond [ITL brand] and a 'Convenience Channel Execution Plan' which set out a channel pricing strategy 'to achieve a selling price of £3.89/£1.86 for MSK [Mayfair Superkings] range [Gallaher brand] and £1.93 and £3.83 for MKS [Mayfair Kingsize] range [Gallaher brand]'.

6.373 In addition to cross-sector objectives such as the above, internal Gallaher documents and communications containing strategic retail pricing objectives were produced for individual retail channels. For example, Gallaher’s 'Multiple Grocer Channel Plan – 2001' contained the objectives that:

'Dorchester [Gallaher brand] will maintain parity with Richmond [ITL brand], Sterling will be at least 5p below. Mayfair [Gallaher brand] – Price differentials will be maintained within standard VPR framework. Multipacks – price differential will be maintained with L&B [ITL brand]; 'Cigars – Price differentials will be maintained at minimal cost.'

6.374 Similarly, an internal Gallaher document concerning pricing in 2001 headed 'Multiple Grocer Pricing' listed the following, among various, objectives:

'Dorchester [Gallaher brand] to remain at parity with Richmond [ITL brand] Sterling [ITL brand] to be at least 5p below Richmond.'

6.375 Various internal Gallaher reports highlighted retail pricing objectives and the actions which would be taken to achieve them. A 'Multiple Grocer Report' dated 8 May 2001, and submitted to Gallaher’s Head of UK Sales, contained a discussion of the retail pricing of Richmond multipacks [ITL brand]. It confirmed that:

'we do not intend to follow with Berkeley or B&H Superkings [Gallaher brands] but plan to maintain differentials and take price points for Mayfair and Sovereign [Gallaher brands] as per the attached pricing forecast. Dorchester [Gallaher brand] will remain...'

471 Document 13, Annex 3 (page 27).
472 Document 10, Annex 3 (page 1).
473 'Volume Protection Reserve' (‘VPR’). Gallaher explained at a meeting with the OFT on 23 January 2006 (see Document 18, Annex 3) that VPR was a type of bonus that applied historically from the 1970s. It had since been replaced by PCPs but the term was still used, on occasions interchangeably, by some Gallaher staff when referring to certain PCPs.
474 Document 14, Annex 3 (page 1).
475 Document 5, Annex 3 (page 2).
at parity with Richmond [ITL brand] with Sterling [Gallaher brand] at least 5p below.’

6.376 A report headed 'Multiple Grocer Pricing' dated 14 May 2001, contained the following information:476

'Premium & Mid Price - Standard bonus for price list differentials. Camel £4.09 / £19.99 UFN. Low Price - Dorchester [Gallaher brand] to remain at parity with Richmond [ITL brand], all packings. Price to increase 6p June 1st. Sterling to be at least 5p below Richmond [ITL brand]. Increase 1p June 1st.'

6.377 Further 'Multiple Grocer Pricing' reports, such as the one attached to an e-mail sent to numerous Gallaher staff on 25 May 2001477 contained the same or similar statements.

6.378 In addition to the use of e-mails, and written reports, retail pricing objectives were communicated directly to Gallaher staff at team meetings. For example, the minutes of the Multiple Grocers Team Meeting held on Wednesday 7 February 2001 informed the recipients of the retail pricing objective of 'Dorchester [Gallaher brand] to be at parity with Richmond [ITL brand]. Sterling 10p below'478. Similarly, the 'Action Points' of a Multiple Grocers Team Meeting held on 25 July 2001479 included the key objective of 'all supermarkets to be at £2.09, £4.10 and £7.99 on A/L [Amber Leaf] with immediate effect' and allocated the responsibility for putting this into action to 'A/c Managers'.

6.379 As with the Multiple Grocer channel, internal Gallaher documents show that Gallaher had specific pricing objectives for the Convenience channel.

6.380 An internal Gallaher e-mail sent to numerous Gallaher staff on 25 May 2001 stated:480

'We will continue to maintain parity – Dorchester [Gallaher brand] v Richmond [ITL brand], and Sterling [Gallaher brand] at least 5p below.'

6.381 An internal Gallaher document headed 'Key Action Points Convenience Channel' sent on 29 July 2002 listed as a key action point following discussions at a recent team meeting: 'Policy - £3.59 Mayfair [Gallaher brand] should not be sold any cheaper than £3.59.481

476 Document 6, Annex 3 (page 1).
477 Document 7, Annex 3 (page 2).
478 Document 2, Annex 3 (page 3).
479 Document 8, Annex 3 (page 1).
480 Document 7, Annex 3 (page 1).
481 Document 11, Annex 3 (page 2, Key Point 17).
6.382 Gallaher’s retail pricing strategy would on occasions be reactive to actual or anticipated retail price increases by competitors. For example, an internal e-mail concerning Gallaher’s retail pricing after an expected MPI by ITL sent on 21 August 2002 by the Head of Gallaher’s Convenience Channel to numerous Gallaher staff, including National Account Managers and Heads of Channel, stated:482

‘Please find attached Pricing schedule for implementation 2nd of September or as and when ITL MPI is implemented. Please note:

*Berkeley* [Gallaher brand] + 6p parity with *JPKS* [ITL brand]

*Hamlet* [Gallaher brand] + 6p parity with *Classic* [ITL brand]

*Hamlet Miniatures* [Gallaher brand] + 6p parity with *Café Crème* [ITL brand].

*King 6* + 6p (MPI) [Gallaher brand]

*Dorchester KS* [Gallaher brand] + 5p parity with *Richmond KS* [ITL brand]

*Dorchester SK* [Gallaher brand] + 7p parity with *Richmond SK* [ITL brand]

*Mayfair KS* [Gallaher brand] + 1p from £3.54 to £3.55 mid September when £3.59 PM [price marked] is exhausted.’

6.383 Internal Gallaher presentations re-emphasised to Gallaher staff the importance of maintaining parity and differential requirements. For example, a Gallaher PowerPoint presentation entitled 'Convenience Channel – Strategic Plan – 2003'483 contained a slide headed 'How will we develop our cigarette business?' which contained the wording 'Retain price list differential with Richmond [ITL brand]'. This objective related to Gallaher's Mayfair brand and similar wording set out the key objective for the Dorchester brand: 'Protect Dorchester [Gallaher brand] by maintaining parity with Richmond [ITL brand]'.

6.384 A further slide within the 'Convenience Channel – Strategic Plan – 2003' presentation headed 'How will we grow our cigar business?'484 confirmed objectives for Gallaher’s cigar retail pricing policy with the wording: 'Price parity with Café Crème [ITL brand]'. A further slide headed 'How can we

482 Document 12, Annex 3 (page 1). It would appear that certain correspondence with Retailers in the convenience channel followed this internal Gallaher email. For example, Document 35, Annex 27 (an email from Gallaher Ltd to T&S Stores Plc dated 29 August 2002), and Document 22, Annex 6 (an email from Gallaher to First Quench dated 27 August 2002).

483 Document 15, Annex 3 (slide 6).

484 Document 15, Annex 3 (slide 8).
most effectively communicate with our smokers?" re-emphasised the message with the wording 'Maintain pricing parities vs competitor products'.

(e) Monitoring of the Retailer’s retail prices

6.385 Even where it was not informed of price changes introduced by its competitors, Gallaher would usually be in a position to react quickly in order to maintain parity and differential requirements between Gallaher brands and competing linked Brands. Gallaher contracted with [C] which throughout the relevant period provided Gallaher with a ‘field force’ of over 50 people including:

‘45 merchandising representatives (‘MR’), to call on the specified retailers at a frequency specified by Gallaher’

In order to:

‘provide general monitoring and retailer assistance services in respect of the offering for sale of tobacco products within UK stores of specified retailers’.

6.386 These MRs carried out a fortnightly resale price review of all tobacco products (both those manufactured by Gallaher and Gallaher’s competitors) and the data they collected was transmitted to Gallaher’s head office so that data reports could be produced for the Heads of the Multiple Grocer and Convenience channels as well as National Account Managers within those channels. Via such data collection methods Gallaher could therefore monitor the implementation of Infringing Agreements (as discussed below in relation to Gallaher’s contacts with each Retailer) in relation to retail prices charged for Gallaher’s products both in absolute terms and relative to retail prices charged for Gallaher’s competitors’ products.

6.387 Gallaher was also provided with price files by Retailers, in some cases on a regular basis and, as demonstrated by the evidence set out in Section 6.C.I-X below, where Gallaher observed discrepancies with Gallaher’s required parity and differential requirements, these would be communicated to the Retailer.

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485 Document 15, Annex 3 (slide 9).
486 Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 65)).
487 Gallaher’s response to the OFT’s section 26 notice dated 15 August 2003 (Document 16, Annex 3 (paragraph 64)).
6.388 The link between Gallaher’s monitoring of the Retailer’s retail prices and its parity and differential strategy is set out in Section 6.A.I.(a).v and Section 6.C.I-X.
C THE INFRINGING AGREEMENTS

I Agreement and/or concerted practice between ITL and Asda and between Gallaher and Asda

Summary

6.389 As set out in Section 6.C.I.(a) below, ITL and Asda were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby ITL coordinated with Asda the setting of Asda’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL in pursuit of ITL’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.390 As set out in 6.C.I.(b), Gallaher and Asda were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby Gallaher coordinated with Asda the setting of Asda’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.391 Each of the Infringing Agreements between ITL/Asda and Gallaher/Asda amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Asda and that each Manufacturer must have been aware\(^{488}\) of each other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of the Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and

\(^{488}\) See Section 6.A.I.(b) in relation to the Manufacturers’ awareness of each other’s parallel and symmetrical parity and differential requirements.
increased the inherently restrictive nature of each Infringing Agreement, as set out in Section 6.A.I.(d) above.

6.392 On 11 July 2008, each of Gallaher and Asda concluded an early resolution agreement with the OFT, pursuant to which each admitted its involvement in each Infringing Agreement to which it was party in breach of the Chapter I Prohibition.

(a) Agreement and/or concerted practice between ITL and Asda

6.393 When considered together with the evidence of ITL’s overall strategy for retail prices described at Section 6.B: ‘Manufacturers’ retail pricing strategies’ above the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between ITL and Asda, whereby ITL coordinated with Asda the setting of Asda’s retail prices for tobacco products in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. For the reasons set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ the Infringing Agreement between ITL and Asda restricted the ability of Asda to determine its retail prices for competing linked brands and had the object of restricting competition.

6.394 The following elements evidence the Infringing Agreement between ITL and Asda:

i ITL’s strategy in relation to Asda’s retail prices

6.395 The trading agreements and contacts set out between ITL and Asda below should be considered in the context of ITL’s retail pricing strategy as set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above,

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489 The OFT infers this as the starting period (in the context of the Chapter I Prohibition coming into force on 1 March 2000) for the following reasons: the earliest document mentioning Asda by name (Document 1, Annex 14) is an internal ITL presentation slide which contains an annotation: ‘from 1/2/00’. This document was provided by ITL in its response to the OFT’s Notice (dated 15 August 2003) under s26 of the Act and was grouped by ITL in the ‘Asda’ section of its response. The next document (Document 2, Annex 14) is dated 9 May 2000. However, internal ITL documents (Documents 22, 46 and 70, Annex 14 (page 1)) suggest that Asda was complying with ITL’s retail pricing objectives during the period ‘up to and including 1999’. Under the heading ‘pricing’ (Document 22 (page 6), Document 46 (pages 7 and 8) and Document 70 (page 9)), it is reported that ‘almost all stores continue to achieve strategy pricing on all of our brands’.

490 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

6.396 In addition, an internal ITL 'National Accounts Business Development Plan' dated 15 January 2002 and 3 March 2003 concerning Asda, both recorded Asda as having '[C]%'\(^{491}\) adherence to pricing, and stated that:\(^{492}\)

'Almost all stores continue to achieve strategy pricing on all of our brands'.

6.397 An internal ITL email dated 23 May 2002 stated:\(^{493}\)

'Asda have moved Raffles [ITL brand] up from £4.10 to £4.11 this week taking it to +1p above Berkeley and Superkings [Gallaher brands]'.

ITL observed that this move was likely in order:

'to match [another retailer] and Sainsbury both of whom have Raffles at £4.11 and Berkeley at £4.10'.

ITL then stated:

'I am endeavouring to persuade Asda to bring Raffles back to £4.10 to meet our strategic pricing requirements (without any further additional funding) and assume that Paul [of ITL] will be attempting to do the same in Sainsbury/[another retailer]'.

6.398 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to ITL's strategy for Asda's retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 10, 22, 28, 36, 44, 49, 51, 58, 62 and 71 of Annex 14 (which are listed in Annex C).

\(\text{ii} \) Trading agreements between ITL and Asda

6.399 There were two trading agreements between ITL and Asda, dated 5 June 2002 and 28 August 2003. Those agreements were a relevant aspect of the ongoing commercial dealing between ITL and Asda and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and Asda in relation to retail prices.

\(^{491}\) Document 46 and 70, Annex 14 (page 1).
\(^{492}\) Document 46 (page 8) and Document 70 (page 9), Annex 14.
6.400 The first trading agreement ('TA1'), signed and dated 5 June 2002, was retrospective in that it covered the period 1 January 2002, until 31 December 2002. The second ('TA2'), signed and dated 28 August 2003, was also retrospective and covered the period 1 January 2003 to 31 December 2003.

6.401 Under the heading 'Trading Agreement Package' in TA1 and TA2 it was stated that:

'Subject to Imperial Tobacco’s requirements on ... Strategic Pricing being met ITL will make a [quarterly] payment to Asda of [C] per 1,000 on all cigarettes purchase[d] from ITL.'

In addition TA2 stated:

'... to be paid off invoice from 1st September 2003. A retrospective payment of [C] made by Promotional Discount Advice covering the period of 1st January to 31st August 2003 ...'

6.402 TA2 also contained 'ITL’s Strategy Pricing Requirements' which included the following:

'| [ITL brand] | [Gallaher brand] |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Marlboro King Size 20s</td>
<td>no more expensive than Benson and Hedges King Size</td>
</tr>
</tbody>
</table>
...

| Raffles 20s | no more expensive than Berkeley Superkings |

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494 Documents 53 and 72, Annex 14. The OFT does not have a copy of the attachments named with icons at the foot of this e-mail.
496 TA1 (Document 53, Annex 14 (page 3)) and TA2 (Document 80, Annex 14 (page 5)).
497 Only in TA1.
498 The OFT infers that this list also formed part of TA1 (see documents 53 and 72, Annex 14)
499 Document 80, Annex 14 (pages 3 and 4).
Embassy Filter 20s at least 5p less expensive than Benson and Hedges King Size

JPS King Size 100s not more than 70p more expensive than Sovereign

Lambert & Butler KS 20s not more than 14p more expensive than Sovereign

6.403 A letter from ITL to Asda dated 13 August 2002 provides further insight into the aims of the trading agreements:500

‘the purpose of our Trade Development Programme is to ensure that we have the range of products available in your stores to meet consumer demand and on sale at prices which reflect the standard Price List differentials against competing lines

... I also left with you full details of our Strategic Pricing Requirements effective from 2nd September. 501

6.404 Although some of the differential requirements communicated by ITL to Asda purportedly provided that Asda was to maintain maximum differential requirements between competing linked brands, the OFT infers from the following evidence that such provisions were in fact implemented as fixed differential requirements, rather than maximum differential requirements: (i) evidence of ITL’s retail pricing strategy; (ii) evidence regarding the way in which the trading relationship between ITL and Asda operated in practice (that is, evidence of the contacts between the ITL and Asda); and (iii) the existence of an Infringing Agreement between Gallaher and Asda pursuant to which Gallaher communicated

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500 Document 56, Annex 14 (page 1).
parallel and symmetrical parity and differential requirements to Asda (see Section 6.C.I.(b) below). The restrictive nature of both parity or fixed differential requirements and maximum differential requirements is described above at 6.A.I.(d).

6.405 In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which Asda would set its retail prices in accordance with the differential requirements set by ITL, and that Asda was rewarded by a bonus for compliance with ITL’s differential requirements.

**iii Contacts between ITL and Asda regarding retail prices**

6.406 A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and Asda regarding: (i) Asda’s retail prices for ITL’s brands; (ii) Asda's retail prices for ITL’s competitors' brands; and (iii) the retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors' brands.

6.407 The documents evidencing the contacts between ITL and Asda demonstrate that: (i) in relation to Asda’s retail prices for ITL's brands (sometimes by reference to Asda’s or other Retailers’ retail prices for ITL’s competitors’ brands) and/or (ii) in relation to Asda’s retail prices for ITL’s competitors’ brands:

- ITL communicated\(^{502}\) to Asda what Asda’s retail prices should be; and/or
- ITL asked and/or incentivised Asda to hold or alter Asda's retail prices; and/or
- Asda informed ITL about, or discussed with ITL, Asda's current or proposed retail prices.

6.408 Asda accepted and/or indicated its willingness to implement the directions contained in such communications.

6.409 In addition, ITL and Asda informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.410 The contacts between ITL and Asda took place in the context of ITL’s retail price strategy for Retailers to maintain specified parities and differentials between ITL’s brands and competing linked brands. Communications in relation to retail pricing were sent by ITL, and were

\(^{502}\) See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.
received and implemented by Asda\textsuperscript{503} on the understanding that the notified retail prices took into account ITL’s retail pricing strategy, together with Asda’s desired pricing position relative to other Retailers and Asda’s desired margin.

6.411 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.412 Various examples of contacts between ITL and Asda regarding retail prices are set out below.

\textit{Contact between ITL and Asda regarding Asda’s retail prices for ITL’s brands}

6.413 Set out below are examples of contact between ITL and Asda in relation to Asda’s retail prices for ITL’s brands, which demonstrate that in relation to Asda’s retail prices for ITL’s brands (sometimes by reference to the retail prices of ITL’s competitors’ brands) and/or for ITL’s competitors’ brands:

- ITL communicated to Asda what Asda’s retail prices should be; and/or
- ITL asked and/or incentivised Asda to hold or alter Asda’s retail prices; and/or
- Asda informed ITL about, or discussed with ITL, Asda’s current or proposed retail prices.

6.414 Asda accepted and/or indicated its willingness to implement the directions contained in such communications.

6.415 The examples of such contacts are as follows.

6.416 ITL sent an email to Asda, dated 7 November 2000, headed ‘DRUM vs AMBER LEAF PRICING.’, ITL stated:\textsuperscript{504}

‘The limited pricing info I currently have suggests that Amber Leaf [Gallaher] is on promotion. If it is I would like to match the prices by fully funding the prices for Drum [ITL brand]. For 12.5g this would be [C]. Could you confirm the current 25g prices.’

6.417 The following day, 8 November 2000, ITL confirmed in an internal email, copied to Asda that Asda had agreed to the proposed price reduction for

\textsuperscript{503} See paragraph 6.441 and 6.442 in relation to implementation.

\textsuperscript{504} Document 12, Annex 14.
Drum [ITL brand] in order to match Gallaher’s Amber Leaf brand, as follows:\textsuperscript{506}

‘Asda have agreed to the price reduction detailed below [7 November 2000 email from ITL to Asda as above]. We have also agreed to fully fund the reduction on 25g from £4.00 to match Amber Leaf [Gallaher brand] at £3.69 ... Both price reductions should take effect on Monday. Please provide John Jolliff [of Asda] with an updated price file.’

6.418 In a letter from ITL to Asda dated 11 December 2000, ITL confirmed a previous conversation in which ITL and Asda had reached agreement on the price of ITL’s Panama brand:\textsuperscript{506}

‘We agreed that Panama pricing would be corrected to £2.55 and £12.69 and I trust that these prices will be effective from 17 December’.

6.419 In an email dated 13 March 2001, ITL confirmed to Asda that it had found out from another source that Dorchester and Sterling [both Gallaher brands] would increase on 26th March. ITL stated that:\textsuperscript{507}

‘... we should wait to see the new Sterling and Dorchester prices [Gallaher brands] on the shelf before moving Richmond [ITL brand] to £3.39 (for which the new retro bonus should be [C]p per Outer ...)

‘In a conversation with John [of Asda] yesterday I indicated that we would not move Richmond [ITL brand] until such time as Sterling and Dorchester [Gallaher brands] had moved up and that we would be looking for parity with Dorchester.’

6.420 Similarly, an email dated 29 March 2001 from ITL to Asda stated:\textsuperscript{508}

‘On the basis that both Sterling and Dorchester [Gallaher brands] will increase by 5p/20s on 1st April 2001, I can confirm that Richmond [ITL brand] prices will increase by the same amount on this date.’

6.421 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Asda regarding Asda’s retail prices for ITL’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents: 2, 4, 6, 7, 13, 14, 24, 25, 26\textsuperscript{509}, 27, 39, 43,

\textsuperscript{505} Document 12, Annex 14.
\textsuperscript{506} Document 15, Annex 14.
\textsuperscript{507} Document 28, Annex 14.
\textsuperscript{508} Document 32, Annex 14.
\textsuperscript{509} The OFT does not have a copy of the attachments (‘Price List’ and ‘Spreadsheet’) referred to in this document.
47, 49, 54, 58, 63, 64, 67 and 75 of Annex 14 (which are listed in Annex C).

Contact between ITL and Asda regarding Asda’s retail prices for ITL’s competitors’ brands

6.422 In addition to the documents above, which concern contact between ITL and Asda regarding Asda’s retail prices for ITL’s brands, there were contacts between ITL and Asda in relation to Asda’s retail prices for ITL’s competitors’ brands. Set out below are examples of such contacts which demonstrate that, in relation to Asda’s retail prices for ITL’s competitors’ brands, Asda informed ITL about, or discussed with ITL, Asda’s current or proposed retail prices.

6.423 Asda accepted and/or indicated its willingness to implement the directions contained in such communications.

6.424 The examples of such contacts are as follows.

6.425 In a letter dated 5 October 2000 from ITL to Asda, ITL noted that Asda should increase the price of ITL’s brands when the price of Gallaher’s brands increased (in the case of the Richmond brand on the same day):510

‘When Mayfair [Gallaher brand] moves up from £3.44 to £3.49 we will be looking to move Lambert & Butler and JPS [ITL] brands to £3.65. I am currently awaiting confirmation as to when the Morrisons price on Lambert & Butler will move to £3.65 and will advise you of this as soon as possible.

...

Subsequent to our meeting you have advised that Dorchester King Size [Gallaher brand] will move to £3.34 on 29th October and we agreed that Richmond King Size 20s and Richmond Lights 20s [ITL brands] will move to £3.34 on 29th October.’

6.426 In an email from ITL to Asda dated 13 March 2001 ITL instructed Asda to increase ITL’s Drum and Golden Virginia brands in the event that the price of Gallaher’s Amber Leaf brand increased:511

‘I believe from a discreet source [C] that: -

AMBER LEAF

Will move up to £2.09, £4.10, £8.11 on 13th March. If it does then please move Drum to the same prices and Golden Virginia [both ITL brands] to £2.19 ... removing the retro bonuses.'

6.427 In a fax dated 20 March 2001 from ITL to Asda, ITL communicated desired pricing as follows:512

'Following yesterday’s increase in the retail prices of Amber Leaf [Gallaher brand], I would like to increase the retail prices of ITL’s RYO range as follows:

<table>
<thead>
<tr>
<th></th>
<th>From (£)</th>
<th>To (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Drum 12.5g</strong></td>
<td>1.95</td>
<td>2.09</td>
</tr>
<tr>
<td><strong>Drum 25g</strong></td>
<td>3.80</td>
<td>4.10</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Golden Virginia 12.5g</strong></td>
<td>2.05</td>
<td>2.19</td>
</tr>
<tr>
<td><strong>Golden Virginia 25g</strong></td>
<td>3.99</td>
<td>4.31</td>
</tr>
</tbody>
</table>

These prices will be achieved by withdrawing the bonus support. Could you confirm a date for this change (Monday 26th March?)'.

6.428 In the responding emails also dated 20 March 2001, Asda indicated their agreement to confirm the date of the increase in the retail price of ITL’s RYO range by stating:513

‘tHIS WILL BE OK’

‘Retails on system to change instore Monday 26.3.01’

6.429 An internal ITL email dated 28 February 2002, referred to a telephone call received from an Asda representative in respect of the new Gallaher selling prices for Sterling and Dorchester:514

‘John Jolliff [of Asda] has called me this morning to advise the following new prices

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514 Document 49, Annex 14 (First email in chain).
Sterling [Gallaher brand] (from 3rd March)

King Size £3.39/£16.75
Superkings £3.42/£16.90

Dorchester [Gallaher brand] (from 10th March)

King Size £3.44
Superkings £3.47

I understand that the increases have been instigated by Gallaher.

I have intimated that we will probably move Richmond Superkings [ITL brand] up to £3.47 from 17th March but have said that I will confirm this shortly.'

6.430 A further internal ITL email also sent on 28 February 2002 to the ITL NAMS referred to an earlier conversation with Asda which appears to have taken place after the earlier email of 28 February 2002 set out above:515

‘Having just spoken to Roger [of ITL] regarding this he has confirmed that we should follow Gallaher’s lead on this by moving Richmond Superkings 20s [ITL brand] up to £3.47 one week after Dorchester Superkings [Gallaher brand] move up. The strategy thereafter (where Sterling [Gallaher brand] is stocked) is that Richmond should be +5p cf. Sterling and at parity with Dorchester. Roger [of ITL] requests that you take appropriate action with your accounts please.’

6.431 In an email from ITL to Asda dated 29 August 2002, ITL stated:516

‘Firstly our strategic pricing requirements are unchanged in that we wish to match Amber Leaf [Gallaher brand] prices with Drum [ITL brand] and to match the Samson [Gallaher brand] with Drum Milde.’

To which Asda replied:

‘That’s fine but if Imperial wish to compete with Gallahers on the Asda pitch and set appropriate retailers then I expect both to fund their own tactical pricing issues.’

6.432 The above email of 29 August 2002 was subsequently circulated internally on the same day by ITL stating.517

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'Asda is currently refusing to accept the margin reduction on Drum [ITL brand] and looks likely that I will have to put some bonuses back in place to maintain the ... prices to match Amber Leaf [Gallaher brand] or move selling prices up slightly to restore the margin.'

6.433 In an email to Asda dated 7 October 2002, ITL stated that the selling prices of Richmond [ITL brand] would go up to £3.59/£3.63 (King Size/Superkings) from 14 October.518

'As part of our pricing strategy we will be moving prices up in the market ...'

'We are anticipating that Gallaher will follow our lead by moving Dorchester King Size and Dorchester Superkings [Gallaher brands] up by 5p per 20 in the not to distant future.'

6.434 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Asda regarding Asda's retail prices for ITL's brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 10, 12, 13, 21, 25, 30, 31, 32, 54 and 63 of Annex 14 (which are listed in Annex C).

Contact between ITL and Asda regarding the retail prices of Asda's competitors

6.435 In addition to the documents above, there were contacts between ITL and Asda in which ITL and Asda informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL's brands and/or for ITL's competitors' brands.

6.436 In an internal ITL email dated 5 October 2000, ITL discussed Asda's reluctance to increase the price of ITL's L&B and JPS [ITL] brands given current Morrisons' retail prices for those brands. ITL stated that Asda was:519

'reluctant to move L&B and JPS from £3.63 to £3.65 given that Morrisons have continued at £3.60 although I had been advised by PRM that they would move to £3.65 on 2nd October'.

6.437 In a letter dated 21 January 2001 from ITL to Asda, in relation to ITL's Small Classic range ITL stated.520

‘Further to our discussion on 8th January I would like to confirm the relevant details …

Ideally I would like to bring these into line with other grocers by implementing the following prices from 28th January … These reduced prices would continue until 2nd March at which point prices would move to your normal prices of £2.65 and £12.99.’

6.438 In a letter dated 9 October 2002 from ITL to Asda, ITL stated:521

‘Further to our meeting on 4th October I would like to confirm our discussion … I drew attention to the fact that we increased our bonus rate on Drum Milde 12.5g on 17th July in order to reduce the selling price from £2.03 to £1.99 but the lower selling price has yet to be implemented in store. The current selling price for Drum Milde 12.5g [ITL brand] within the Multiple Grocers is £1.99 and will continue whilst Samson [Gallaher brand] is at that price.’

6.439 It can be seen from the above that references by ITL to the retail prices of other Retailers were used by ITL as a means to encourage the implementation by Asda of ITL’s parity and differential requirements. In particular, such references provided an assurance to Asda that retail price changes put to Asda by ITL would not cause Asda to be out of step with its retail competitors. The function of references to the retail prices of other Retailers was to assist in the implementation of ITL’s pricing strategy and to ensure that ITL’s desired parities and differential requirements were maintained or, where need be, realigned.

Conclusion on the contacts between ITL and Asda

6.440 In conclusion in relation to all the contacts between ITL and Asda regarding retail prices, the above paragraphs demonstrate that there were regular contacts between ITL and Asda, which related to the retail prices of Asda, as well as other Retailers. The evidence of such contacts together with the context of ITL’s strategy, demonstrates that ITL’s retail pricing strategy was for Asda to maintain parities and differentials between ITL brands and competing linked brands. The contacts between ITL and Asda assisted the implementation of that strategy, through communications from ITL in relation to Asda’s retail prices for ITL’s brands and in some cases ITL’s competitors’ brands, the aim of which was to ensure that ITL’s desired parities and differentials requirements were maintained and realigned. The contacts between Asda and ITL also demonstrate that Asda accepted and/or indicated its willingness to

implement the directions contained in communications from ITL to Asda in that connection.

6.441 The OFT notes that ITL submitted that there were instances where Asda did not implement instructions and/or requests in ITL's pricing communications.

6.442 However, the OFT considers that, the fact that there may have been some instances where Asda did not implement, did not implement fully\textsuperscript{522}, or delayed the implementation of instructions and/or requests in ITL's pricing communications, that does not negate the existence of the Infringing Agreement between ITL and Asda, as there is sufficient evidence over a period of time of Asda's compliance, or intention to comply, with ITL's retail pricing strategy (see for example the sections entitled 'Trading agreements between ITL and Asda' and 'Contacts between ITL and Asda regarding retail prices' above).

\textit{iv} Bonuses

6.443 As set out above, ITL paid an ongoing bonus to Asda:\textsuperscript{523}

'Subject to Imperial Tobacco's requirements on … Strategic Pricing being met.'

6.444 There are also documents relating to the provision of tactical bonuses from ITL to Asda, examples of which are set out in the contacts sections entitled 'Contacts between ITL and Asda regarding retail prices' above.

6.445 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Asda. In particular, the bonuses ensured that Asda's margin was not significantly affected by the changes in retail prices instructed or requested by ITL to achieve ITL's retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Asda's retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.446 The evidence demonstrates that ITL paid bonuses to Asda in order to ensure that its retail pricing strategy was maintained. Asda accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain the parities and differentials set by ITL.

\textsuperscript{522} For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.

\textsuperscript{523} Document 53, Annex 14 (page 3) (TA1) and Document 80, Annex 14 (page 5) (TA2).
Monitoring of retail prices by ITL

The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement, to spot deviations from the prices communicated (and thereby its parity and differential strategy) and communicated 'errors' to Asda.

Asda participated in this monitoring by providing ITL with details of its proposed retail prices for ITL’s brands and/or for ITL’s competitors’ brands.

Examples of documents in relation to monitoring are as follows.

A letter dated 5 October 2000 from ITL to Asda demonstrates Asda's participation in Monitoring by giving ITL advanced notice of future changes in Gallaher's pricing on its Dorchester brand:

'Subsequent to our meeting you have advised that Dorchester King Size [Gallaher brand] will move to £3.34 on 29th October and we agreed that Richmond King Size 20s and Richmond Lights 20s [ITL brands] will move to £3.34 on 29th October.'

In an email dated 31 January 2001 from ITL to Asda, ITL stated:

'... I omitted to mention in my earlier e-mail that we have noted that you have only increased Embassy No.1 K S 20s and Embassy Mild 20s [ITL brand] to £4.09 rather than the £4.10 shown on the Price File.'

In addition to showing that ITL was monitoring Asda’s prices, the OFT considers that this demonstrates that the original 'Price File' was not viewed as being a maximum price.

In an email dated 25 June 2003, ITL forwarded an internal email to Asda that stated:

'Our representatives have reported that branches 4140 (Dagenham) and 4994 (Tilehurst) were still displaying the old shelf prices yesterday. This was the case on all ITL products.'

Asda subsequently forwarded this email internally, stating:

'There have been price changes put through for most Imperial Tobacco products which don’t appear to have been actioned in your stores. Could you please confirm that these price changes have been actioned now so that customers don’t feel we are charging different prices across the chain.'

524 Document 9, Annex 14 (page 2).
ITL subsequently noted Asda’s ‘Fast action’ in a further internal email.527

6.454 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of Asda’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 4, 5, 8, 14, 21, 22528, 23, 33, 38, 40, 43, 49, 52, 60, 64, 67, 68, 69, 71, 77529 and 78 of Annex 14 (which are listed in Annex C).

6.455 These documents demonstrate that ITL monitored Asda’s retail prices of both ITL and Gallaher brands to ensure that parity and differential requirements were maintained and would point out pricing errors to Asda.

vi Conclusion on the agreement and/or concerted practice between ITL and Asda

6.456 The evidence described above demonstrates the existence of the Infringing Agreement between ITL and Asda, which had the object of restricting competition in the manner set out in Section 6.A.1: ‘The anti-competitive object of the Infringing Agreements’, given that the remaining constituent elements of the statutory test are also met (see Section 7: ‘Legal assessment’), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.457 In addition to the above, the existence of the Infringing Agreement between ITL and Asda is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- ITL and each of the other Retailers, which evidence ITL’s approach toward the Retailers as a collective; and between
- Gallaher and Asda (see below), which is part of the context of the Infringing Agreement between ITL and Asda.

528 The OFT infers that the fact that Asda provided ITL with EPOS data aided further ITL’s monitoring of Asda’s pricing (see Document 22, Annex 14 (page 9) which stated: ‘The ongoing availability of EPOS data has enabled us to monitor promotional activity …’ see also Document 46, Annex 14 (page 10)).
529 The OFT does not have a copy of the attachment named at the foot of this e-mail chain.
6.458 The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and Asda) lends further support to the fact that there was an agreement and/or concerted practice between ITL and Asda which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or concerted practice between Gallaher and Asda

6.459 When considered together with the evidence of Gallaher’s overall strategy for retail prices described at Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, the elements and evidence demonstrate that, at least from 1 March 2000 to 15 August 2003, an agreement and/or concerted practice existed between Gallaher and Asda, whereby Gallaher co-ordinated with Asda the setting of Asda’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.1: ‘The anti-competitive object of the Infringing Agreements’ the Infringing Agreement between Gallaher and Asda restricted the ability of Asda to determine its retail prices for competing linked brands and had the object of restricting competition.

6.460 The following elements evidence the Infringing Agreement between Gallaher and Asda.\(^{530}\)

\(i\) Gallaher’s strategy in relation to Asda’ retail prices

6.461 The contacts set out below between Gallaher and Asda should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.462 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher’s multiple grocer channel, demonstrate that Gallaher’s objective was that multiple grocers, of which Asda was one such grocer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

6.463 A good example is an internal Gallaher document headed ‘Promotional Policy - Retail Promotion Contributions – March 2000’, which listed the ‘Pricing Objectives’ in relation to the following brands amongst others:

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\(^{530}\) The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s multiple grocer channel, is set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, which refers to a number of other documents containing evidence of the same or similar nature.  

6.464 Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s multiple grocer channel, is set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, which refers to a number of other documents containing evidence of the same or similar nature.  

ii Contacts between Gallaher and Asda regarding retail prices  

6.465 A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and Asda regarding: (i) Asda’s retail prices for Gallaher’s brands; and (ii) the retail prices of other Retailers for Gallaher’s brands:

6.466 The documents evidencing the contacts between Gallaher and Asda demonstrate that: (i) in relation to Asda’s retail prices for Gallaher’s brands (sometimes by reference to Asda’s or other Retailers’ retail prices for Gallaher’s competitors’ brands):

- Gallaher communicated to Asda what Asda’s retail prices should be; and/or
- Gallaher asked and/or incentivised Asda to hold or alter Asda’s retail prices; and/or

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[531] ITL has distributed Marlboro since 12 September 2001.
[532] Document 1, Annex 3 (page 2). This document also set out parity and differential requirements for cigars and hand rolled tobacco.
[533] See, in particular, documents 2 to 10, 13 and 14, Annex 3.
• Asda informed Gallaher about, or discussed with Gallaher, Asda’s current or proposed retail prices.

6.467 Asda accepted and/or indicated its willingness to implement the directions contained in such communications.

6.468 In addition, Gallaher and Asda informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands.

6.469 The contacts between Gallaher and Asda took place in the context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent by Gallaher, and were received and implemented by Asda535 on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together with Asda’s desired pricing position relative to other Retailers and Asda’s desired margin.

6.470 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.471 Various examples of contacts between Gallaher and Asda regarding retail prices are set out below.

Contacts between Gallaher and Asda regarding Asda’s retail prices for Gallaher’s brands

6.472 Set out below are examples of contacts between Gallaher and Asda in relation to Asda’s retail prices for Gallaher’s brands, which demonstrate that in relation to Asda’s retail prices for Gallaher’s brands (sometimes by reference to the retail prices of competing linked brands):

• Gallaher communicated to Asda what Asda’s retail prices should be; and/or

• Gallaher asked and/or incentivised Asda to hold or alter Asda’s retail prices; and/or

• Asda informed Gallaher about, or discussed with Gallaher, Asda’s current or proposed retail prices.

6.473 Asda accepted and/or indicated its willingness to implement the directions contained in such communications.

535 See paragraph 6.499 in relation to implementation.
The examples of such contacts are as follows.

In an email from Gallaher to Asda dated 10 February 2000, Gallaher stated:

'I note retails of Classic Miniatures [ITL brand] are still 20p below that of Hamlet Miniature's [Gallaher brand], could you please reduce Hamlet Min's as follows:-

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<tr>
<td>10</td>
<td>£2.24 currently £2.44</td>
</tr>
</tbody>
</table>

Also, has the price increase on ITL 200mp for Superkings [ITL brand] seems to have been missed – this weeks survey reported £34.80 as opposed to the £35.20 price I believe they should have moved to.'

In an email from Gallaher to Asda dated 12 February 2000, in the context of an MPI, Gallaher stated:

'Gallaher’s brands should NOT be price disadvantage versus competitor’s & current price relationship’s should apply'.

In an email dated 22 March 2001, Gallaher sent Asda, a new Budget pricing schedule containing costs and retails:

'To note:

**Dorchester KS and SK** [Gallaher brand]

Hold all 20’s (currently 11p below normal 5p MPI & 6p Budget duty increase) until Sterling increases [Gallaher brand] …'

And also,

**Sterling KS and SK** [Gallaher brand]

Hold prices for all 20’s and multipacks as above

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536 Document 18, Annex 4. This document was provided to the OFT by Gallaher in response to a request from the OFT dated 12 February 2009 pursuant to the Early Resolution agreement that Gallaher had concluded with the OFT. This document is relied on by the OFT to demonstrate that the Infringing Agreement was in place before the Chapter I Prohibition came into force on 1 March 2000.

537 Document 19, Annex 4. This document was provided to the OFT by Gallaher in response to a request from the OFT dated 12 February 2009 pursuant to the Early Resolution agreement that Gallaher had concluded with the OFT. This document is relied on by the OFT to demonstrate that the Infringing Agreement was in place before the Chapter I Prohibition came into force on 1 March 2000.

538 Document 3, Annex 4
As and when 100mp’s are increased I will then fund a new Sterling (100mp KS/SK) [Gallaher brand] price point (probably £16.05/£16.09).

... 

**Amber Leaf** [Gallaher brand]

Revert to normal prices ~i.e go up budget increase + remove ‘extra’ price cut. New prices therefore £2.09/£4.10/£8.11’.

[Emphasis as in source document]

The final paragraph of the email stated:

‘All cigarettes 10’s packs are shown at RRP on the schedule (if you are selling below rrp on competitor brands please adjust accordingly.

Our objective is to maintain price differentials at discounted prices. All extra discounts for reduced retails are confirmed on the attached.’ [Emphasis as in source document]

6.478 The email above shows Gallaher giving pricing instructions to Asda. In the final paragraph, Gallaher specifically requested that Asda adjust retail prices on Gallaher’s brands if Asda was selling below RRP on competitor brands. The OFT considers that this is evidence of Gallaher seeking to maintain differentials.

6.479 Also on 22 March 2001, Gallaher sent a further email to Asda:

'Can you please arrange to increase Dorchester [Gallaher brand] retails in line with the MPI increase from 1st April. I believe that Richmond [ITL brand] will be increasing on this date as well? Please advise if this is not the case.

Therefore: -

**Dorchester KS 20’s** [Gallaher brand] should therefore be £3.39

**Dorchester SK 20’s** [Gallaher brand] should therefore be £3.40.

As Richmond 100mp [ITL brand] still has price marked pack in the trade the price for Dorchester KS & SK 100mp’s [Gallaher brand] should not be increased.

As regards the BUDGET price holding on Sterling [Gallaher brand] I would like to increase 20’s in line with the above (which will result in Sterling increasing + 5p for 20 with +1p still to go) and continue to hold the 100mp prices, therefore:-

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539 Document 3, Annex 4
Sterling KS 20's should therefore be £3.34.
Sterling SK 20's should therefore be £3.37

I have updated retail prices for 20's on the attached …'

[emphasis as in source document]

A spreadsheet for 'Asda Ltd Cost and Retail Prices' for Gallaher’s brands was attached to the email.

6.480 In the first section of the 22 March 2001 email above, Gallaher requested that Asda increase retail prices for its Dorchester brand on 1st April. Gallaher stated that ITL’s Richmond brand 'will be increasing on this date as well?' but asked Asda to 'Please advise if this is not the case'.

6.481 It is also relevant to note that in the latter part of the 22 March 2001 email above Gallaher specified absolute price points for its Dorchester and Sterling brands, for example:

'Dorchester KS 20’s should therefore be £3.39', and

'Sterling KS 20’s should therefore be £3.34'.

[Emphasis as in source document]

6.482 In an email dated 5 June 2002 from Gallaher, to Asda, Gallaher stated:

'Please find attached the MPI cost and retail spreadsheet. I would be grateful if you would action the following:- '

The email listed a number of Gallaher brands which Gallaher expected Asda to hold the prices on: Berkeley (all 20s, 100s and 200s) Dorchester KS (20s and MPs), Dorchester SK (20s and 100s), Hamlet Minis (10s and 50s), King Six (6s and 30s) and Samson (all packings). The email also listed price increases for Camel (all 20s and 100mps).

6.483 A subsequent email (in the same chain) dated 1 July 2002, from Gallaher to Asda stated:

'. . . further to this mornings telephone call please also HOLD the retails of Hamlet range [Gallaher brand] (5’s £2.78, 10’s £5.51 and 5x5mp £13.64) as confirmed on the attached …'

6.484 In an email dated 5 September 2002, from Gallaher to Asda, Gallaher made pricing requests in context of bonus payments:

'Can you kindly make the following changes as the price holding bonus support will cease (on MPI price holds) or be reduced

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540 Document 3, Annex 4
541 Document 7, Annex 4
542 Document 8, Annex 4
The remainder of the email set out new absolute price points for Berkeley, Hamlet, Mayfair, Hamlet miniatures, Dorchester, Kings Six and Old Holborn [all Gallaher brands].

6.485 In a further email dated 17 October 2002, from Gallaher to Asda, Gallaher stated:

'Can you kindly make the following changes as the extra price holding bonus support will cease or be reduced from 3rd November. These are lines which have been held in price since the budget and where we have sought to gradually move prices up over time (there are no cost price changes.)'

The 'lines' set out included Mayfair KS and SK, Dorchester KS and SK and Sterling KS and SK [all Gallaher brands].

6.486 In an email dated 20 December 2002 from Gallaher to Asda, Gallaher communicated required pricing as follows:

'Please note that from the 1st January 2003 the bonus on 20’s for Silk Cut house and Benson & Hedges SK (off invoice) will be adjusted. The retail price will need to increase by +2p for 20 …'

6.487 In an email dated 10 April 2003, from Gallaher to Asda, Gallaher stated:

'. . .please find attached the new C&R post Budget schedule, Sterling Price list, Gallaher Multipack Price List and Gallaher (E&OE) Trade Price list on which I have based the C&R schedule.'

In the same email Gallaher also stated:

'Old Holborn 12.5g/25g/50g [Gallaher brand] £2.29/£4.49/£8.87 (to retain Old Holborn’s market position v. Golden Virginia [ITL brand]).'

6.488 Similarly, an email dated 23 June 2003 from Gallaher to Asda included the following pricing communication under the heading 'Asda – new MPI price schedule (July 2003)'.

'Old Holborn £2.33/£4.57/£9.03 (to match GV) [Golden Virginia, an ITL brand]'.

543 Document 9, Annex 4
544 Document 10, Annex 4
545 Document 11, Annex 4
546 Document 13, Annex 4
6.489 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and Asda regarding Asda’s retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 2, 4, 6, 12, 15 to 17 of Annex 4 (which are listed in Annex C).

Contacts between Gallaher and Asda regarding the retail prices charged by Asda’s competitors

6.490 In addition to the documents above, there were contacts between Gallaher and Asda in which Gallaher and Asda informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands.

6.491 Examples of such contacts are as follows.

6.492 An email from Gallaher to Asda dated 3 September 2002 stated:

'Most of Gallaher lines currently "price held" will be moving up across the Multiple Grocer's from w/c 16th [another retailer]/JS/ Safeway/Kwik Save and Somerfield.'

6.493 As noted above, in an email dated 20 December 2002 from Gallaher to Asda, Gallaher communicated required pricing as follows:

'Please note that from the 1st January 2003 the bonus on 20’s for Silk Cut house and Benson & Hedges SK (off invoice) will be adjusted. The retail price will need to increase by + 2p for 20 …'

6.494 Asda advised by email on 24 December 2002 that they [C] and asked if the increase could:

547 In the absence of any indication to the contrary from Gallaher, although no covering correspondence is on the OFT’s file, the OFT has inferred that this document was sent to Asda. The document, a spreadsheet, contains a bonuses column headed 'Off Inv. Discount' and 'H.O. Discounts' ('1/4 retro' and 'Special'), a column on standard retail selling prices and a 'Comments' column which details actual price points and 'price hold' information.

548 This document contains evidence of a pricing instruction. The OFT notes the change in language used from Document 14 onwards, in that Document 14 refers to a 'maximum resale price' and states that 'Asda is at all times free to sell its products at a price lower than that which is supported by any Gallaher bonus payment'. Such changes in language are stark when compared to the language used in long-standing previous correspondence. The OFT infers that this is not how the situation was understood by Asda to be at least prior to the date of Document 14 (that is, 30 July 2003).

549 Document 7, Annex 4
550 Document 10, Annex 4
'come into effect from 6th Jan?’ Have [another retailer] been told the same...remember Mayfair [Gallaher brand] … I do.’

The OFT infers that the reference to [another retailer] in the above email is a reference to [another retailer].

6.495 In an email dated 30 December 2002, from Gallaher to Asda, Gallaher responded to the email of 24 December 2002 on the implementation dates for retail price changes in respect of Gallaher brands confirming that 6th January would be an acceptable implementation date for the changes, that a related bonus would be paid retrospectively and that Gallaher had taken this action across all retail accounts:552

'Go with the 6th for the retail price change (Silk Cut KS /100s – all 20s [Gallaher brands]) and I’ll pay via retro at the end of the month ... As regards competitors, we have taken this action across all retail accounts without exception.

...

nb Mayfair [Gallaher brand] retail in [another retailer] is not supported by us …’

6.496 Asda responded on 7 January 2003 stating: 'All understood.' The OFT considers that this chain of emails between Gallaher and Asda demonstrates Asda’s acceptance of a pricing instruction from Gallaher.

6.497 It can be seen from the above that references by Gallaher to the retail prices of other Retailers provided an assurance to Asda that retail price changes put to Asda by Gallaher would not cause Asda to be out of step with its retail competitors.

**Conclusion on the contacts between Gallaher and Asda**

6.498 In conclusion in relation to all the contacts between Gallaher and Asda regarding retail prices, the above paragraphs demonstrate that there were regular contacts between Gallaher and Asda, which related to the retail prices of Asda and sometimes included references to retail competitors. The evidence of such contacts together with the context of Gallaher’s strategy demonstrates that Gallaher’s retail pricing strategy was for Asda to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. The contacts between Gallaher and Asda assisted the implementation of that strategy, through communications from Gallaher in relation to Asda’s retail prices for Gallaher’s brands and in some cases Gallaher ’s competitors' brands, the aim of which was to

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ensure that Gallaher's desired parities and differential requirements were maintained or realigned. The contacts between Gallaher and Asda also demonstrate that Asda accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher to Asda in that connection.

6.499 The OFT does not exclude the possibility that there may have been some instances where Asda did not implement, did not implement fully\textsuperscript{553}, or delayed the implementation of instructions and/or requests in Gallaher's pricing communications. However, the OFT considers that does not negate the existence of the Infringing Agreement between Gallaher and Asda, as there is sufficient evidence over a period of time of Asda's compliance, or intention to comply, with Gallaher's retail pricing strategy (see for example the sections entitled 'Contacts between Gallaher and Asda regarding retail prices' above).

\textit{iii} \hspace{1em} \textbf{Bonuses}

6.500 There are documents relating to the provision of tactical bonuses from Gallaher to Asda, examples of which are set out in the section entitled 'Contacts between Gallaher and Asda regarding retail prices' above.

6.501 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Asda. In particular, the bonuses ensured that Asda's margin was not significantly affected by the changes in retail prices instructed or requested by Gallaher to achieve Gallaher's retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Asda's retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement. Asda accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

\textit{iv} \hspace{1em} \textbf{Monitoring of retail prices by Gallaher}

6.502 A number of documents sent by Gallaher to Asda contained spreadsheets headed 'Asda Ltd cost and retail prices' and 'Gallaher Ltd', with a bonuses column headed 'Off Inv. Discount' and 'H.O. Discounts' ('1/4 retro' and 'Special'), a column on standard retail selling prices and a 'Comments' column which details actual price points and 'price hold'

\textsuperscript{553} For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
information. The OFT infers that these spreadsheets were used to assist Gallaher’s monitoring of Asda’s prices (as well as to communicate its general pricing strategy and record bonus payments).

 Authors: Gallaher and Asda

6.503 The evidence described above demonstrates the existence of the Infringing Agreement between Gallaher and Asda which had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ above and, given that the remaining constituent elements of the statutory test are also met (see Section 7: ‘Legal assessment’), amounted to a breach of the Chapter I Prohibition.

vi Further supporting evidence

6.504 In addition to the above, the existence of the Infringing Agreement between Gallaher and Asda is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher’s approach towards the Retailers as a collective; and between
- ITL and Asda (see above), which is part of the context of the Infringing Agreement between Gallaher and Asda.

6.505 The existence of the further supporting evidence described above (and in particular the relationship between ITL and Asda) lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and Asda which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.

554 Further spreadsheets are contained in Documents 2, 3, 5, 8 and 9, Annex 4
(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.506 As noted in the sections above relating to the existence of an Infringing Agreement between each of ITL/Asda and Gallaher/Asda, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.507 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Asda and that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d)).
II Agreement and/or concerted practice between ITL and the Co-operative Group and between Gallaher and the Co-operative Group

Summary

6.508 As set out in Section 6.C.II.(a) below, ITL and the Co-operative Group were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby ITL co-ordinated with the Co-operative Group the setting of the Co-operative Group’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.509 As set out in Section 6.C.II.(b) below, Gallaher and the Co-operative Group were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby Gallaher co-ordinated with the Co-operative Group the setting of the Co-operative Group’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher, in pursuit of Gallaher’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.510 Each of the Infringing Agreements between ITL/the Co-operative Group and Gallaher/the Co-operative Group amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to the Co-operative Group and that each Manufacturer must have been aware555 of the other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of the Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and increased

555 See also Section 6.A.I.(b) above in relation to the Manufacturers’ awareness of each other’s parallel and symmetrical parity and differential requirements.
the inherently restrictive nature of each Infringing Agreement, as set out in Section 6.A.I.(d) above.

6.511 Reference is made in paragraphs 7.6 to 7.16 below in relation to the role of the Co-operative Group within CRTG in respect of the Infringing Agreements.

6.512 On 11 July 2008, Gallaher concluded an early resolution agreement with the OFT, pursuant to which Gallaher admitted its involvement in each Infringing Agreement to which it was party, in breach of the Chapter I Prohibition.

(a) Agreement and/or concerted practice between ITL and the Co-operative Group

6.513 When considered together with the evidence of ITL’s overall strategy for retail prices described in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, the evidence referred to below demonstrates that, at least from 1 March 2000\textsuperscript{556} to 15 August 2003, an Infringing Agreement existed between ITL and the Co-operative Group, whereby ITL co-ordinated with the Co-operative Group the setting of the Co-operative Group’s retail prices for tobacco products in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. For the reasons set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between ITL and the Co-operative Group restricted the ability of the Co-operative Group to determine its retail prices for competing linked brands and had the object of restricting competition.

\textsuperscript{556} A letter from ITL to the Co-operative Group dated 14 August 2000 (Document 4, Annex 15) which set out the terms of the trading agreement between the Co-operative Group and ITL for 2000 made clear that the period covered by that agreement was from 1 January 2000 in the hand written annotations (made, the OFT infers, by an employee of the Co-operative Group given that this document was provided to the OFT by the Co-operative Group) and confirmed that the ‘Yearly maximum payment’ of ‘£C’ was to be paid ‘in full’ (page 2). In addition, the letter indicated that there were 13 promotion periods in the year 2000 and that ITL would pay the Co-operative Group ‘£C per promotion period’ for maintaining ‘strategic pricing differentials’. An e-mail dated 2 March 2000 (Document 1, Annex 15) from the Co-operative Group to ITL attached a CRTG pricing matrix relating to ‘Period 3 Promotion’. The OFT infers from this e-mail that Promotion Periods 1 and 2 pre-dated 2 March 2000 and, therefore, the Infringing Agreement existed at least from 1 March 2000.
6.514 The following elements evidence the Infringing Agreement between ITL and the Co-operative Group:

\[\text{i} \quad \text{ITL’s strategy in relation to the Co-operative Group’s retail prices}\]

6.515 The trading agreements and contacts set out between ITL and the Co-operative Group below should be considered in the context of ITL’s retail pricing strategy as set out in Section 6.B: 'Manufacturers' retail pricing strategies' above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

6.516 A presentation document entitled 'Imperial Tobacco & Co-op Meeting June 6th 2001' contained a page headed 'National Account Sales Strategy', and stated that there should be a:

\['\text{Pragmatic approach to pricing to achieve [RRP] differentials that exist between competitors brands}'].

6.517 An ITL internal 'National Accounts Business Development Plan' prepared in January 2002 by ITL’s National Account Manager for the Co-operative Group, stated under the heading 'Strategy for the period 1.1.02 until 31.12.02' that 'key objectives' included 'Continue to achieve ITL Strategy Pricing'. Above that wording, a handwritten annotation added: 'Increased support from CRTG SM in applying the pricing strategy'.

6.518 The same document stated:

\['\text{I expect CWS Retail to challenge the strategy pricing differentials during this year. They believe that the manufacturers are restricting promotion and activity by demanding strategic differentials. This will affect all manufacturers over the coming year.}']

\[\text{ii} \quad \text{Trading agreements between ITL and the Co-operative Group}\]

6.519 There were four trading agreements between ITL and the Co-operative Group as the representative member of CRTG, dated 14 August 2000, 21

\[\text{557 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.}\]

\[\text{558 The OFT obtained this document from ITL and so infers that it was prepared by ITL (Document 8, Annex 15 (Slide 5)).}\]

\[\text{559 Document 11, Annex 15 (page 7).}\]

\[\text{560 Document 11, Annex 15 (page 8).}\]
May 2001, 13 May 2002 and 8 July 2003\(^{561}\). Those agreements were a relevant aspect of the ongoing commercial dealing between ITL and the Co-operative Group and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and the Co-operative Group in relation to retail prices.

\[
\begin{align*}
6.520 & \text{ The terms of the first trading agreement ('TA1')}^{562}, \text{ were set out in a letter dated 14 August 2000}^{563} \text{ from ITL to the Co-operative Group in relation to the period of '2000'. The terms of the second trading agreement ('TA2'), were set out in a letter dated 21 May 2001}^{564} \text{ from ITL to the Co-operative Group in relation to the period of '2001'. The terms of the third trading agreement ('TA3') were set out in a letter dated 13 May 2002}^{565} \text{ from ITL to the Co-operative Group in relation to the period of '2002'. The terms of the fourth trading agreement ('TA4'), were set out in a letter dated 8 July 2003}^{566} \text{ from the Co-operative Group to ITL in relation to 'the period of 1 January 2003 to 31 December 2003'.}
\end{align*}
\]

\[
\begin{align*}
6.521 & \text{ TA1 and TA2 contained the following clauses, among other matters:}^{567}
\end{align*}
\]

\[
\begin{align*}
& '\text{This agreement requires the support of all CRTG members on an ongoing basis during the year.}'
\end{align*}
\]

\[
\begin{align*}
& '\text{The four main objectives of the plan are to ensure that Imperial Tobacco products are}'
\end{align*}
\]

\[
\begin{align*}
& '\text{• Priced at all times inline with the agreed strategic price differentials.}'
\end{align*}
\]

\[
\begin{align*}
& '\text{The achievement of these specific objectives will result in incentive payments being made to CRTG under the overall heading of "Performance Award" payments. The specific details of the four elements of the agreement are listed below.}'
\end{align*}
\]

\[
\begin{align*}
& '\text{PRICING STRATEGY}'
\end{align*}
\]

\[
\begin{align*}
561 & \text{ See Section 7.B.I: 'The Co-operative Group' below for further details on the role of the Co-operative Group in relation to CRTG in the context of the Infringing Agreements.}
\end{align*}
\]

\[
\begin{align*}
562 & \text{ Document 4, Annex 15.}
\end{align*}
\]

\[
\begin{align*}
563 & \text{ This is a letter from ITL addressed to 'CWS Retail' and is stated to be 'in confirmation of the 2000 trading agreement between CRTG and Imperial Tobacco Ltd'. It also stated that the agreement would be 'on behalf of all the CRTG members'. The OFT infers that the entity that was to enter into the agreement was the Co-operative Group, as a retailer and/or member of the CRTG (see Section 7.B.I: 'The Co-operative Group').}
\end{align*}
\]

\[
\begin{align*}
564 & \text{ Document 7, Annex 15.}
\end{align*}
\]

\[
\begin{align*}
565 & \text{ Document 14, Annex 15.}
\end{align*}
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\[
\begin{align*}
566 & \text{ Document 24, Annex 15.}
\end{align*}
\]

\[
\begin{align*}
\end{align*}
\]
• *Price at all times inline with the agreed strategic pricing differentials.*

*A copy of the agreed differentials is attached. This payment is agreed to reward the consistent price control offered by CRTG within the current three\textsuperscript{568} price brands that are currently operated.*

*All Imperial brands must achieve this strategy across the complete CRTG group for the payment to be made.*

*Maximum levels of payment will £[ ]\textsuperscript{569} per promotion period.*

\textbf{Yearly maximum payment $[ ] \times \mathbf{E}[ ] = \mathbf{E}[ ]$\textsuperscript{570}} [emphasis as in source document]

In addition, the first page of TA1 contained handwritten annotations dated 25 January 2001, along with a handwritten tick:\textsuperscript{571}

\textit{‘25/01/01 Final agreed sum: … Pricing/merchandising £[C].’}

6.522 There were additional handwritten annotations on the second page of TA1\textsuperscript{572} next to a reference to the ‘\textit{Yearly maximum payment}’ calculation which stated:\textsuperscript{573}

\textit{‘25/01/01 To be paid in full’}.

6.523 In view of the foregoing, the OFT takes the view that the Co-operative Group, not only agreed to the requirement to ‘\textit{price at all times inline with agreed strategic price differentials}’, but also implemented that requirement for the 13 promotional periods on the basis that CRTG was to be paid the maximum yearly payment from ITL for compliance with the obligation to ‘\textit{Price at all times within the strategic price differentials}’. 

6.524 TA3 set out the following:\textsuperscript{574}

\textit{‘This trading agreement is designed to support CRTG in the aim of achieving category performance through the industry-accepted disciplines within the Tobacco category. The elements included cover: … Pricing & Promotion: Supporting differentials…’}

\textbf{...}

\textsuperscript{568} Document 4, Annex 15 (TA1). Document 7, Annex 15 (TA2). In document 4, Annex 15, ‘four’ was deleted by hand and replaced by ‘3’.

\textsuperscript{569} TA1 £[C], TA2 £[C].

\textsuperscript{570} TA1[ ]\times \mathbf{E}[ ] = \mathbf{E}[ ], TA2[ ]\times \mathbf{E}[ ] = \mathbf{E}[ ].

\textsuperscript{571} Document 4, Annex 15 (page 1). Most likely made by the relevant Category Buyer or one of his colleagues, as this document was provided to the OFT by the Co-operative Group.

\textsuperscript{572} These were most likely made by the relevant Category Buyer.

\textsuperscript{573} Document 4, Annex 15 (page 2).

\textsuperscript{574} Document 14, Annex 15 (pages 2, 4 and 5).
‘PRICING & PROMOTION

This element of the agreement is designed to ensure Imperial Tobacco products are priced in line with the industry agreed strategic pricing differentials across all segments of the tobacco category. A copy of the agreed differentials is attached.

This payment is agreed to reward the consistent price disciplines offered by CRTG within the current three price bands currently operated.

All Imperial brands must achieve this strategy across the complete CRTG group for the payments to be made.

... A payment of £[C] per promotion period is payable, if the pricing strategy and the [C] is as agreed above.

If the pricing is not to strategy then £[C] will be withdrawn from the [C].

... The annual maximum payment for this element of the plan is [C] × £[C] = £[C].’

6.525 A letter dated 5 July 2002575 from the Co-operative Group to ITL attached a copy of TA3576. In that letter the Co-operative Group, on behalf of CRTG, confirmed its agreement to the terms of the trading agreement and, in particular, confirmed the level of payments to be made by ITL to the CRTG, including in respect of ‘Pricing and Promotion’.

575 Document 16, Annex 15. The OFT considers that the handwritten annotations on page 5 of this document do not materially alter the typewritten terms of the TA3. The annotations consist of two small crosses by each of the first two paragraphs of the ‘Pricing and Promotion’ terms of TA3, which stipulated:

‘This element of the agreement is designed to ensure Imperial Tobacco products are priced in line with the industry agreed strategic pricing differentials across all segments of the tobacco category. A copy of the agreed differentials is attached. This payment is agreed to reward the consistent price disciplines offered by CRTG within the current three price bands currently operated.’

These paragraphs have not been struck through, nor has any issue in respect of pricing and promotional terms been raised in the covering letter to the trading agreement. Therefore, the OFT takes the view that the annotations do not indicate disagreement with the typewritten terms of the trading agreement. The OFT considers it more likely that the annotations are intended to draw attention to important typewritten terms.

576 This is identical to the copy that was sent on 13 May 2002, Document 14, Annex 15.
6.526 The Co-operative Group’s agreement and commitment to the terms of TA3 were further emphasised in a letter dated 9 July 2002 from the Co-operative Group to ITL, which stated:  

‘... I can confirm that with regard to price positioning the following general guidelines will be adopted by CRTG in establishing retail prices across the various store brands.

In terms of the price differentials we are currently putting together a price matrix for CRTG which defines our strategic pricing position. This document will recognise the need to maintain price differentials across the competing segments of the tobacco category.

In addition the price guidelines will ensure consistent price disciplines are applied by CRTG across the price bands currently operated.

...

Therefore, based on the above, which summarises the agreed positioning at our recent meetings, we are confident that we have satisfied the requirements to ensure the payment of the on-going off-invoice support discounts and the negotiated central payments in respect of pricing and promotion.’

The OFT considers the words 'we are confident that we have satisfied the requirements...' in the above document indicate that the Co-operative Group had taken account of ITL’s 'strategic price differentials' in formulating its own pricing policy.

6.527 The above letter was acknowledged by ITL in a letter dated 12 July 2002 to the Co-operative Group.

6.528 The OFT has not been able to obtain a copy of the 'agreed differentials' stated to be attached to TA1, TA2 and TA3. Nevertheless, the OFT is of the view that given ITL’s pricing strategy in regards to Retailers including the Co-operative Group, it is likely that the parity and differential requirements referred to in TA1, TA2 and TA3 were similar to those agreed for the same period by ITL and other Retailers to the extent that they would have set out parity and differential requirements between

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577 Document 17, Annex 15.
578 Document 18, Annex 15.
579 Both ITL and the Co-operative Group have confirmed (in ITL’s response dated 11 April 2005 to the OFT’s section 26 request and the Co-operative Group’s letter to the OFT dated 28 March 2006 – Document 5, Annex 13 and Document 2, Annex 23 respectively) that they no longer had in their possession and were not aware of the whereabouts of the document setting out the parity and differential requirements purportedly attached to Document 4, Annex 15.
competing linked brands of both Manufacturers (see the other ITL trading agreements referred to in this Section 6.C.i-X). There is further support for this inference at paragraph 6.77 of ITL’s Response dated 24 April 2008 to the Statement of Objections, which stated:

‘From ITL’s perspective, the differential provisions were simply a reflection of the differences between the RRPs ... of the relevant ITL brands and the respective benchmark competitor brands.’

6.529 TA4 contained the following clause:

‘Total Support £[C] – To [C], pricing, promotions and Marlboro [ITL brand] support. To be paid in four equal instalments of £[C].’

6.530 TA4 does not set out the Co-operative Group’s obligations in relation to ‘pricing’, but the OFT is of the view that this payment by ITL was in part in return for certain entities, including the Co-operative Group, complying with pricing obligations under TA4 identical or similar to those contained in TA1, TA2 and TA3, including the obligation to set retail prices in line with ITL’s desired parity and differential requirements.

6.531 That is demonstrated by the discussion of the terms of TA4 in a letter to the Co-operative Group dated 12 May 2003, under a sub-heading entitled ‘2003 Trading Terms’, in which ITL referred to the ‘maximum amount payable to CRTG for 2002’ in relation to pricing obligations and stated that:

‘I am proposing an increase for 2003 trading year to £[C], an increase of over [C]% from 2002 payments. This increased figure will cover CRTG including the Alldays estate ... The elements behind this payment ... must cover all the disciplines as covered in the 2002 agreement’.

The OFT notes that the ‘disciplines’ covered in the ‘2002 agreement’ (TA3) included obligations relating to pricing.

6.532 In a letter dated 23 May 2003, ITL confirmed its proposed terms for the TA4:

‘...a large element of the terms agreement concerns retail price relationships within your stores. ...

I will expect all CRTG societies and Co-operative stores to operate retail prices at the price tiers set out in your pricing matrix. If there are any exceptions, I reserve the right to reduce invoice investment accordingly.’

580 Document 24, Annex 15 (Clause 1).
The OFT infers that the reference to 'retail price relationships within your stores' relates to the relationships between the prices of different brands and hence to ITL’s desired parity and differential requirements. Further, the OFT infers that the reference to 'I reserve the right to reduce invoice investment accordingly' is further evidence of the link between bonuses offered by ITL and the retail prices set by the Co-operative Group.

The OFT notes that at least the pricing element of TA4 also applied to the Alldays stores that the Co-operative Group acquired in 2002, as the payment made by ITL to the Co-operative Group in relation to TA4 was explained in ITL’s letter of 23 May 2003 as having been increased by ITL to £\[C\]:

’in recognition of the integration of the Alldays estate into your business’.

In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which the Co-operative Group would set its retail prices in accordance with the parity and differential requirements set by ITL, and that the Co-operative Group was rewarded with the payment of a bonus for compliance with ITL’s parity and differential requirements.

### iii Contacts between ITL and the Co-operative Group regarding retail prices

A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and the Co-operative Group regarding the Co-operative Group’s retail prices for ITL’s brands.

The documents evidencing the contacts between ITL and the Co-operative Group demonstrate that in relation to the Co-operative Group’s retail prices for ITL’s brands:

- ITL communicated to the Co-operative Group what the Co-operative Group’s retail prices should be; and/or
- ITL asked and/or incentivised the Co-operative Group to hold or alter the Co-operative Group’s retail prices; and/or
- the Co-operative Group informed ITL about, or discussed with ITL, the Co-operative Group’s current or proposed retail prices.

The Co-operative Group accepted and/or indicated its willingness to implement the directions contained in such communications.

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584 See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’. 
6.539 The contacts between ITL and the Co-operative Group took place in the context of ITL’s retail pricing strategy for Retailers to maintain specified parities and differentials between ITL’s brands and competing linked brands. Communications in relation to retail prices were sent by ITL, and were received and implemented by the Co-operative Group on the understanding that the notified retail prices took into account ITL’s retail pricing strategy, together with the Co-operative Group’s desired margin.

6.540 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.541 Various examples of contacts between ITL and the Co-operative Group regarding retail prices are set out below.

6.542 The Co-operative Group sent pricing matrices for ITL’s brands to ITL in advance of every promotional period of four weeks (in 2000) or three weeks (from 2001), usually accompanied by a request that ITL ‘check’ and/or ‘confirm’ the contents of the matrix.

6.543 For example, in an email dated 2 March 2000, the Co-operative Group requested that ITL: ‘check the Period 3 Matrix and confirm all is ok.’

6.544 In an email dated 5 February 2001, the Co-operative Group requested that ITL: ‘check its contents carefully and confirm these to be correct …’

6.545 For all ITL brands sold by the Co-operative Group, these matrices listed the cost price, bonuses, RRP, retail prices in the Co-operative Group’s price tiers and the Co-operative Group’s percentage margin for each price tier, as well as any changes made to these figures for the relevant period. The Co-operative Group asked ITL to confirm that the matrices were

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585 See paragraphs 6.551 to 6.552 in relation to implementation.
586 Document 1, Annex 15.
588 Document 5, Annex 15.
589 The Co-operative Group explained the contents of its pricing matrices in a table at paragraph 8.6 of its response dated 29 April 2005 to the OFT’s section 26 Notice. The table indicated that one of the columns in the Co-operative Group’s pricing matrix lists ‘O/I...off-invoice discount...’ which was the on-going bonus paid by ITL to the Co-operative Group under TA1, TA2, TA3 and TA4. The explanation at paragraph 8.6 was provided ‘with reference to the Gallaher price matrix, period 3, 2000’, but there is no suggestion that the Co-operative Group’s pricing matrices are different in structure/content for Gallaher and ITL or are different across promotion periods.
correct, clearly not only referring to the cost price information but also to the retail price information.

6.546 According to the Co-operative Group’s response to the OFT’s section 26 Notice\(^{590}\), these matrices formed part of ITL’s monitoring of its prices and were meant to demonstrate that the Co-operative Group’s proposed retail prices met the requirements for the payment of bonuses by ITL which were linked to the Co-operative Group’s retail prices and any promotion support package (see paragraph 6.561 below).

6.547 There is evidence that ITL, at least occasionally, responded to the Co-operative Group’s requests to ‘check’ and/or ‘confirm’ the contents of the pricing matrices. An email dated 15 January 2002 from the Co-operative Group to ITL stated:\(^{591}\)

‘Please see attached Period 2 pricing file. Please check and confirm acceptance of these terms’.

6.548 ITL responded on 15 January 2002, as follows:\(^{592}\)

‘Regal Filter [ITL brand] has returned to the same price as Regal KS not 2p below as we agreed. Raffles 10’s [ITL brand] cost is 6p out as BDD\(^{593}\) has not been added to your matrix’.

6.549 In an email dated 2 May 2001 from ITL to the Co-operative Group, ITL stated:\(^{594}\)

‘I notice that you have increased the Richmond [ITL brand] family prices for this period. I am concerned that you will move a long way from the market price which will remain at £3.44 KS/3.45 S/kings … I suggest you remain at your current prices.

The £16.75 PMP will be effective from period 7, with the following costs …

Bonus [C]p Retro Bonus [C]p…”

\(^{590}\) The Co-operative Group’s response dated 29 April 2005 to the OFT’s section 26 Notice paragraphs 8.2 and 8.3 Document 25, Annex 15. Document 3 (an internal ITL document referring to the matrix in Document 2) shows that ITL used the matrix to monitor the prices in the Co-operative Group’s stores.

\(^{591}\) Document 12, Annex 15.

\(^{592}\) Document 12, Annex 15.

\(^{593}\) ‘BDD’ signifies a ‘reduction to the list price available dependent on ordering a certain volume on individual deliveries to warehouses’: see the Co-operative Group’s response dated 29 April 2005 to the OFT’s section 26 notice, paragraph 8.6 Document 25, Annex 15.

\(^{594}\) Document 6, Annex 15.
Conclusion on the contacts between ITL and the Co-operative Group

6.550 In conclusion in relation to all the contacts between ITL and the Co-operative Group regarding retail prices, the above paragraphs demonstrate that there were contacts between ITL and the Co-operative Group, which related to the retail prices of the Co-operative Group. The evidence of such contacts, together with the context of ITL’s strategy demonstrates that ITL’s retail pricing strategy was for the Co-operative Group to maintain specified parities and differentials between ITL’s brands and competing linked brands. The contacts between ITL and the Co-operative Group assisted the implementation of that strategy, through communications in relation to the Co-operative Group’s retail prices for ITL’s brands the aim of which was to ensure that ITL’s desired parities and differential requirements were maintained or realigned. The contacts between ITL and the Co-operative Group also demonstrate that, by sending to ITL pricing matrices for checking and/or approval, the Co-operative Group accepted and/or indicated its willingness to implement directions from ITL to the Co-operative Group in that connection.

6.551 The OFT notes that ITL and the Co-operative Group submitted that there were instances where the Co-operative Group did not implement instructions and/or requests in ITL’s pricing communications.

6.552 However, the OFT considers that the fact that there may have been some instances where the Co-operative Group did not implement, did not implement fully, or delayed the implementation of instructions and/or requests in ITL’s pricing communications does not negate the existence of the Infringing Agreement between ITL and the Co-operative Group, as there is sufficient evidence over a period of time of the Co-operative Group’s compliance, or intention to comply, with ITL’s retail pricing strategy (see the sections entitled ‘Trading agreements between ITL and the Co-operative Group’ and ‘Contacts between ITL and the Co-operative Group regarding retail prices’ above).

iv  Bonuses

6.553 As set out above in relation to TA1, TA2, TA3 and TA4, ITL paid an ongoing bonus to the Co-operative Group on the condition that, among other matters, the Co-operative Group priced ITL’s brands:

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595 For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
‘... at all times inline with the agreed strategic price differentials’ (TA1 and TA2)\textsuperscript{596}

‘... in line with the industry agreed strategic pricing differentials across all segments of the tobacco category’ (TA3)\textsuperscript{597}

'Total support £[C] – To [C], pricing, promotions and Marlboro [ITL brand] support. To be paid in four equal instalments of £[C]' (TA4)\textsuperscript{598}.

6.554 Furthermore, the price matrices referred to above demonstrate the payment of tactical bonuses by ITL to the Co-operative Group. The level of any tactical bonus was specified in the column headed ‘Retro’ on the right hand side of the price matrix - the side dealing with ‘Promotional Pricing’. The right hand side of the price matrix also specified the promotional Retail Shelf Price (RSP) for each of the Co-operative Group’s three retail price tiers. The promotional RSP would be reduced relative to the normal RSP specified in the left hand side of the matrix. Where a ’Retro’ and promotional RSPs were specified, the ’Notes’ to the price matrix stated:

‘Retro paid on sales out on reduced rsts only’\textsuperscript{599},

or

‘Retro paid on stated rsts only’\textsuperscript{600},

or

‘Retro bonus applicable to reduced RSPs only’\textsuperscript{601}.

6.555 The OFT, therefore, concludes that the payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was directly linked to the retail prices to be charged by the Co-operative Group. In particular, the bonuses ensured that the Co-operative Group’s margin was not significantly affected by the changes in retail prices instructed or requested by ITL to achieve ITL’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of the Co-operative Group’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.556 The evidence demonstrates that ITL paid bonuses to the Co-operative Group in order to ensure that ITL’s retail pricing strategy was maintained.

\textsuperscript{597} Document 14, Annex 15.
\textsuperscript{598} Document 24, Annex 15.
\textsuperscript{599} Document 2, Annex 15 at page 2.
\textsuperscript{600} Document 9, Annex 15 at page 2.
\textsuperscript{601} Document 19, Annex 15 at page 5.
The Co-operative Group accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by ITL.

vi Monitoring of retail prices by ITL

6.557 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to the Co-operative Group.

6.558 The evidence also demonstrates that the Co-operative Group participated in this monitoring by checking its prices with ITL in advance of providing ITL with details of its proposed retail prices for ITL’s products (see paragraphs 6.542 to 6.545 above).

6.559 The Co-operative Group's seeking and receiving confirmation of its proposed retail prices through the provision of price matrices as described at paragraphs 6.542 to 6.545 above, in conjunction with ITL’s general monitoring of the Co-operative Group’s retail prices for ITL’s products enabled the checking and approval of the Co-operative Group’s prices by ITL.

6.560 In a fax to the Co-operative Group dated 29 April 2002, ITL stated:

'Richmond Family' [ITL brand]

Having looked at the CRTG pricing for yesterday's calls, I am very concerned about the Richmond Family pricing.

The matrix indicates the KS should be 3.52/54/56 and the Superkings should be 3.53/55/56. In the 82 calls covered yesterday only 31 were at the right prices.

The other 51 calls were at 3.60 or 3.61...

... these error prices are above the normal market price.

Lambert & Butler KS [ITL brand]

The agreed prices are 3.86 flat price but in the calls covered yesterday 47 calls were above that price.

...

Superkings family [ITL brand]

Again the promotion prices agreed are 4.05/05/17, the store prices are 4.05/4.13/4.17.
I am very concerned about this situation as I had continued our levels of investment over this post-budget period at your request but still the pricing is confused.’ [Emphasis as in source document]

6.561 The Co-operative Group’s response dated 29 April 2005 to the OFT’s Section 26 Notice, stated:\footnote{Document 25, Annex 15.}

‘8.1 The Co-operative Group to the best of its knowledge believes the tobacco companies monitor the prices at which cigarettes etc. are sold by the Co-operative Group stores and other CRTG member society stores.

8.2 The monitoring of the Co-operative Group is understood to take two forms:

(a) surveys carried out in store by the tobacco companies\footnote{Documents 10 and 15, Annex 15 are examples of internal ITL account briefs for ‘Account: CRTG’ which refer to price and availability surveys. In particular, reference is made in the documents to checking ‘correct differentials’. Although the co-operative societies listed on the first page of Document 10 do not include the Co-operative Group, the OFT infers that this document was used by ITL’s staff to monitor retail prices in the Co-operative Group’s stores as well as in other CRTG members’ stores.}; and

(b) the provision by the Co-operative Group of a price matrix in advance of each period to each of the tobacco companies’.

6.562 Further evidence of ITL’s monitoring of retail prices through in-store surveys was contained in a letter dated 15 April 2003 from ITL to the Co-operative Group, which stated:\footnote{Document 20, Annex 15.}

‘I would like to confirm the responsibilities of our Multiple Trade Representatives (MTR’s) who call on CRTG retail stores.

The role is designed to record and report on retail price … compliance with the CRTG agreements between Imperial Tobacco and CRTG.’

6.563 The evidence demonstrates that ITL would monitor the Co-operative Group’s retail prices of ITL’s brands to ensure that parity and differential requirements were maintained and would point out pricing errors to the Co-operative Group.
vi Conclusion on the agreement and/or concerted practice between ITL and the Co-operative Group

6.564 The evidence described above, demonstrates the existence of the Infringing Agreement between ITL and the Co-operative Group which had the object of restricting competition, in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements’ and, given that the remaining constituent elements of the statutory test are also met (see Section 7: 'Legal assessment’), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.565 In addition to the above, the existence of the Infringing Agreement between ITL and the Co-operative Group is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- ITL and each of the other Retailers, which evidence ITL’s approach towards the Retailers as a collective; and between

- Gallaher and the Co-operative Group (see below), which is part of the context of the Infringing Agreement between ITL and the Co-operative Group.

6.566 The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and the Co-operative Group) lends further support to the fact that there was an agreement and/or concerted practice between ITL and the Co-operative Group which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or concerted practice between Gallaher and the Co-operative group

6.567 When considered together with the evidence of Gallaher’s overall strategy for retail prices described in Section 6.B: 'Manufacturers’ retail pricing strategies', the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003 an Infringing Agreement existed between Gallaher and the Co-operative Group whereby Gallaher co-ordinated with the Co-operative Group the setting of the Co-operative Group’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.1: 'The anti-competitive object of the Infringing Agreements', the Infringing Agreement between Gallaher and the Co-operative Group restricted the ability of the Co-operative Group to determine its retail prices for competing linked brands and had the object of restricting competition.

6.568 The following elements evidence the Infringing Agreement between Gallaher and the Co-operative Group:

i. Gallaher’s strategy in relation to the Co-operative Group’s retail prices

6.569 The trading agreement and contacts set out below between Gallaher and the Co-operative Group should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: 'Manufacturers’ retail pricing strategies' above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.570 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher’s multiple grocer channel, demonstrate that Gallaher’s objective was that multiple grocers, of which

605 Although the Gallaher/Co-operative Group trading agreement referred to below did not apply after 2002, the OFT considers that the other documents referred to below and the lack of documents showing any changes in the conduct of the parties between 2002 and 2003 is sufficient evidence of the continuation of the Infringing Agreement into 2003.

606 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
the Co-operative Group was one such grocer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

6.571 A good example is an internal Gallaher document headed ‘Promotional Policy - Retail Promotion Contributions – March 2000’, which listed the 'Pricing Objectives' in relation to the following brands amongst others:

'Camel [Gallaher brand] – Parity with Marlboro [competitor brand]\(^{607}\)


B&H [Gallaher brand] – 5p above Regal [ITL brand], 3p above Embassy No 1 [ITL brand]


Club [Gallaher brand] 14p below Regal [ITL brand]

Sovereign [Gallaher brand] 10p below L&B [ITL brand]

Mayfair 7p below Sovereign [Gallaher brands] and at least parity with Richmond [ITL brand]…\(^{608}\)

6.572 Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s multiple grocer channel, is set out in Section 6.B: 'Manufacturers' retail pricing strategies' above, which refer to a number of other documents containing evidence of the same or similar nature.\(^{609}\)

ii Trading agreement between Gallaher and the Co-operative Group

6.573 There was a trading agreement between Gallaher and the Co-operative Group, signed on behalf of CRTG on 22 September 2000\(^{610}\) and signed on behalf of Gallaher on 2 October 2000\(^{611}\) ('the Trading Agreement')\(^{612}\).

\(^{607}\) ITL has distributed Marlboro since 12 September 2001.

\(^{608}\) Document 1, Annex 3 (page 2). This document also sets out parity and differential requirements for cigars and hand rolled tobacco.

\(^{609}\) See, in particular, Documents 2 to 10, 13 and 14 of Annex 3.

\(^{610}\) Document 6, Annex 5. The letter dated 26 September 2000 was headed ‘CWS Retail’ and included the company name ‘Co-operative Wholesale Society Limited’ at the bottom and thanked Gallaher for sending the ‘final copy of the new CRTG and Gallaher Trading Agreement’. The OFT infers that the entity which signed the agreement was the Co-operative Group as a retailer and/or member of CRTG.

\(^{611}\) Document 7, Annex 5.
Trading Agreement applied during 2000, 2001 and 2002. That agreement was a relevant aspect of the ongoing commercial dealing between Gallaher and the Co-operative Group and formalised the basis for certain aspects of the trading relationship between them. The trading agreement is assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between Gallaher and the Co-operative Group in relation to retail prices.

Page two of the Trading Agreement stipulated:

‘...Gallaher have agreed to pay [C]p per thousand on all cigarettes invoiced from 1st January to 31st December for each year.

This rate will be split by achievement in the following key disciplines which effect overall category performance: ... Pricing [C]%...’

Page eight of the Trading Agreement stipulated:

‘PRICING ([C])

- GALLAHER WILL CONTINUE TO OFFER BONUSES TO SUPPORT RETAIL PRICING
- GALLAHER ALSO RESERVE THE RIGHT TO ALTER BONUSES AS THE MARKET DICTATES
- IN ADDITION, IF GALLAHER COMPETITORS OFFER ADDITIONAL BONUSES/SUPPORT, CRTG SHOULDS ALSO ALLOW THE OPPORTUNITY FOR GALLAHER TO COMPETE EQUALLY

a. PRE-AGREED BRAND / PRICE LIST PARITIES AND DIFFERENTIALS OF GALLAHER BRANDS/PACKINGS VERSUS COMPETITORS, FOR ALL MARKET SECTORS MUST AT LEAST BE MAINTAINED REF APPENDIX 1 (THEY MAY BE LESS EXPENSIVE)

b. WHILST PRICE CUTS BY SECTOR MAY VARY (I.E. PREMIUM, MID, CHEAP) THE RELATIONSHIP MUST BE AT LEAST MATCHED WITHIN SECTOR

c. IT IS NOT RECOMMENDED THAT HOUSE VARIANTS HAVE DISSIMILAR PRICES, BUT IS ACCEPTABLE IF POLICY DOES NOT REFLECT DISADVANTAGE TO GALLAHER I.E. B.S.K. MENTHOL [Gallaher brand] v J.P.S.K. MENTHOL [ITL brand]

613 Document 7, Annex 5.
d. **GALLAHER PRICING SUPPORT/BONUSES MUST BE PASSED ONTO SHOPPERS**

**PENALTY CLAUSES**

*IF CRTG OR SOCIETY DOES NOT IMPLEMENT THE PRICING AGREEMENT, THE APPROPRIATE FINANCIAL DEDUCTION WILL BE ACTIONED.*'

Page eleven of the Trading Agreement stipulated:

‘**PERFORMANCE WILL BE JUDGED FROM A SELECTION OF STORE VISITS CONDUCTED BY GALLAHER PERSONNEL TO MONITOR RESULTS. ’**

Page twelve of the Trading Agreement stipulated:

‘**BREAKDOWN OF SOCIETIES**

*IF ANY AGREED ACTIVITY IS NOT IMPLEMENTED, THE FOLLOWING PERCENTAGE WILL BE DEDUCTED FROM PAYMENTS’.*

6.575 Appendix 1 to the Trading Agreement listed a range of Gallaher and ITL brands for which market parity/differential should be maintained.\(^{614}\)

‘**Pricing**

*Market (RRP) Parity/Differential brand range including packings*

<table>
<thead>
<tr>
<th>Gallaher brands</th>
<th>ITL brands</th>
</tr>
</thead>
<tbody>
<tr>
<td>B&amp;HKS</td>
<td>Embassy No1 Regal, Marlboro</td>
</tr>
<tr>
<td>...KS(^{615})</td>
<td>Embassy Mild, Marlboro Lights</td>
</tr>
<tr>
<td>Club</td>
<td>Regal</td>
</tr>
<tr>
<td>Berkeley SK</td>
<td>JPSK, Raffles</td>
</tr>
<tr>
<td>B&amp;H SK</td>
<td></td>
</tr>
<tr>
<td>Sovereign</td>
<td>Lambert &amp; Butler and JPS</td>
</tr>
<tr>
<td>Mayfair</td>
<td>Richmond</td>
</tr>
<tr>
<td>Hamlet</td>
<td>Classics</td>
</tr>
</tbody>
</table>

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\(^{614}\) Document 7, Annex 5 (page 9). The right hand column of Appendix 1 to the Trading Agreement listed both ITL brands and other Manufacturers’ brands. In the extract above, the OFT lists only the ITL and Gallaher brands mentioned in Appendix 1 and does not list the other Manufacturers’ brands referred to therein.

\(^{615}\) The brand is not clear in the document provided to the OFT.
Hamlet mins } V Café Crème, Classic Smalls
Sobraine Cuban } V
King Six V Panama
Old Holborn V Golden Virginia
Amber Leaf V Drum
Condor V St Bruno

Range of products to be updated and agreed each year.

6.576 Although the parity and differential requirements contained in the Trading Agreement purportedly provided that the Co-operative Group was to maintain maximum differential requirements between competing linked brands, the OFT infers from the following evidence that such provisions were in fact implemented as parity or fixed differential requirements, rather than maximum differential requirements: (i) evidence of Gallaher’s retail pricing strategy and (ii) evidence regarding the way in which the trading relationship between the Gallaher and the Co-operative Group operated in practice (that is, evidence of the contacts between the Manufacturer and the Retailer). The restrictive nature of both parity or fixed differential requirements and maximum differential requirements is described above at Section 6.A.I.(d).

6.577 In conclusion, the evidence demonstrates that there was a formal trading agreement, pursuant to which the Co-operative Group would set its retail prices in accordance with the parity and differential requirements set by Gallaher and that the Co-operative Group was rewarded with the payment of a bonus for compliance with Gallaher’s parity and differential requirements.

iii Contacts between Gallaher and the Co-operative Group regarding retail prices

6.578 A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and the Co-operative Group regarding the Co-operative Group’s retail prices for Gallaher’s brands.

6.579 The documents evidencing the contacts between Gallaher and the Co-operative Group demonstrate that in relation to the Co-operative Group’s retail prices for Gallaher’s brands:
• Gallaher communicated\(^{616}\) to the Co-operative Group what the Co-operative Group’s retail prices should be; and/or
• Gallaher asked and/or incentivised the Co-operative Group to hold or alter the Co-operative Group’s retail prices; and/or
• The Co-operative Group informed Gallaher about, or discussed with Gallaher, the Co-operative Group’s current or proposed retail prices.

6.580 The Co-operative Group accepted and/or indicated its willingness to implement the directions contained in such communications.

6.581 The contacts between Gallaher and the Co-operative Group took place in the context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent, received and implemented by the Co-operative Group on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together the Co-operative Group’s desired margin.

6.582 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.583 Various examples of contacts between ITL and the Co-operative Group regarding retail prices are set out below.

6.584 The following documents demonstrate that there was contact between Gallaher and the Co-operative Group whereby the Co-operative Group sent a pricing matrix to Gallaher in advance of every promotional period of four weeks (in 2000) or three weeks (from 2001), usually accompanied by a request that Gallaher ‘check’ and/or ‘confirm’ the contents of the matrix.

6.585 For all of Gallaher’s products sold by the Co-operative Group, these matrices listed the cost price, bonuses, RRP and retail prices in the Co-operative Group’s price tiers and the Co-operative Group’s percentage margin for each price tier, as well as any changes made to the figures for the relevant period. The Co-operative Group asked Gallaher to confirm that the matrices were correct, clearly not only referring to the cost price information but also to the retail price information. For example, in an email dated 10 September 2002, the Co-operative Group stated to Gallaher:\(^{617}\)

‘Please see attached period 13 price file for you to check and confirm.’

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\(^{616}\) See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.

\(^{617}\) Document 13, Annex 5.
In an email dated 15 May 2000, the Co-operative Group stated to Gallaher:  

‘… I can confirm that [C] [other manufacturer’s brand] 20s will be at £3.39 in all price bands during this period, please advise as to whether you are wishing to follow with Mayfair [Gallaher brand] as we will have to agree an appropriate level of bonus that will not adversely effect the current margin in each price band.

Please check the attached prices and confirm acceptance asap.’  

According to the Co-operative Group’s response dated 29 April 2005 to the OFT’s Section 26 Notice:  

‘The price matrix demonstrates that the Co-operative Group’s RSPs:

(a) meet the requirements of the off-invoice (O/I) discount; and

(b) accurately reflect and are therefore compliant with any promotional support package’.

The OFT considers that Gallaher used matrices not only as a record of the prices that the Co-operative Group indicated that it would charge for Gallaher’s brands in the upcoming period and hence for monitoring purposes, but also to inform the Co-operative Group of the prices it should charge for Gallaher’s brands, further to its Trading Agreement with the Co-operative Group that the Co-operative Group would set its retail prices in line with Gallaher’s desired parity and differential requirements.

There is also evidence that Gallaher, at least occasionally, responded to the Co-operative Group’s requests to ‘check’ and/or ‘confirm’ the contents of the pricing matrices. An email dated 30 September 2002 from Gallaher to the Co-operative Group stated:

‘I have checked through the Matrix and outside of the 4 points, below all seems to be in order. Can you advise on these observations? Observations are:-

1. Will Dorchester KS & SK 10’s [Gallaher brand] fall in line again with Richmond [ITL brand], which were £1.92 and £1.94 across all Price Bands. Or will the Richmond Range [ITL brand]...
have parity with the Dorchester Range 10’s [Gallaher brand] at £1.92/£1.93/£1.94 for KS and £1.93/£1.94/£1.95 for S.K.?

Sovereign 10’s [Gallaher brand] appears to be missing of the Matrix completely!! I did mean to mention this last time but omitted to do so.

Hamlet singles [Gallaher brand] do not appear to have parity with Classic Singles [ITL brand] in RSP 6. Classic [ITL brand] are 1p less at 0.61p versus Hamlet [Gallaher brand] at 0.62p. This was reported back from Price check carried out at store level in Period 13.

Dorchester SK Multipacks [Gallaher brand] in RSP6. You appear have kept this at £17.49 which was the price in P13. My proposed price was £17.55, just thought that I would point this out in case it was an oversight.

I will send through a separate spreadsheet on my proposals for the Mayfair 40’s standard pricing for action as and when we exhaust the Price Marked packs’.

6.590 In an email dated 17 August 2000 from Gallaher to the Co-operative Group, Gallaher referred in the following terms to details from an earlier telephone conversation between Gallaher and the Co-operative Group which the Co-operative Group had 'agreed to':

'I confirm that I will arrange an additional bonus for the Mayfair range [Gallaher brand] of £[C]p per outer (pro rata Multipacks) for PP09, possibly PP10.

You agreed to review current Mayfair [Gallaher brand] retails and reduce prices as soon as possible from £3.45p which is in line with our main competitors.'

6.591 In a related email dated 18 August 2000 from Gallaher to the Co-operative Group, Gallaher stated:

'... the repricing of the Mayfair range [Gallaher brand] from £[C]p will be from week commencing 28th August, in line with our competitors.'

6.592 A letter dated 20 September 2000 from Gallaher to the Co-operative Group stated:

'BHKS 100’s [Gallaher brand] extra £[C]p bonus (retrospective) for the following retails:-

622 Document 2, Annex 5.
624 Document 4, Annex 5.
A letter dated 23 October 2000 from Gallaher to CWS Retail Buying (the Co-operative Group) which attached a price matrix stated:  

'The attached matrix highlights the agreed bonuses for 20’s and multipacks ... retails should be £3.49 and £17.29 for ALL stores.’

An email dated 9 March 2001 from Gallaher to the Co-operative Group, referred to an earlier telephone conversation between Gallaher and the Co-operative Group and stated:  

'Further to our telephone conversation earlier today.

Berkeley SK range [Gallaher brand]

Agreed 20’s retails in [C] of £3.99 ... retro bonus...

This decrease is on a temporary basis and will continue until the next MPI/budget.

Dorchester KS / SK [Gallaher brand]

As discussed, the price holding of Dorchester brands will continue at least until the end of April.

... 

<table>
<thead>
<tr>
<th>New CRTG net cost</th>
<th>difference</th>
<th>Old net CRTG net cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dorchester KS range 20s</td>
<td>[C]</td>
<td>[C]</td>
</tr>
<tr>
<td>Dorchester SK range 20s</td>
<td>[C]</td>
<td>[C]</td>
</tr>
<tr>
<td>Dorchester SK multipack</td>
<td>[C]</td>
<td>[C]</td>
</tr>
</tbody>
</table>

We would therefore pay the difference by retro bonus on sales out in return for prices being held at pre budget retails'.

A letter dated 12 July 2001 from Gallaher to the Co-operative Group stated:  

'Further to our meeting of 10th July, I attach the agreed Mayfair [Gallaher brand] bonus for the twenties and one hundred Multipacks.
As agreed the retail should be £3.60 for twenties with the Multipack at £17.79 in ALL stores.

In addition, I have amended the Amber Leaf [Gallaher brand] bonus and you will note a more 'generous' contribution ... I am sure at £1.99 and £3.88 for the 12.5g/25g respectively we should observe some encouraging off take and demand.'

6.596 An email dated 11 June 2002 from Gallaher to the Co-operative Group stated:

'MAYFAIR KS RANGE [Gallaher brand]

My proposal is that we move the King Size range up to £3.55 across the Tiers and hold this with the bonus provided to give an [C]p per pack profit margin.

... Amber Leaf [Gallaher brand]

... In respect of Amber Leaf 12.5g I have addressed the Margin issue and improved the Bonus level against the new price structure to give ... improved Margins in Tiers 1 & 2 ...

... Samson [Gallaher brand]

Samson to be maintained at £1.99 and £3.88

Margins improved for 12.5g from [C]% to [C]%...'

6.597 In an email dated 23 May 2003 from Gallaher to the Co-operative Group, Gallaher stated:

'Further to our earlier telephone discussions, I can confirm that we will increase the Support Bonus... This additional bonus has been offered with your agreement to maintain prices of £4.05; £3.99 and £3.97... based on the current Recommended Price of £4.07.'

6.598 In an email dated 16 June 2003 from Gallaher to the Co-operative Group, Gallaher stated:

'Will you be holding the price of Cafe Crème & Cafe Crème Blue [ITL brand] until August 1st as is stated in their price list or has a decision been made to go up in June?'

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If you are holding the price, we would wish to support Hamlet Miniatures 10’s and Hamlet Filter 10’s [Gallaher brand] until the price of Cafe Crème [ITL brand] is changed. This will result in an additional Retro Bonus from us of [C]p, per outer of 100 Cigars, which accommodates the full RRP increase of 0.07p per pack of 10 cigars.

Can you please confirm what action you are taking with Cafe Crème [ITL brand] and allow us the opportunity to maintain Parity should you have decided to hold the Price.

Can advise that this action is being taken across the Multiple and Convenience Channel and I would not wish the Coop to be disadvantaged on price with other Convenience or Multiple Outlets’.

**Conclusion on the contacts between Gallaher and the Co-operative Group**

6.599 In conclusion in relation to all the contacts between Gallaher and the Co-operative Group regarding retail prices, the above paragraphs demonstrate that there were contacts between Gallaher and the Co-operative Group, which related to the retail prices of the Co-operative Group as well as other Retailers. The evidence of such contacts, together with the context of Gallaher’s strategy demonstrates that Gallaher’s retail pricing strategy was for the Co-operative Group to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. The contacts between Gallaher and the Co-operative Group assisted the implementation of that strategy, through communication in relation to the Co-operative Group’s retail prices for Gallaher’s brands the aim of which was to ensure that Gallaher’s desired parities and differential requirements were maintained or realigned. The contacts between Gallaher and the Co-operative Group also demonstrate that the Co-operative Group accepted and/or indicated its willingness to implement directions from Gallaher to the Co-operative Group in that connection.

6.600 The OFT notes that the Co-operative Group submitted that there were instances where the Co-operative Group did not implement instructions and/or requests in Gallaher’s pricing communications.

6.601 However, the OFT considers that the fact that there may have been some instances where the Co-operative Group did not implement, did not implement fully 630, or delayed the implementation of instructions and/or

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630 For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
requests in Gallaher’s pricing communications does not negate the existence of the Infringing Agreement between Gallaher and the Co-operative Group, as there is sufficient evidence over a period of time of the Co-operative Group’s compliance, or intention to comply, with Gallaher’s retail pricing strategy (see the sections entitled ‘Trading agreement between Gallaher and the Co-operative Group’ and ‘Contacts between Gallaher and the Co-operative Group regarding retail prices’ above).

iv Bonuses

6.602 As set out above, Gallaher paid an ongoing bonus to the Co-operative Group on the condition, among other matters, that:

‘PRE AGREED BRAND/PRICE LIST PARITIES AND DIFFERENTIALS OF GALLAHER BRANDS/PACKINGS, VERSUS COMPETITORS, FOR ALL MARKET SECTORS MUST AT LEAST BE MAINTAINED … (THEY MAY BE LESS EXPENSIVE)’.

6.603 There are also documents relating to the provision of tactical bonuses from Gallaher to the Co-operative Group, examples of which are set out in the section entitled ‘Contacts between Gallaher and the Co-operative Group regarding retail prices’ above.

6.604 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by the Co-operative Group. In particular, the bonuses ensured that the Co-operative Group’s margin was not significantly affected by the changes in retail prices instructed or requested by Gallaher to achieve Gallaher’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of the Co-operative Group’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.605 The evidence demonstrates that Gallaher paid bonuses to the Co-operative Group in order to ensure that Gallaher’s parity and differential strategy was maintained. The Co-operative Group accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

631 Document 7, Annex 5 (page 8).
v Monitoring of retail prices by Gallaher

6.606 The documents set out below demonstrate that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its retail pricing strategy).

6.607 In addition, monitoring was formalised in the Trading Agreement. As noted above, compliance with the terms of the Trading Agreement would be monitored by Gallaher:632

‘PERFORMANCE WILL BE JUDGED FROM A SELECTION OF STORE VISITS CONDUCTED BY GALLAHER PERSONNEL TO MONITOR RESULTS.’

6.608 As noted above, the Co-operative Group participated in this monitoring by providing Gallaher with details of its proposed retail prices for Gallaher’s brands though the provision of a price matrix.

6.609 In response to the OFT’s section 26 Notice dated 29 April 2005 the Co-operative Group stated:633

‘8.1 The Co-operative Group to the best of its knowledge believes the tobacco companies monitor the prices at which cigarettes etc. are sold by the Co-operative Group stores …

8.2 The monitoring of the Co-operative Group is understood to take two forms:

(a) surveys carried out in store by the tobacco companies; and

(b) the provision by the Co-operative Group of a price matrix in advance of each period…’

6.610 These documents demonstrate that Gallaher would monitor the Co-operative Group’s retail prices of both ITL and Gallaher brands, to ensure that parity and differential requirements were maintained.

vi Conclusion on the agreement and/or concerted practice between Gallaher and the Co-operative Group

6.611 The evidence described above, demonstrates the existence of the Infringing Agreement between Gallaher and the Co-operative Group, which had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ above and, given that the remaining constituent elements of the statutory

632 Document 7, Annex 5 (Bullet 4, Page 11).
test are also met (see Section 7: 'Legal assessment'), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.612 In addition to the above, the existence of the Infringing Agreement between Gallaher and the Co-operative Group is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher's approach towards the Retailers as a collective; and between
- ITL and the Co-operative Group (see above), which is part of the context of the Infringing Agreement between Gallaher and the Co-operative Group.

6.613 The existence of the further supporting evidence described above (and in particular the relationship between ITL and the Co-operative Group) lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and the Co-operative Group which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.

(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.614 As is noted in the sections above relating to the existence of an Infringing Agreement between each of ITL/the Co-operative Group and Gallaher/the Co-operative Group, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.615 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to the Co-operative Group and that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d) above).
III Agreement and/or concerted practice between ITL and First Quench and between Gallaher and First Quench

Summary

6.616 As set out in 6.C.III.(a) below, ITL and First Quench were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby ITL co-ordinated with First Quench the setting of First Quench’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set in pursuit of ITL’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.617 As set out in 6.C.III.(b) below, Gallaher and First Quench were party to an agreement and/or concerted practice at least from 1 March 2000 to 19 December 2002 (‘the Infringing Agreement’) whereby Gallaher co-ordinated with First Quench the setting of First Quench’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.618 Each of the Infringing Agreements between ITL/First Quench and Gallaher/First Quench amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to First Quench and that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of an Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement, as set out in 6.A.I.(d) above.

634 See also 6.A.I.(b) above in relation to the Manufacturers’ awareness of each others’ symmetrical parity and differential requirements.
6.619 On 11 July 2008, each of Gallaher and First Quench concluded an early resolution agreement with the OFT, pursuant to which each admitted its involvement in each Infringing Agreement to which it was party, in breach of the Chapter I Prohibition.

(a) Agreement and/or Concerted Practice between ITL and First Quench

6.620 When considered together with the evidence of ITL’s overall strategy for retail prices described at Section 6.B: ‘Manufacturers’ retail pricing strategies’, the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between ITL and First Quench, whereby ITL co-ordinated with First Quench the setting of First Quench’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set in pursuit of ITL’s retail pricing strategy. For the reasons set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between ITL and First Quench restricted the ability of First Quench to determine its retail prices for competing linked brands and had the object of restricting competition.

6.621 The following elements evidence the Infringing Agreement between ITL and First Quench:635

i  ITL’s strategy in relation to First Quench’s retail prices

6.622 The trading agreements and contacts set out between ITL and First Quench below should be considered in the context of ITL’s retail pricing strategy as set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

ii  Trading agreements between ITL and First Quench

6.623 There were two trading agreements between ITL and First Quench, dated 1 December 2000 and 1 March 2003. Those agreements were a relevant aspect of the ongoing commercial dealing between ITL and First Quench

635 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and First Quench in relation to retail prices.

6.624 The first trading agreement (‘TA1’), signed by ITL on 1 December 2000,636 was in relation to the period 1 October 2000 to 30 September 2001 and was extended by a letter dated 26 February 2002 until the date at which the subsequent trading agreement came into effect.637 The second trading agreement (‘TA2’), signed and dated 1 March 2003,638 was in relation to the period 1 March 2003 to 29 February 2004.

6.625 The trading agreements contained the following clauses, among other matters:

- Clause A set out ongoing bonus levels for certain brands. In the notes to Clause A, ITL and First Quench agreed that:

  In TA1 and TA2:
  - ‘ITL pricing strategy to be adhered to on all brands’ (clause A, note 1);
  - ‘… support levels may be reduced or withdrawn in the event of brand pricing not achieving the required competitive levels’ (clause A, note 2).

  And in TA1:
  - ‘The bonus levels...will only be paid if existing levels of pricing and percentage of branches within each Pricing Tier are maintained.’
  - The bonus levels would be subject to a proportionate reduction should there be ‘Movement of prices in any Tier, relative to RRP, to a more expensive Tier’ and or ‘Transfer of branches to a more expensive Tier’ (clause A, note 3).

TA2 contained similar wording in clause A concerning the relationship of bonus levels to pricing.

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636 Document 7, Annex 16. The copy of TA1 received by the OFT is signed by ITL and was provided to the OFT by First Quench. The OFT infers that First Quench signed the 2000 trading agreement and that that copy of the trading agreement was held by ITL, who was unable to provide it to the OFT. TA1 was to be signed ‘on behalf of First Quench’ on 1 December 2000. The OFT infers that the entity to which this refers was First Quench Retailing Limited.

637 Document 26, Annex 16. This letter from ITL to First Quench extended the agreement for the period ending 30 September 2001 'until such time as a new Trading Agreement is negotiated'.

638 Document 48, Annex 16. TA2 was signed ‘on behalf of First Quench’. The OFT infers that the entity which signed the agreement was First Quench Retailing Limited.
In a letter dated 19 October 2001 from ITL to First Quench, ITL set out the objective of the new trading agreement (TA2). In relation to pricing, the letter stated that the objective was:

‘To ensure ITL’s strategies are achieved both in actual levels and differentials measured against Gallaher competing brands. Pay bonus only in price competitive tiers.’

That demonstrates that ITL’s pricing strategy was that parity and differential requirements with Gallaher competing brands would be achieved and that First Quench was aware of that strategy.

In a subsequent letter dated 1 November 2001 from ITL to First Quench, ITL set out its proposals for the revised trading agreement, including ITL’s anticipation of a ‘very close working relationship with First Quench’ whereby ITL would be given the opportunity to ‘contribute to all Tobacco related issues affecting ... pricing.’

In addition to TA1 and TA2, in a witness statement dated 24 July 2008, the First Quench Tobacco Buyer from 1986 to 2002 confirmed that TA1:

‘simply represented the continuing of a trading arrangement which had existed for many years. Each year some of the detailed financial provisions changed but the overall trading relationship continued broadly as it had done for some time.’

Furthermore, in a letter dated 24 February 2000 from ITL to First Quench, ITL referred to a trading agreement applicable at the time and stated:

‘Can I also confirm that Embassy Filter [ITL brand] price should be -3p to Embassy No 1 [ITL brand] in all branches. We adjusted the bonus level in this year’s Trading Agreement to reflect this price point.’

In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which First Quench would set its retail prices in accordance with the parity and differential requirements set by ITL and

\[^{639}\text{Document 20, Annex 16 (page 3).}\]
\[^{640}\text{Document 22, Annex 16 (page 1).}\]
\[^{641}\text{Document 55, Annex 16. This was provided to the OFT by First Quench in response to a request from the OFT dated 12 November 2008, pursuant to the Early Resolution agreement that First Quench had concluded with the OFT. This document is relied on to demonstrate that the Infringing Agreement was in place before the Chapter I Prohibition came into force on 1 March 2000.}\]
\[^{642}\text{Document 56, Annex 16, which was part of the OFT’s case file, was highlighted by ITL in response to a request from the OFT dated 31 October 2008. This document is relied on to demonstrate that the Infringing Agreement was in place before the Chapter I Prohibition came into force on 1 March 2000.}\]
that First Quench was rewarded with the payment of a bonus for compliance with ITL’s parity and differential requirements.

***Contacts between ITL and First Quench regarding retail prices***

6.632 A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and First Quench regarding (i) First Quench’s retail prices for ITL’s brands; (ii) First Quench’s retail prices for ITL’s competitors’ brands; and (iii) the retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.633 The documents evidencing the contacts between ITL and First Quench demonstrate that: (i) in relation to First Quench’s retail prices for ITL’s brands (sometimes by reference to First Quench’s retail prices for ITL’s competitors’ brands) and/or (ii) in relation to First Quench’s retail prices for ITL’s competitors’ brands:

- ITL communicated\(^{643}\) to First Quench what First Quench’s retail prices should be; and/or
- ITL asked and/or incentivised First Quench to hold or alter First Quench’s retail prices; and/or
- First Quench informed ITL about, or discussed with ITL, First Quench’s current or proposed retail prices.

6.634 First Quench accepted and/or indicated its willingness to implement the directions contained in such communications.

6.635 In addition, ITL and First Quench informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.636 The contacts between ITL and First Quench took place in the context of ITL’s retail pricing strategy for Retailers to maintain specified parities and differentials between ITL’s brands and competing linked brands. Communications in relation to retail prices were sent by ITL, and were received and implemented\(^{644}\) by First Quench on the understanding that the notified retail prices took into account ITL’s retail pricing strategy, together with First Quench’s desired pricing position relative to other Retailers and First Quench’s desired margin.

\(^{643}\) See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.

\(^{644}\) See paragraphs 6.673 and 6.674 in relation to implementation.
The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

Various examples of contacts between ITL and First Quench regarding retail prices are set out below.

**Contact between ITL and First Quench regarding First Quench’s retail prices for ITL’s brands**

Set out below are examples of contact between ITL and First Quench in relation to First Quench’s retail prices for ITL’s brands, which demonstrate that in relation to First Quench’s retail prices for ITL’s brands (sometimes by reference to the retail prices of competing linked brands):

- ITL communicated to First Quench what First Quench’s retail prices should be; and/or
- ITL asked and/or incentivised First Quench to hold or alter First Quench’s retail prices; and/or
- First Quench informed ITL about, or discussed with ITL, First Quench’s current or proposed retail prices.

First Quench accepted and/or indicated its willingness to implement the directions contained in such communications.

The examples of such contacts are as follows.

In a letter dated 11 January 2001 from ITL to First Quench, ITL summarised various points that were the subject of a meeting between the two parties on 10 January 2001. In particular, ITL stated:

> 'From 1st February Drum [ITL brand] will be priced at parity with Amber Leaf [Gallaher brand]. You will confirm actual prices post MPI but the anticipated gross bonus from ITL to achieve parity is currently [£]p for the 12.5 gm.'

In a similar letter dated 9 February 2001 from ITL to First Quench, ITL referred to a meeting held on 8 February 2001. In particular, ITL stated:

> 'Following our meeting we agreed that L&B [ITL brand] 20s and 100s, and JPS [ITL brand] 20s will be reduced by 1p (5p for 100s) in the £3.70 Price Tier only. [Emphasis as in source document]

I also note that Amber Leaf [Gallaher brand] will move up to £1.99 from the date of the Gallaher MPI. Drum [ITL brand] will match

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645 Document 8, Annex 16.
646 Document 10, Annex 16.
Amber Leaf and I will set out the new bonus in the Retro Payment.'

The OFT infers that these documents support the existence of an agreement, as the discussions took place in a meeting and the outcome was subsequently communicated in a letter.

In a letter dated 27 September 2001 from ITL to First Quench, ITL stated:

'Drum [ITL brand] / Amber Leaf [Gallaher brand] pricing and bonus levels. Please move Drum up in price from £2.02 to £2.05 as soon as possible. I will advise new bonus rates asap.'

In a letter dated 20 June 2002, ITL informed First Quench that the differentials between ITL brands and competitor brands would be increased, until such time as ITL introduced their own MPI. ITL stated as follows:

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

For example, our normal differential between Embassy No 1 [ITL brand] and B&H KS [Gallaher brand] is -3p and Superkings [ITL brand] is at parity with Berkeley [Gallaher brand].

From the date of the Gallaher MPI (24th June) can you please ensure that these increased differentials are maintained until such time as ITL introduce their own MPI.' [Emphasis as in source document].

In a letter dated 30 August 2002 from ITL to First Quench, ITL stated:

'I should just like to record the issues discussed at our meeting last week:-

... For the MPI we went through all relevant price changes noting in particular:

a) Both Richmond brands [ITL brands] to go up the extra 1p – King Size by 5p to £3.54 and Superkings by 7p to £3.58.

b) The bonus levels on Richmond brands will be reduced by [C]p.

c) Embassy [ITL brand] and Regal brands [ITL brands] up by 7p.

d) GV [ITL brand] - no change.

e) Drum [ITL brand] to match Amber Leaf [Gallaher brand].

f) Castella [ITL brand] – no change.’ [Emphasis as in source document]

6.648 The OFT infers that this document supports the existence of an agreement, as the discussions took place in a meeting and the outcome was subsequently communicated in a letter.

6.649 In a letter dated 5 September 2002 from ITL to First Quench regarding MPI pricing, ITL gave various absolute pricing instructions to First Quench. The letter stated as follows:\textsuperscript{650}

’… I thought I would confirm the major changes required to ensure that ITL brands are priced correctly following the MPI.

…

On Drum [ITL brand] we should move to a common price of £2.03, or £2.04 depending on Amber Leaf [Gallaher brand] price. We can wait a few days before this change. The retro bonus will be applied, its amount depending on the final price.’

6.650 In a letter dated 14 October 2002 from ITL to First Quench, ITL stated:\textsuperscript{651}

’As you know, we are increasing the price of Richmond [ITL] brands by 5p from 28th October in First Quench. The rest of the Trade went up from today, or in some cases will go up from 21st October.’

The NAM asked First Quench to implement various absolute price points on Richmond brands on 28th October, including prices of £3.59, £3.69 and £3.75 on Richmond Kingsize and prices of £3.63, £3.73 and £3.79 on Richmond Superkings, depending on the price tier. Handwritten annotations on this document (such as a tick and a handwritten date of 18/11) suggest First Quench’s intention to comply with the communication, albeit that in the event there was some delay. However, the delay appears to be explained by the chain of correspondence below.

6.651 In a subsequent letter on 28 October 2002 from ITL to First Quench, setting out a note of a meeting between ITL and First Quench on 24 October 2002, ITL referred to the same price increase and stated:\textsuperscript{652}

’My recent fax setting out all price changes has not been received and therefore the change on Richmond [ITL brand] KS to

\textsuperscript{650} Document 33, Annex 16.

\textsuperscript{651} Document 38, Annex 16.

\textsuperscript{652} Document 41, Annex 16.
£3.59/£3.69/£3.75 scheduled for 28 October cannot now be implemented until 17th November.

*Richmond SKS [ITL brand] is already at the new prices.*

6.652 An e-mail on 18 November 2002 at 9.27am from First Quench to ITL related to the same price increase. The e-mail had the heading:

‘*Impending price increases*’

In the email, First Quench asked ITL:

‘*Please can you confirm what the RSP’s should be?*’

6.653 At 1.38pm ITL responded with fixed pricing points for the Richmond brands:

‘*From 28th October, you should have been as follows :-*

<table>
<thead>
<tr>
<th>Richmond KS [ITL brand]</th>
<th>Richmond SKS [ITL brand]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1 (cheapest)</td>
<td>£3.59</td>
</tr>
<tr>
<td>Tier 2</td>
<td>£3.69</td>
</tr>
<tr>
<td>Tier 3 (most expensive)</td>
<td>£3.75</td>
</tr>
</tbody>
</table>

*Richmond SKS [ITL brand] is already at these prices, by accident, for several weeks.*

6.654 The OFT considers that this demonstrates that pricing was not independent but co-ordinated and that, given the previous correspondence on the subject, these were not recommended prices, but actual pricing instructions.

6.655 Furthermore, in a letter dated 29 November 2002, ITL stated:

‘*On Richmond KS I accept that Bob [of First Quench] was confused by the various changes to prices and tiers.*’

6.656 Further examples of communications in relation to parity and differential requirements include a letter dated 17 February 2003 from ITL to First Quench, in which ITL stated:

‘*With regard to other items discussed :-*'

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653 Document 42, Annex 16.
656 Document 46, Annex 16.
e) You will adjust cigar pricing and achieve parity for ITL and Gallaher brands."

6.657 As above, the OFT infers that this document supports the existence of an agreement, as discussions had taken place prior to the sending of the letter and the outcome was subsequently confirmed in the letter.

6.658 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and First Quench regarding First Quench’s retail prices for ITL’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 3, 4, 5, 6, 9, 11 to 18, 21, 24, 27, 28, 30, 32, 33, 34, 36, 39, 40, 45, and 49 to 53 of Annex 16 (which are listed in Annex C).

**Contact between ITL and First Quench regarding First Quench’s retail prices for ITL’s competitors’ brands**

6.659 In addition to the documents above, which concern contact between ITL and First Quench regarding First Quench’s retail prices for ITL’s brands, there were contacts between ITL and First Quench in relation to First Quench’s retail prices for ITL’s competitors’ brands. Set out below are examples of such contacts which demonstrate that in relation to First Quench’s retail prices for ITL’s competitors' brands:

- ITL communicated to First Quench what First Quench’s retail prices should be; and/or
- First Quench informed ITL about, or discussed with ITL, First Quench’s current or proposed retail prices.

6.660 The examples of such contacts are as follows.

6.661 In a letter dated 26 October 2000 from ITL to First Quench, ITL summarised various points that had been covered in a meeting between the two parties on 19 October 2000. In particular, ITL stated:657

‘When Dorchester [Gallaher brand] is increased by 5p for 20, expected soon, please leave Richmond [ITL brand] price unaltered, thereby matching the Dorchester price.’

An annotation next to this point states: ‘Done?’ which, the OFT infers, suggests that the request was expected to be implemented by First Quench.

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ITL also attempted to get First Quench to influence Gallaher’s pricing. For example, in a letter dated 8 June 2001 from ITL to First Quench, ITL stated:

‘With regard to the price of Dorchester [Gallaher brand] and Richmond [ITL brand], we would like to move Richmond [ITL brand] up in price to £3.45 as soon as possible. Other Accounts are moving in a similar direction and, if you are speaking with Gallaher in the next few days, should be grateful if you would encourage them to move Dorchester [Gallaher brand] to £3.45 on, say 18th or 26th June.’

Subsequently, ITL encouraged First Quench to influence Gallaher’s pricing. In a letter dated 24 August 2001 from ITL to First Quench, ITL stated:

‘On the MPI can you please action the recommended increases for all our brands. The only possible exception to this is Richmond [ITL brand] and I believe Gallaher may be maintaining Dorchester [Gallaher brand] at current levels. Can you please try and persuade them to go up by the recommended amounts.’

In a letter dated 5 August 2002 from ITL to First Quench, regarding ITL’s forthcoming MPI, ITL stated:

‘At the MPI we wish to move the market up on Richmond brands [ITL brands] and bring greater profitability to this end of the market. Therefore, on 2nd September please increase Richmond brands by 4p for KS and 6p for SKS. We would encourage you to follow on Dorchester [Gallaher brand] and, as a guideline across the Trade, anticipate shelf prices as below :-


Furthermore, there is evidence that First Quench circulated its intended pricing to both Manufacturers simultaneously, thereby reducing uncertainty. For example, in an e-mail dated 28 January 2003 from First Quench to ITL and Gallaher, First Quench disclosed to both Manufacturers the new pricing policy on 10s. That resulted in both Manufacturers knowing the retail prices at which each other’s brands would be sold in First Quench from 2 February 2003. In the same e-mail, First Quench stated:

‘If you do find any products which are out of line please let me know, it could be one of our infamous system errors!’

659 Document 17, Annex 16.
Similarly, in an e-mail dated 19 February 2003 from First Quench to ITL and Gallaher, First Quench confirmed the new retail pricing strategy for HRT. That resulted in ITL and Gallaher knowing the retail prices at which each other’s brands would be sold in First Quench from 24 February 2003.

In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and First Quench regarding First Quench’s retail prices for ITL’s competitors’ brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 10, 25, and 34 of Annex 16 (which are listed in Annex C).

Contact between ITL and First Quench regarding the retail prices of First Quench’s competitors

In addition to the documents above, there were contacts between ITL and First Quench in which ITL and First Quench informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

As noted above, in a letter from ITL to First Quench dated 8 June 2001, ITL stated: 'we would like to move Richmond up in price to £3.45 as soon as possible.' ITL also stated that 'Other Accounts are moving in a similar direction.'

Similarly, in fax dated 5 August 2002 from ITL to First Quench, that asked First Quench to increase prices on Richmond brands to a specified level, ITL stated:  

'We would encourage you to follow on Dorchester and, as a guideline across the Trade, anticipate shelf prices as below:-

Richmond KS/SKS [ITL brands], Dorchester KS/SKS [Gallaher brands] £3.54/£3.58'.

It can be seen from the above that references to the retail prices of other Retailers were used by ITL as a means to encourage the implementation by First Quench of ITL’s parity and differential requirements. In particular, such references provided an assurance to First Quench that retail price

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662 Document 47, Annex 16.
663 In this document First Quench also referred to the fact that it would confirm cigar prices the following week. The OFT infers that this would have been done in the same manner and sent to both Manufacturers.
changes put to First Quench by ITL would not cause First Quench to be out of step with its retail competitors. The function of references to the retail prices of other Retailers was to assist in the implementation of ITL’s pricing strategy and to ensure that ITL’s desired parities and differential requirements were maintained or, where need be, realigned.

**Conclusion on the contacts between ITL and First Quench**

6.672 In conclusion in relation to all the contacts between ITL and First Quench regarding retail prices, the above paragraphs demonstrate that there were regular contacts between ITL and First Quench, which related to the retail prices of First Quench as well as other Retailers. The evidence of such contacts, together with the context of ITL’s strategy, demonstrates that ITL’s retail pricing strategy was for First Quench to maintain specified parities and differentials between ITL’s brands and competing linked brands. The contacts between ITL and First Quench assisted the implementation of that strategy, through communications between ITL and First Quench in relation to First Quench’s retail prices for ITL’s brands and in some cases also ITL’s competitors’ brands, the aim of which was to ensure that ITL’s desired parity and differential requirements were maintained or realigned. The contacts between ITL and First Quench also demonstrate that First Quench accepted and/or indicated its willingness to implement the directions contained in communications from ITL to First Quench in that connection.

6.673 The OFT notes that ITL submitted that there were instances where First Quench did not implement, did not implement fully\(^{666}\), or delayed the implementation of instructions and/or requests in ITL’s pricing communications. Paragraphs 6.650 to 6.655 set out details of an occasion where First Quench delayed implementing ITL’s requests in relation to Richmond Superkings’ pricing. In addition, on one occasion when ITL asked First Quench to change its retail price for a Gallaher product, that was rejected by First Quench.\(^{667}\)

6.674 However, the OFT considers that, notwithstanding that there may have been some instances where First Quench did not implement, did not implement fully, or delayed the implementation of instructions and/or requests in ITL’s pricing communications, that does not negate the existence of the Infringing Agreement between ITL and First Quench, as

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\(^{666}\) For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested. 

\(^{667}\) See Documents 34 and 37, Annex 16.
there is sufficient evidence over a period of time of First Quench’s compliance, or intention to comply, with ITL’s retail pricing strategy (see for example the sections entitled ‘Trading agreements between ITL and First Quench’ and ‘Contacts between ITL and First Quench regarding retail prices’ above). Furthermore, as noted in paragraph 6.665 above, the e-mail from First Quench to ITL dated 28 January 2003\(^{668}\) refers to the ‘infamous system errors’ at First Quench, suggesting that certain retail price changes may not have been implemented due to system errors, rather than that there was deliberate non-implementation.

### iv Bonuses

6.675 As set out above, ITL paid an ongoing bonus to First Quench on the condition that, among other matters, ITL’s retail pricing strategy was adhered to on ‘all brands’. As also noted above, the letter from ITL to First Quench dated 19 October 2001\(^{669}\) demonstrates that ITL’s retail pricing strategy was that First Quench would maintain specified parities and differentials between competing linked brands.

6.676 There are also documents relating to the provision of tactical bonuses from ITL to First Quench, examples of which are set out in the section entitled ‘Contacts between ITL and First Quench regarding retail prices’ above.

6.677 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by First Quench. In particular, the bonuses ensured that First Quench’s margin was not significantly affected by the changes in retail prices instructed or requested by ITL to achieve ITL’s retail pricing strategy (see Section 6.A.1.(a).iv above). The manipulation of First Quench’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.678 In addition to those documents referred to in the contacts sections above, which specifically refer to tactical bonuses, the following documents also evidence the use of tactical bonuses.

6.679 In a letter dated 21 February 2001 from ITL to First Quench, ITL stated:\(^{670}\)

‘...until further notice, Drum [ITL brand] will be the same price as Amber Leaf [Gallaher brand] at £1.99, a reduction of 13p for

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\(^{668}\) Document 44, Annex 16.  
\(^{669}\) Document 20, Annex 16.  
\(^{670}\) Document 11, Annex 16.
Drum. Bonus will be £C per outer (125gms). [Emphasis as in source document]

6.680 In a letter dated 30 August 2002 from ITL to First Quench, ITL stated: 671

'I can confirm that Panama [ITL brand] receives a bonus for its reduced price which should be maintained at +10p above King Six [Gallaher brand].

Assuming King Six [Gallaher brand] is increased in line with other Gallaher Cigar prices I believe Panama [ITL brand] should be increased by 6p to £2.76 from 2nd September.'

6.681 In addition to the documents referred to in this section, other documents contain evidence of contacts of the same or a similar nature in relation to the provision of bonuses by ITL to First Quench which demonstrates the same matters as set out in respect of the documents quoted above: documents 16 and 31 of Annex 16 (which are listed in Annex C).

6.682 The evidence demonstrates that ITL paid bonuses to First Quench in order to ensure that ITL’s retail pricing strategy was maintained. First Quench accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by ITL.

5 Monitoring of retail prices by ITL

6.683 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to First Quench.

6.684 For example, in a fax dated 28 January 2002 from ITL to First Quench, ITL stated: 672

'I appreciate that I wrote to you on 18th January regarding Panama [ITL brand] pricing errors, but I notice that for the calls on 21st January that the errors are still maintained.'

6.685 In the same fax, ITL stated:

'I also notice that Amber Leaf [Gallaher brand] has 19 calls at £2.09 and 11 calls at £2.05. Is this the transition stage to both Drum [ITL brand] and AL [Amber Leaf] moving to all at £2.09?'

6.686 In addition, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of First Quench’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 7, 20, 34, 39, 40 and 54 of Annex 16 (which are listed in Annex C).

6.687 These documents demonstrate that ITL would monitor First Quench’s retail prices of both ITL and Gallaher brands to ensure that parity and differential requirements were maintained and would point out pricing errors to First Quench.

vi Conclusion on the agreement and/or concerted practice between ITL and First Quench

6.688 The evidence described above demonstrates the existence of the Infringing Agreement between ITL and First Quench, which had the object of restricting competition in the manner set out in Section 6.A.1: ‘The anti-competitive object of the Infringing Agreements’ and, given that the remaining constituent elements of the statutory test are also met (see Section 7: 'Legal assessment’), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.689 In addition to the above, the existence of the Infringing Agreement between ITL and First Quench is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- ITL and each of the other Retailers, which evidence ITL’s approach towards the Retailers as a collective; and between
- Gallaher and First Quench (see below), which is part of the context of the Infringing Agreement between ITL and First Quench.

6.690 The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and First Quench) lends further support to the fact that there was an agreement and/or concerted practice between ITL and First Quench which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or Concerted Practice between Gallaher and First Quench

6.691 When considered together with the evidence of Gallaher’s overall strategy for retail prices described in Section 6.B: 'Manufacturers' retail pricing strategies', the evidence referred to below demonstrates that, at least from 1 March 2000 to 19 December 2002 an Infringing Agreement existed between Gallaher and First Quench whereby Gallaher co-ordinated with First Quench the setting of First Quench’s retail prices for tobacco products in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between Gallaher and First Quench restricted the ability of First Quench to determine its retail prices for competing linked brands and had the object of restricting competition.

6.692 The following elements evidence the Infringing Agreement between Gallaher and First Quench.674

i. Gallaher’s Strategy in relation to First Quench’s retail prices

6.693 The contacts set out below between Gallaher and First Quench should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: 'Manufacturers' retail pricing strategies' above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.694 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher’s convenience channel, demonstrate that Gallaher’s objective was that retailers within that channel, of which First Quench was one such retailer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

6.695 A good example is an internal Gallaher document headed 'Promotional Policy - Retail Promotion Contributions – March 2000', which listed the 'pricing objectives' in relation to the following brands amongst others:

673 19 December 2002 is the date of the last document relied upon.
674 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
‘Camel [Gallaher brand] – Parity with Marlboro [competitor brand]675


B&H [Gallaher brand] – 5p above Regal [ITL brand], 3p above Embassy No 1 [ITL brand]

Berkeley and B&H Superkings [both Gallaher brands] – parity with JP Superkings [ITL brand]

Club [Gallaher brand] 14p below Regal [ITL brand]

Sovereign [Gallaher brand] 10p below L&B [ITL brand]

Mayfair 7p below Sovereign [both Gallaher brands] and at least parity with Richmond [ITL brand]...676

6.696 Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s convenience channel, is set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, which refer to a number of other documents containing evidence of the same or similar nature.677

ii Trading agreement between Gallaher and First Quench

6.697 Gallaher and First Quench entered into a trading agreement, signed and dated by First Quench on 20 October 1999 and by Gallaher on 8 November 1999678, in relation to the period 1 July 1999 to 30 June 2002. The agreement was a relevant aspect of the ongoing commercial dealing between Gallaher and First Quench and formalised the basis for certain aspects of the trading relationship between them. The trading agreement is assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between Gallaher and First Quench in relation to retail prices.

675 ITL has distributed Marlboro since 12 September 2001.
676 Document 1, Annex 3 (page 2). This document also set out parity and differential requirements for cigars and hand rolled tobacco.
677 See, in particular, documents 3, 4, 11-13 and 15 of Annex 3.
678 Document 1, Annex 6. Document 1 is headed ‘Gallaher Limited First Quench (Victoria Wine/Threshers) Limited – Agreement Year 1st July 1999-30th June 2002’ and was signed ‘for First Quench (Victoria Wine/Threshers)’ on 20 October 1999. The OFT infers that the entity which signed the agreement was First Quench Retailing Limited as this company was the counter-party to another trading agreement that overlaps with this agreement.
In the terms of this trading agreement, Gallaher and First Quench agreed, among other matters, the following:

Gallaher would pay First Quench \$C per 1,000 cigarettes sold by First Quench during the term of the agreement, subject to the following:

- retail prices being mutually agreed prices for each promotional period (clause 1, bullet 1);
- First Quench maintaining price parity and differential requirements between Gallaher’s brands and Gallaher’s competitors’ brands in all stores in line with their Pricing Category (a list of brand pairs is set out in appendix 1 to the agreement) (clause 1, bullet 2 and appendix 1);
- First Quench maintaining parent brand and variants pricing at the same level regardless of their Pricing Category (clause 1, bullet 3); and
- where First Quench was involved in the promotion of Gallaher’s competitors’ brands, First Quench offering to Gallaher the opportunity to conduct similar promotional activity on a brand to be selected by Gallaher, as soon as reasonably requested by Gallaher following that competitor’s promotion (clause 1, bullet 4).

Appendix 1 was entitled ‘Gallaher Vs Competitors Pricing Parities/Differentials’ and set out various competing linked brands. For example:

'BENSON & HEDGES KING SIZE, SILK CUT KING SIZE and CAMEL HOUSES [Gallaher brands] Vs EMBASSY NO. 1 [ITL brand]

... 

BERKELEY SUPERKINGS HOUSE [Gallaher brand] Vs JOHN PLAYER SUPERKINGS HOUSE [ITL brand]

... 

HAMLET MINIATURE [Gallaher brand] Vs CAFÉ CRÈME [ITL brand]

...

OLD HOLBORN [Gallaher brand] [...] Vs GOLDEN VIRGINIA [ITL brand]’. [Emphasis as in source document]

In a letter dated 19 May 2000 from Gallaher to First Quench, Gallaher noted that following a meeting held on 11 May 2000, First Quench was to alter slightly some terms within the trading agreement for the period
January to June 2000.\textsuperscript{679} However, the clauses listed above and payments for adherence remained unaffected.

6.701 A further trading agreement which was drafted, signed and dated by Gallaher on 5 August 2002, and sent to First Quench, was intended to cover the period 1 January 2002 to 31 December 2003. This draft trading agreement contained, among other matters, the following proposed clauses:\textsuperscript{680}

In consideration of Gallaher paying certain retrospective discounts to First Quench on all Gallaher cigarettes sold by First Quench during the term of the trading agreement, First Quench was to comply with the following:

- First Quench maintaining ‘\textit{price differentials/price parities between Gallaher’s brands and their respective competitive brands as set out in Appendix 1, at all times}’ (clause 1(a)); and

- where First Quench was involved in the promotion of Gallaher’s competitors’ brands, First Quench offering to Gallaher the opportunity to ‘\textit{conduct similar promotional activity}’ in relation to Gallaher brands to be selected by Gallaher, as soon as reasonably requested by Gallaher following that competitor’s promotion (clause 1(b)).

6.702 On the version of this document which was provided to the OFT by First Quench, there are various handwritten annotations next to a number of clauses. The OFT has inferred that these annotations were made by First Quench. In particular, there is a handwritten annotation next to the second of the two clauses listed above (clause 1(b)), stating ‘\textit{NO}’. The draft trading agreement was not signed by First Quench and the OFT has inferred that this was at least in part due to First Quench objecting to clause 1(b) of the agreement.

6.703 The OFT infers, however, that First Quench was not objecting to the parity/differential provisions contained in clause 1(a), given the absence of any similar annotation next to that clause. That suggests that neither party changed its position on the maintenance of the parity and differential requirements in the course of 2002 and that there was continued common intention to maintain the parity and differential requirements.

\textsuperscript{679} Document 2, Annex 6 (Clause 18). This document is an unsigned file copy.
\textsuperscript{680} Document 21, Annex 6. The trading agreement was stated to be between ‘First Quench Retailing Limited & Gallaher Limited’ and was to be signed ‘for and on behalf of FIRST QUENCH’. The OFT infers from the first page of this agreement that the entity which was to sign the agreement was First Quench Retailing Limited.
In conclusion, the evidence demonstrates that there was a formal and a draft trading agreement, pursuant to which First Quench would set its retail prices in accordance with parity and differential requirements set by Gallaher and that First Quench was rewarded with the payment of a bonus for compliance with Gallaher’s parity and differential requirements.

iii  Contacts between Gallaher and First Quench regarding retail prices

A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and First Quench regarding First Quench’s retail prices for Gallaher’s brands.

The documents evidencing the contacts between Gallaher and First Quench demonstrate that, in relation to First Quench’s retail prices for Gallaher’s brands (sometimes by reference to First Quench’s retail prices for Gallaher’s competitors’ brands):

- Gallaher communicated\(^{681}\) to First Quench what First Quench’s retail prices should be; and/or
- Gallaher asked and/or incentivised First Quench to hold or alter First Quench’s retail prices; and/or
- First Quench informed Gallaher about, or discussed with Gallaher, First Quench’s current or proposed retail prices.

First Quench accepted and/or indicated its willingness to implement the directions contained in such communications.

The contacts between Gallaher and First Quench took place in the context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent, received and implemented\(^{682}\) on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together with First Quench’s desired pricing position relative to other Retailers and First Quench’s desired margin.

The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

\(^{681}\) See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.

\(^{682}\) See paragraphs 6.723 and 6.724 in relation to implementation.
6.710 Various examples of contacts between Gallaher and First Quench regarding retail prices are set out below.

6.711 In a letter dated 19 May 2000 from Gallaher to First Quench, which recorded details of a meeting on 11 May 2000, Gallaher confirmed price increases and decreases to absolute levels on various brands and also stated that First Quench should revert to 'normal' pricing on Benson & Hedges, Silk Cut KS and Camel [Gallaher brands]. Regarding Mayfair [Gallaher brand], Gallaher stated:683

'(i) Mayfair KS House [Gallaher brand] to retail at £3.39 in all pricing Tiers, subject to [another manufacturer’s brand] Price marked at £3.39.

(ii) Timing – First Quench to confirm.

(iii) Gallaher Ltd to maintain cash margin, with individual bonuses by pricing Tier.

(iv) Bonuses to be paid subject to EPoS volumes per pricing Tiers.'

6.712 In a letter dated 14 August 2000 from Gallaher to First Quench, Gallaher confirmed various points which were discussed at a meeting on 3 August 2000. The letter referred to various fixed pricing points at which Gallaher brands would retail in First Quench stores. In particular, in relation to Mayfair, the NAM stated as follows:684

'(i) Mayfair KS House [Gallaher brand] to retail at £3.44 in all pricing Tiers.

(ii) Period – As from 8th August

(iii) Bonusing – Gallaher Ltd to maintain cash margin, with individual bonuses by pricing Tier.

…

(v) Mayfair KS House to retail at £3.49 in all pricing Tiers except Tier 6 at £3.47 when [another manufacturer’s brand] increase to £3.44'.

The OFT infers that the two documents quoted above are consistent with the existence of the Infringing Agreement, as they reflect discussions which took place in a meeting and the outcome was subsequently communicated in a letter. The OFT notes that these documents refer to parity and differential requirements, albeit by reference to another competitor’s brand.

Similarly, in a letter from Gallaher to First Quench dated 10 October 2000\textsuperscript{685} recording details of meetings on 22 and 28 September 2000, Gallaher ‘confirmed’ the fixed retail prices for Hamlet, Amber Leaf, Camel and Benson and Hedges and Silk Cut KS 2 x 20 [Gallaher brands].

In an e-mail dated 12 October 2000 from Gallaher to First Quench, Gallaher attached a list of outstanding bonuses. The top of the list stated: \textsuperscript{686}

‘(i) First Quench retail prices of Mayfair KS [Gallaher brand] to increase by 3p.

(ii) Period – As from 11 January.

…

(iv) Standard Bonusing – As from 11th January the Mayfair KS [Gallaher brand] bonuses will be as per the Trading Agreement. E.g. [C\$]p per outer Vat exc.’

In the comments column next to the above points, the comment stated ‘paid’. The OFT infers that this indicates that this price increase was implemented by First Quench, and the corresponding bonus was accordingly paid.

In an e-mail dated 13 March 2001 from Gallaher to First Quench, Gallaher stated: \textsuperscript{687}

‘Further to our telephone conversation of yesterday, I can confirm the following with effect from Tuesday, 20th March 2001: -

1. – Dorchester [Gallaher brand]

- Implement 5p per pack MPI increase

- Do not add 6p budget increase

- Retrospective bonus levels will be amended accordingly

[...]

- Maintain pre-budget price of King Six, Amber Leaf and Camel Lights 20’s [Gallaher brands], retrospective bonus to increase accordingly.

All details will be confirmed in more depth at our pricing meeting of next week.’ [Emphasis added]

\textsuperscript{685} Document 5, Annex 6.
\textsuperscript{686} Document 6, Annex 6.
\textsuperscript{687} Document 8, Annex 6.
The OFT notes that this document contains a reference to a subsequent meeting to be held between the parties specifically to discuss pricing.

6.716 In an e-mail dated 29 August 2001 from Gallaher to First Quench headed 'MPI Price Changes', Gallaher set out a series of specific pricing instructions as follows:688

'Prices to move up in line with declared increase on 11.9.2001 with the exception of:

[all Gallaher brands]

'Dorchester KS – Hold @ £3.39

Dorchester SK (range) – Hold @ £3.40

Mayfair 20 (range) – Hold @ £3.60

Mayfair 100 – Increase to £17.95 from £16.99 (all price tiers to remain cheaper than 5x20)

Sovereign 100 – Prices to revert to normal (promotion ended)

Camel 20 (range) – Increase to £4.15 from £4.09 (in essence the MPI increase)

Amber Leaf 12.5g – Increase to £2.05 from £1.99

Samson 12.5g – Hold @ £1.99

King 6 – Hold @ £2.59

Sobranie Cuban Small Cigars – Apply MPI increase and reduce by 10p to match selling price of Hamlet Min 10.

The above price points to be held and confirmed until the end of September.'

6.717 In a letter dated 12 October 2001 from Gallaher to First Quench, Gallaher confirmed various points which were discussed at a meeting the previous day, in particular, Gallaher noted:689

'- I can confirm our intention to increase the price of Dorchester KS [Gallaher brand] range to £3.49 and Dorchester SK [Gallaher brand] range to £3.51 with effect from 5th November 2001.

...

- I will continue to track JPSK [ITL brand] with my Superking brands. Please advise of any change to your current JPSK [ITL brand] pricing initiative.'

6.718 In an e-mail dated 27 August 2002 from Gallaher to First Quench, Gallaher sent a pricing schedule to an assistant at First Quench. The cover e-mail stated:

'All changes from 2nd Sept please except Mayfair KS which can run until 9th September.'

6.719 The First Quench Trading Director responded to that e-mail on the same date, stating that it was:

'... unacceptable both in format, date of notice, and the fact that it has been sent to an Assistant. It will not be processed until discussions have been had on my return from holiday.'

6.720 Although this document initially rejected the price change instructions from Gallaher, the OFT considers that this was, as expressed, due to the format, date of notice and the fact that it was sent to an assistant, rather than that it was an objection in principle to receiving pricing instructions. Furthermore, in the context of communications between First Quench and Gallaher, the words 'will not be processed until discussions have been had on my return from holiday' suggest that First Quench would implement the price changes following discussion.

6.721 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and First Quench regarding First Quench’s retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 5, 7, 11, 13 15 to 17, 19, 20, 24 and 25 of Annex 6 (which are listed in Annex C).

Conclusion on the Contacts between Gallaher and First Quench

6.722 In conclusion in relation to all the contacts between Gallaher and First Quench regarding retail prices, the above paragraphs demonstrate that there were regular contacts between Gallaher and First Quench, which related to the retail prices of First Quench. The evidence of such contacts, together with the context of Gallaher’s strategy, demonstrates that Gallaher’s retail pricing strategy was for First Quench to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. The contacts between Gallaher and First Quench

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assisted the implementation of that strategy, through communications between Gallaher and First Quench in relation to First Quench’s retail prices for Gallaher’s brands, the aim of which was to ensure that Gallaher’s desired parities and differential requirements were maintained or realigned. The contacts also demonstrate that First Quench accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher in that connection.

6.723 There is evidence contained in certain documents692 that on some instances, First Quench delayed the implementation of, or rejected, Gallaher’s pricing instructions and/or requests. For example, in an e-mail dated 2 October 2002693, Gallaher pointed out various pricing errors, including the fact that the ITL MPI had only been partially implemented on cigars. In its response, First Quench rejected Gallaher’s attempts to change its retail prices of ITL’s cigar brands.

6.724 However, the OFT considers that, the fact that there may have been some instances where First Quench did not implement, did not implement fully694, or delayed the implementation of instructions and/or requests in Gallaher’s pricing communications, does not negate the existence of the Infringing Agreement between Gallaher and First Quench, as there is sufficient evidence over a period of time of First Quench’s compliance, or intention to comply, with Gallaher’s retail pricing strategy (see for example the sections entitled 'Trading agreements between Gallaher and First Quench' and 'Contacts between Gallaher and First Quench regarding retail prices’ above).

iv Bonuses

6.725 As noted above, Gallaher paid an ongoing bonus to First Quench subject to First Quench maintaining price parity and differential requirements between Gallaher’s brands and Gallaher’s competitors’ brands.

6.726 There is evidence in a letter dated 14 August 2000 that Gallaher did not pay a bonus to First Quench for 'price parity' for the period from January to June 2000 as price parity was ‘not achieved’.695

6.727 In a fax dated 26 February 2002 from Gallaher to First Quench, Gallaher set out:696

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692 See also paragraphs 6.718 to 6.720 above and 6.726 below.
694 For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
'confirmation of our discussions in respect of the second half-year trading agreement for 2001.'

The communication subsequently stated that the calculation for price parity was 'Agreed' and a table attached to the fax set out a figure for 'Price Parity' of £[C], based on volume for the period July – December 2001.

6.728 There are also documents relating to the provision of tactical bonuses from Gallaher to First Quench, examples of which are set out in the section entitled 'Contacts between Gallaher and First Quench regarding retail prices' above.

6.729 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by First Quench. In particular, the bonuses ensured that First Quench's margin was not significantly affected by the changes in retail prices instructed or requested by Gallaher to achieve Gallaher’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.730 In addition to those documents referred to in the contacts section above, which specifically refer to tactical bonuses, the following documents also evidence the use of tactical bonuses:

6.731 In letter dated 14 August 2000 from Gallaher to First Quench, Gallaher made the following points:697

'Dorchester KS House [Gallaher brand]

(i) to continue to retail price of £3.29.

(ii) Period – Gallaher Ltd to confirm finish date.

(iii) Gallaher Ltd to maintain cash margin, with individual bonuses by pricing Tier. Therefore bonuses will be standard [C]p plus ... additional. Additional average of [C]p in Tiers 1 to 6

(iv) Bonuses to be paid subject to EPoS volumes per pricing Tiers.'

6.732 A further example is an e-mail dated 11 December 2001 from Gallaher to First Quench, which stated:698

'Following our discussion, earlier today, please find attached the pricing schedule effective from 1sy January 2002. I summarise

the key points below ... Amber Leaf [Gallaher brand] moves from £2.05 - £2.09 wef 1/1/02 and support is adjusted accordingly.'

6.733 In addition to the documents referred to in this section, other documents contain evidence of the same or similar nature in relation to the provision of bonuses by Gallaher to First Quench which demonstrates the same matters as set out in respect of the documents quoted above: documents 2 to 8 and 13 of Annex 6 (which are listed in Annex C).

6.734 The evidence demonstrates that Gallaher paid bonuses to First Quench in order to ensure that Gallaher's parity and differential strategy was maintained. First Quench accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

v Monitoring of retail prices by Gallaher

6.735 The documents set out below demonstrate that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its retail pricing strategy) and communicated 'errors' to First Quench.

6.736 In addition, it appears from the correspondence that Gallaher used, among other systems (such as EPOS data), information from P&H to process bonus payments, thereby implicitly monitoring compliance (see for example, documents 3\(^{699}\), 5, 7, and 13 of Annex 6 (which are listed in Annex C). Such conduct is consistent with the existence of the Infringing Agreement.

6.737 Particular examples of monitoring include an e-mail dated 2 January 2002 from Gallaher to First Quench, which stated:\(^{700}\)

'I noticed on a store visit today that the Clewer Hill store in Windsor is still retailing Mayfair [Gallaher brand] at £3.59. It maybe that this is a one-off store that has missed a price change communication, but thought that I should bring this to your attention.'

6.738 In an e-mail dated 19 December 2002 from Gallaher to First Quench entitled 'Pricing anomalies?', Gallaher referred to the incorrect implementation of a price increase in First Quench. Gallaher referred to a price increase of both Gallaher and ITL brands:\(^{701}\)

\(^{699}\) See paragraph 82.
\(^{700}\) Document 12, Annex 6.
'Please find attached details from our Price Audit fieldwork carried out yesterday.

You will see that there are a number of £3.54 prices appearing for Dorchester [Gallaher brand], Richmond [ITL brand] and Mayfair KS [Gallaher brand]. The price increase seems to have been implemented correctly in most stores but it appears that maybe one group of stores have been overlooked? … Hopefully you will be able to identify the problem on your system.'

6.739 In addition to the documents quoted above, other documents contain evidence of the same or similar nature in relation to the monitoring by Gallaher of First Quench’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 2 to 7, 10, and 24 to 27 of Annex 6 (which are listed in Annex C).

6.740 These documents demonstrate that Gallaher would monitor First Quench’s retail prices of both Gallaher and ITL brands, to ensure that parity and differential requirements were maintained and would point out pricing errors to First Quench.

vi Conclusion on the agreement and/or concerted practice between Gallaher and First Quench

6.741 The evidence described above demonstrates that the existence of the Infringing Agreement between Gallaher and First Quench which had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and, given that the remaining constituent elements of the statutory test are also met (see Section 7: ’Legal assessment’), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.742 In addition to the above, the existence of the Infringing Agreement between Gallaher and First Quench is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers' which evidence Gallaher's approach towards the Retailers as a collective; and between
• ITL and First Quench (see above), which is part of the context of the Infringing Agreement between Gallaher and First Quench.

6.743 The existence of the further supporting evidence described above (and in particular the relationship between ITL and First Quench) lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and First Quench which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.

(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.744 As is noted in the sections above relating to the existence of an Infringing Agreement between each of ITL/First Quench and Gallaher/First Quench, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.745 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to First Quench and that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d) above).
IV Agreement and/or concerted practice between ITL and Morrisons and between Gallaher and Morrisons

Summary

6.746 As set out in 6.C.IV.(a), ITL and Morrisons were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 ('the Infringing Agreement') whereby ITL co-ordinated with Morrisons the setting of Morrisons' retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL's retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' and amounted to a breach of the Chapter I Prohibition.

6.747 As set out in 6.A.IV.(b) below, Gallaher and Morrisons were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 ('the Infringing Agreement') whereby Gallaher co-ordinated with Morrisons the setting of Morrisons' retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher, in pursuit of Gallaher's retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' and therefore amounted to a breach of the Chapter I Prohibition.

6.748 Each of the Infringing Agreements between ITL/Morrisons and Gallaher/Morrisons amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Morrisons and that each Manufacturer must have been aware\(^\text{702}\) of the other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of the Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement, as set out in 6.A.I.(d) above.

\(^{702}\) See also 6.A.I.(b) above in relation to the Manufacturers' awareness of each other’s parallel and symmetrical parity and differential requirements.
On 11 July 2008, Gallaher concluded an early resolution agreement with the OFT, pursuant to which it admitted its involvement in each Infringing Agreement to which it was party in breach of the Chapter I Prohibition.

(a) Agreement and/or concerted practice between ITL and Morrisons

When considered together with the evidence of ITL's overall strategy for retail prices described in Section 6.B: 'Manufacturers' retail pricing strategies' above, the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between ITL and Morrisons, whereby ITL co-ordinated with Morrisons the setting of Morrisons' retail prices for tobacco products in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of its retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' above, the Infringing Agreement between ITL and Morrisons restricted the ability of Morrisons to determine its retail prices for competing linked brands and had the object of restricting competition.

The following elements evidence the Infringing Agreement between ITL and Morrisons.

i. ITL's strategy in relation to Morrisons' retail prices

The trading agreements and contacts set out between ITL and Morrisons below should be considered in the context of ITL's retail pricing strategy as set out in Section 6.B: 'Manufacturers' retail pricing strategies' above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

In addition, in ITL's 'National Account Business Development Plan' for Morrisons, ITL stated:

'Strategy for the financial year 1.10.01 - 30.09.02'

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703 The earliest document relied upon, Document 1 of Annex 17, the ITL National Accounts Business Development Plan for Morrisons is dated 17 March 2000 but covers the period 1 October 1999 to 30 September 2000. However, although the first trading agreement is dated later (26 June 2000) it covers the period 1 August 1999 to 31 July 2001.

704 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT's finding of infringement is based on the evidence as a whole, including its context.

705 Document 23, Annex 17 (page 9). See also Document 24, Annex 17 (page 8).
That Morrison accept Imperial’s pricing strategy of reflecting current price list differentials between manufacturers’ brands, and that levels of on-going and tactical support are also based on absolute shelf prices.’

6.754 In addition to the document quoted above, a number of other documents contain evidence of the same or similar nature regarding ITL’s strategy for Morrisons’ retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 10 to 12, 22, 24, 42, 44, 47, 48, 70, 76 and 96 of Annex 17 (which are listed in Annex C).

ii Trading agreements between ITL and Morrisons

6.755 There were trading agreements between ITL and Morrisons, dated 26 June 2000 and 4 April 2003. Those agreements were a relevant aspect of the ongoing commercial dealing, between ITL and Morrisons and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and Morrisons in relation to retail prices.

6.756 The first trading agreement (‘TA1’), dated 26 June 2000, was in relation to the period 1 August 1999 to 31 July 2001 and was extended by letter of 4 October 2001 until the commencement of the next trading agreement. The second trading agreement (‘TA2’), dated 4 April 2003 and subsequently signed by Morrisons, but agreed by the parties on 29 November 2002, was in relation to the period 1 August 2002 to 31 July 2004. See also the following documents related to these agreements:

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706 Document 1, Annex 17 (page 4). Appendix 2, referred to in this document, was not attached to the document supplied by ITL. However, in view of the context and the consistency of wording, the OFT considers that the document is likely to have been identical or similar to the ITL Strategy Pricing Sheet found at Appendix 2 to the trading agreement for the period 1 August 1999 to 31 July 2001 (Document 4, Annex 17).
707 Document 22, Annex 17 (page 5).
708 Document 23, Annex 17 (page 8).
709 Document 4, Annex 17.
710 Document 45, Annex 17.
711 Document 85, Annex 17.
712 TA2 was sent from ITL to Morrisons for signature and returned under cover of a letter dated 4 April 2003 (Documents 77 and 84, Annex 17). However, an annotation, dated 6 December 2002, on a copy of the covering letter for an earlier draft of this document, supplied by ITL, (Document 71, Annex 17 and see also documents 72 – 74, Annex 17) suggests that the terms contained in TA2 were agreed by the parties at a meeting on 29 November 2002. It is also noteworthy that ITL stated that a new trading agreement had been in place for six months in Document 77, Annex 17.
two trading agreements: documents 29, 49, 67, 71, 72, 73, 74, 77, 78 and 79 to 86 of Annex 17.

6.757 In TA1, ITL and Morrisons agreed that, among other matters, ITL would maintain specified bonuses provided Morrisons’ prices for ITL’s brands were in line with ITL’s current strategy.715

‘ITL agree to maintain levels of off invoice bonuses, (as shown in Appendix 1,) provided [ITL] prices are in line with our716 current strategy.717 (see appendix 2) …If our pricing strategy changes, Morrisons to be notified and a new pricing sheet will take effect.’

6.758 In TA1, ITL and Morrisons also agreed the following in relation to promotional activities which may affect pricing strategy:

‘Morrison to confirm in-store promotional activities which may affect pricing strategy. ITL agree to maintain bonus levels in line with Appendix 1, should we elect not to respond to other manufacturers’ pricing initiatives’.

6.759 Appendix 2 of TA1 contained a page headed ‘ITL Strategy Pricing Sheet’ where parity and maximum differential provisions were set out. For example:

<table>
<thead>
<tr>
<th>ITL BRAND</th>
<th>STRATEGY PRICING</th>
<th>COMPARISON BRANDS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

713 Although this document is an unsigned draft trading agreement which was superseded by a later draft dated 4 April 2003, the covering letter demonstrates that ITL at least considered it to be a final draft and ready for signature.

714 The unsigned version of TA2 has been included as it is attached to ITL’s covering letter of 4 April 2003 (Documents 77 and 84, Annex 17). Also attached to this letter were Documents 78 to 83, 85 and 86, although only ITL supplied Documents 78 to 83, Annex 17 to the OFT. The copy of TA2 signed by Morrisons is Document 85.


716 The OFT is of the view that the words ‘our current strategy’, used in the document are a reference to ITL’s current strategy on the basis that the trading agreement appears to have been drafted by ITL.

717 Document 4, Annex 17 (Appendix 2). Although the agreements, in fact, state ‘... provided ITL prices are in line with our current strategy’ [emphasis added], the OFT considers that the reference to ITL is an error and interprets this clause to be relating to the prices charged by Morrisons for ITL’s products. This interpretation is consistent with the appearance of such wording in an agreement between Morrisons and ITL (i.e. ITL agrees to do x provided that Morrisons does y) and the presumption that ITL would be unlikely to publish prices which are not in line with its own pricing strategy. Furthermore, TA2 makes reference to Morrisons agreeing ‘to continue supporting ITL’s pricing strategy’ (see below), Document 85 (page 2).
20s 100s 200s

**SUPERKINGS FAMILY**  
Level with on = = = Against  
*Berkeley, B&H Superkings* …  
[Gallaher brands]

...

**REGAL KINGSIZE**  
At least -5p -25p -50p Less than  
*B&H Kingsize*  
[Gallaher brand]

...

**CLASSIC**  
Level with on = Parity pricing on range Against  
*Hamlet*  
[Gallaher brand]

...

**CAFÉ CRÈME & MILD** …  
= Parity on Range Against  
*Hamlet Miniatures*  
[Gallaher brand]'

6.760 In TA2, ITL and Morrisons agreed, among other matters, that:  

'Subject to the various criteria detailed below, Imperial Tobacco agree to pay Wm Morrison £[C] per annum, or £[C] over the two years of this Trading Agreement'.

Under the heading 'Pricing', TA2 stated:

'Morrison agree to continue supporting Imperial Tobacco’s pricing strategy and accept that Imperial Tobacco make pricing investments based on two fundamental criteria: achievement of the natural price list differentials that exist between the manufacturers; and the absolute levels of those shelf prices'.

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718 Document 85, Annex 17 (pages 1 – 3).
719 TA2, Document 85, Annex 17 (page 1).
In addition, TA2 stated:

'Based on the continued achievement of those differentials and the shelf prices highlighted in the ongoing schedule of costs, bonuses and margins document, Imperial Tobacco would pay all of these bonuses off-invoice, subject to the following conditions'.

The conditions included the following:

'Should our competitors\textsuperscript{720} reduce their shelf prices, Imperial Tobacco should be allowed to respond, in order to realign with the price list differentials. Should any additional funding be agreed to support a response to competitor activity, it should be removed once that activity had ended';

'With the exception of the application of either Budget or Manufacture Price Increases, Imperial Tobacco investment should reduce in line with any upward movement in shelf price';

'The off-invoice payment of all bonuses is not a de facto position. …following the purchase of stock at a discounted price, in order to achieve a pre-arranged shelf price, that the shelf price of that brand, or brands, might increase, necessitating a reduction in bonus'; and

The price list differentials at the time of writing the trading agreement were set out and 'should be reflected in Morrison shelf prices'.

6.761 By way of example, at the time of writing TA2 the 'price list differentials' that 'should be reflected in Morrison shelf prices' included the following maximum differentials:\textsuperscript{721}

'Marlboro KS skus No more expensive than B&H KS skus

... Superkings skus No more expensive than Berkeley skus

... Richmond skus Not more than 5p more expensive than Sterling skus; no more expensive than Dorchester skus

Classic skus No more expensive than Hamlet skus'.

6.762 Although some of the parity and differential requirements contained in TA1 and TA2 purportedly provided that the Retailer was to maintain maximum differential requirements between competing linked brands, the OFT infers from the following evidence that such provisions were in fact

\textsuperscript{720} The OFT is of the view that the words 'our competitors' used in the document are a reference to ITL’s competitors on the basis that the trading agreement appears to have been drafted by ITL.

\textsuperscript{721} TA2, Document 85, Annex 17 (page 3).
implemented as parity or fixed differential requirements, rather than maximum differential requirements: (i) evidence of ITL’s retail pricing strategy; (ii) evidence regarding the way in which the trading relationship between ITL and Morrisons operated in practice (that is, evidence of the contacts between ITL and Morrisons); and (iii) the existence of an Infringing Agreement between Gallaher and Morrisons pursuant to which Gallaher communicated parallel and symmetrical parity and differential requirements to Morrisons (see further 6.C.IV.(b) below). It is also instructive to note that the terms of draft trading agreements contained price list differentials phrased in terms of parity or fixed differentials (rather than maximum differentials). The restrictive nature of both parity or fixed differential requirements and maximum differential requirements is described above at Section 6.A.I.(d).

6.763 In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which Morrisons would set its retail prices in accordance with the parity and differential requirements set by ITL, and that Morrisons was rewarded with the payment of a bonus for compliance with ITL’s parity and differential requirements.

### iii Contacts between ITL and Morrisons regarding retail prices

6.764 A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and Morrisons regarding: (i) Morrisons’ retail prices for ITL’s brands; (ii) Morrisons’ retail prices for ITL’s competitors’ brands; and (iii) the retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.765 The documents evidencing the contacts between ITL and Morrisons demonstrate: (i) in relation to Morrisons’ retail prices for ITL’s brands (sometimes by reference to Morrisons’ or other Retailers’ retail prices for ITL’s competitors’ brands) and/or (ii) in relation to Morrisons’ retail prices for ITL’s competitors’ brands:

- ITL communicated\(^{722}\) to Morrisons what Morrisons’ retail prices should be; and/or
- ITL asked and/or incentivised Morrisons to hold or alter Morrisons’ retail prices; and/or
- Morrisons informed ITL about, or discussed with ITL, Morrisons’ current or proposed retail prices.

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\(^{722}\) See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.
6.766 Morrisons accepted and/or indicated its willingness to implement the directions contained in such communications.

6.767 In addition, ITL and Morrisons informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL's brands and/or for ITL's competitors' brands.

6.768 The contacts between ITL and Morrisons took place in the context of ITL's retail pricing strategy for Retailers to maintain specified parities and differentials between ITL's brands and competing linked brands. Communications in relation to retail prices were sent by ITL, and were received and implemented by Morrisons\textsuperscript{723} on the understanding that the notified retail prices took into account ITL's retail pricing strategy, together with Morrisons' desired pricing position relative to other Retailers and Morrisons' desired margin.

6.769 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.770 Various examples of contacts between ITL and Morrisons regarding retail prices are set out below.

**Contact between ITL and Morrisons regarding Morrisons' retail prices for ITL's brands**

6.771 Set out below are examples of contact between ITL and Morrisons in relation to Morrisons' retail prices for ITL's brands, which demonstrate that in relation to Morrisons' retail prices for ITL's brands (sometimes by reference to the retail prices of competing linked brands):

- ITL communicated to Morrisons what Morrisons' retail prices should be; and/or
- ITL asked and/or incentivised Morrisons to hold or alter Morrisons' retail prices; and/or
- Morrisons informed ITL about, or discussed with ITL, Morrisons' current or proposed retail prices.

6.772 Morrisons accepted and/or indicated its willingness to implement the directions contained in such communications.

6.773 Examples of such contacts are set out in the paragraphs below.

6.774 Evidence of explicit agreement can be seen in a number of documents (see documents 4, 9, 13, 22, 27, 38 to 40 and 50 of Annex 17). For

\textsuperscript{723} See paragraph 6.800 and 6.801 in relation to implementation.
example, in a record of a meeting dated 10 April 2000 between ITL and Morrisons, Morrisons stated\(^{724}\):

‘JA [Justin Addison of Morrisons] to re-align HR [hand rolling] tobacco retails.’

6.775 In an e-mail dated 2 July 2002 from ITL to Morrisons entitled ‘Pricing’, ITL stated:

‘I understand that one of our competitor’s has decided to reduce the RSP of Amber Leaf [Gallaher brand]. Whilst I would prefer to keep more cash in this important sub-Category, I need my brands to remain competitive.

To this end, I would be grateful if you would bring all Drum [ITL brand] skus into alignment with all Amber Leaf [Gallaher brand] skus. This will necessitate the following shelf price reductions and increases in bonuses:

…’

In response, Morrisons stated\(^{725}\)

‘Prices are keyed down from 08.07.02’.

6.776 In addition, evidence of pricing instructions with reference to earlier telephone conversations, meetings or discussions, where no objections were raised by Morrisons on each of many occasions can be seen in other documents (see document 3\(^{726}\), 5 to 7, 14 to 20, 25, 26, 29 to 32, 37\(^{727}\), 41, 43, 46, 51 to 57\(^{728}\), 58, 61 to 66, 69, 83, 88 and 93 of Annex 17).

6.777 For example, in a letter dated 15 November 2000 from ITL to Morrisons entitled ‘Richmond KS and Richmond Superkings [ITL brand]’, ITL stated\(^{729}\)

‘Regarding our earlier telephone conversation on the above. You are probably aware that the broad marketplace has moved from 329/330 to 334/335 on Dorchester KS and Dorchester Superkings [Gallaher brand]. You may remember from my presentation on the Richmond repositioning (and launch of Richmond Superkings) [ITL brand] that our strategy is parity with Dorchester [Gallaher brand]. In light of this we are moving Richmond KS and Richmond Superkings [ITL brand] up to 334/335’.

\(^{724}\) Document 2, Annex 17.

\(^{725}\) Document 60, Annex 17.

\(^{726}\) There are several documents similar to the ‘Schedule of Costs, Bonuses and Margins’ attached to this document. Such documents and their covering letters have been included in Annex 17.

\(^{727}\) The OFT does not have a copy of the attachment to this document.

\(^{728}\) The OFT does not have a copy of the attachment to this document.

\(^{729}\) Document 16, Annex 17.
In addition, in a fax dated 6 April 2001 from ITL to Morrisons, ITL stated:

'With reference to yesterday afternoon’s telephone conversation, please find attached two new Schedules of Costs, Bonuses and Margins

... 

The fourth covers the period from 9 April 2001 (Richmond [ITL brand] 5p shelf price increase)’.

In a similar letter dated 19 June 2001 from ITL to Morrisons, ITL stated:

'Please find attached a new schedule of costs bonuses and margins. This document is effective from Sunday 24 June 2001, and supersedes the last schedule, which ran from 9 April 2001.

The only shelf price change is:

The shelf price of Richmond KS and Lights 100s [ITL brand] multipacks moving from 1625 to 1675’. [Emphasis as in source document]

In an e-mail dated 1 March 2002 from ITL to Morrisons, ITL set out the following specified increase in retail price to its Richmond brand:

'With reference to our recent conversation concerning the forthcoming Sterling [Gallaher brand] price moves, I too would like to move the shelf price of Richmond Superkings [ITL brand] up 2p, to 347p’.

Likewise, in an e-mail dated 4 October 2002 from ITL to Morrisons, ITL stated:

'as per yesterday’s conversation.

it looks like there is going to be some upward movement at the bottom of the market: at last!

i would be grateful if you could make the following moves, from October 14:

richmond KS/lights 20s [ITL brand] from 354 -359p, which will mean a [C]p/1000 reduction in our contribution

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731 Document 31, Annex 17 (page 1, paragraph 2).
733 Document 68, Annex 17.
richmond SKS/lts/menthol 20s from 358-363p, which will mean a 1p/1000 reduction in our contribution. Wouldn’t it be good if Mayfair and Dorchester [Gallaher brands] followed us?.

Contact between ITL and Morrisons regarding Morrisons’ retail prices for ITL’s competitors’ brands

6.782 In addition to the documents above, which concern contact between ITL and Morrisons regarding Morrisons’ retail prices for ITL’s brands, there were contacts between ITL and Morrisons in relation to Morrisons’ retail prices for ITL’s competitors’ brands. Set out below are examples of such contacts which demonstrate that in relation to Morrisons’ retail prices for ITL’s competitors’ brands Morrisons informed ITL about, or discussed with ITL, Morrisons’ current or proposed retail prices.

6.783 The examples of such contacts are as follows.

6.784 In a letter dated 26 September 2000 from ITL to Morrisons, ITL set out the following retail price increases in relation to its Lambert and Butler and John Player Special brands:734

‘Following our meeting on Friday, I thought I should write to you concerning the issues we discussed and items we agreed on.

Pricing Movements: L&B/JPS brands [ITL brands]

I understand that Mayfair brands [Gallaher brand] are moving up from next Monday 2 October 00; I believe this is a general increase in the Multiple Retailers.

As discussed, could you increase the shelf prices of L&B and JPS brands [ITL brands] from 360 to 365 from that date. This will mean a removal of the additional retro bonuses, used to achieve the lower shelf prices. As you are aware your competitor’s shelf prices have been a little higher at 363, but they will also be moving to 365’.

6.785 ITL also stated the following in relation to its Richmond brand735:

‘Pricing Movements: Richmond [ITL brand]

I understand that Dorchester King Size [Gallaher brand] will also be moving from next Monday 2 October: from 338 to 329. You believe that this is a temporary move, and that this position will only last for one month.

734 Document 9, Annex 17.
735 Document 9, Annex 17.
Following our announcement to the Trade last Monday, the RRP of Richmond [ITL brand] has been reduced by 10p; our strategy is parity with Dorchester [Gallaher brand]. As agreed, I am willing to maintain your cash margin position on Richmond King Size and Lights [ITL brand], at the same shelf price as Dorchester [Gallaher brand]. Please reduce these brands to 329 on the same date that Dorchester [Gallaher brand] goes down’.

6.786 In addition, in an e-mail dated 5 February 2002 from ITL to Morrisons, ITL stated:736

‘I notice that A. Leaf [Amber Leaf, Gallaher brand] 12.5g has been priced at 209p for some time; whilst I think we would both prefer to keep more cash in the till, if this is semi-permanent position, could you reduce the shelf price of Drum [ITL brand] 12.5g to a parity position with A. Leaf [Gallaher brand] i.e. from 212 to 209p.

This will necessitate an increase in our support from [C]p to [C]p/outer.

Please let me know when you could affect this change; in the meantime, I will ask Graham to prepare an update to the latest Schedule (effective 11.11.01)’.

6.787 In a later e-mail also dated 5 February 2002 from ITL to Morrisons, which attached the e-mail above, ITL stated:737

‘Ref. our earlier conversation: yes, I would like match A. Leaf [Gallaher brand] across all skus.

As well as the move on 12.5g I would like to move 25g from 415 to 410, and 50g from 814 to 809.

This will necessitate increases in bonus of [C]p to [C]p on 25g and [C]p to [C]p on 50g.

I will ask Graham to include this on the updated schedule’.

6.788 In an e-mail dated 18 April 2002 from ITL to Morrisons regarding post-budget pricing, ITL attached a new pricing list reflecting duty increases and also listed exceptions in response to competitor activity, among other matters. In relation to Richmond, ITL stated the following:738

‘Richmond [ITL brand]
In response to competitor activity, I would be grateful if you would increase Richmond KS and Superkings [ITL] brands by only 5p, necessitating an additional bonus of [C]p/1000.

738 Document 57, Annex 17.
This means the shelf price of Richmond KS 20s brands will move from 344 to 349p; Richmond Superkings 20s brands will move from 347 to 352p.

Both Richmond KS and Superkings 100s multi-packs will continue to be price-marked at 1699/1700, necessitating additional bonuses of \[\text{C}p/1000\] on both skus'.

6.789 In relation to Drum, ITL also stated:

"In response to competitor activity I would be grateful if you would hold the price on all Drum/Drum Milde ITL brand at pre-Budget shelf prices. This will necessitate additional bonuses of \[\text{C}p/\text{C}p\] [\text{C}p/\text{C} per outer'].

6.790 In a letter dated 11 June 2002 from ITL to Morrisons, ITL stated:739

'As you are already aware, one of our competitors has already announced a price increase, effective June 25 2002. This means that the differentials that exist naturally between our brands and our competitor’s will widen; this means, I would expect to see the following example disparities from June 25, or from the date you implement our competitor’s price increase'.

6.791 In a letter dated 5 August 2002 from ITL to Morrisons, ITL stated the following in relation to its Embassy and Regal brands:740

'As you will see from our new Price List, the RSP differentials between our Embassy and Regal families ITL brands and those of our competitor’s [comparable] brands have narrowed. Specifically:


In relation to its Richmond brand, ITL stated:

'Despite fierce competition, we feel there should be some upward movement in the Ultra Low Price sector of the market. From the date you apply this increase, please increase the shelf price of Richmond brands as follows:

Richmond KS 20s +5p from 349 to 354
Richmond SKS 20s +6p from 353 to 358'.

739 Document 58, Annex 17.
740 Document 63, Annex 17.
In relation to its Drum brand, ITL stated:

'Reluctantly, due to our competitor’s actions in the RYO market, we are reducing the RSP’s of our Drum and Drum Milde skus by 12p for 12.5g, 23p for 25g and 46p for 50g'.

6.792 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Morrisons regarding Morrisons’ retail prices for ITL’s competitors’ brands which demonstrates the same matters as set out in respect of the document quoted above: documents: 17, 26, 59, 60 and 93 of Annex 17 (which are listed in Annex C).

**Contact between ITL and Morrisons regarding the retail prices of Morrisons’ competitors**

6.793 In addition to the documents above, there were contacts between ITL and Morrisons in which ITL and Morrisons informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.794 Examples of such contacts are as follows.

6.795 In a letter dated 26 September 2000 from ITL to Morrisons, ITL set out the 'issues we discussed and items we agreed on' at a recent meeting with Morrisons. In particular, ITL stated:741

‘As discussed, could you increase the shelf prices of L&B and JPS brands [ITL brands] from 360 to 365 from that date. This will mean a removal of the additional retro bonuses, used to achieve the lower shelf prices. As you are aware your competitor’s shelf prices have been a little higher at 363, but they will also be moving to 365’.

6.796 In a letter dated 13 December 2002 from ITL to Morrisons, ITL stated:742

‘I am writing concerning your e-mail highlighting the perceived differences between your own shelf prices and those of some of your grocery competitors …’

‘Richmond KS 100 [ITL brand] multi-packs at 1728 in Asda is doubtful because, although some plain stock is beginning to enter the trade, we have only been sending out Price Marked Packs for some time; no incarnation has been Price Marked at 1728.

741 Document 9, Annex 17.
742 Document 75, Annex 17.
L&B KS 100 [ITL brand] multi-packs at 1897 in Kwik Save are improbable, as I could not find one store on our system selling at that shelf price.

I am quite sure that [another retailer’s] shelf price for Classic 5s [ITL brand] is 284, and has been since the MPI last September.

L&B KS 20 [ITL brand] at 386 in Kwik Save is unlikely; although I believe there is some localised fighting between Kwik Save and T&S, their predominant shelf price is 389.

Sainsbury’s current shelf price for Small Classic Filter [ITL brand] is determined by whatever Price Marked Pack is in their system; it may still be 255, although it is more likely to have moved to the new Price Mark of 269.

6.797 It can be seen from the above that references by ITL to the retail prices of other Retailers provided an assurance to Morrisons that retail price changes put to Morrisons by ITL would not cause Morrisons to be out of step with its retail competitors.

6.798 In addition to the documents quoted above, document 29 of Annex 17 (which is listed in Annex C) contains evidence of contact of the same or similar nature between ITL and Morrisons which demonstrates the same matters as set out in respect of the documents quoted above.

**Conclusion on the contacts between ITL and Morrisons**

6.799 In conclusion in relation to all the contacts between ITL and Morrisons regarding retail prices, the above paragraphs demonstrate that there was contact between ITL and Morrisons, which related to the retail prices of Morrisons as well as other Retailers. The evidence of such contacts, together with the context of ITL’s strategy, demonstrates that ITL’s retail pricing strategy was for Morrisons to maintain specified parities and differentials between ITL’s brands and competing linked brands. The contacts between ITL and Morrisons assisted the implementation of that strategy, through communications between ITL and Morrisons in relation to Morrisons’ retail prices for ITL’s brands and in some cases also ITL’s competitors’ brands, the aim of which was to ensure that ITL’s desired parities and differential requirements were maintained or realigned. The contacts between ITL and Morrisons also demonstrate that Morrisons accepted and/or indicated its willingness to implement the directions contained in communications from ITL to Morrisons in that connection.

6.800 The OFT notes that ITL and Morrisons submitted that there were instances where Morrisons did not implement instructions and/or requests in ITL’s pricing communications.
6.801 However, the OFT considers that, the fact that there may have been some instances where Morrisons did not implement, did not implement fully\textsuperscript{743}, or delayed the implementation of instructions and/or requests in ITL’s pricing communications, does not negate the existence of the Infringing Agreement between ITL and Morrisons, as there is sufficient evidence over a period of time of Morrisons' compliance, or intention to comply, with ITL's retail pricing strategy (see for example the sections entitled ‘Trading agreements between ITL and Morrisons’ and ‘Contacts between ITL and Morrisons regarding retail prices’ above).

\textit{iv. Bonuses}

6.802 As set out above, ITL paid an ongoing bonus to Morrisons on the condition that, among other matters, Morrisons' retail prices were in line with ITL's retail pricing strategy as set out in the trading agreements. As noted above, TA1 set out parity and differential provisions in the ‘\textit{ITL Strategy Pricing Sheet}’ attached to TA1. TA2 set out ‘\textit{price list differentials}’ that ‘should be reflected in Morrisons shelf prices’ in the trading agreement.

6.803 There are also documents relating to the provision of tactical bonuses from ITL to Morrisons, examples of which are set out in section entitled ‘Contacts between ITL and Morrisons regarding retail prices’ above.

6.804 The payment of tactical bonuses was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Morrisons. In particular, the bonuses ensured that Morrisons' margin was not significantly affected by the changes in retail prices instructed or requested by ITL to achieve ITL’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Morrisons' retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.805 In addition to those documents referred to in the contacts sections above, which specifically refer to tactical bonuses, the following documents also evidence the use of tactical bonuses.

6.806 In a fax dated 3 July 2000 from ITL to Morrisons, ITL provided a schedule including columns indicating the relevant brand, pack size, ongoing and tactical bonuses, selling price and changes from 10 July 2000 to 13 August 2000. In particular, ITL stated in the fax attached to the schedule

\textsuperscript{743} For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
'please note bonus and price changes indicated in the right column' and then provided the 'selling price'.\textsuperscript{744}

6.807 In a similar letter dated 9 January 2001 from ITL to Morrisons, ITL attached another schedule and stated the following:\textsuperscript{745}

'Please find attached a new schedule of costs, bonuses and margins: this document is effective from Monday 15 January 2001 and supersedes the last schedule, which ran from 4 December 2000.

The following changes have been made:

1. Embassy and Regal [ITL brands] 100s and 200s multi-pack bonuses return to 'on-going' levels from Monday 15 January 2001, this is in response to our closest competitors decision to end the 1999/3988 price points on B&H/S.Cut [Gallaher brands] KS from this date'.

6.808 In a letter dated 16 March 2001 from ITL to Morrisons, ITL stated:\textsuperscript{746}

'As per Tuesday’s telephone conversation with Justin [of Morrisons], the changes are as follows:

…

iii) Drum [ITL brand] 12.5g to be at parity with Amber Leaf [Gallaher brand]: a shelf prices of 196p. This represents a 10p reduction per SKU, necessitating an additional bonus of \(\text{C}\)p/outer; although not discussed yesterday, I would also be grateful for a parity position on 25g: a shelf price of 384p. This would represent a 22p reduction per SKU, necessitating an additional bonus of \(\text{C}\)p/outer;

…

v) Please allow the shelf prices of L&B/JPS brands [ITL brands] to increase by 7p (pro-rate on multi-packs) which brings to an end our support (\(\text{C}\)p/1000) for the pre-budget shelf position of 369'. [Emphasis as in source document]

6.809 In a letter dated 19 November 2001 from ITL to Morrisons, ITL stated:\textsuperscript{747}

'Small Classic/Small Classic Filter' [ITL brands]

As discussed earlier today please find attached a new schedule of costs, bonuses and margins. The changes affect Small Classic and Small Classic Filter 10s and Multipacks, the shelf price of 10s should be reduced by 30p and Multipacks by £1.55

Café Crème/Café Crème Mild [ITL brands]

\textsuperscript{744} Document 6, Annex 17.
\textsuperscript{745} Document 17, Annex 17.
\textsuperscript{746} Document 26, Annex 17.
\textsuperscript{747} Document 50, Annex 17.
During our conversation last week we also agreed to bring down the price of Café Crème and Café Crème Mild Multipacks to be in line with the Hamlet Miniature Multipacks [Gallaher brand] with a shelf price of £13.10. The schedule of costs, bonuses and margins has been amended in accordance with these changes.

I would be grateful if you could set this up on Wednesday 21st November'.

6.810 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the provision of bonuses by ITL to Morrisons which demonstrates the same matters as set out in respect of the documents quoted above: documents 3, 8, 9, 11, 12, 25, 28, 29, 31, 40 and 83 of Annex 17 (which are listed in Annex C). Invoices made by Morrisons can be seen in documents 33 to 36, 79 to 82, 86, 89, 92, 94 and 95 of Annex 17 (which are listed in Annex C).

6.811 The evidence demonstrates that ITL paid bonuses to Morrisons in order to ensure that ITL’s retail pricing strategy was maintained. Morrisons accepted bonuses on the understanding they were paid for compliance with, or in order to maintain, the parities and differentials set by ITL.

v Monitoring of retail prices by ITL

6.812 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to Morrisons.

6.813 In addition, monitoring was formalised in TA2 and was included as a provision in draft trading agreements:748

‘Imperial Tobacco Multiple Trade Representatives will continue to visit every Morrison store and PFS at least once every eight weeks to collect availability and pricing data’.

6.814 TA2 also stated:

‘Imperial Tobacco should provide appropriate feedback concerning out of stock, do not stock and NPD distribution to Morrison together with any other mutually agreed information, with a view to providing any necessary remedial action.’749

748 Document 85, Annex 17.
749 Similar provisions are also contained in Document 67, Annex 17.
However, monitoring had occurred prior to TA2 and continued throughout the period of the Infringing Agreement.

6.815 Examples of other documents in relation to monitoring are as follows.

6.816 In a letter dated 19 June 2001 from ITL to Morrisons, ITL stated the following in relation to increasing retail prices:750

‘As per the message I left some weeks ago, your current shelf prices on our cigar brands are still below those outlined in the last schedule. All brands are 6p below where they should be’.

6.817 Similarly, in a fax dated 4 July 2001 from ITL to Morrisons, ITL stated:751

‘I have not looked this week but I assume you have increase shelf prices of cigars (+6p) as per last two schedules’.

6.818 In an e-mail dated 2 July 2002 from ITL to Morrisons, ITL stated:752

‘Not sure why, but Café Crème 50s [ITL brand] are out of line with Hamlet Miniatures [Gallaher brand] (which must have been held following the Gallaher MPI?).

Whilst Hamlet Miniatures are at 1299 [Gallaher brand], I would like Café Crème [ITL brand] to also be at 1299.

This would mean an increase in bonus of £/outer, or £/100’.

[Emphasis as in source document]

6.819 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of Morrisons’ retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 8, 9 (page 2), 21, 30, 44, 48, 52, 53, 67, 82, 85 and 87 of Annex 17 (which are listed in Annex C).

6.820 These documents demonstrate that ITL would monitor Morrisons’ retail prices of both ITL and Gallaher brands to ensure that parity and differential requirements were maintained and would point out pricing errors to Morrisons.

vi Conclusion on the agreement and/or concerted practice between ITL and Morrisons

6.821 The evidence described above, demonstrates the existence of the Infringing Agreement between ITL and Morrisons, which had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-
competitive object of the Infringing Agreements’ above and given that the remaining constituent elements of the statutory test are also met (see Section 7: ‘Legal assessment’), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.822 In addition to the above, the existence of the Infringing Agreement between ITL and Morrisons is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of the Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- ITL and each of the other Retailers, which evidence ITL’s approach towards the Retailers as a collective; and between
- Gallaher and Morrisons (see below), which is part of the context of the Infringing Agreement between ITL and Morrisons.

6.823 The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and Morrisons) lends further support to the fact that there was an agreement and/or concerted practice between ITL and Morrisons which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or Concerted Practice between Gallaher and Morrisons

6.824 When considered together with the evidence of Gallaher’s overall strategy for retail prices described in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, the evidence referred to below, demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between Gallaher and Morrisons, whereby Gallaher co-ordinated with Morrisons the setting of Morrisons’ retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between Gallaher and Morrisons restricted the ability of Morrisons to determine its retail prices for competing linked brands and had the object of restricting competition.

6.825 The following elements evidence the Infringing Agreement between Gallaher and Morrisons.\(^{753}\)

\(i\) Gallaher’s strategy in relation to Morrisons’ retail prices

6.826 The contacts set out between Gallaher and Morrisons below should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.827 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher’s multiple grocer channel, demonstrate that Gallaher’s objective was that multiple grocers, of which Morrisons was one such grocer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

6.828 A good example is an internal Gallaher document headed ‘Promotional Policy - Retail Promotion Contributions – March 2000’, which listed the ‘pricing objectives’ in relation to the following brands amongst others:

\('Camel [Gallaher brand] – Parity with Marlboro [competitor brand]\(^{754}\)\)

\(^{753}\) The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.

B&H [Gallaher brand] – 5p above Regal [ITL brand], 3p above Embassy No 1 [ITL brand]

Berkeley and B&H Superkings [both Gallaher brands] – parity with JP Superkings [ITL brand]

Club [Gallaher brand] 14p below Regal [ITL brand]

Sovereign [Gallaher brand] 10p below L&B [ITL brand]

Mayfair 7p below Sovereign [both Gallaher brands] and at least parity with Richmond [ITL brand]…

6.829 Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s multiple grocer channel, is set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, which refer to a number of other documents containing evidence of the same or similar nature.

ii Contact between Gallaher and Morrisons regarding Morrisons’ retail prices

6.830 A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and Morrisons regarding Morrisons’ retail prices for Gallaher’s brands.

6.831 The documents evidencing the contacts between Gallaher and Morrisons demonstrate that in relation to Morrisons’ prices for Gallaher’s brands:

- Gallaher communicated to Morrisons what Morrisons’ retail prices should be; and/or
- Gallaher asked and/or incentivised Morrisons to hold or alter Morrisons’ retail prices; and/or
- Morrisons informed Gallaher about, or discussed with Gallaher, Morrisons current or proposed retail prices.

6.832 Morrisons accepted and/or indicated its willingness to implement the directions contained in such communications.

754 ITL has distributed Marlboro since 12 September 2001.
755 Document 1, Annex 3 (page 2). This document also set out parity and differential requirements for cigars and hand rolled tobacco.
756 See, in particular, documents 2 to 10, 13 and 14 of Annex 3.
757 See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.
6.833 The contacts between Gallaher and Morrisons took place in the context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent by Gallaher, and were received and implemented by Morrisons on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together with Morrisons’ desired pricing position relative to other Retailers and Morrisons’ desired margin.

6.834 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.835 Various examples of contacts between Gallaher and Morrisons regarding retail prices are set out below.

6.836 In the minutes of a meeting dated 16 May 2000 between Gallaher and Morrisons, Morrisons recorded under the heading ‘Pricing’ that it was to move certain Gallaher brands to specified pricing points:

\[\text{‘JA [Justin Addison of Morrisons] to move} \]

\begin{align*}
B + H & \quad 100\text{’s to }19.99 \text{ from }20.10 \\
& \quad 200\text{’s to }39.88 \text{ from }40.15 \\
\text{BERK} & \quad 100\text{’s to }18.99 \text{ from }19.10 \\
& \quad 200\text{’s to }37.88 \text{ from }38.15'.
\end{align*}

The OFT considers that this constitutes evidence that Morrisons discussed its pricing with Gallaher and that Morrisons accepted and/or indicated its willingness to implement the specific pricing points.

6.837 Furthermore, in the minutes of a meeting dated 7 September 2000 between Gallaher and Morrisons, Morrisons recorded:

\[\text{‘JA [Justin Addison of Morrisons] to review retail pricing on Embassy + Regal [ITL brands]. Sobranie Panatellas should be }2.67\text{ and Miniatures }2.62\text{ [Gallaher brand]’}.\]

The OFT notes that this action point from the meeting with Gallaher refers to a review by Morrisons of its retail prices for ITL’s brands as well as what Morrisons’ retail prices for Gallaher’s brands should be.

6.838 In a fax dated 20 September 2000 from Gallaher to Morrisons, entitled ‘Dorchester Pricing / POS’ Gallaher set out specified price points including price increases:

\[\text{See paragraph 6.845 and 6.846 in relation to implementation.}\]

\[\text{Document 2, Annex 7.}\]

\[\text{Document 5, Annex 7.}\]
'I write to confirm that Dorchester [Gallaher brand] pricing should be as follows:

King Size 20s - £3.34 ~ bonus [C]p per outer
King Size 100s - £15.99 ~ bonus [C]p per 100

...

I also confirm that Mayfair [Gallaher brand] pricing should rise to £3.53 for 20s, £17.60 for 100s & £35.20 for 200s.'

6.839 Similarly, in a fax dated 9 February 2001 from Gallaher to Morrisons entitled 'Dorchester Pricing', Gallaher stated:762

'Following our further discussion could you please implement the following price changes in-store from 19th February 2001:-

<table>
<thead>
<tr>
<th>[Gallaher] Brand</th>
<th>Price</th>
<th>Retro Bonus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dorchester KS 20s</td>
<td>£3.34</td>
<td>[C]p per outer</td>
</tr>
<tr>
<td>Dorchester KS 100s Mp</td>
<td>£16.25</td>
<td>[C]p per 100</td>
</tr>
<tr>
<td>Dorchester KS 200s</td>
<td>£32.39</td>
<td>[C] per 200</td>
</tr>
</tbody>
</table>

...

6.840 Another example includes a fax dated 25 February 2002 from Gallaher to Morrisons entitled 'Sterling Pricing', in which Gallaher stated:763

'As discussed earlier today on the telephone, it is our intention to move the Sterling [Gallaher brand] Range prices back to their normal RRP from the 1st of March. Within Morrisons we agreed that this price change would take effect on 4th of March. As such the tactical bonus paid will stop and we will return to the standard bonus price of £[C] per 000 across the entire Sterling range. The retail prices will therefore return to:

<table>
<thead>
<tr>
<th>[Gallaher brands]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sterling KS 20's</td>
</tr>
<tr>
<td>Sterling KS 100's</td>
</tr>
<tr>
<td>Sterling KS 20's</td>
</tr>
<tr>
<td>Sterling KS 100's</td>
</tr>
</tbody>
</table>

All other tactical prices are unaffected.'

762 Document 9, Annex 7.
6.841 The OFT considers that this document demonstrates that Morrisons discussed its pricing with Gallaher and that Morrisons accepted and intended to implement Gallaher’s pricing instructions on the dates stipulated.

6.842 In an e-mail dated 17 June 2002 from Gallaher to Morrisons entitled ‘MPI Suggested Prices’, Gallaher stated:\(^{764}\)

‘Please see detailed below the prices I am suggesting holding etc.

If you are happy with these then I will send you a revised margin spreadsheet. I will give you a call in morning.

[Gallaher] Brands holding price
Berkeley & BHSH all 20’s hold at £4.10
...
Dorchester King size all 20’s hold at £3.49
...
[Gallaher] Brands moving up
Camel all 20’s move from £4.25 to £4.31
...
All other [Gallaher] brands to move as from the 25th June by the relevant amount on the price list.’

6.843 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and Morrisons regarding Morrisons’ retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 1 to 12\(^{765}\), 13, 16\(^{766}\) and 17 to 19 of Annex 7 (which are listed in Annex C).

**Conclusion on the contacts between Gallaher and Morrisons**

6.844 In conclusion in relation to all the contacts between Gallaher and Morrisons regarding retail prices, the above paragraphs demonstrate that there was contact between Gallaher and Morrisons, which related to the retail prices of Morrisons. The evidence of such contacts together with the context of Gallaher’s strategy demonstrates that Gallaher’s retail pricing strategy was for Morrisons to maintain specified parities and

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\(^{764}\) Document 15, Annex 7.

\(^{765}\) The OFT infers that this document was sent to Morrisons by Gallaher, as evidenced by the fact that the document was supplied to the OFT by Morrisons and that it is marked as ‘FAO Paul Giles’, [Morrisons’ tobacco buyer].

\(^{766}\) Documents 16 and 17, Annex 7, the margins spreadsheets were supplied to the OFT by Morrisons.
differentials between Gallaher’s brands and competing linked brands. The contacts between Gallaher and Morrisons assisted the implementation of that strategy, through communications from Gallaher in relation to Morrisons’ retail prices, the aim of which was to ensure that Gallaher’s desired parities and differentials were maintained or realigned. The contacts between Gallaher and Morrisons also demonstrate that Morrisons accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher to Morrisons in that connection.

6.845 The OFT notes that Morrisons submitted that there were instances where Morrisons did not implement instructions and/or requests in Gallaher’s pricing communications.

6.846 The OFT considers that, notwithstanding that there may have been some instances where Morrisons did not implement, did not implement fully\textsuperscript{767}, or delayed the implementation of instructions and/or requests in Gallaher’s pricing communications, that does not negate the existence of the Infringing Agreement between Gallaher and Morrisons, as there is sufficient evidence over a period of time of Morrisons’ compliance, or intention to comply, with Gallaher’s retail pricing strategy (see for example the section entitled ‘Contact between Gallaher and Morrisons regarding Morrisons’ retail prices’ above).

\textbf{iii} \quad \textbf{Bonuses}

6.847 There are documents relating to the provision of tactical bonuses from Gallaher to Morrisons, examples of which are set out in the section entitled ‘Contact between Gallaher and Morrisons regarding Morrisons’ retail prices’ above.

6.848 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Morrisons. In particular, the bonuses ensured that Morrisons’ margin was not significantly affected by the changes in retail prices instructed or requested by Gallaher to achieve Gallaher’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Morrisons’ retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

\textsuperscript{767} For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
In addition to those documents referred to in the contacts sections above, the following documents also evidence the use of tactical bonuses.

In an urgent fax dated 31 May 2000 from Gallaher to Morrisons entitled 'Mayfair Price Change', Gallaher stated:

'I write to confirm the following price changes and bonuses for Mayfair [Gallaher brand]. These to be in-store from Monday 5th June - UFN

Mayfair 20s (all) – Prices: £3.39 from **£3.48**, bonus of **C**p per 200

Mayfair 100 MPs – Prices: **£16.90** from £17.35, bonus of **C**p per 100

Mayfair 200s – Prices: **£33.80** from £34.60, bonus of **C**p per 200' [Emphasis as in source document]

In a fax dated 31 July 2000 from Gallaher to Morrisons, entitled 'Post MPI prices – from 15th Aug', Gallaher stated:

'Please find below the new prices for key brands/ on promotions;'

Certain Gallaher brands, including Dorchester, B&H, Silk Cut, Sovereign, Mayfair Amber Leaf and King Six, were listed with a specified price and bonus. For example:

<table>
<thead>
<tr>
<th>Brand/Packing</th>
<th>Price</th>
<th>Bonus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mayfair 20s</td>
<td>£3.44</td>
<td><strong>C</strong>p per 200</td>
</tr>
<tr>
<td>Mayfair 100 MPs</td>
<td>£16.99</td>
<td><strong>C</strong>p per 100 unit</td>
</tr>
<tr>
<td>Mayfair 200s</td>
<td>£33.88</td>
<td><strong>L</strong>C per 200 unit</td>
</tr>
<tr>
<td>Dorchester KS 20s</td>
<td>£3.33</td>
<td><strong>C</strong>p per 200</td>
</tr>
<tr>
<td>Dorchester SK 20s</td>
<td>£3.34</td>
<td><strong>C</strong>p per 200</td>
</tr>
<tr>
<td>Dorchester KS 100 MPs</td>
<td>No change (£15.99)</td>
<td><strong>C</strong>p/100</td>
</tr>
</tbody>
</table>

In the fax Gallaher further stated:

'Please note that all other prices other than those above should rise in line with the announced increase.'

In a fax dated 16 October 2000 from Gallaher to Morrisons entitled 'Mayfair [Gallaher brand] Pricing/Bonusing', Gallaher stated:

'Following our recent discussions regarding Mayfair. I write to confirm the following as agreed:

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Mayfair 20’s [Gallaher brand] to move to 10p off of the retail price ongoing. This would currently mean £3.49. Bonus on 20s (off-invoice) to move to [C]p from November 1st.

100 Multipacks to move to £17.39. Bonus on a 3000 case of 100s will be [C]p (off-invoice)

200 Multipacks – sell at £34.88

These additional bonuses will continue as long as a 10p of the rrp price is maintained’.


‘As discussed during our recent telephone conversation the price of Dorchester 20s [Gallaher brand] will rise in-store Sunday April 1st.

The prices/bonuses will be as follows:

<table>
<thead>
<tr>
<th>Brand/packing</th>
<th>Selling price</th>
<th>Retro bonus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dorchester KS 20s range</td>
<td>£3.39</td>
<td>[C] p per Outer</td>
</tr>
<tr>
<td>Dorchester SK 20s range</td>
<td>£3.40</td>
<td>[C] p per Outer</td>
</tr>
</tbody>
</table>

6.854 In a fax dated 10 July 2001 from Gallaher to Morrisons entitled 'Price Changes', Gallaher stated the following and included a table setting out 'brand', 'selling price' and 'retro bonus from 16/07/01':772

‘Please find attached the price changes/retro bonuses from July 16th until further notice.’773

6.855 In a fax dated 19 November 2001 from Gallaher to Morrisons entitled 'Amber Leaf [Gallaher brand] 50g – bonus detail', Gallaher stated:774

‘I write to confirm our telephone conversation regarding Amber Leaf 50g [Gallaher brand]. In order to meet your margin expectation an off-invoice bonus of [C] p per outer will be effective from order date.

This bonus will remain whilst your retail price is maintained at the current £8.09 or at 41p below the RRP.’

773 The second page of the fax lists increases from previous prices when, for example, compared to Document 9, Annex 7. The OFT notes that these are all specific price points. Similar examples which also appear to show increases are Documents 4, 6, 8, and 10, Annex 7.
In addition to the documents quoted above, other documents contain evidence of the same or similar nature in relation to the payment of bonuses by Gallaher to Morrisons which demonstrates the same matters as set out in respect of the documents quoted above: documents 6 and 8 to 10 of Annex 7 (which are listed in Annex C).

The evidence demonstrates that Gallaher paid bonuses to Morrisons in order to ensure that Gallaher’s parity and differential strategy was maintained. Morrisons accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

**iv Monitoring of retail prices by Gallaher**

The document set out below demonstrates that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to Morrisons.

The minutes of a meeting on 7 September 2000 between Gallaher and Morrisons, recorded that:

> ‘JA [Justin Addison of Morrisons] to review retail pricing on Embassy and Regal [ITL brands]. Sobranie Panatellas should be 2.67 and Miniatures 2.62 [Gallaher brand].’

The OFT notes that this action point from the meeting refers to a review by Morrisons of its retail prices for ITL’s brands as well as what the retail prices for Gallaher’s brands should be.

**v Conclusion on the agreement and/or concerted practice between Gallaher and Morrisons**

The evidence described above, demonstrates that there was an agreement and/or concerted practice between Gallaher and Morrisons which had the object of restricting competition, in the manner set out in Section 6.A.1: 'The anti-competitive object of the Infringing Agreements' and given that the remaining constituent elements of the statutory test are also met (see Section 7: 'Legal assessment'), amounted to a breach of the Chapter I Prohibition.

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775 Document 5 Annex 7.
vi  Further Supporting Evidence

6.861 In addition to the above, the existence of the Infringing Agreement between Gallaher and Morrisons is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of the Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher’s approach towards the Retailers as a collective; and between
- ITL and Morrisons (see above), which is part of the context of the Infringing Agreement between Gallaher and Morrisons.

6.862 The existence of the further supporting evidence described above (and in particular the relationship between ITL and Morrisons) lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and Morrisons which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.

(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.863 As is noted in the sections above relating to the existence of an Infringing Agreement between each of ITL/Morrisons and Gallaher/Morrisons, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.864 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Morrisons and that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d) above).
V Agreement and/or concerted practice between ITL and Safeway and between Gallaher and Safeway

Summary

6.865 As set out in 6.C.V.(a) below, ITL and Safeway were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby ITL co-ordinated with Safeway the setting of Safeway’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.866 As set out in 6.C.V.(b) below, Gallaher and Safeway were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby Gallaher co-ordinated with Safeway the setting of Safeway’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.867 Each of the Infringing Agreements between ITL/Safeway and Gallaher/Safeway amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Safeway and that each Manufacturer must have been aware\(^{776}\) of each other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of an Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement, as set out in Section 6.A.I.(d) above.

\(^{776}\) See also 6.A.I.(b) in relation to the Manufacturers’ awareness of each other’s parallel and symmetrical parity and differential requirements.
On 11 July 2008, Gallaher concluded an early resolution agreement with
the OFT, pursuant to which Gallaher admitted its involvement in each
Infringing Agreement to which it was party, in breach of the Chapter I
Prohibition.

(a) Agreement and/or concerted practice between ITL and Safeway

When considered together with the evidence of ITL’s overall strategy for
retail prices described in Section 6.B: ‘Manufacturers’ retail pricing
strategies’ above, the evidence referred to below demonstrates that, at
least from 1 March 2000 to 15 August 2003, an Infringing Agreement
existed between ITL and Safeway, whereby ITL co-ordinated with
Safeway the setting of Safeway’s retail prices for tobacco products, in
order to achieve the parity and differential requirements between
competing linked brands that were set by ITL, in pursuit of ITL’s retail
pricing strategy. For the reasons set out in Section 6.A.I: ‘The anti-
competitive object of the Infringing Agreements’, the Infringing
Agreement between ITL and Safeway restricted the ability of Safeway to
determine its retail prices for competing linked brands and had the object
of restricting competition.

The following elements evidence the Infringing Agreement between ITL
and Safeway.

i. ITL’s strategy in relation to Safeway’s retail prices

The trading agreements and contacts between ITL and Safeway set out
below should be considered in the context of ITL’s retail pricing strategy
as set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above,
and as demonstrated below, namely to achieve the parity and differential
requirements between competing linked brands that were set by ITL.

In addition, in an internal ‘National Accounts Business Development Plan’
for ‘Safeway Stores Plc’ dated March 2001, ITL stated:

‘The opportunity to test the effect of differential pricing on
premium brands is being pursued. … a test involving premium
brand pricing parity has been proposed’.

777 The earliest document relied upon, document 1 of Annex 28, is dated 1 December
1999, and shows that the Infringing Agreement was actually in place before the Chapter
I Prohibition came into force on 1 March 2000.
778 The analysis of the evidence by reference to the elements of the Infringing
Agreements is purely for presentational purposes. The OFT’s finding of infringement is
based on the evidence as a whole, including its context.
An internal ‘ITL National Accounts Brief’ for Safeway dated 1 April 2002, stated: 

’Safeway are currently undertaking a test in their ‘tilt’ stores whereby prices have increased by a further 5 pence on packets of 20 and accordingly on multipacks. Differentials with OM\textsuperscript{781} brands should however be maintained. A fully updated price list will be issued when it becomes clear what the long-term pricing policy is to be.’ [Emphasis as in source document]

An internal memorandum dated 4 December 2002 detailed ITL’s new Maxim brand in Safeway stores and ITL’s representative and noted that:

‘Trevor [of Safeway] is adamant that he wants price parity with Sterling [Gallaher brand] … from a personal view I am keen to match Sterling [Gallaher brand] but how would this affect the ‘common’ pricing of Maxim in [another retailer], JS etc …’

An internal ITL e-mail of 11 June 2003 set out post-MPI pricing and noted:

‘Classic [ITL brand]: Match Hamlet [Gallaher brand] shelf price (all packings)

Panama [ITL brand]: should be -3p against Hamlet [Gallaher brand] price except where King 6 [Gallaher brand] is present, in which case Panama [ITL brand] to be King 6 [Gallaher brand] shelf price + 10p, but to a basement of £2.85 for Panama [ITL brand]. Please note Gallaher have only increased King 6 [Gallaher brand] by 3p in forthcoming MPI, creating a 13p differential with Panama [ITL brand], but I would like to maintain the 10p differential if possible.’

In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to ITL’s strategy for Safeway’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 9, 14, 18, and 33, 80, 84 of Annex 28 (which are listed in Annex C).

ii Trading agreements between ITL and Safeway

The OFT does not possess copies of trading agreements entered into between ITL and Safeway, but other documents contain references to

\textsuperscript{780} Document 56, Annex 28.
\textsuperscript{781} The OFT considers that ‘OM’ refers to other manufacturers.
\textsuperscript{782} Document 69, Annex 28.
\textsuperscript{783} Document 76, Annex 28.
such trading agreements that existed at the time.\textsuperscript{784} A letter from ITL to Safeway dated 13 December 2000, entitled ‘\textit{Safeway Bonus}’, referred to a trading agreement between ITL and Safeway as having been in operation for a number of years.\textsuperscript{785}

6.878 The letter also made clear that, in the trading agreement, Safeway’s retail pricing was linked to bonuses paid to Safeway by ITL:\textsuperscript{786}

‘\textit{You moved to RRP pricing in the PFS}\textsuperscript{787} on 18th September 2000 and I reduced your bonus entirely from 1st October 2000 ... If you want to apply the Agreement strictly from now on I fully accept that the deduction should be reduced to £[\ldots]}’.

6.879 In a letter from ITL to Safeway dated 20 March 2001,\textsuperscript{788} ITL also referred to a trading agreement between the parties and, again, referred to the relationship between retail pricing and applicable bonuses paid to Safeway by ITL.\textsuperscript{789}

\textit{iii} Contacts between ITL and Safeway regarding retail prices

6.880 A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and Safeway regarding: (i) Safeway’s retail prices for ITL’s brands; (ii) Safeway’s retail prices for ITL’s competitors’ brands; and (iii) the retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.881 The documents evidencing the contacts between ITL and Safeway demonstrate that: (i) in relation to Safeway’s retail prices for ITL’s brands (sometimes by reference to Safeway’s or other Retailer’s retail prices for

\textsuperscript{784} It is also instructive to note that in its response dated 15 August 2008 to the SO, ITL did not deny that it had a trading agreement with Safeway, but stated instead that ‘\textit{the trading arrangements between ITL and Safeway contained no anti-competitive provisions, and Safeway retained the decisive ability to set its retail prices. The arrangements merely offered to fund price reductions which were conditional upon Safeway not exceeding relative price maxima}’ (paragraph 6.349(a)). This passage also indicates that, similar to the trading agreements that ITL had with other Retailers, the trading agreement or arrangement that ITL had with Safeway contained provisions for ITL to pay bonuses conditional on Safeway pricing in accordance with a list of parity and differential requirements.

\textsuperscript{785} Document 22, Annex 28.

\textsuperscript{786} Document 22, Annex 28 (Point 2).

\textsuperscript{787} The OFT considers that ‘\textit{PFS}’ refers to petrol filling stations.

\textsuperscript{788} Document 31, Annex 28.

\textsuperscript{789} In commenting on this document in its Response dated 15 August 2008 to the SO, ITL also appeared to concede that it had a trading agreement with Safeway. At paragraph 6.359, ITL stated that document 31 should be read ‘\textit{in the context of negotiating either an extension of the existing trading agreement or a reformulation of the bonus ‘agreements’ to a more traditional format}’.\textit{'}
ITL’s competitors’ brands) and/or (iii) in relation to Safeway’s retail prices for ITL’s competitors’ brands:

- ITL communicated\textsuperscript{790} to Safeway what Safeway’s retail prices should be; and/or
- ITL asked and/or incentivised Safeway to hold or alter Safeway’s retail prices; and/or
- Safeway informed ITL about, or discussed with ITL, Safeway’s current or proposed retail prices.

6.882 Safeway accepted and/or indicated its willingness to implement the directions contained in such communications.

6.883 In addition, ITL and Safeway informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.884 The contacts between ITL and Safeway took place in the context of ITL’s retail pricing strategy for Retailers to maintain specified parities and differentials between ITL’s brands and competing linked brands. Communications in relation to retail prices were sent by ITL, and were received and implemented by Safeway\textsuperscript{791} on the understanding that the notified retail prices took into account ITL’s retail pricing strategy, together with Safeway’s desired pricing position relative to other Retailers and Safeway’s desired margin.

6.885 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.886 Various examples of contacts between ITL and Safeway regarding retail prices are set out below.

\textit{Contact between ITL and Safeway regarding Safeway’s retail prices for ITL’s brands}

6.887 Set out below are examples of contact between ITL and Safeway in relation to Safeway’s retail prices for ITL’s brands, which demonstrate that in relation to Safeway’s retail prices for ITL’s brands (sometimes by reference to the retail prices of competing linked brands):

\textsuperscript{790} See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.

\textsuperscript{791} See paragraphs 6.917 and 6.918 in relation to implementation.
• ITL communicated to Safeway what Safeway’s retail prices should be; and/or
• ITL asked and/or incentivised Safeway to hold or alter Safeway’s retail prices; and/or
• Safeway informed ITL about, or discussed with ITL, Safeway’s current or proposed retail prices.

6.888 Safeway accepted and/or indicated its willingness to implement the directions contained in such communications.

6.889 The examples of such contacts are as follows.

6.890 A fax from ITL to Safeway dated 11 May 2000 communicated various price reductions that were expressed to:792

‘...achieve the appropriate strategic pricing differentials....As always, these reductions will be fully funded and will last as long as the promotional prices are available on Mayfair 20s.’

6.891 A fax from ITL to Safeway dated 9 January 2001, referred to a meeting between the parties on 8 January 2001 and stated:793

‘2. On pricing, you will adjust the 10s of Superkings [ITL brand] to match Berkeley [Gallaher brand] following the MPI.’

6.892 In an internal Safeway e-mail dated 6 July 2001, it was stated:794

‘I had my quarterly update with Roger Batty [of ITL] today. Please find below some point that have come out from this meeting … Pricing: I explained our position on pricing again but illuded to the potential opportunity for us to maybe move 1 or 2 brands if they are REALLY important to IMPERIAL … He seemed mainly concerned with the tilt on L&B family [ITL brand] vs Mayfair [Gallaher brand] and Richmond No1’s [ITL brand] v S/Kings [ITL brand]. There is a real opportunity, I believe to scratch their back a little here, and in return get them to give you ALL your funding that they are withholding on pfs and superstores - pls pick up with George [of ITL].’

6.893 Another example is a letter from ITL to Safeway dated 24 August 2001, which stated:795

‘2. We agreed that Superkings 20s [ITL brand] would be priced at £3.99 and £4.02 post MPI with the M/Ps [multipacks] also being held at current prices. Again, bonus in full.

792 Document 9, Annex 28.
3. *All other brands to be increased as per the MPI.*

The OFT infers that the handwritten ticks on this document indicate that Safeway accepted ITL’s price instructions and was aware of the resulting bonus payment.

6.894 In a letter from ITL to Safeway dated 11 March 2002, ITL communicated various pricing requests to Safeway:\[796\]

‘Please increase the price of Richmond Superkings [ITL brand] from 17th March by 2p for 20 to match Dorchester Superkings [Gallaher brand] …

*In the PFS please correct the price of Superkings [ITL brand] from £4.20 down to £4.18 …*

*The prices of Drum, [ITL brand] Amber Leaf, [Gallaher brand] G.V. [Golden Virginia, an ITL brand], and O.H. [Old Holborn, a Gallaher brand] are now incorrect and need discussing, both within Safeway and from external comparisons with Other Grocers …’

6.895 A letter from ITL to Safeway dated 16 June 2003, which recorded items covered at a previous meeting between ITL and Safeway, stated:\[797\]

‘**MPI - 23 JUNE 2003:** You confirmed that the prices charged to consumers would increase on 23 June’. [Emphasis as in source document]

On page 2, under the same heading, it stated that:

‘All Safeway stores retail-selling prices, when changed, will continue to reflect the differentials in recommended selling prices between ITL and other manufacturers’.

6.896 A further example is a fax from ITL to Safeway dated 1 July 2003, which stated:\[798\]

‘**POST MPI PRICES.** Thank you for ensuring that the prices of Café Crème [ITL brand] were not increased. Do not forget to change these prices by 7p per 10 with effect from 1 August 2003 …

*Most of the errors have now been corrected - thank you. I have highlighted the few that still need adjustment I believe following our discussions.*’ [Emphasis as in source document]

6.897 The list of 'errors' referred to in the fax of 1 July 2003 of the previous paragraph, included a pricing error in relation to Benson & Hedges Silver (which is a Gallaher brand). The OFT infers that the annotated ticks made

\[796\] Document 54, Annex 28.
by Safeway on the document indicate that Safeway complied, or would comply, with ITL’s pricing instructions.

6.898 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Safeway regarding Safeway’s retail prices for ITL’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 2, 3, 4, 7, 8, 13, 14, 15, 16, 17, 20, 21, 24, 25, 26, 27, 29, 30, 32, 34, 37, 40, 41, 42, 44, 45, 48, 49, 55, 57, 58, 59, 60, 61, 65, 66, 70, 74, 75, 81 of Annex 28 (which are listed in Annex C).

*Contact between ITL and Safeway regarding Safeway’s retail prices for ITL’s competitors’ brands*

6.899 In addition to the documents above, which concern contact between ITL and Safeway regarding Safeway’s retail prices for ITL’s brands, there were contacts between ITL and Safeway in relation to Safeway’s retail prices for ITL’s competitors’ brands. Set out below are examples of such contacts which demonstrate that in relation to Safeway’s retail prices for ITL’s competitors’ brands:

- ITL communicated to Safeway what Safeway’s retail prices should be; and/or
- Safeway informed ITL about, or discussed with ITL, Safeway’s current or proposed retail prices.

6.900 Safeway accepted and/or indicated its willingness to implement the directions contained in such communications.

6.901 The examples of such contacts are as follows.

6.902 An internal ITL memo dated 16 June 2000 referred to Amber Leaf [Gallaher brand] and reported back from a meeting with Safeway confirming that:799


6.903 In a letter from ITL to Safeway dated 13 October 2000, which recorded a meeting that had taken place the previous day, ITL stated:800

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3. *Dorchester* [Gallaher brand] is increasing to £334/£335 from 29th October. *Richmond* [ITL brand] will follow and I will advise you of this change along with a reduction in retros.

4. *JPS and L&B brands* [ITL brands] will increase to £365 from Monday, 16th October with MPs at equivalent rates. Retros will now cease on these brands.'

6.904 In a letter from ITL to Safeway dated 9 March 2001, ITL stated:801

'A late change!! Ignore our conversation this morning. We now need to maintain parity pricing on Richmond [ITL brand] with *Dorchester* [Gallaher brand] and the differential with *Sterling* [Gallaher brand]. Therefore, no increase on Richmond KS and Richmond Superkings [ITL brands]. They remain at £334 and £335 or £337/£338. You should have received our Price List by now giving all other prices.'802 [Emphasis as in source document]

6.905 A letter from ITL to Safeway dated 19 March 2001, stated:803

'Following our meeting on 15th March, I am writing to confirm the main points discussed: … We went through the pricing of brands following the Budget and all errors will be rectified on 19th March with the exception of *Sterling* [Gallaher brand] in the Superstores which will be increased by 3p on 25th March.'

6.906 In a fax from ITL to Safeway dated 24 April 2001, ITL asked Safeway to increase the retail prices of two Gallaher brands (Mayfair and Sovereign):804

'There is still an error in the pricing of both Mayfair and Sovereign [Gallaher brands] in all Safeway Stores. The differential between *L&B/JPS* [ITL brands] should be -16p and -9p respectively. Currently, the differentials are -18p and -11p. Can you please increase the prices of both Mayfair and Sovereign [Gallaher brands] by +2p … Many thanks.'

6.907 A letter dated 14 June 2001 from ITL to Safeway, noted that:805

'Following our meeting this week, I set out below the prices in Safeway which are ‘wrong’ or require further investigation:-

1. *Sterling* [Gallaher brand] is £3.34/3.37 in all stores. There is no ‘tilt’ of 3p and this should be applied, raising the price to £3.37/3.40 in these +3p stores.

802 The OFT infers that these prices are £3.34, £3.35, and £3.37/£3.38.
2. **Mayfair** [Gallaher brand] is £3.60 **in all stores**. Same problem as Sterling, but the differential against L&B [ITL brand] is normally 15p or 16p. Suggest the price should be £3.60/3.63.

3. **Sovereign** [Gallaher brand] is £3.67 **in all stores**. Same problem as Mayfair. Price should be £3.66/3.69 or £3.67/3.70.

... 

*There should be one price for all cigars and, noting your main competitors, I suggest the following levels:*

- **Hamlet/Classic** [ITL brand] £270/£5.39/£13.29
- **Miniatures** £270/£13.28

[Emphasis as in source document]

6.908 In a fax from ITL to Safeway dated 20 March 2002, ITL stated: \(^{806}\)

'1. From Sunday, 24th March please reduce the price of Richmond Superkings [ITL brand] in Supermarkets and PFS\(^{807}\) by 1p to match Dorchester Superkings [Gallaher brand] at £3.47...

2. In PFS please reduce the price of all Superkings [ITL brand] variants by 2p to £4.18 to match Berkeley 20s [Gallaher brand].

3. …Please reduce Drum [ITL brand] by 4p to £4.09/£4.10 to match A.L. [Amber Leaf, a Gallaher brand] Parity is the policy on the 25gm and also with Drum Milde [ITL brand].

4. Golden Virginia [ITL brand] is currently some 1p or 8p more expensive than Old Holborn [Gallaher brand] 12.5gm when we are paying for parity at 10p/20p/40p more than Drum [ITL brand]/Amber Leaf [Gallaher brand].

I recommend that you move into line with other Grocers, but not [another retailer], Asda and Kwiksave and move both G.V. [Golden Virginia, an ITL brand] and O.H. [Old Holborn, a Gallaher brand] up to the common price of £2.28, and the equivalent on 25/50 gm.

The current bonus on G.V. [Golden Virginia, an ITL brand] will cease from this date of implementation. Can you please advise Gallaher of this move.' [Emphasis as in source document]

6.909 In a letter from ITL to Safeway dated 20 June 2002, ITL stated that: \(^{808}\)

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\(^{806}\) Document 55, Annex 28.

\(^{807}\) The OFT considers that ‘PFS’ refers to petrol filling stations.

\(^{808}\) Document 59, Annex 28.
‘A very important part of ITL’s pricing strategy is the differential pricing between our leading brands and selected Other Manufacturer’s brands in the same segment.

For example, our normal differential between Embassy No 1 [ITL brand] and B&H KS [Gallaher brand] is -3p and Superkings [ITL brand] is at parity with Berkeley [Gallaher brand].’

6.910 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Safeway regarding Safeway’s retail prices for ITL’s competitors’ brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 8\(^809\), 9, 14, 15, 23, 35\(^810\), 36, 39, 44, 50, 54\(^811\), 57, 58, 60, 61, 65, 74, 75 and 79 of Annex 28 (which are listed in Annex C).

**Contact between ITL and Safeway regarding the retail prices of Safeway’s competitors**

6.911 In addition to the documents above, there were contacts between ITL and Safeway in which ITL informed Safeway about the current retail prices of other Retailers for ITL’s brands.

6.912 The examples of such contacts are as follows.

6.913 In a letter from ITL to Safeway dated 10 February 2000, ITL stated the following in relation to its Regal Filter brand:\(^812\)

‘To confirm, this price is still out of line with Regal KS [ITL brand]. The price should be £3.71 (3p below Regal KS). It is currently £3.78. As advised, [another retailer] are currently selling Regal Filter in Northern Ireland at £3.71. Please confirm that this price can be corrected.’

6.914 In a letter from ITL to Safeway dated 3 May 2003, ITL noted that:\(^813\)

‘I can confirm that the correct price for K.E.Crowns [King Edward Crown, an ITL brand] is £3.99 - I will check the Asda price.’

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\(^809\) Documents 8, 9, 15, 17 and 23, Annex 28 referred, variously, to Mayfair, Benson & Hedges, Dorchester, Amber Leaf and Berkeley, all Gallaher brands.

\(^810\) Documents 35, 39 and 42, Annex 28 referred, variously, to Sterling, Dorchester, Mayfair, Hamlet and Sovereign, all Gallaher brands.

\(^811\) Documents 54, 60, 61, 65 and 75, Annex 28 referred, variously, to Dorchester, Amber Leaf, Berkeley, Old Holborn, Mayfair, Benson & Hedges and Samson, all Gallaher brands.


\(^813\) Document 74, Annex 28.
It can be seen from the above that references by ITL to the retail prices of other Retailers provided an assurance to Safeway that retail price changes put to Safeway by ITL would not cause Safeway to be out of step with its retail competitors.

**Conclusion on the contacts between ITL and Safeway**

In conclusion in relation to all the contacts between ITL and Safeway regarding retail prices, the above paragraphs demonstrate that there were regular contacts between ITL and Safeway, which related to the retail prices of Safeway as well as other Retailers. The evidence of such contacts, together with the context of ITL’s strategy, demonstrates that ITL’s retail pricing strategy was for Safeway to maintain specified parities and differentials between ITL’s brands and competing linked brands. The contacts between ITL and Safeway assisted the implementation of that strategy, through communications from ITL in relation to Safeway’s retail prices for ITL’s brands and in some cases ITL’s competitors’ brands, the aim of which was to ensure that ITL’s desired parity and differential requirements were maintained or realigned. The contacts between ITL and Safeway also demonstrate that Safeway accepted and/or indicated its willingness to implement the directions contained in communications from ITL to Safeway in that connection.

The OFT notes that ITL and Safeway submitted that there were instances where Safeway did not implement instructions and/or requests in ITL’s pricing communications.

However, the OFT considers that the fact that there may have been some instances where Safeway did not implement, did not implement fully\(^{814}\), or delayed the implementation of instructions and/or requests in ITL’s pricing communications does not negate the existence of the Infringing Agreement between ITL and Safeway, as there is sufficient evidence over a period of time of Safeway’s compliance, or intention to comply, with ITL’s retail pricing strategy (see for example the section entitled ‘Contacts between ITL and Safeway regarding retail prices’ above).

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\(^{814}\) For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
iv Bonuses

6.919 There are documents relating to the provision of tactical bonuses from ITL to Safeway, examples of which are set out in the section entitled 'Contacts between ITL and Safeway regarding retail prices', above.\textsuperscript{815}

6.920 The payment of tactical bonuses was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Safeway. In particular, the bonuses ensured that Safeway's margin was not significantly affected by the changes in retail prices instructed or requested by ITL to achieve ITL's retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Safeway's retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.921 The evidence demonstrates that ITL paid bonuses to Safeway in order to ensure that its retail pricing strategy was maintained. Safeway accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by ITL.

v Monitoring of retail prices by ITL

6.922 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to Safeway. Safeway participated in this monitoring by providing ITL with details of its proposed retail prices for ITL's brands and/or for ITL's competitors' brands.

6.923 Examples of documents in relation to monitoring are as follows.

6.924 In a fax from ITL to Safeway dated 24 April 2001, ITL noted that:\textsuperscript{816}

\textit{'There is still an error in the pricing of both Mayfair and Sovereign [both Gallaher brands] in all Safeway Stores.}

\textit{The differential between L&B/JPS [both ITL brands] should be -16p and -9p respectively.'}

6.925 Further evidence of such monitoring can also be seen in a letter from ITL to Safeway dated 18 May 2001, which stated:\textsuperscript{817}

\textsuperscript{815} In addition, documents 27 and 28, Annex 28 provide evidence of bonus schedules and tactical retro bonuses being paid to Safeway.

\textsuperscript{816} Document 34, Annex 28.

\textsuperscript{817} Document 35, Annex 28.
'Please keep me up-dated on any change in the price of Sterling/ Dorchester. Also the price of Mayfair and Sovereign is still wrong' [all Gallaher brands].

6.926 A letter from ITL to Safeway dated 21 June 2001, stated:818

'On pricing I note that you have not managed to rectify the errors pointed out in my letter of 14th June ...'

6.927 Similarly, in a fax from ITL to Safeway dated 2 November 2001, ITL communicated that:819

'Something has gone very wrong with pricing this week - I enclose 4 days results. Pricing should be:-

Non TILT STORES
Sterling Ks [Gallaher brand] -339
Sterling SKs [Gallaher brand] -340

Richmond KS [ITL brand] -344

Richmond SKs [ITL brand] -345

Dorchester Ks [Gallaher brand] -344
Dorchester SKs [Gallaher brand] -345

TILT STORES

Sterling Ks [Gallaher brand] -342
Sterling SKs [Gallaher brand] -343

Richmond KS [ITL brand] -347

Richmond SKs [ITL brand] -348
Dorchester Ks [Gallaher brand] -347
Dorchester SKs [Gallaher brand] -348'

6.928 Further evidence is contained in a fax from ITL to Safeway dated 13 July 2002, in which ITL reported:820

'As discussed I have listed some of the price points from the store visits to Basingstoke and Woking could we discuss as a matter of urgency as there appear to be a number of wrong prices out there and no consistency.'

6.929 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of Safeway's retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 3, 8, 9,

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These documents demonstrate that ITL would monitor Safeway’s retail prices of both ITL and Gallaher brands to ensure that parity and differential requirements were maintained and would point out pricing errors to Safeway.

vi  Conclusion on the agreement and/or concerted practice between ITL and Safeway

The evidence described above demonstrates the existence of the Infringing Agreement between ITL and Safeway, which had the object of restricting competition, in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' and, given that the remaining constituent elements of the statutory test are also met (see Section 7: 'Legal assessment'), amounted to a breach of the Chapter I Prohibition.

vii  Further Supporting Evidence

In addition to the above, the existence of the Infringing Agreement between ITL and Safeway is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationship between:

- ITL and each of the other Retailers, which evidence ITL's approach towards the Retailers as a collective; and between
- Gallaher and Safeway (see below), which is part of the context of the Infringing Agreement between ITL and Safeway.

The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and Safeway) lends further support to the fact that there was an agreement and/or concerted practice between ITL and Safeway which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or concerted practice between Gallaher and Safeway

6.934 When considered together with the evidence of Gallaher’s overall strategy for retail prices described in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between Gallaher and Safeway whereby Gallaher co-ordinated with Safeway the setting of Safeway’s retail prices for tobacco products in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between Gallaher and Safeway restricted the ability of Safeway to determine its retail prices for competing linked brands and had the object of restricting competition.

6.935 The following elements evidence the Infringing Agreement between Gallaher and Safeway:821

i Gallaher’s strategy in relation to Safeway’s retail prices

6.936 The contacts set out below between Gallaher and Safeway should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.937 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher’s multiple grocer channel, demonstrate that Gallaher’s objective was that multiple grocers, of which Safeway was one such grocer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

6.938 A good example is an internal Gallaher document headed ‘Promotional Policy - Retail Promotion Contributions – March 2000’, which listed the ‘pricing objectives’ in relation to the following brands amongst others:

'Camel [Gallaher brand] – Parity with Marlboro [competitor brand]822'

821 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.

B&H [Gallaher brand] – 5p above Regal [ITL brand], 3p above Embassy No 1 [ITL brand]

Berkeley and B&H Superkings [both Gallaher brands] – parity with JP Superkings [ITL brand]

Club [Gallaher brand] 14p below Regal [ITL brand]

Sovereign [Gallaher brand] 10p below L&B [ITL brand]

Mayfair 7p below Sovereign [both Gallaher brands] and at least parity with Richmond [ITL brand]...  

6.939 Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s multiple grocer channel, is set out in Section 6.B: 'Manufacturers' retail pricing strategies’ above, which refer to a number of other documents containing evidence of the same or similar nature...  

ii Contacts between Gallaher and Safeway regarding retail prices

6.940 A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and Safeway regarding: (i) Safeway’s retail prices for Gallaher’s brands; (ii) Safeway’s retail prices for Gallaher’s competitors’ brands; and (iii) the retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

6.941 The documents evidencing the contacts between Gallaher and Safeway demonstrate that: (i) in relation to Safeway’s retail prices for Gallaher’s brands (sometimes by reference to Safeway’s or other Retailers’ retail prices for Gallaher’s competitors’ brands) and/or (ii) in relation to Safeway’s retail prices for Gallaher’s competitors’ brands:

- Gallaher communicated to Safeway what Safeway’s retail prices should be; and/or
- Gallaher asked and/or incentivised Safeway to hold or alter Safeway’s retail prices; and/or

822 ITL has distributed Marlboro since 12 September 2001.
823 Document 1, Annex 3 (page 2). This document also set out parity and differential requirements for cigars and hand rolled tobacco.
824 See, in particular, documents 2 to 10, 13 and 14 of Annex 3.
825 See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.
• Safeway informed Gallaher about, or discussed with Gallaher, Safeway's current or proposed retail prices.

6.942 Safeway accepted and/or indicated its willingness to implement the directions contained in such communications.

6.943 In addition, Gallaher and Safeway informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher's brands and/or for Gallaher's competitors' brands.

6.944 The contacts between Gallaher and Safeway took place in the context of Gallaher's retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher's brands and competing linked brands. Communications in relation to retail prices were sent by Gallaher, and were received and implemented by Safeway826 on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together with Safeway’s desired pricing position relative to other Retailers and Safeway’s desired margin.

6.945 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.946 Various examples of contacts between Gallaher and Safeway regarding retail prices are set out below.

### iii Contact between Gallaher and Safeway regarding Safeway’s retail prices for Gallaher’s brands

6.947 Set out below are examples of contact between Gallaher and Safeway in relation to Safeway’s retail prices for Gallaher’s brands, which demonstrate that, in relation to Safeway’s retail prices for Gallaher’s brands (sometimes by reference to Safeway’s or other Retailers’ retail prices of competing linked brands):

- Gallaher communicated to Safeway what Safeway’s retail prices should be; and/or
- Gallaher asked and/or incentivised Safeway to hold or alter Safeway’s retail prices; and/or
- Safeway informed Gallaher about, or discussed with Gallaher, Safeway’s current or proposed retail prices.

6.948 Safeway accepted and/or indicated its willingness to implement the directions contained in such communications.

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826 See paragraphs 6.976 and 6.977 in relation to implementation.
The examples of such contacts are as follows.

In a fax dated 24 November 2000 from Gallaher to Safeway, Gallaher stated:

(i) Sterling [Gallaher brand]: Hold price to the Budget.

(ii) Dorchester [Gallaher brand]: Further to our discussion, we now understand that Richmond [ITL brand] is to stay down in price until the Budget. Would you please ensure Dorchester brands & packs will be in line. (20’s/MP’s) – We will fund the MPI increase to achieve this.

(iii) Camel [Gallaher brand]: 20’s should now be at £4.09 in line with agreed retro’s & MP’s @ £19.99.

An 'Urgent Fax' dated 14 March 2001 from Gallaher to Safeway in relation to Dorchester stated:

'As discussed please hold Dorchester 20’s [Gallaher brand] and Multipacks at pre budget pricing. We are currently holding the MPI retail (5p/20) + the budget increase (6p/20) where Richmond [ITL brand] is being held down. When Richmond [ITL brand] moves up we would wish to move up on 20’s but continue the price points on 100 multipacks’s due to price marked packs of Richmond [ITL brand] being in store. Perhaps you could confirm how long Richmond PMP [ITL brand] £16.25 multipacks are likely to last.'

And in relation to Sterling [Gallaher brand]:

'We are holding price until the end of March on 20’s and multipacks at current levels. We will then move both 20’s and multipacks by the budget increase of 6p. this could also be dependent on the pricing strategy of Richmond [ITL brand] but I will confirm.'

An e-mail dated 18 July 2001 from Gallaher to Safeway stated:

'Reference our conversation regarding pricing, I would be grateful if you could move the following brands from the 22nd July

From 22nd July

Old Holborn 12.5grm from £2.16 to £2.19 (previously advised 11th June move agreed for 24th June)

Old Holborn 25grm from £4.30 to £4.31 (previously advised 11th June move agreed for 24th June)'.

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6.953 An e-mail dated 30 August 2001 from Gallaher to Safeway stated:

'Reference our conversation this morning regarding additional pricing arrangements details are as follows:-

(1) Hold B&H Superkings and Berkeley [both Gallaher brands] ranges in line with Imperial Superkings [ITL brand] (5p hold) possible price move on the 1st October (assumption is that Superkings will move from the 1st?) we are also currently 1p more expensive than Superkings, is there a reason for this? perhaps you could let me know'.

6.954 In an e-mail exchange dated 18 and 19 February 2002 between Gallaher and Safeway, Gallaher stated:

'Some price changes from the 3rd March please

Sterling KS [Gallaher brand] all 100’s multipacks from £16.45 to £16.75

Sterling SK all 20’s from £3.40 to £3.42

Sterling SK all 100’s multipacks £16.49 to £16.90'.

In response, Safeway confirmed the implementation of the pricing communications:

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

6.955 An undated e-mail from Gallaher to Safeway regarding 'November 4th price moves / '02' stated:

'The margin sheets are in the post to you, changes are highlighted in yellow and the additional off invoice bonus on Mayfair and Dorchester [both Gallaher brands] will now revert to retro as the bonuses are smaller'.

Among other matters the 'margin sheets' stated:

'Old Holborn [Gallaher brand] [12.5, 25 & 50]... To match GV [Golden Virginia, an ITL brand]').

6.956 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and Safeway regarding Safeway’s retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the

documents quoted above: documents 1, 6, 8 to 10, 12, 16, 17, 19, 20, 22, 26, 27, 28, 29, 32, 34 to 38, 40, 42, 43, 46, 49, 51, 52, 54, 56, 58 and 59 of Annex 26 (which are listed in Annex C). In documents 38, 40 and 41 Safeway indicated its intention to implement the prices required by Gallaher. Documents 6, 8, 9, 12, 16, 19, 21, 25, 28, 31, 32, 42, 46 and 49 include references that suggest that Safeway had previously indicated its intention to implement the pricing instructions then being confirmed by Gallaher.

Contact between Gallaher and Safeway regarding Safeway's retail prices for Gallaher's competitors' brands

6.957 In addition to the documents above, which concern contact between Gallaher and Safeway regarding Safeway's retail prices for Gallaher's brands, there were contacts between Gallaher and Safeway in relation to Safeway's retail prices for Gallaher's competitors' brands. Set out below are examples of such contacts which demonstrate that in relation to Safeway's retail prices for Gallaher's competitors' brands:

- Gallaher communicated to Safeway what Safeway's retail prices should be; and/or
- Safeway informed Gallaher about, or discussed with Gallaher, Safeway’s current or proposed retail prices

6.958 Safeway accepted and/or indicated its willingness to implement the directions contained in such communications.

6.959 The examples of such contacts are as follows.

6.960 A fax dated 18 June 2000 from Gallaher to Safeway titled 'Richmond [ITL brand] 100 MP pricing' stated:\(^{833}\)

> 'As discussed, there seems to be a discrepancy here whereby the 20’s price is 3.39 and the MP is 15.29 v Dorchester [Gallaher brand] at 15.99. By my reckoning the price for Richmond should [ITL brand] be 16.90 ... Can you advise please'.

6.961 A fax dated 30 August 2000 from Gallaher to Safeway regarding 'Price Survey Anomalies ...' stated:\(^{834}\)

> 'Can I please draw your attention to the following ‘anomalies’:

1. **RICHMOND** [ITL brand]: Held at £3.39? vs Mayfair [Gallaher brand] at £4.44. Is this ongoing?

\(^{834}\) Document 6, Annex 26.
2. **DORCHESTER KS MP’s [Gallaher brand]**: Correct price agreed at £15.99 (supported). However, a small number of branches appear to be at £16.25

3. **BERKELEY SK 200 MP** [Gallaher brand]: Priced at £38.70 (seems correct) but JP SK 200 MP [ITL brand] is at £38.20. Is this correct?

4. **OLD HOLBORN [Gallaher brand]** VS **GOLDEN VIRGINIA** [ITL brand]: Price of Golden Virginia not yet increased in line with MPI?

5. **SOBRAINE CUBAN** [Gallaher brand]: You appear to have priced these at full RSP whereas our agreed proposals were for competitive pricing at the following levels:

   …'

6.962 In a letter dated 9 October 2000 from Gallaher to Safeway, Gallaher stated: \(^{835}\)

   'From the 29th October we would like to increase the retail price of Dorchester King Size to £3.34 and Dorchester Superking [Gallaher brands] to £3.35, provided that this does not leave us out of line with Richmond [ITL brand].'

6.963 A letter dated 25 October 2000 from Gallaher to Safeway stated: \(^{836}\)

   'May I draw your attention to the following pricing:

   ...

   5. **Old Holborn** [Gallaher brand] **25g 424p** / **Golden Virginia** [ITL brand] **25g 422p**

   You had agreed to put these on parity with each other.'

   [Emphasis as in source document]

6.964 A letter dated 24 November 2000 from Gallaher to Safeway, recorded the outcome of a meeting held the previous day. It stated: \(^{837}\)

   'May I confirm the following points of our discussions.

e) **Cigars:**

   Hamlet Min’s [Gallaher brand] out of line with Classic Min’s [ITL brand] and with other leading MG’s. You confirmed the latter would be adjusted ...'

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In a fax dated 23 February 2001 from Gallaher to Safeway, Gallaher stated:\textsuperscript{838}

‘The pricing report shows the following anomalies:-

1. \textit{B&H 20’s [Gallaher brand]} Vs \textit{Regal 20’s [ITL brand]}

\begin{align*}
£4.15 & & £4.09 & \text{difference 6p} \\
\text{Price list differential 5p} & & & \\
\end{align*}

2. \textit{L&B [ITL brand]} Vs \textit{Sovereign [Gallaher brand]}

\begin{align*}
\text{L&B £3.70 all regions} & & \text{Sovereign £3.61 - £3.64} \\
\text{L&B [ITL brand] should be £3.73 some regions} & & \\
\end{align*}

...  

7. \textit{Amber Leaf [Gallaher brand] 50g £7.95 to match Drum [ITL brand] 50gm £7.85 Could you adjust this week’}.

In an 'Urgent Fax' dated 26 March 2001 from Gallaher to ITL, Gallaher stated:\textsuperscript{839}

'Dorchester [Gallaher brand]'

\begin{itemize}
\item Move king size and Superkings 20’s up by 5p per pack to £3.39 and £3.40. \textit{Hold multipacks at £16.45 for King size and £16.49 for Superkings.}
\item Please let me know where Richmond prices [ITL brand] will be, as this has a bearing on what action we take’.
\end{itemize}

[Emphasis as in source document]

The OFT infers that the annotated 'ticks' made by Safeway on the document indicate that Safeway complied, or would comply, with Gallaher’s pricing instructions.

An e-mail dated 17 September 2002 from Gallaher to Safeway stated:\textsuperscript{840}

‘With reference to our discussion this morning could you please reduce the price of Old Holborn [Gallaher brand] (3 sizes 12.5, 25 & 50) to match Golden Virginia [ITL brand] in both supermarkets and superstores, details as follows:- ...’

\textsuperscript{838 Document 24, Annex 26.}
\textsuperscript{839 Document 26, Annex 26.}
\textsuperscript{840 Document 50, Annex 26.}
In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and Safeway regarding Safeway’s retail prices for Gallaher’s competitors’ brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 4, 5, 11, 12, 16, 21, 23 to 25, 30, 31, 48, 50 and 53 of Annex 26 (which are listed in Annex C). In documents 6, 12, 16, 21, 25, 31 and 48 references are made that suggest that Safeway had previously indicated its intention to implement the pricing instructions then confirmed by Gallaher.

**Contact between Gallaher and Safeway regarding the retail prices of Safeway’s competitors**

In addition to the documents above, there were contacts between Gallaher and Safeway in which Gallaher and Safeway informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

A fax dated 28 March 2000 from Gallaher to Safeway reviewing post-budget pricing, and containing price reductions stated:\(^841\)

> I have now had an opportunity to analyse your post-budget pricing and attach details of comparisons with competitors along with suggested prices where applicable

The main areas to detail are as follows:-

1. **Gallaher Premium Brands**

   **B&H KS/SILK CUT RANGE/CAMEL**

   You are pricing these at £4.04 when Asda/J. Sainsbury/ [another retailer] are at £3.99

   ...

6. **MAYFAIR RANGE 20’s** [Gallaher brand]

   You should be aware that you remain 2p adrift vs. your main competition who are now 344p vs. your 346p. As discussed, this brand is now significant in the Market Place and I believe warrants competitive pricing

   ...

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\(^841\) Document 1, Annex 26.
10. **HAMLET RESERVE** [Gallaher brand]

   You are £3.34. Move to £3.49? (Asda price)

11. **HAMLET SPECIAL** [Gallaher brand]

   You are £4.74. Move to £4.99 (Asda price)

12. **HAMLET MINIATURE 10’s & 5x10’s** [Gallaher brands]

   Please move to same as Café Crème [ITL brand]

   ...

13. **KING SIX** [Gallaher brand]

   *Should be 10p below Panama* [ITL brand]. Your Panama price at £2.49 is 1p below rest of the market. King Six should, therefore, be £2.39*. 

   [Emphasis as in source document]

6.972 A letter dated 24 November 2000 from Gallaher to Safeway stated:

   ‘...

   c.  *Amber Leaf* [Gallaher brand]: *Pricing comparisons left with you. I believe that with this fast growing brand you should be in line with [another retailer]/JS.*

   *Old Holborn* [Gallaher brand]: *You confirmed that you would adjust OH* [Old Holborn, a Gallaher brand] *pricing in line with GV* [Golden Virginia, an ITL brand] *from 26th November. We will fund the reduction...*

   *Cigars:*

   *Hamlet Min’s* [Gallaher brand] *out of line with Classic Min’s* [ITL brand] *and with other leading MG’s*. You confirmed the latter would be adjusted.*

6.973 It can be seen from the above that references to the retail prices of other Retailers were used by Gallaher as a means to encourage the implementation by Safeway of Gallaher’s parity and differential requirements. In particular, such references provided an assurance to Safeway that retail price changes put to Safeway by Gallaher would not cause Safeway to be out of step with its retail competitors. The function of references to the retail prices of other Retailers was to assist in the

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843 The OFT considers that 'MG's' refers to Multiple Grocers.
implementation of Gallaher’s pricing strategy and to ensure that Gallaher’s desired parities and differential requirements were maintained or, where need be, realigned.

6.974 In addition to the documents quoted above, other documents contain evidence of contacts of the same or similar nature between Gallaher and Safeway regarding Safeway’s retail prices for Gallaher’s competitors’ brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 6, 7, 8, 12, 14 and 15 of Annex 26 (which are listed in Annex C).

Conclusion on the contacts between Gallaher and Safeway

6.975 In conclusion in relation to all the contacts between Gallaher and Safeway regarding retail prices, the above paragraphs demonstrate that there were regular contacts between Gallaher and Safeway, which related to the retail prices of Safeway as well as other Retailers. The evidence of such contacts, together with the context of Gallaher’s strategy, demonstrates that Gallaher’s retail pricing strategy was for Safeway to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. The contacts between Gallaher and Safeway assisted the implementation of that strategy, through communications from Gallaher in relation to Safeway’s retail prices for Gallaher’s brands and in some cases also Gallaher’s competitors’ brands, the aim of which was to ensure that Gallaher’s parities and differential requirements were maintained or realigned. The contacts between Gallaher and Safeway also demonstrate that Safeway accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher to Safeway in that connection.

6.976 The OFT notes that Safeway submitted that there were instances where Safeway did not implement instructions and/or requests in Gallaher's pricing communications.

6.977 However, the OFT considers that the fact that there may have been some instances where Safeway did not implement, did not implement fully844, or delayed the implementation of instructions and/or requests in Gallaher’s pricing communications, does not negate the existence of the Infringing Agreement between Gallaher and Safeway, as there is sufficient evidence over a period of time of Safeway’s compliance, or intention to comply, with Gallaher’s retail pricing strategy (see for example the sections

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844 For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
entitled 'Contacts between Gallaher and Safeway regarding retail prices' above).

iv  Bonuses

6.978 There are documents relating to the provision of tactical bonuses from Gallaher to Safeway, examples of which are set out in the section entitled 'Contacts between Gallaher and Safeway regarding retail prices' above.

6.979 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Safeway. In particular, the bonuses ensured that Safeway's margin was not significantly affected by the changes in retail prices communicated by Gallaher to achieve Gallaher’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Safeway's retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.980 In addition to those documents referred to in the contacts sections above, which specifically refer to tactical bonuses, the following documents also evidence the use of tactical bonuses:

6.981 In a letter dated 9 October 2000 from Gallaher to Safeway, Gallaher stated:\footnote{845}{Document 11, Annex 26.}

> 'From the 29th October we would like to increase the retail price of Dorchester King Size to £3.34 and Dorchester Superking [Gallaher brands] to £3.35, provided that this does not leave us out of line with Richmond [ITL brand]….

> From the 29th October, therefore, the following bonus levels will apply:-’ [details of new bonus levels then follow].

6.982 An e-mail dated 9 September 2002 from Gallaher to Safeway stated:\footnote{846}{Document 48, Annex 26.}

> 'This is to confirm the details of prices to move on Sunday the 15th September. I will adjust the margin sheets and forward these to you shortly. Any additional off invoice bonus levels will be changed from the 16th September these will be advised shortly …

> Cigar and HRT prices below TBC at our meeting tomorrow, to match Imperial Brands moving on the 15th September

……
In addition to the documents quoted above, a number of other documents provide evidence of the same or similar in relation to the provision of bonuses by Gallaher to Safeway which demonstrates the same matters as set out in respect of the documents quoted above: documents 5, 16, 18, 20, 21, 22, 25, 26, 28, 29, 31, 36, 49, 50 and 52 of Annex 26 (which are listed in Annex C).

The evidence demonstrates that Gallaher paid bonuses to Safeway in order to ensure that Gallaher’s parity and differential strategy was maintained. Safeway accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

**Monitoring of retail prices by Gallaher**

The documents set out below demonstrate that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to Safeway.

In a fax dated 26 October 2001 from Gallaher to Safeway, Gallaher stated:

> ‘Apart from the prices due to change on the 29th October (listed below) there are some anomalies on in store pricing which are detailed on the price sheets you receive, I have also listed these below. Could we discuss the changes and when they can be effective please.

…

**ANOMALIES** [all Gallaher brands]

- Berkeley and B&H Superkings all variants pricing too low […]
- Amber leaf 50grm £8.12 should be £8.09
- Samson 12.5grm £1.98 should be £1.99
- Hamlet 5x5 £13.74 should be £13.59
- Hamlet min 5’s £1.47 should be £1.49
- King Six 5x5 £12.50 should be £12.60’.

[Emphasis as in source document]
6.987 The OFT infers that the annotation 'W/E/F 4/11/01' made by Safeway on the document indicates that Safeway complied, or would comply, with Gallaher's pricing instructions.

6.988 An e-mail dated 6 December 2001 from Gallaher to Safeway stated:848

'Just monitoring the prices this week we still have some anomalies as detailed below

**URGENT ~ ~ WRONG PRICES PLEASE CHANGE FROM SUNDAY 9TH DECEMBER**

Sterling KS [Gallaher brand] all 20’s £3.42 should be £3.39

Sterling SK all 20’s £3.43 should be £3.40

As you are aware there is a duty implication

I have also noticed that Forecourts prices on Sterling are above the MRP, if your policy is MRP in these outlets could you please adjust to £3.39 for Sterling KS and £3.43 for Sterling superkings.

Old Holborn [Gallaher brand] still at £2.16 for 12.5grm £4.30 for 25grm and £8.48 for 50grm (these price are showing in all regions)'.

[Emphasis as in source document]

6.989 An e-mail dated 13 July 2002 between Gallaher and Safeway stated:849

'As discussed I have listed some of the price points from the store visits to Basingstoke and Woking could we discuss as a matter of urgency as there appear to be a number of wrong prices out there and no consistency.

<table>
<thead>
<tr>
<th></th>
<th>Basingstoke</th>
<th>Woking</th>
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</thead>
<tbody>
<tr>
<td>Dorchester KS</td>
<td>£3.56</td>
<td>£3.49</td>
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<tr>
<td>...</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Richmond KS</td>
<td>£3.52</td>
<td>£3.50</td>
</tr>
<tr>
<td>...</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

As these are both Superstores I would expect the pricing to be the same, can we go through all the price points by format to ensure we don’t get confused'.

In an e-mail dated 6 September 2002 from Gallaher to Safeway regarding 'Cigar pricing', Gallaher stated:

'Could you let me know price the following brands have moved to in Supermarkets please

[all ITL brands]

Café crème 10’s

Café crème 50’s

Classic 5’s

Classic 10’s

Classic 25’s

Panama 6’s

Golden Virginia 12.5, 25, 50 grm

I will then be able to advise you of new Hamlet/King six prices/Old Holborn prices [all Gallaher brands].

Similarly, in an e-mail dated 8 July 2003 from Gallaher to Safeway, Gallaher stated:

'Can you take a look at the attached [margin sheets], there are several differences from where I believe prices should sit:

Among other matters the 'margin sheets' stated:

[Gallaher brand] [Golden Virginia, an ITL brand]

'Old Holborn 12.5 Hold 4p to match GV

Old Holborn 25 Hold 8p to match GV

Old Holborn 50 Hold 4p to match GV'.

In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by Gallaher of Safeway’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 2, 6, 7, 12 to 15, 18, 23, 24, 31, 33, 36, 39, 44, 45, 47, 54, 55 and 57 of Annex 26 (which are listed in Annex C).

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These documents demonstrate that Gallaher would monitor Safeway’s retail prices of both Gallaher and ITL brands, to ensure that parity and differential requirements were maintained and would point out pricing errors to Safeway.

vi Conclusion on the agreement and/or concerted practice between Gallaher and Safeway

The evidence described above demonstrates the existence of the Infringing Agreement between Gallaher and Safeway, which had the object of restricting competition in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements’ and, given that the remaining constituent elements of the statutory test are also met (see Section 7: 'Legal assessment' above), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

In addition to the above, the existence of the Infringing Agreement between Gallaher and Safeway is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher’s approach towards the Retailers as a collective; and between
- ITL and Safeway (see above), which is part of the context of the Infringing Agreement between Gallaher and Safeway.

The existence of the further supporting evidence described above (and in particular the relationship between ITL and Safeway) lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and Safeway which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.997 As is noted in the sections above relating to the existence of an Infringing Agreement between each of ITL/Safeway and Gallaher/Safeway, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.998 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Safeway and that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d) above).
VI Agreement and/or concerted practice between ITL and Sainsbury and between Gallaher and Sainsbury

Summary

6.999 As set out in 6.C.VI.(a) below, ITL and Sainsbury were party to an agreement and/or concerted practice at least from 1 March 2000 to 9 March 2003 (‘the Infringing Agreement’), whereby ITL coordinated with Sainsbury the setting of Sainsbury’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.1000 As set out in 6.C.VI.(b), Gallaher and Sainsbury were party to an agreement and/or concerted practice at least from 1 March 2000 to 9 March 2003 (‘the Infringing Agreement’), whereby Gallaher coordinated with Sainsbury the setting of Sainsbury’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher, in pursuit of Gallaher’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.1001 Each of the Infringing Agreements between ITL/Sainsbury and Gallaher/Sainsbury amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Sainsbury and that each Manufacturer must have been aware\(^{852}\) of the other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of the Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement, as set out in 6.A.I.(d) above.

\(^{852}\) See also 6.A.I.(b) above in relation to the Manufacturers’ awareness of each other’s parallel and symmetrical parity and differential requirements.
6.1002 In March 2003, Sainsbury was granted conditional total leniency\(^{853}\), pursuant to the OFT’s leniency programme applicable at the time.\(^{854}\) On 11 July 2008, Gallaher concluded an early resolution agreement with the OFT, pursuant to which Gallaher admitted its involvement in each Infringing Agreement to which it was party in breach of the Chapter I Prohibition.

(a) Agreement and/or concerted practice between ITL and Sainsbury

6.1003 When considered together with the evidence of ITL’s overall strategy for retail prices described in Section 6.B: ‘Manufacturers’ retail pricing strategies’, the evidence referred to below demonstrates that, at least from 1 March 2000\(^{855}\) to 9 March 2003\(^{856}\), an Infringing Agreement existed between ITL and Sainsbury, whereby ITL coordinated with Sainsbury the setting of Sainsbury’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. For the reasons set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between ITL and Sainsbury restricted the ability of Sainsbury to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1004 The following elements evidence the Infringing Agreement between ITL and Sainsbury.\(^{857}\)

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\(^{853}\) The leniency granted was in connection with any cartel activities relating to price-fixing and/or market-sharing for tobacco and tobacco-related products.

\(^{854}\) As set out in Part 3 of the *Director General of Fair Trading’s Guidance as to the Appropriate Amount of a Penalty*, OFT 423 (March 2000). That was superseded by Part 3 of the *OFT’s guidance as to the appropriate amount of a penalty*, OFT 423 (December 2004) and supplemented, most recently, by *Leniency and no-action*, OFT 803 (December 2008).

\(^{855}\) The OFT concludes that the Infringing Agreement between ITL and Sainsbury was in existence before the Chapter I Prohibition came into force on 1 March 2000. The existence of an agreement to that effect (whether formally written down or not) is inferred from the date of, and language used in, documents 1 to 3 of Annex 18 (which pre-date the Chapter I Prohibition).

\(^{856}\) This date is determined by a condition contained in Sainsbury’s accepted leniency application (leniency was formally granted on 12 March 2003).

\(^{857}\) The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
i  ITL’s strategy in relation to Sainsbury’s retail prices

6.1005 The trading agreements and contacts set out between ITL and Sainsbury below should be considered in the context of ITL’s retail pricing strategy as set out in Section 6.B: 'Manufacturers' retail pricing strategies' and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

6.1006 In addition, an internal ITL ‘National Accounts Business Development Plan’ for Sainsbury dated January 2002. In its 'Review of financial year 1.10.00 to 30.09.01', ITL stated:

'Pricing

Sainsbury have supported our strategy e.g. Richmond repositioning, every PMP incarnation and have responded quickly to every shelf price move.'

6.1007 Subsequently, in an internal ITL memorandum dated 30 April 2003, ITL stated:

'As an aside, albeit an important one, Peter [of Sainsbury] is uncomfortable with the direct link between our investment and Sainsbury’s shelf price.'

6.1008 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to ITL’s strategy for Sainsbury’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 6, 57, 83 and 90 of Annex 18 (which are listed in Annex C).

ii  Trading agreements between ITL and Sainsbury

6.1009 There were two trading agreements between ITL and Sainsbury, dated 16 August 2000 and 23 August 2002. Those agreements were a relevant aspect of the ongoing commercial dealing between ITL and Sainsbury and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and Sainsbury in relation to retail prices.

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858 Document 51, Annex 18 (page 8).
860 This document is one of a number of internal briefs which were produced by ITL during the period of the Infringing Agreement and provided to the OFT by ITL in response to the OFT’s section 26 Notice of 15 August 2003.
6.1010 The first trading agreement ('TA1') signed by ITL on 16 August 2000\textsuperscript{861}, was in relation to the period 1 April 2000 to 31 March 2001 and was extended by an email dated 4 September 2001\textsuperscript{862} until the date at which the subsequent trading agreement came into effect. The second trading agreement ('TA2') signed and dated 23 August 2002,\textsuperscript{863} was in relation to the period 1 April 2002 to 31 March 2003.

6.1011 The trading agreements provided that ITL would pay retrospective bonuses to Sainsbury during the term of the trading agreements for maintaining certain pricing requirements.

6.1012 TA1 under ‘Prices’ stated:\textsuperscript{864}

‘Price differentials maintained between ITL and competitor brands where appropriate.’

6.1013 TA2 under ‘Pricing’ stated:\textsuperscript{865}

‘ITL’s pricing strategy is to replicate the differentials that exist naturally between our brands and those of our competitors

See appendix 5 for Price List differentials.’

6.1014 TA1 set out the ‘price list differentials between ITL and competitor brands’ which included:\textsuperscript{866}

\begin{itemize}
\item \textsuperscript{861} Document 17, Annex 18. Although Document 17 (page 31) stated that it was only ‘a working document of intent and not a contract of supply’, the OFT is of the view that the document set out the trading terms agreed between the parties, initially to be effective between 1 April 2000 and 31 March 2001 but extended until further notice (that is, effectively up to 31 March 2002, after which another trading agreement came into force). The document is signed as an agreement, it is stated on its face to be the ‘SSL & ITL Trading Agreement’ and the covering email refers to it as ‘the Trading Agreement’. The OFT also refers to Documents 16, 31 (page 6) and 43 of Annex 18, paragraphs 51 and 52 of the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer], document 2, Annex 2, and paragraph 101 of the witness statement of Paul Matthews [ITL National Account Manager from October 1997 to October 2004] of 7 August 2008, (PM1, ITL’s response to the SO), in support of its conclusions in this connection.
\item \textsuperscript{862} Document 43, Annex 18.
\item \textsuperscript{863} Document 61, Annex 18.
\item \textsuperscript{864} Document 17, Annex 18 (page 26).
\item \textsuperscript{865} Document 61, Annex 18 (page 2).
\item \textsuperscript{866} Document 17, Annex 18 (Schedule 3, Page 37).
\end{itemize}
<table>
<thead>
<tr>
<th>'Brand'</th>
<th>Market share</th>
<th>Benchmark Competitor brand</th>
<th>RSP differential</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Berkeley Superkings [Gallaher brand]</td>
<td>parity</td>
</tr>
<tr>
<td>Mid Price</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Superkings [ITL brand]</td>
<td>[C]%</td>
<td>Sovereign/Mayfair KS [Gallaher brands]</td>
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<tr>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>L&amp;B KS [ITL brand]</td>
<td>[C]%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RYO</td>
<td></td>
<td>Old Holborn [Gallaher brand]</td>
<td>parity'</td>
</tr>
<tr>
<td>Golden Virginia [ITL brand]</td>
<td>[C]%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6.1015 Similarly, TA2 set out 'Appendix 5 Price List differentials' which included:

'Cigarettes

<table>
<thead>
<tr>
<th>ITL brand</th>
<th>Competitor brand...</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>14p above Mayfair [Gallaher brand] KS skus</td>
</tr>
<tr>
<td></td>
<td>parity with Dorchester [Gallaher brand] KS skus</td>
</tr>
</tbody>
</table>

... 

RYO...

*Drum* [ITL brand] *skus*  *parity with Amber Leaf* [Gallaher brand] *skus*'

6.1016 In return for compliance with the trading agreements' pricing requirements, ITL would reward Sainsbury with a bonus on the following basis:

6.1017 TA1 under ‘*Prices*’ stated:868

*‘Bonuses to be paid based on selling price’.*

6.1018 TA2 under ‘*Pricing*’ stated:869

*‘Based on SSL’s current shelf prices and the achievement of the Price List differentials detailed in appendix 5, ITL will continue to pay those bonuses framed in the example Price File in appendix 3’.*

6.1019 In relation to these trading agreements, the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer]870 described the importance ITL attached to parity and differential requirements871. Fiona Bayley further set out her understanding that adherence to absolute price levels as well as maintaining parity and differential requirements was required in order for Sainsbury to receive bonuses from ITL.872 Fiona Bayley also described how a promotions matching clause within a trading agreement would operate in practice.873

6.1020 In particular, the Witness Statement of Fiona Bayley stated the following:

‘*The 2002 Trading Agreement...was really just a continuation of the existing relationship.*'874

‘*In effect, in the Trading Agreement, I understood Imperial to be asking for two things: they wanted to maintain a difference between their price and their competitors’ prices, but also, if we are to get our bonus, we also have to stick to the price that they are telling us to stay with. If we do not do that, we lose the bonus. If you have an agreement with somebody, you want to know what the agreement is. If Imperial are going to pay you...*'

868 Document 17, Annex 18 (page 26).
869 Document 61, Annex 18 (page 2).
874 Document 2, Annex 2 (paragraph 51).
some money to do a particular thing, and you are not going to do that, then you cannot expect Imperial to pay you that money.\textsuperscript{875}

6.1021 The Witness Statement of Fiona Bayley further confirmed that:

'Maintenance of the price relativities (i.e. the price differentials) and the absolute level of the shelf prices were important to Imperial'.\textsuperscript{876}

'It was their ideal strategy to have price relativities. Probably for 99\% of the time those relativities were in place, but there would be the odd couple of weeks between MPIs where they would be out of parity.'\textsuperscript{877}

6.1022 A letter dated 2 May 2003 from ITL to Sainsbury, showed the importance attached by ITL to its investment and pricing strategy and its embodiment in the trading agreement:\textsuperscript{878}

'There is a de facto relationship between the majority of the investment that I make in Imperial brands and their prices on Sainsbury’s shelves. Our strategy, concomitant to this critical element of our commercial relationship is based on the custom and practice of many years and is made quite clear in our Trading Agreement, signed by both parties:

'SSL accept that ITL make investments in their brands based on two fundamental criteria: shelf price relativities and the absolute levels of those shelf prices'

I know that nothing last forever; I have no objection to mutually acceptable moderation to reflect your sensibilities, but the response to every pricing enquiry – we are the guardians [of shelf prices] etc – is making me feel distinctly uncomfortable.

I must tell you how I feel; if I am to have absolutely no input or influence into the relative, or absolute shelf price of Imperial brands why would I continue to invest nearly £\textsuperscript{879}

6.1023 In addition, the trading agreements provided that where Sainsbury was involved in the promotion of ITL’s competitors’ products, ITL would have the opportunity to respond with promotional activities.

6.1024 TA1 under 'Prices' stated:\textsuperscript{879}

'ITL to be able to respond to any price promotions where appropriate'.

\textsuperscript{875} Document 2, Annex 2 (paragraph 59).
\textsuperscript{876} Document 2, Annex 2 at paragraph 54.
\textsuperscript{877} Document 2, Annex 2 at paragraph 55.
\textsuperscript{878} Document 79, Annex 18.
\textsuperscript{879} Document 17, Annex 18 (pages 26 and 27).
6.1025 TA2 under ‘Pricing’ stated:880

‘From time to time, ITL’s competitors may reduce the shelf price of their brands. SSL should allow ITL the opportunity to respond, in order to realign with the differentials highlighted in appendix 5’.

6.1026 In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which Sainsbury would set its retail prices in accordance with the parity and differential requirements set by ITL, and that Sainsbury was rewarded with the payment of a bonus for compliance with ITL’s parity and differential requirements.

iii Contacts between ITL and Sainsbury regarding retail prices

6.1027 A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and Sainsbury regarding: (i) Sainsbury’s retail prices for ITL’s brands; (ii) Sainsbury’s retail prices for ITL’s competitors’ brands; and (iii) the retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.1028 The documents evidencing the contacts between ITL and Sainsbury demonstrate that: (i) in relation to Sainsbury’s retail prices for ITL’s brands (sometimes by reference to Sainsbury’s or other Retailers’ retail prices for ITL’s competitors’ brands) and/or (ii) in relation to Sainsbury’s retail prices for ITL’s competitors’ brands:

- ITL communicated881 to Sainsbury what Sainsbury’s retail prices should be; and/or
- ITL asked and/or incentivised Sainsbury to hold or alter Sainsbury’s retail prices; and/or
- Sainsbury informed ITL about, or discussed with ITL, Sainsbury’s current or proposed retail prices

6.1029 Sainsbury accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1030 In addition, ITL and Sainsbury informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

6.1031 The contacts between ITL and Sainsbury took place in the context of ITL’s retail pricing strategy for Retailers to maintain specified parities and differentials between ITL’s brands and competing linked brands.

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880 Document 61, Annex 18 (page 2).
881 See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.
Communications in relation to retail prices were sent by ITL, and were received and implemented\textsuperscript{882} by Sainsbury on the understanding that the notified retail prices took into account ITL’s retail pricing strategy, together with Sainsbury’s desired pricing position relative to other Retailers and Sainsbury’s desired margin.

6.1032 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1033 Various examples of contacts between ITL and Sainsbury regarding retail prices are set out below.

Contact between ITL and Sainsbury regarding Sainsbury’s retail prices for ITL’s brands

6.1034 Set out below are examples of contact between ITL and Sainsbury in relation to Sainsbury’s retail prices for ITL’s brands, which demonstrate that in relation to Sainsbury’s retail prices for ITL’s brands (sometimes by reference to the retail prices for competing linked brands):

- ITL communicated to Sainsbury what Sainsbury’s retail prices should be; and/or
- ITL asked and/or incentivised Sainsbury to hold or alter Sainsbury’s retail prices; and/or
- Sainsbury informed ITL about, or discussed with ITL, Sainsbury’s current or proposed retail prices

6.1035 Sainsbury’s accepted and/or indicated its willingness to implement the directions contained in such communications

6.1036 The examples of such contacts are as follows.

6.1037 In a fax dated 25 February 2000 from ITL to Sainsbury, ITL ‘confirmed’ discussions with Sainsbury which had taken place earlier that day and stated:\textsuperscript{883}

‘You plan to investigate/correct unusual price differentials on Pipe tobbaccoos and Golden Virginia [ITL brand]. The natural price differential between Old Holborn [Gallaher brand] and Golden Virginia is zero. Currently the Golden Virginia 25g pack is 3p more

\textsuperscript{882} See paragraphs 6.1075 and 6.1076 in relation to implementation.

\textsuperscript{883} Document 2, Annex 18. The OFT notes that Documents 1, 2 and 3 of Annex 18 pre-date the period of infringement under the Act but are relied upon by the OFT to highlight that Sainsbury fully understood ITL’s retail pricing strategy (including the maintenance of parity and differential requirements) which existed at the start of the period of the infringement.
than Old Holborn. The natural price differential between St Bruno [ITL brand] and Condor [Gallaher brand] is zero, currently the price of St Bruno is 3p above Condor.’

6.1038 In a letter dated 5 April 2000 from ITL to Sainsbury, ITL confirmed that Sainsbury was to set the price of an ITL brand to achieve price parity with a Gallaher brand and that this would be funded by ITL.\textsuperscript{884}

‘I understand that Small Classic [ITL brand] is to be distributed from week commencing 17 April 2000.

I write to confirm the following:

...

I agree to pay a bonus of [C]p to achieve parity with Café Crème [ITL brand]/Hamlet Miniature [Gallaher brand] position.’

6.1039 In a letter dated 12 April 2000 from ITL to Sainsbury, the ITL NAM referred to previous discussions and stated:\textsuperscript{885}

‘As discussed on Monday, I would like to respond to the Mayfair [Gallaher brand] £3.44 price position … our aim is to achieve parity with Richmond [ITL brand] pricing … I confirm that this will be a fully funded position’.

6.1040 Similarly, in an email dated 26 September 2000 from ITL to Sainsbury, the ITL NAM stated:\textsuperscript{886}

‘I understand the market is moving up on Mayfair [Gallaher brand], from 344 to 349, on Monday 2 October.

If this is the case with you, please could you increase L&B and JPS brands [ITL brands] by the [C]p additional bonus we have been committed to since 7.05.00 (L&B) and 28.05.00 (JPS) This would make 20s of these brands 365, which is the 16p price list differential.’

6.1041 Further contact can be seen in a fax from ITL to Sainsbury dated 15 November 2000, in which ITL stated:\textsuperscript{887}

‘I understand that you have increased the shelf price of Dorchester KS [Gallaher] brands from 329 to 334 ...

You may remember from my presentation on the price repositioning of Richmond KS (and launch of Richmond Superkings [ITL brands]) that our strategy is parity with Dorchester KS

\textsuperscript{884 Document 7, Annex 18.}
\textsuperscript{885 Document 8, Annex 18.}
\textsuperscript{886 Document 20, Annex 18.}
\textsuperscript{887 Document 22, Annex 18.}
[Gallaher brand].  In light of this, and not to hold the market up, I would be grateful if you would increase the shelf price of Richmond KS and Lights 20s from 329 to 334.

In order to maintain your cash margin position, the bonus levels at 334 should be as follows:

...  

[C]

[Emphasis added]

6.1042 Sainsbury responded to that request in an email dated 16 November 2000, and stated:

'I have increased the price of Richmond x20 (KS and Lts [ITL brands]) from 20/11 in line with your fax.'

6.1043 In response, in an email dated 17 November 2000, ITL thanked Sainsbury for a quick response and confirmed the resulting changes to bonuses paid to Sainsbury.

'Thanks for your quick response.

I have amended the attached spreadsheet to show the end of the [C] bonus level and the start of the [C] bonus.'

6.1044 In an email from ITL to Sainsbury dated 16 January 2001, the ITL NAM referred to previous conversations, and confirmed the following price instructions including 'Tactical Bonus' payment levels:

'I would like to increase the shelf prices of both Embassy and Regal multi-packs [ITL brands] as follows

\[
\begin{array}{ccc}
\text{Old} & \text{Tactical Bonus} & \ldots & \text{New} \\
\text{Embassy No.1 KS 100s} & 1984 & [C] & \ldots & 1995 \\
\text{Embassy No1 KS 200s} & 3958 & [C] & \ldots & 3985 \\
\text{Regal KS 100s} & 1974 & [C] & \ldots & 1985 \\
\text{Regal KS 200s} & 3910 & [C] & \ldots & 3965 \\
\ldots & \\
\end{array}
\]

\]

6.1045 In a letter dated 16 February 2001 from ITL to Sainsbury, ITL referred to suggested changes in the pricing of ITL’s brands ‘as per yesterday’s telephone conversation’: 891

‘I confirm my support for a 369/1840/3670 price point on all L&B [ITL] brands. The additional bonus payable should be [C] on all these brands. I would be grateful if you could also implement these price points on JPS [ITL] brands; the same additional bonus would apply’.

6.1046 ITL also referred to changes in the pricing of other ITL brands: 892

‘Embassy No. 1 and Regal KS multi-packs

Thanks for confirming the increases on the above, from 18 Feb.’

6.1047 After some explanation of the impact of these changes on the level of tactical bonuses, ITL then asked Sainsbury to make a further increase to prices in response to any increase on certain Gallaher brands: 893

‘However, I understand that the market is moving to a B&H KS [Gallaher brand] price point of 2060/4110. If this is the case in Sainsbury, please move to 2045/4080 on Embassy [ITL brand]. At this price point the tactical funding on Embassy would cease.’

6.1048 In an email of the same date, Sainsbury responded by confirming the implementation of the above request and the change to the level of bonus: 894

‘From 25/02 the price of these lines will increase to 2045/4080 and the bonus has reverted to standard.’

6.1049 In a letter from ITL to Sainsbury dated 27 July 2001, the ITL NAM wrote to confirm ‘some of the issues we discussed earlier this week at Stamford Street’, including bonuses paid to maintain parity with Gallaher brands: 895

‘Based on current market pricing, Drum [ITL brand] 50g’s shelf price should be 799p; a bonus of [C]p/[C] will be paid to maintain parity with A. Leaf [Gallaher brand].

Based on current market pricing, Drum Milde 25g’s shelf price should be 410; a bonus of [C]p/[C] will be paid to maintain parity with A. Leaf.’

In a letter dated 2 October 2001 from ITL to Sainsbury, the ITL NAM wrote to ‘confirm some of the issues … discussed’ in a previous meeting and stated:896

‘I understand that there may be an upward move on Sterling [Gallaher brand] prices in the market place. If that were the case in Sainsbury, based on an anticipated 5p Sterling increase, I would be grateful if you would move Richmond [ITL brand] as follows:

Richmond King Size 20s 339 to 344 +5p
Richmond Superkings 20s 340 to 347* +7p

…

This upward movement in shelf price should be reflected in the total bonuses as follows:

Richmond King Size 20s [C]p to [C]p/1000 [C]p
Richmond Superkings 20s [C]p to [C]p/1000 [C]p.’

There were emails between ITL and Sainsbury that have been annotated by Sainsbury following receipt of price instructions. In an email dated 15 November 2001 from ITL to Sainsbury, ITL stated:897

‘As per conversation earlier can you please bring Café Crème and Café Crème Mild 50 Multipack [ITL brand] into line with the Hamlet Miniatures 50 Multipack [Gallaher brand] of £12.99 … As per conversation can you please set this up during next Tuesdays (20/11/01) price changes until further notice.’

The email had been annotated by hand with the comment ‘actioned for 27/11’. The OFT considers that the annotations on this document were made by Sainsbury and they demonstrate that Sainsbury complied with ITL’s instructions.

In an email dated 28 February 2002 from ITL to Sainsbury ITL stated:898

‘To recap:

The market price for Small Classic and Small Classic Filter [ITL brands] is moving from 235 to 265 over the next few days.

I understand your shelf price will move on 12.3.02; the bonus implications are as follows:

…’

6.1054 The email had been annotated by hand with the comment 'actioned'. The OFT considers that the annotation on this document was made by Sainsbury and demonstrates that Sainsbury complied with ITL's instructions.

6.1055 In a further email dated 1 March 2002\textsuperscript{899} from ITL to Sainsbury, ITL stated:

'In light of our conversation regarding the forthcoming price moves on Sterling [Gallaher brand], I too would like to move Richmond Superkings [ITL brand] up 2p to 347p.'

6.1056 Sainsbury responded by email on 4 March 2002\textsuperscript{900} and stated:

'I can action these from the 13th March.'

6.1057 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Sainsbury regarding Sainsbury's retail prices for ITL's brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 2 to 5\textsuperscript{901}, 9 to 16\textsuperscript{902}, 19, 21, 24, 26 to 28, 32 to 35, 36, 37, 39 to 42, 44, 46 to 48\textsuperscript{903}, 50\textsuperscript{904}, 52, 55, 56, 58 to 60, 62 to 67, 70, 71, 73 and 87 of Annex 18 (which are listed in Annex C).

The Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer],\textsuperscript{905} (paragraphs 5, 6, 44, 45, 47, 60 to 63, 65, 66, 79, 80, 89 and Exhibits FB1, FB6, FB7, FB8, FB9, FB10, FB13) of Annex 2 (listed in Annex A below).

\textsuperscript{899} Document 54, Annex 18.
\textsuperscript{900} Document 54, Annex 18.
\textsuperscript{901} Documents 1, 2 and 3 of Annex 18, pre-date the period of infringement under the Act but are relied upon by the OFT to highlight that Sainsbury fully understood ITL's pricing strategy which included the operation of bonuses and maintaining parity and differential requirements which existed at the start of the period of the infringement. This is confirmed in the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] at paragraph 51, Document 2, Annex 2.
\textsuperscript{902} The OFT infers that Sainsbury implemented the price instructions in Document 15, Annex 18, based on the details of price moves provided in a later ITL email dated 22 August 2000 (Document 16, Annex 18).
\textsuperscript{903} The OFT further considers that annotations on this document were made by Sainsbury and also demonstrate that Sainsbury complied with ITL's instructions; see also Document 47, Annex 18.
\textsuperscript{904} This document demonstrates that Sainsbury agreed to comply with ITL's price instructions; see also documents 20, 27, 50, 54, 60, and 71 of Annex 18 (which are listed in Annex C).
\textsuperscript{905} Document 2, Annex 2.
Contact between ITL and Sainsbury regarding Sainsbury’s retail prices for ITL’s competitors’ brands

6.1058 In addition to the documents above, which concern contact between ITL and Sainsbury regarding Sainsbury’s retail prices for ITL’s brands, there were contacts between ITL and Sainsbury in relation to Sainsbury’s retail prices for ITL’s competitors’ brands. Set out below are examples of such contacts which demonstrate that in relation to Sainsbury’s retail prices for ITL’s competitors’ brands, Sainsbury informed ITL about, or discussed with ITL, Sainsbury’s current or proposed retail prices.

6.1059 The examples of such are as follows.

6.1060 In an email dated 28 March 2000 from ITL to Sainsbury, ITL asked Sainsbury for information relating to the price of a number of Gallaher brands:906

‘Embassy/Regal [ITL brands]

I would like to respond to the £3.99 position adopted by Gallaher.…

Mayfair [Gallaher brand]

Mayfair 20’s have moved from £3.23 to £3.44; a 21p increase (Richmond [ITL brand] have gone up by 25p). Is this a long term position?

Sovereign [Gallaher brand]

As I mentioned last week, you are cheaper than Kwik Save on Sovereign! Is the 2p discount a long term position?

Hamlet Miniatures [Gallaher brand]

…

Before the Budget increase, Café Crème [ITL brand] we were struggling to maintain parity with Hamlet; is their 10p below position long term?’

[Emphasis as in source document]

6.1061 In an email dated 9 May 2000907 from ITL to Sainsbury, ITL stated:

‘Following conversations over the last couple of days:

1. I understand that Embassy No. 1 KS and Regal KS 20s, 100s and 200s [ITL brands] will be returning to their 'natural' prices from 28 May, following Gallahers decision to move up from the 399 position'.

6.1062 In the email, ITL also stated that:

'Gallaher have decided to move Mayfair 20s down to the 339 position ... from 14 May.

As a consequence Richmond 20s [ITL brand] will also move down to 339 from 14 May'.

6.1063 In an email dated 6 June 2000 from ITL to Sainsbury, the ITL NAM referred to a previous conversation regarding multi-pack pricing and stated the following:

'I understand that B&H/Silk Cut [Gallaher brands] are moving from PMP to 1985/3965; I assume these prices will be on shelf for more than a few weeks? Whilst I wish prices would return to 'natural' levels, I need to maintain the price list differentials: 15/30p on Embassy No. 1 KS and 25/50p on Regal KS [ITL brands]'.

6.1064 In addition to the documents quoted above, a number of other documents contain evidence of contact of the same or similar nature between ITL and Sainsbury regarding Sainsbury's retail prices for ITL's competitors' brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 4, 20, 22 and 29 of Annex 18 (which are listed in Annex C). The Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] paragraphs 44, 63, 79 to 80 and exhibits FB6, FB7, FB9 and FB13 (Document 2 of Annex 2 ).

Contact between ITL and Sainsbury regarding the retail prices of Sainsbury's competitors

6.1065 In addition to the documents above, there were contacts between ITL and Sainsbury in which ITL informed Sainsbury about, or ITL and Sainsbury discussed, the current or proposed retail prices of other Retailers for ITL's brands and/or for ITL's competitors' brands.

6.1066 In an email dated 28 March 2000 from ITL to Sainsbury, the ITL NAM stated:

______________________________

'As I mentioned last week, you are cheaper than Kwik Save on Sovereign! [Gallaher brand] Is the 2p discount a long term position?'

6.1067 In an email dated 13 February 2001 from ITL to Sainsbury, the ITL NAM set out retail prices for a number of retailers including Asda and Sainsbury on a variety of ITL brands and stated:911

'Calls made last Friday 9 Feb. 01:

<table>
<thead>
<tr>
<th>[another retailer]</th>
<th>Asda</th>
<th>Sainsbury</th>
</tr>
</thead>
<tbody>
<tr>
<td>JPS 100</td>
<td>1845</td>
<td>1845</td>
</tr>
<tr>
<td>JPS 200</td>
<td>3680</td>
<td>3680</td>
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<tr>
<td>Skings 100</td>
<td>1955</td>
<td>1955</td>
</tr>
<tr>
<td>Skings 200</td>
<td>3900</td>
<td>3900</td>
</tr>
<tr>
<td>Emb No.1 KS 100</td>
<td>2030</td>
<td>2030</td>
</tr>
<tr>
<td>Emb No.1 KS 200</td>
<td>4050</td>
<td>4050</td>
</tr>
<tr>
<td>Regal KS 100</td>
<td>2020</td>
<td>2020</td>
</tr>
<tr>
<td>Regal KS 200</td>
<td>3995</td>
<td>4030</td>
</tr>
</tbody>
</table>

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

6.1068 In an email dated 12 March 2001 from ITL to Sainsbury, headed 'L&B/JPS [ITL brands] pricing' the ITL NAM stated:912

'The market has moved to 376.

I would be grateful if you could move from 375 to 376 (pro-rata on 100/200 multi-packs).'

6.1069 Similarly, in a letter dated 26 June 2001 from ITL to Sainsbury, ITL provided the following information:913

'Drum Milde 25g [ITL brand] …

… the market has recently moved upwards, offering an opportunity for you to increase your cash take, and for us to reduce contribution.

Asda have moved to 209p/410p on Drum [ITL brand] and Amber Leaf [Gallaher brand]; [another retailer], have moved to 209p/410p

913 Document 37, Annex 18.
on Amber Leaf, and will be moving from 205p/388p to a similar position on Drum.

Can I suggest you also move Drum to 209/410p?’

6.1070 In a letter dated 2 May 2003 from ITL to Sainsbury, the ITL NAM indicated that the provision of competitor price information to Sainsbury was an established practice.914

‘On a more prosaic level, how would you have felt on the numerous occasions when you have asked me for competitor shelf price information...if I had refused to discuss it with you?’

6.1071 Additional evidence can be found in the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer], in which she stated that:915

‘... Paul Matthews [of ITL] would give me an indication if Imperial’s shelf price was going up or down i.e. whether the tactical bonus was being withdrawn / increased. He would also give me an indication of when it was going to increase at [another retailer] and Morrisons. This was very useful since I could not afford to go and put the price up if they were not doing the same thing.’916

6.1072 It can be seen from the above that references by ITL to the retail prices of other Retailers were used by ITL as a means to encourage the implementation by Sainsbury of ITL’s parity and differential requirements. In particular, such references provided an assurance to Sainsbury that retail price changes put to Sainsbury by ITL would not cause Sainsbury to be out of step with its retail competitors. The function of references to the retail prices of other Retailers was to assist in the implementation of ITL’s pricing strategy and to ensure that ITL’s desired parities and differential requirements were maintained or, where need be, realigned.

6.1073 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Sainsbury which demonstrates the same matters as set out in respect of the document quoted above: documents 11, 20, 29, 45 and 72 of Annex 18 (which are listed in Annex C).

Conclusion on the contacts between ITL and Sainsbury

6.1074 In conclusion in relation to all the contacts between ITL and Sainsbury regarding retail prices, the above paragraphs demonstrate that there were regular contacts between ITL and Sainsbury, which related to the retail prices of Sainsbury as well as other Retailers. The evidence of such contacts, together with the context of ITL’s strategy, demonstrates that ITL’s retail pricing strategy was for Sainsbury to maintain specified parities and differentials between ITL’s brands and competing linked brands. The contacts between ITL and Sainsbury assisted the implementation of that strategy, through communications between ITL and Sainsbury in relation to Sainsbury’s retail prices for ITL’s brands and in some cases ITL’s competitors’ brands, the aim of which was to ensure that ITL’s desired parity and differential requirements were maintained or realigned. The contacts between ITL and Sainsbury also demonstrate that Sainsbury accepted and/or indicated its willingness to implement the directions contained in communications from ITL to Sainsbury in that connection.

6.1075 The OFT notes that ITL submitted that there were instances where Sainsbury did not implement instructions and/or requests in ITL’s pricing communications.

6.1076 The OFT considers that, notwithstanding that there may have been some instances where Sainsbury did not implement, did not implement fully917, or delayed the implementation of instructions and/or requests in ITL’s pricing communications, that does not negate the existence of the Infringing Agreement between ITL and Sainsbury, as there is sufficient evidence over a period of time of Sainsbury’s compliance, or intention to comply, with ITL’s retail pricing strategy (see for example the sections entitled ‘Trading Agreements between ITL and Sainsbury’ and ‘Contacts between ITL and Sainsbury regarding retail prices’ above).

iv Bonuses

6.1077 As set out above, ITL rewarded Sainsbury with an ongoing bonus on the condition that, among other matters, Sainsbury maintained the required price ‘differentials’ between ITL brands and ITL’s competitors’ brands as stipulated in the appendix to the trading agreements.

917 For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
6.1078 There are also documents relating to the provision of tactical bonuses from ITL to Sainsbury, examples of which are set out in the section entitled 'Contacts between ITL and Sainsbury regarding retail prices' above.

6.1079 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Sainsbury. In particular, the bonuses ensured that Sainsbury’s margin was not significantly affected by the changes in retail prices requested by ITL to achieve ITL’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Sainsbury’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.1080 In addition to those documents referred to in the contacts sections above, which specifically refer to tactical bonuses, the following documents also evidence the use of tactical bonuses.

6.1081 In an email dated 16 February 2001 from ITL to Sainsbury, ITL stated:918

‘... I was incorrect to suggest that all the tactical bonuses should end when you moved from 2020/4035 to 2030/4050 on Embassy [ITL brand] and from 2010/4015 to 2020/4030 on Regal KS [ITL brand].

Prior to this move, the tactical bonus on these brands equated to discounts of [C]p/[C]p on Embassy and [C]p/[C]p on Regal, which means we should still be funding [C]p/[C]p on Embassy after this Sundays increases of 10p/15p on both Embassy and Regal.

However, I understand that the market is moving to a B&H KS [Gallaher brand] price point of 2060/4110. If this is the case in Sainsbury, please move to 2045/4080 on Embassy.

At this point the tactical funding on Embassy would cease.’

6.1082 In an email dated 5 September 2002 from Sainsbury to ITL entitled 'period 4 invoice', Sainsbury quoted the following text from a previous email from ITL to Sainsbury:919

‘... I would be grateful if you could bring all Drum [ITL brand] skus into line with the Amber Leaf [Gallaher brand] skus. This will mean the following shelf price movements and bonus amendments:

Drum 12.5g shelf price move from 209 – 203 bonus increases by [C]p/outer

919 Document 64, Annex 18 (page 1 and 2).
Drum 25g shelf price move from 415 – 399 bonus increases by £/outer

Drum 50g shelf price move from 809 – 789 bonus increases by £/outer.

6.1083 The Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] described, in some detail, how the bonus systems of the tobacco companies worked.920

'Imperial, Gallaher and [another manufacturer] each provided us with these bonuses and they operated in much the same way.’921

6.1084 Furthermore, she stated:

'The level of the bonuses had a direct impact on the shelf prices of the brands and was one way the tobacco companies maintained the price differential between its brands and those of its competitors.'922

6.1085 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the provision of bonuses by ITL to Sainsbury which demonstrates the same matters as set out in respect of the documents quoted above: documents 12, 13, 19, 21, 24, 32 to 34, 36, and 37 of Annex 18 (which are listed in Annex C).

6.1086 The evidence demonstrates that ITL paid bonuses to Sainsbury in order to ensure that its retail pricing strategy was maintained. Sainsbury accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by ITL.

v Monitoring of retail prices by ITL

6.1087 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to Sainsbury. Sainsbury participated in this monitoring by providing ITL with details of its proposed retail prices for ITL's brands and/or for ITL's competitors' brands.

6.1088 In a fax dated 8 September 2000, Sainsbury provided ITL with a letter of authority to.923

923 Document 18, Annex 18.
‘...call on all stores every eight weeks ... they will be checking prices ...’

6.1089 In an email dated 16 November 2001 from ITL to Sainsbury, ITL stated:

‘Looking through your Small Classic and Small Classic Filter prices [ITL brands] it would appear that your stores are still selling out at £2.31. From the price file I think the price should be £2.35 post-MPI. Could you have a look at this?’

6.1090 In an email dated 16 November 2001 from Sainsbury to ITL, Sainsbury explained:

'We are going up to 2.35 from 28/11. I agreed this with Paul [of ITL].'

6.1091 In an email dated 9 July 2003, the ITL NAM set out a number of observations regarding errors in pricing on various ITL brands following several store visits. He further stated:

'Clearly, from such a small sample these could be 'driver error'; if so, I hope this is an example of where a discussion concerning your shelf prices could be of benefit to you.'

6.1092 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of Sainsbury’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 2, 11, 27, 28, 47, 60, 64, 69, 80, 83 and 89 of Annex 18 and the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] (Document 2 of Annex 2) (which are listed in Annex C).

6.1093 These documents demonstrate that ITL would monitor Sainsbury’s retail prices of both ITL and Gallaher brands to ensure that parity and differential requirements were maintained and would point out pricing errors to Sainsbury.

vi Conclusion on the agreement and/or concerted practice between ITL and Sainsbury

6.1094 The evidence described above demonstrates the existence of the Infringing Agreement between ITL and Sainsbury, which had the object of
restricting competition, in the manner set out in Section 6.A.I: 'The anti-
competitive object of the Infringing Agreements' and, given that the
remaining constituent elements of the statutory test are also met (see
Section 7: 'Legal assessment'), amounted to a breach of the Chapter I
Prohibition.

vii Further Supporting Evidence

6.1095 In addition to the above, the existence of the Infringing Agreement
between ITL and Sainsbury is also supported by the pattern of conduct in
the market as a whole as revealed by the existence of similar agreements
and/or concerted practices as detailed throughout this section of the
Decision and likewise supported by documents which are similar in
content, tone and nature to those pleaded above in relation to the
Infringing Agreement and which concern the relationships between:

- ITL and each of the other Retailers, which evidence ITL's approach
towards the Retailers as a collective; and between

- Gallaher and Sainsbury (see below), which is part of the context of
the Infringing Agreement between ITL and Sainsbury.

6.1096 The existence of the further supporting evidence described above (and in
particular the relationship between Gallaher and Sainsbury) lends further
support to the fact that there was an agreement and/or concerted practice
between ITL and Sainsbury which had the object of restricting
competition and, given that the remaining constituent elements of the
statutory test are also met, amounted to a breach of the Chapter I
Prohibition.
6.1097 When considered together with the evidence of Gallaher’s overall strategy for retail prices described in Section 6.B: 'Manufacturers’ retail pricing strategies’, the evidence referred to below demonstrates that at least from 1 March 2000\(^{928}\) to 9 March 2003\(^{929}\), an Infringing Agreement existed between Gallaher and Sainsbury, whereby Gallaher coordinated with Sainsbury the setting of Sainsbury’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between Gallaher and Sainsbury restricted the ability of Sainsbury to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1098 The following elements evidence the Infringing Agreement between Gallaher and Sainsbury.\(^ {930}\)

\(i\) Gallaher’s Strategy in relation to Sainsbury’s retail prices

6.1099 The contacts set out below between Gallaher and Sainsbury should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: 'Manufacturers’ retail pricing strategies’ above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.1100 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher’s multiple grocer channel, demonstrate that Gallaher’s objective was that multiple grocers, of which Sainsbury was one such grocer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

\(^{928}\) The OFT concludes that the Infringing Agreement was in existence before the Chapter I Prohibition came into force on 1 March 2000. The existence of an agreement to that effect (whether formally written down or not) is inferred from the date of, and language used in, Documents 1 and 2, Annex 8 (which pre-date the Chapter 1 prohibition) and in the witness statement of Fiona Bayley [Sainsbury Tobacco Buyer] at paragraph 5.

\(^{929}\) This date is determined by a condition contained in Sainsbury’s accepted leniency application (the leniency was formally granted on 12 March 2003).

\(^{930}\) The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
6.1101 A good example is an internal Gallaher document headed 'Promotional Policy - Retail Promotion Contributions – March 2000', which listed the 'pricing objectives' in relation to the following brands amongst others:

'Camel [Gallaher brand] – Parity with Marlboro [competitor brand]\(^{931}\)]


_B&H_ [Gallaher brand] – _5p above Regal_ [ITL brand], _3p above Embassy No 1_ [ITL brand]

_Berkeley and B&H Superkings_ [both Gallaher brands] – _parity with JP Superkings_ [ITL brand]

_Club_ [Gallaher brand] _14p below Regal_ [ITL brand]

_Sovereign_ [Gallaher brand] _10p below L&B_ [ITL brand]

_Mayfair_ _7p below Sovereign_ [both Gallaher brands] _and at least parity with Richmond_ [ITL brand]\(^{932}\)

6.1102 Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s multiple grocer channel, is set out in Section 6.B: 'Manufacturers' retail pricing strategies' above, which refer to a number of other documents containing evidence of the same or similar nature.\(^{933}\)

\(\text{\textit{ii} Trading agreements between Gallaher and Sainsbury}\)

6.1103 There were three trading agreements between Gallaher and Sainsbury, dated 12 October 2000, 18 December 2001 and 31 May 2002. Those agreements were a relevant aspect of the ongoing commercial dealing between Gallaher and Sainsbury and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between Gallaher and Sainsbury in relation to retail prices.

6.1104 The first trading agreement ('TA1')\(^{934}\), signed and dated 12 October 2000, was in relation to the period 1 January 2000 to 31 December 2000.\(^{\text{\textit{\textsuperscript{931}} ITL has distributed Marlboro since 12 September 2001.}}\)

\(^{932}\) Document 1, Annex 3 (page 2). This document also set out parity and differential requirements for cigars and hand rolled tobacco.

\(^{933}\) See, in particular, documents 2 to 10, 13 and 14, Annex 3.

\(^{934}\) Document 4, Annex 8.
2000. The second trading agreement (‘TA2’)\(^\text{935}\), signed and dated 18 December 2001, was in relation to the period 1 January 2001 to 31 December 2001, and was extended by letter of 31 May 2002\(^\text{936}\) until the earlier of the date of commencement of the ‘Trading Agreement 2002’ and 31 December 2002. The third trading agreement (‘TA3’)\(^\text{937}\), signed and dated 31 May 2002, was in relation to the period 24 June 2002 (or the date of signature by Sainsbury of the merchandising agreement) to 31 December 2007.

6.1105 In the terms of these trading agreements, Gallaher and Sainsbury agreed, among other matters, the following:\(^\text{938}\)

‘Where Sainsbury’s is involved in the promotion of a brand by a competitor of Gallaher, Gallaher shall be offered the opportunity to conduct similar promotional activity with Sainsbury’s, on a brand to be selected by Gallaher as soon as is reasonably requested by Gallaher following that competitor’s promotion and subject to mutual agreement.’ [Emphasis as in source document]

6.1106 Although these trading agreements did not contain any clauses requiring Sainsbury to maintain any specified price parity and differential requirements between Gallaher’s brands and Gallaher’s competitors’ brands, when referring to the extended trading agreement which resulted from the letter of 31 May 2002\(^\text{939}\), the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] explained that:\(^\text{940}\)

‘This agreement did not have a list of differentials between Gallaher’s brands and competing brands like there was in appendix 5 of the Trading Agreement between Imperial and Sainsbury’s, but Gallaher had a similar strategy to Imperial in that they benchmarked themselves against particular brands or wanted us to sell at a certain price and they then paid us a bonus to achieve that. They just did not have it down in black and white like Imperial had it, but it was implicit in the agreement and the way we did business together.’

6.1107 That demonstrates that Sainsbury was aware of Gallaher’s strategy that parity and differential requirements would be achieved.

6.1108 In conclusion, the evidence highlighted in this section demonstrates that Sainsbury understood that pursuant to its trading arrangements with

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\(^{935}\) Document 29, Annex 8. The OFT infers that the handwritten notes on this document were made by Gallaher.

\(^{936}\) Document 35, also included as part of Document 36, Annex 8.


\(^{938}\) See Documents 4 (Clause 2.5), 29 (Clause 2.5), 35 (Clause 3.5), and 36, Annex 8.


\(^{940}\) Document 2, Annex 2 (paragraph 69). See also paragraphs 67 and 68 of the same document in relation to this agreement.
Gallaher, Sainsbury would set its retail prices in accordance with the parity and differential requirements set by Gallaher, and that Sainsbury was rewarded with the payment of a bonus for compliance with Gallaher’s parity and differential requirements. Furthermore, there were formal written trading agreements, pursuant to which Sainsbury would give Gallaher the opportunity to match promotions on Gallaher’s competitors’ brands.

iii Contacts between Gallaher and Sainsbury regarding retail prices

6.1109 A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and Sainsbury regarding: (i) Sainsbury’s retail prices for Gallaher’s brands; and (ii) the retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

6.1110 The documents evidencing the contacts between Gallaher and Sainsbury demonstrate that: (i) in relation to Sainsbury’s retail prices for Gallaher’s brands (sometimes by reference to Sainsbury’s or other Retailers’ retail prices for Gallaher’s competitors’ brands)

- Gallaher communicated\(^{941}\) to Sainsbury what Sainsbury’s retail prices should be; and/or
- Gallaher asked and/or incentivised Sainsbury to hold or alter Sainsbury’s retail prices; and/or
- Sainsbury informed Gallaher about, or discussed with Gallaher, Sainsbury’s current or proposed retail prices.

6.1111 Sainsbury accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1112 In addition, Gallaher and Sainsbury informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands.

6.1113 The contacts between Gallaher and Sainsbury took place in the context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent by Gallaher, received and implemented by Sainsbury’s\(^{942}\) on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together

\(^{941}\) See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.

\(^{942}\) See paragraph 6.1152 in relation to implementation.
with Sainsbury’s desired pricing position relative to other Retailers and Sainsbury’s desired margin.

6.1114 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1115 Various examples of contacts between Gallaher and Sainsbury regarding retail prices are set out below.

**Contact between Gallaher and Sainsbury regarding Sainsbury’s retail prices for Gallaher’s brands**

6.1116 Set out below are examples of contact between Gallaher and Sainsbury in relation to Sainsbury’s retail prices for Gallaher’s brands, which demonstrate that in relation to Sainsbury’s retail prices for Gallaher’s brands (sometimes by reference to the retail prices of competing linked brands):

- Gallaher communicated to Sainsbury what Sainsbury’s retail prices should be; and/or
- Gallaher asked and/or incentivised Sainsbury to hold or alter Sainsbury’s retail prices; and/or
- Sainsbury informed Gallaher about, or discussed with Gallaher, Sainsbury’s current or proposed retail prices.

6.1117 Sainsbury accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1118 The examples of such contacts are as follows.

6.1119 In an email dated 9 November 2000 from Gallaher to Sainsbury, Gallaher stated:

> ‘I write to confirm our recent discussions regarding the pricing / bonusing of the Dorchester range [Gallaher brand].

> **Prices – Effective from Sunday 12th November – UFN**

> **King Size 20s** - £3.34

> **Super kings 20s** - £3.35

> **King Size 100 Multipacks** - £16.45

> **Superkings 100 Multipacks** - £16.50

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943 Document 5, Annex 8.
Bonuses – these to return to the standard bonuses effective from the date of the price change.  

6.1120 Similarly, in an email dated 28 March 2001 from Gallaher to Sainsbury, Gallaher confirmed the following price increases:

‘...following our conversation yesterday I write to confirm the following price moves:

April 1st


Bonus rate of £[C] reduces to [C]p

Dorchester SKs 20s range – Move from £3.35 to £3.40.

Bonus rate of £[C] reduces to [C]p. …’

6.1121 In an email dated 1 June 2001 from Gallaher to Sainsbury, Gallaher stated:

‘Dorchester [Gallaher brand] Multipacks

I wish to move the prices of MULTIPACKS up; (no change on 20s)

King Size - £16.75 ~ new bonus rate £[C]’

Superkings £16.90 ~ new bonus rate £[C]

Please could you move at your earliest convenience and advise accordingly.’

6.1122 A further example can be seen in a chain of correspondence from 23 to 30 August 2001 between Gallaher and Sainsbury. In an email dated 23 August 2001 from Sainsbury to Gallaher, Sainsbury explained:

‘I wish to make our position clear on the above products’ price points...

2. From the 12th Sept they [Mayfair/Sovereign x100 Gallaher brands] will revert to the original price points of 17.95/18.25.

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944 Similar confirmations are evidenced in Documents 7, 8, 21, 27, 30 and 31, Annex 8.
945 Document 8, Annex 8.
946 Document 9, Annex 8. The OFT infers that Sainsbury agreed to implement the above change in retail price, based on the related content of Documents 10, 13 and 20 of Annex 8 (see below).
947 Documents 11, 12, 16, 18 and 19, Annex 8. The OFT infers the handwritten comments on Document 19 were made by Sainsbury.
948 Document 16, Annex 8 (page 2 and 3).
3. As you have now announced an MPI from 11th Sept, the costs will obviously change from that date. However, we are not prepared to increase the rsp from 16.99 to the post mpi position of 18.20 for Mayfair and 17.49 to 18.50 for Sovereign.'

6.1123 In an email dated 24 August 2001 from Gallaher to Sainsbury, Gallaher responded:949

'Can I suggest that due to Sovereign multipack only increasing by 10p (2p on 20s) that we move straight away to the new price of £18.35.

Mayfair to £17.95.'

6.1124 In addition in an email reply dated 29 August 2001 from Sainsbury to Gallaher, Sainsbury confirmed:950

'I agree that it makes sense to put Sovereign [Gallaher brand] up from the 12/09 to the post mpi position of 18.35.

Mayfair [Gallaher brand] x100 will revert to the original price of 17.95 ...

From the 25th Sept the new price positions will be 18.20 for the 100 pack ...

...

Please confirm your agreement'.

6.1125 In an email dated 30 August 2001, from Gallaher to Sainsbury, Gallaher also confirmed:951

'I write to confirm your price movements request/bonuses on Mayfair & Sovereign post MPI.'

6.1126 Meanwhile, in an email dated 28 August 2001 from Gallaher to Sainsbury, Gallaher stated:952

'It has become apparent that our competitors are holding certain prices on key lines until further notice. We will therefore be holding certain lines of ours in response; I will confirm brands/packings/bonuses/prices by Friday 31st August.'

6.1127 In a follow-up email of the same date from Gallaher to Sainsbury, Gallaher set out a number of pricing points including proposed bonus levels, for Gallaher brands by reference to the retail prices of ITL’s brands.953

951 Documents 18 and 19, Annex 8.
'Should Richmond [ITL brand] hold price then the Dorchester [Gallaher brand] range should remain at Parity. The bonuses would then be:

Dorchester KS 20s @ £3.39 ~ bonus to be £[C] per '000 ([C])
Dorchester KS 100 MPs @ £16.75 ~ bonus to be £[C] per '000 ([C])
Dorchester SK 20s @ £3.40 ~ bonus to be £[C] per '000 ([C])
Dorchester SK 100 MPs @ £16.90 ~ bonus to be £[C] per '000 ([C])'

6.1128 Sainsbury responded to the above email on 29 August 2001 noting:

'Dorchester [Gallaher brand], I agree the tactical bonus figures with the exception of KS x 100, where the tactical bonus seems to have gone down instead of up…'

6.1129 In a response to the above email dated 30 August 2001 from Gallaher to Sainsbury, Gallaher confirmed its agreement with Sainsbury's point:954

'…following your E:Mail yesterday I agree'.

6.1130 The OFT infers that this chain of emails demonstrates that Sainsbury’s acceptance of the price points set out by Gallaher.

6.1131 In an email dated 2 October 2001 from Gallaher to Sainsbury entitled 'Prices / Bonus confirmations from October 9/ 10th', Gallaher stated:955

'Please could you change the following prices as discussed on the 9 / 10th October:

Berkeley Superkings [Gallaher brand]

100 MPs - £19.99, bonus of £[C] ([C]tactical[||C]Std)'

6.1132 The OFT infers that the handwritten annotations on the document, including tick marks against proposed price changes, were made by Sainsbury and demonstrate Sainsbury’s agreement to implement Gallaher’s price changes.

6.1133 In an email dated 25 February 2002 from Gallaher to Sainsbury, the Gallaher NAM stated:956

953 Document 13, Annex 8 and Document 14, Annex 8 contains the same content with handwritten annotations (which the OFT infers were made by Sainsbury).
954 Document 20, Annex 8. The OFT infers the handwritten note on this document were made by Sainsbury.
'As we discussed last Thursday, we are planning to raise Sterling prices [Gallaher brand] … back to RRP effective March 1st (though we agreed it will be 5th March for yourself). This will mean that the current tactical bonus will cease from that date.'

6.1134 In an email dated 5 March 2002 from Gallaher to Sainsbury, the Gallaher NAM stated:957

'As discussed last week, with the prices now revised on the Sterling range [Gallaher brand] it is appropriate to move the price of Dorchester SK 20’s range [Gallaher brand] up from £3.45 to £3.47. This will mean that your retro bonus will be reduced …'

6.1135 The OFT infers that Sainsbury agreed to implement the change in price on the basis of the following manuscript comment made on this document:

'actioned from 13/3.'

6.1136 In response to an email dated 9 June 2002 from Gallaher to Sainsbury entitled 'Suggested Pricing after MPI', Sainsbury confirmed acceptance of Gallaher’s instructions to hold, raise or lower the retail prices of its brands:958

'They look fine apart from King 6 x30 [Gallaher brand] which we don’t sell.'

6.1137 In an email dated 1 July 2002 from Gallaher to Sainsbury, Gallaher attached a pricing spreadsheet which contained a column for comments. Gallaher stated the following in relation to B&H Superkings, B&H SK Lights, Berkeley SK and Berkeley SK Lights [Gallaher brands]:959

'MPI + 1p on 20 reduction to Match JPSK [ITL brand].'

6.1138 The Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] highlighted that Sainsbury fully understood Gallaher’s strategy, as evidenced in these communications:960

'Each cigarette company has a strategy with regard to what price the consumer pays for a packet of its cigarettes. It either tries to align itself with a competitor’s brand or it positions itself either above or below another company’s brand. These relativities (i.e. the price differentials) were in existence when I took over as tobacco buyer. Throughout my time as a tobacco buyer, whenever Sainsbury’s put the price for a packet of cigarettes up or down, these price differentials were usually, in a relatively short time span, brought into alignment.'

958 Documents 37 and 38, Annex 8.
960 Document 2, Annex 2 (paragraph 5).
6.1139 The Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] also highlighted that any such changes in retail prices would be driven by requests from manufacturers rather than unilateral action by Sainsbury.\(^{961}\)

‘Because of the way the bonus system worked and the desire on the part of tobacco companies to maintain price differentials we tended to react to requests by manufacturers to change bonuses and shelf prices. If we ever instigated changes, I do not recall doing so.’

6.1140 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and Sainsbury regarding Sainsbury’s retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the documents quoted above: document 1, 2\(^{962}\), 3, 6, 7, 13, 14, 17, 21, 22, 23 to 25, 27, 28\(^{963}\), 30, 33, 34, 39, 41, 45, 48, 51 to 53, \(^{964}\) 54, 57, 59\(^{965}\) of Annex 8 (which are listed in Annex C), and Fiona Bayley’s witness statement, Document 2, Annex 2.

**Contact between Gallaher and Sainsbury regarding the retail prices of Sainsbury’s competitors**

6.1141 In addition to the documents above, there were contacts between Gallaher and Sainsbury in which Gallaher and Sainsbury informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

6.1142 In her witness statement of 2 September 2005 Fiona Bayley stated:\(^{966}\)

‘I had two sources for knowing what our competitors were doing: … Gallaher used to send me a price list, compiled from their reps’ visits. It did not come from their account manager, but from

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\(^{961}\) Document 2, Annex 2, (paragraph 76).

\(^{962}\) Documents 1 and 2 pre-date the period of infringement under the Act but are relied upon by the OFT to highlight that Sainsbury fully understood Gallaher’s pricing strategy which included the maintenance of parity and differential requirements and the operation of bonuses, which existed at the start of the period of infringement and at the time Fiona Bayley became Sainsbury’s tobacco buyer in October 2000 as confirmed in Fiona Bayley’s Witness Statement at paragraph 5.

\(^{963}\) The OFT infers that the handwritten notes on this document were made by Sainsbury and they demonstrate Sainsbury’s agreement to implement the retail price points communicated by Gallaher.

\(^{964}\) The OFT infers Sainsbury’s agreement to implement the retail price points communicated in this letter, as they have been ticked by Sainsbury.

\(^{965}\) The OFT infers that Sainsbury accepted Gallaher’s pricing instructions based on handwritten notes (in the form of dates) against the retail prices in this document.

\(^{966}\) Document 2, Annex 2 (paragraph 82).
somebody at Gallaher’s head office. Gallaher’s list was usually 2-3 weeks out of date. It was filed for reference. I do not think Imperial or [another manufacturer] supplied us with a similar list – we only needed one as it covered all brands …

6.1143 In an email dated 8 January 2001 from Gallaher to Sainsbury, Gallaher informed Sainsbury of the end of a Gallaher promotion and about the future prices of Sainsbury’s competitors:

‘Retail prices should therefore increase to normal pricing. I will find out [another retailer’s] price if you require.

All multiple Grocers will move as from the 14th.’

6.1144 In an email dated 9 June 2002 from Gallaher to Sainsbury, Gallaher referred to the prices for Amber Leaf [Gallaher brand] moving down in Sainsbury’s competitors and stated:

‘The following will happen in your nearest rivals, but I am not sure if you will want to follow i.e. there will be no VPR support. My thoughts are that you would go to new RRP which is your current prices?

Amber leaf 12.5grm flip top moves down from £2.09 to £2.03

Amber leaf 25grm pouch moves down from £4.10 to £3.99

Amber leaf 50grm pouch moves down from £8.09 to £7.89’.

[Emphasis as in source document]

6.1145 In an email dated 12 July 2002 from Gallaher to Sainsbury, the Gallaher NAM stated:

‘I have spoken to the [another retailer] account manager and visited a site for myself this afternoon, and I can confirm that [another retailer] are definitely selling B&H MP [Gallaher brand] at £21.80. I can only assume that the store visited on your price audit had not changed the price ticket on shelf???’

6.1146 In a further email dated 11 September 2002 from Gallaher to Sainsbury, Gallaher provided information to Sainsbury about future prices and bonus payments of its competitors:

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967 The second source for Sainsbury ‘knowing what our competitors were doing’, according to paragraph 82(b) of the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer], was Sainsbury’s own corporate price index.

968 Document 6, Annex 8.

969 Document 37, Annex 8. See also Documents 38 and 41, Annex 8.

970 Document 44, Annex 8. See also Documents 45 and 46, Annex 8.

'As discussed here are the proposed changes to pricing from the 16.09.02

... 

Hamlet 5x5 £13.69 - £13.99 (Asda and [another retailer] are currently at £13.64 moving to £13.94. No extra contribution from us).'

6.1147 Similarly, in an email dated 26 September 2002 entitled 'Prices', Sainsbury made the following query:972

'I've just received through the post your weekly recorded prices survey...there are 35 lines on there that [another retailer] is showing cheaper than us. I presume/hope that this is really not the case as it would put us at a significant competitive disadvantage... My biggest concern however, is that they are showing as 12.39 on Hamlet 5x5 [Gallaher brand] vs our price of 13.95, this is more than the mpi increase, could you find out what is going on?'

6.1148 In an email dated 27 September 2002 from Gallaher to Sainsbury, the Gallaher NAM responded to Sainsbury’s query:973

'They had problems with UDEX, prices did not change when they were meant too and the price audit was carried out the day before they actually went up ...

The Hamlet [Gallaher brand] MP price is same as Sainsbury’s, this must just be a typo, as I have confirmed the price with the [another retailer] NAM.'

6.1149 It can be seen from the above that references by Gallaher to the retail prices of other Retailers provided an assurance to Sainsbury that retail price changes put to Sainsbury by Gallaher would not cause Sainsbury to be out of step with its retail competitors.

6.1150 In addition to the documents quoted above, other documents contain evidence of contacts of the same or similar nature between Gallaher and Sainsbury regarding the retail prices being charged by Sainsbury’s competitors which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 38, 41, 45, 46, 56974 of Annex 8 (which are listed in Annex C) and the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer], document 2 of Annex 2.

974 This document shows Sainsbury complaining about the difference in prices charged by its competitors compared to the prices quoted in price instructions sent by Gallaher to Sainsbury.
Conclusion on the contacts between Gallaher and Sainsbury

6.1151 In conclusion in relation to all the contacts between Gallaher and Sainsbury regarding retail prices, the above paragraphs demonstrate that there were regular contacts between Gallaher and Sainsbury, which related to the retail prices of Sainsbury as well as other Retailers. The evidence of such contacts, together with the context of Gallaher’s strategy, demonstrates that Gallaher’s retail pricing strategy was for Sainsbury to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. The contacts between Gallaher and Sainsbury assisted the implementation of that strategy, through communications between Gallaher and Sainsbury in relation to Sainsbury’s retail prices for Gallaher’s brands and in some cases also Gallaher’s competitors’ brands the aim of which was to ensure that Gallaher’s desired parities and differential requirements were maintained or realigned. The contacts between Gallaher and Sainsbury also demonstrate that Sainsbury accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher to Sainsbury in that connection.

6.1152 The OFT does not exclude the possibility that there may have been some instances where Sainsbury did not implement, did not implement fully\textsuperscript{975} or delayed the implementation of instructions and/or requests in Gallaher’s pricing communications. However, the OFT considers that does not negate the existence of the Infringing Agreement between Gallaher and Sainsbury, as there is sufficient evidence over a period of time of Sainsbury’s compliance, or intention to comply, with Gallaher’s retail pricing strategy (see for example the sections entitled ‘Trading agreements between Gallaher and Sainsbury’s and ‘Contacts between Gallaher and Sainsbury regarding retail prices’ above).

\textit{iv} Bonuses

6.1153 As noted above, Sainsbury understood that pursuant to its trading arrangements with Gallaher, Sainsbury would set its retail prices in accordance with the parity and differential requirements set by Gallaher, and that Sainsbury was rewarded with the payment of a bonus for compliance with Gallaher’s parity and differential requirements.

\textsuperscript{975} For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
6.1154 There are documents relating to the provision of tactical bonuses from Gallaher to Sainsbury, examples of which are set out in the section entitled 'Contacts between Gallaher and Sainsbury regarding retail prices' above.

6.1155 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Sainsbury. In particular, the bonuses ensured that Sainsbury’s margin was not significantly affected by the changes in retail prices requested by Gallaher to achieve Gallaher’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Sainsbury’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.1156 In addition, the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] observed how tactical bonuses were typically introduced and operated in practice:976

‘Generally, a tactical bonus would be in place for a period of time, which was not usually defined at the beginning. We put the bonus in place and they would then say at some point in the future ‘right, we want to end the bonus on that date, when can you move the shelf price’, and you would have to agree with them when you were moving the shelf price so they knew when to amend the bonus on their system. Usually they gave us about a week’s notice.’

6.1157 The Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] also confirmed how the levels of bonuses affected shelf prices and that Gallaher (as well as ITL) achieved retail price parities and differentials through the payment of such bonuses:977

‘Typically I had a weekly price meeting with my boss on a Thursday at which we would agree any price changes to be effective from the following Tuesday or Wednesday.’

‘Imperial, Gallaher and [another manufacturer] all knew I had this weekly meeting. If any of them wanted to amend, withdraw or offer a bonus on a particular brand of cigarettes, then the variations had to be given to my assistant by the Wednesday before my meeting.’

976 Document 2, Annex 2 (paragraph 41(b)(iii)). The OFT notes that in the subsequent paragraph of her witness statement, Fiona Bayley [Sainsbury Tobacco Buyer] suggests that, although she did not recall it happening, if the tobacco company no longer wanted to pay a bonus, the supermarket could keep the price down if it funded the reduction itself. Similar arguments were made by ITL in ITL’s Response to the SO. The OFT has dealt with these arguments at paragraphs 6.136 and 6.145 above.

'The level of the bonuses had a direct impact on the shelf prices of the brands and was one way the tobacco companies maintained the price differential between its brands and those of its competitors.'

6.1158 Furthermore, the Witness Statement of Fiona Bayley [Sainsbury Tobacco Buyer] confirmed that Sainsbury were well aware that similar bonuses were being offered to their competitors and that to decline the offer of a bonus risked adverse effects upon sales or margins:978

'Generally, I was confident that if a manufacturer changed the tactical bonus, my retail competitors were going to react in the same way as me.'

'In practice, the prices were usually the same between retailers within a few days.'

'If a manufacturer offered us a bonus to go down, we would do so because not doing so could lead to an adverse result...' Accordingly, if I was offered a tactical bonus, I tended to take it – I cannot recall not doing so.'

6.1159 The evidence demonstrates that Gallaher paid bonuses to Sainsbury in order to ensure that Gallaher's retail pricing strategy was maintained. Sainsbury accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

v Monitoring of retail prices by Gallaher

6.1160 The documents set out below demonstrate that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy).

6.1161 In addition, there are a number of examples of correspondence from Gallaher to Sainsbury which contained pricing/margin spreadsheets.979 These spreadsheets contain a number of columns including previous and current retail shelf prices, and a 'Comments' column which provided details of price promotions, tactical bonuses, actual price points and 'price hold' information.

979 See Documents 32, 33, 42, 43, 44, 47, 48, 52, 54, 55, and 57, Annex 8.
6.1162 In an email dated 17 June 2002 from Gallaher to Sainsbury, Gallaher explained the purpose of the pricing/margin spreadsheets as follows:980

'As discussed last week, please find attached a spreadsheet that I use to monitor any price promotions/tactical bonus that we agree. Each time that we change a price or run a promotion I usually supply Fiona [of Sainsbury] with a copy, I will continue to do so with Tim [of Sainsbury] when he takes over.'

6.1163 The OFT therefore infers that these spreadsheets were used to assist Gallaher’s monitoring of Sainsbury’s retail prices (as well as communicate Gallaher’s general pricing strategy).

6.1164 It is clear from Fiona Bayley’s witness statement that Sainsbury was aware that Gallaher monitored Sainsbury’s prices981:

'Gallaher used to send me a price list, compiled from their reps’ visits… I do not think Imperial or [another manufacturer] supplied us with a similar list – we only needed one as it covered all brands.'

6.1165 Such exchanges also included Gallaher giving information about a competing Retailer’s pricing. For example, in an email dated 26 September 2002 from Sainsbury to Gallaher, the Category Buyer for Sainsbury stated:982

‘… I’ve just received through the post your weekly recorded prices survey. I’m not sure if you send it out or it comes through Coral [of Gallaher], but there are 35 lines on there that [another retailer] is showing cheaper than us …’

6.1166 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by Gallaher of Sainsbury’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 32, 42, 44, 50, 53 of Annex 8 (which are listed in Annex C).

6.1167 These documents demonstrate that Gallaher would monitor Sainsbury’s retail prices of both ITL’s and Gallaher’s brands, to ensure that parity and differential requirements were maintained.

981 Document 2, Annex 2 (paragraph 82(a)).
vi Conclusion on the agreement and/or concerted practice between Gallaher and Sainsbury

6.1168 The evidence described above demonstrates the existence of the Infringing Agreement between Gallaher and Sainsbury, which had the object of restricting competition, in the manner set out in Section 6.A.1: 'The anti-competitive object of the Infringing Agreements' and, given that the remaining constituent elements of the statutory test are also met (see Section 7: 'Legal assessment'), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.1169 In addition to the above, the existence of the Infringing Agreement between Gallaher and Sainsbury is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise proved by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher’s approach towards the Retailers as a collective; and between
- ITL and Sainsbury (see above), which is part of the context of the Infringing Agreement between Gallaher and Sainsbury.

6.1170 The existence of the further supporting evidence described above (and in particular the relationship between ITL and Sainsbury), lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and Sainsbury which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.

(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.1171 As is noted in the sections above relating to the existence of the Infringing Agreements between each of ITL/Sainsbury and Gallaher/Sainsbury, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.1172 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Sainsbury
and that each Manufacturer must have been aware of the other Manufacturer's parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d) above).
VII Agreement and/or concerted practice between ITL and Shell and between Gallaher and Shell

Summary

6.1173 As set out in Section 6.C.VII.(a) below, ITL and Shell\textsuperscript{983} were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 ('the Infringing Agreement') whereby ITL co-ordinated with Shell the setting of Shell’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' and amounted to a breach of the Chapter I Prohibition.

6.1174 As set out in Section 6.C.VII.(b) below, Gallaher and Shell were party to an agreement and/or concerted practice from 20 August 2001 to 15 August 2003 ('the Infringing Agreement') whereby Gallaher co-ordinated with Shell the setting of Shell’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' and amounted to a breach of the Chapter I Prohibition.

6.1175 Each of the Infringing Agreements between ITL/Shell and Gallaher/Shell amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Shell and that each Manufacturer must have been aware\textsuperscript{984} of the other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of the Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and

\textsuperscript{983} Factual background information about the ownership and operation of Shell’s petrol forecourts is set out in Section 7.B.II: 'Shell'.

\textsuperscript{984} See also Section 6.A.I.(b) above in relation to the Manufacturers’ awareness of each other’s parallel and symmetrical parity and differential requirements.
increased the inherently restrictive nature of each Infringing Agreement, as set out in Section 6.A.I.(d) above.

6.1176 Reference is made to paragraph 2.54 above and 7.17 to 7.28 below in relation to the ownership and operation of Shell petrol forecourts during the infringement period.

6.1177 On 11 July 2008, Gallaher concluded an early resolution agreement with the OFT, pursuant to which Gallaher admitted its involvement in each Infringing Agreement to which it was party, in breach of the Chapter I Prohibition.

(a) Agreement and/or concerted practice between ITL and Shell

6.1178 When considered together with the evidence of ITL's overall strategy for retail prices described in Section 6.B: 'Manufacturers' retail pricing strategies' above, the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between ITL and Shell, whereby ITL co-ordinated with Shell the setting of Shell’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL's retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' above, the Infringing Agreement between ITL and Shell restricted the ability of Shell to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1179 The following elements evidence the Infringing Agreement between ITL and Shell.985

i ITL's strategy in relation to Shell's retail prices

6.1180 The trading agreements and contacts set out between ITL and Shell below should be considered in the context of ITL’s retail pricing strategy as set out in Section 6.B: 'Manufacturers' retail pricing strategies' above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

6.1181 In addition, the following internal ITL documents demonstrate that ITL’s objective was that Shell should set the retail price for ITL's brands and/or

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985 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
for ITL's competitors' brands in accordance with ITL's retail pricing strategy and that such strategy was communicated to Shell.

6.1182 The ITL 'National Accounts Business Development Plan' dated March 2001 stated:\footnote{986}

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

6.1183 The ITL 'National Accounts Business Development Plan' dated 7 January 2002 (updated April 2002), stated:\footnote{987}

'Shell recommends a pricing policy to all Select sites. The price file consists of a Shell Recommended Price and a Maximum price for each product. A copy of the price file is provided to ITL. In the main differentials between manufacturers comparable brands are maintained, however since the change over of Category Managers some shoulder brands such as Superkings Lights [ITL brand] are showing incorrect differentials.'

Under the heading 'Objectives' it stated:\footnote{988}

'Bring Shell recommended prices in line with ITL required differentials.'

Under the heading 'Strategy' it stated:\footnote{989}

'Devise and propose a Shell price file that automatically changes the Shell recommended and maximum prices once each manufacturer RRP has been altered. This will ensure that ITL target differentials are maintained in the Shell price file across all manufacturer brands.'

6.1184 The ITL 2002 'National Accounts Business Development Plan' also had a section headed 'Imperial Tobacco Ltd Merchandising Report (08-Jan-02)' which listed the brands that Shell stocked (including those of ITL and Gallaher). Information was recorded against the brands including 'Differential Errors' where ITL recorded differential errors for ITL and Gallaher brands.\footnote{990}

6.1185 Evidence that the earlier incorrect 'differentials' mentioned in the January 2002 'National Accounts Business Development Plan' above were resolved to ITL's satisfaction is contained in the 'National Accounts Business Development Plan' dated February 2003, as is the fact that ITL

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988 Document 44, Annex 19 (page 4, no.6).
989 Document 44, Annex 19 (page 4, no.5).
990 Document 44, Annex 19 (page 8).
was clearly aware of Gallaher’s active involvement in seeking to maintain differentials.\textsuperscript{991}

'Shell recommends a pricing policy to all Select sites. The price file consists of a Shell Recommended Price and a Maximum price for each product. A copy of the price file is provided to ITL. Under the previous Category Manager the price file was in a state of disrepair with many differentials out of line. Under the new Category Manager and the aid of both Gallaher and ITL this has been resolved and in the main differentials between manufacturers comparable brands are now maintained.'

In addition to the documents quoted above, a number of other documents contain evidence of the same or a similar nature in relation to ITL’s strategy for Shell’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 5 to \textsuperscript{7}, 8, 11, 12, 15, 16, 20, 21, 23, 25, 26 and 32 of Annex 19 (which are listed in Annex C).

\textit{ii} Trading agreements between ITL and Shell

6.1186 There were trading agreements between ITL and Shell entered into, in or around July 2001 (‘TA1’) and August 2002 (‘TA2’). Those agreements were a relevant aspect of the ongoing commercial dealing between ITL and Shell and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and Shell in relation to retail prices.

6.1187 The first trading agreement (‘TA1’)\textsuperscript{993} was in relation to the period 1 January 2001 to 31 December 2001. The second trading agreement (‘TA2’)\textsuperscript{994} was for the period 1 January 2002 to 31 December 2002.\textsuperscript{995}

\textsuperscript{991} Document 57, Annex 19 (page 4).

\textsuperscript{992} Although all the National Accounts Briefs contain the text ‘see over for prices or details’, ITL was unable to provide the OFT (in response to the relevant Section 26 notice) the relevant price details that were attached. However, Documents 15, 23, 25 and 26 of Annex 19 (all National Accounts Briefs) did have appended to them such details. The OFT is of the view that each National Account Brief would have had appended to it a document in similar terms. The OFT is of the view that ‘OM’ stands for ‘Other Manufacturers’ brands.

\textsuperscript{993} Documents 27, Annex 19. The date inference is drawn from text in italics at the end of the second page. Document 27, Annex 19 was provided to the OFT by Shell in response to the Section 26 notice dated 15 August 2003. Since the document was created by ITL and sent to Shell this, combined with Document 43 (quoted at paragraph 6.1192 below), confirmed that Document 27 set out the terms of supply agreed by Shell and ITL for the period 1 January 2001 to 31 December 2001.
6.1188 Under the terms of TA1 and TA2, ITL and Shell agreed the following:\footnote{996}{Document 27 and Document 40, Annex 19 (Clauses 1 and 2, page 1).}

   ‘In return for Shell UK setting the selling out prices at Company owned sites reflecting ITL products no worse than the relative rrp compared to other manufacturers similar products an annual payment of [C] will be made. A detailed list is these requirements is as attached’

   ‘Price files must be provided to ITL and any errors corrected within 2 weeks of notification to head office. ITL must be given the opportunity to respond to other manufacturers price offers, but may choose not to respond.’

In addition TA1 stated:\footnote{997}{Document 27, Annex 19 (Clause 3, page 1). This provision does not appear in TA2.}

   ‘At least 95% + of company owned sites must follow the ‘official’ Select price policy guidelines’.

6.1189 TA1 contained a page headed ‘Price Requirements’ where the parity and differential requirements between ITL and Gallaher’s competing linked brands were set out:\footnote{998}{Document 27, Annex 19 (page 2). The OFT considers that a similar list of price requirements was agreed and attached to TA2 as per its terms as attached to TA1.}

   **PRICE REQUIREMENTS**

   *Embassy Number 1; Embassy Mild* [ITL brand]:
   
   20s packings at least 3p less than the price of Benson & Hedges
   King Size 20s [Gallaher brand]

   *Regal King Size* [ITL brand]:
   
   20s packings at least 5p less than the price of Benson & Hedges
   King Size 20s [Gallaher brand]

   *Embassy Filter* [ITL brand]:
   
   20s packings at least 6p less than the price of Benson & Hedges
   King Size 20s [Gallaher brand]

   *Superkings; Superkings Lights; Superkings Methol; Superkings Ultra* [ITL brand]:
   
   20s packings at least no more than the price of Berkeley
   Superkings/Lights/Methol 20s [Gallaher brand]
John Player Special; John Player Special Lights [ITL brand]:
20s packings no more than 9p above Sovereign King Size 20s
20s packings no more than 16p above the price of Mayfair King
Size 20s [Gallaher brands] …

... 

Details correct as at July 2001. ITL can alter the above requirements if the relative RRP’s of ITL products compared with Gallaher brand changes. All store tiers to follow the same requirements.’

6.1190 Although the parity and differential requirements contained in TA1 and TA2 purportedly provided that Shell was to maintain maximum differential requirements between competing linked brands, the OFT infers from the following evidence that such provisions were in fact implemented as parity or fixed differential requirements, rather than maximum differential requirements: (i) evidence of ITL’s retail pricing strategy; (ii) evidence regarding the way in which the trading relationship between ITL and Shell operated in practice (that is, evidence of the contacts between the Manufacturer and the Retailer); and (iii) the existence of an Infringing Agreement between Gallaher and Shell pursuant to which Gallaher communicated parallel and symmetrical parity and differential requirements to Shell (see further Section 6.C.VII.(b) below). The restrictive nature of both parity or fixed differential requirements and maximum differential requirements is described above at Section 6.A.I.(d).

6.1191 Under the terms of TA1 and TA2, ITL and Shell agreed that ITL would pay Shell a retrospective annual bonus for compliance:999

‘Subject to the correct policy being followed full payment will be due after the 31 December 2001’1000

6.1192 In an e-mail dated 13 February 2002, ITL requested that Shell:1001

‘… raise an invoice for the ITL/Shell UK Business Plan Investment for 01/01/01 to 31/12/01. The invoice should be £[C] for Pricing … this should make us square for 2001’

6.1193 Similarly, in an e-mail dated 8 January 2003, ITL requested that Shell:1002

‘please raise an invoice … for the 2002 Business Plan Investment. That is £[C] for Pricing …’

1000 31 December 2002 for TA2.
6.1194 The requested figure of '￡[C] for Pricing' in both invoices accords with the provisions of TA1 and TA2 in respect of the years 1 January 2001 to 31 December 2001 and 1 January 2002 to 31 December 2002 respectively. The timing of the requests to raise invoices (February 2002 and January 2003) is also consistent with the requirement that ITL pay those sums to Shell to cover the periods in question.

6.1195 Further written agreements were also entered into between ITL and Shell dated 15 August 2000 and 24 January 2001.

6.1196 Under the terms of both agreements, ITL and Shell agreed that, in return for ITL supplying and storing pre-bought stock in advance of the 21 August 2000 and 29 January 2001 MPIs respectively, Shell would, among other matters:

- Maintain the 'current differentials against other manufacturers products' [emphasis as in source document] (both 15 August 2000 and 24 January 2001 agreements), and
- Implement certain new price differentials against other manufacturers' products (15 August 2000 agreement only).

6.1197 In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which Shell would set its retail prices in accordance with the parity and differential requirements set by ITL, and that Shell was rewarded with the payment of a bonus for compliance with ITL’s parity and differential requirements.

iii Contacts between ITL and Shell regarding retail prices

6.1198 A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and Shell regarding: (i) Shell’s retail prices for ITL’s brands; and (ii) Shell’s retail prices for ITL’s competitors’ brands.

6.1199 The documents evidencing the contacts between ITL and Shell demonstrate that: (i) in relation to Shell’s retail prices for ITL’s brands

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1003 Documents 13 and 14, Annex 19. In Document 14 (a letter from Shell to ITL dated 15 August 2000), Shell confirmed to ITL that ‘The Shell selling out prices, will continue to reflect the differences in RRP’s, i.e. differentials will be maintained ...’.
1004 Document 28, Annex 19. The OFT refers to a circled handwritten note on this document which stated ‘verbal yes from AC 24/1/01 8.44am’ as evidence that Shell agreed to terms of the pre-buy as set out in the document. The OFT considers that the initials 'AC' refer to Alex Conrad, Category Manager at Shell.
1005 Document 13, Annex 19 (Clause 2, Page 1); Document 28, Annex 19 (Clause 2, Page 1).
1006 Document 13, Annex 19 (Clause 2, Page 1).
(sometimes by reference to Shell's retail prices for ITL's competitors' brands); and (ii) in relation to Shell's retail prices for ITL's competitors' brands:

- ITL communicated\textsuperscript{1007} to Shell what Shell's retail prices should be; and/or
- ITL asked and/or incentivised Shell to hold or alter Shell's retail prices; and/or
- Shell informed ITL about, or discussed with ITL, Shell's current or proposed retail prices.

6.1200 Shell accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1201 The contacts between ITL and Shell took place in the context of ITL's retail pricing strategy for Retailers to maintain specified parities and differentials between ITL's brands and competing linked brands. Communications in relation to retail prices were sent by ITL, and were received and implemented by Shell\textsuperscript{1008} on the understanding that the notified retail prices took into account ITL's retail pricing strategy, together with Shell’s desired pricing position relative to other Retailers and Shell's desired margin.

6.1202 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1203 Various examples of contacts between ITL and Shell regarding retail prices are set out below.

\textit{Contact between ITL and Shell regarding Shell's retail prices for ITL's brands}

6.1204 Set out below are examples of contact between ITL and Shell in relation to Shell’s retail prices for ITL's brands, which demonstrate that in relation to Shell’s retail prices for ITL's brands (sometimes by reference to the retail prices of competing linked brands):

- ITL communicated to Shell what Shell’s retail prices should be; and/or

\textsuperscript{1007} See paragraphs 6.108 and 6.109 above in relation to the nature of such 'communications'.

\textsuperscript{1008} See paragraphs 6.1227 to 6.1228 in relation to implementation.
• ITL asked and/or incentivised Shell to hold or alter Shell’s retail prices; and/or
• Shell informed ITL about, or discussed with ITL, Shell’s current or proposed retail prices.

6.1205 Shell accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1206 The examples of such contacts are as follows.

6.1207 In a fax dated 11 June 2000 from ITL to Shell under the heading 'Budget – March 2000', ITL confirmed that Shell had agreed to correct a pricing error to restore parity with the Gallaher competing linked brand:1009

'I highlighted a price error in your post budget prices, which you said would be corrected in sites by 1st June. Classic cigars [ITL brand] should now be sold at £2.88, the same as Hamlet 5s [Gallaher brand].'

6.1208 Subsequently, ITL’s National Accounts Briefs under the heading 'Price and Availability Survey' dated 3 July 20001010 and 31 July 20001011 both stated:

'Hamlet 5’s [Gallaher brand] and Classic 5’s [ITL brand] pricing has now been resolved and should now be the same.'

6.1209 In a fax dated 22 September 2000 from ITL to Shell entitled 'Outstanding Payments' ITL requested an invoice in relation to 'Retail Price Differential Policy':1012

'Will you please send … invoices as follows:

1/7/99 – 30/6/00 Retail Price Differential Policy £[C] + vat

…'

6.1210 The OFT infers that this was payment for Shell’s compliance with ITL’s price parity and differential requirements.

6.1211 A fax dated 3 September 2001 from ITL to Shell under the heading 'Price File' stated:1013

'As agreed at the meeting can you please send the new post MPI price file by e-mail once all manufacturers changes have been amended.'

1009 Document 9, Annex 19.
1012 Document 18, Annex 19.
And under the heading ‘Richmond King Size’ [ITL brand]:

'It was agreed at the meeting that Richmond King Size [ITL brand] would move from £3.64 and £3.65 to their natural prices of £3.70 and £3.71 either on the 26th September or the 4th October (tbc). It was mentioned that the natural price may move to a greater minimum and maximum differential, if this is the case can you please ensure that the differentials reflect those of Dorchester [Gallaher brand] and are no more expensive than Dorchester [Gallaher brand] in these tiers.

Can you please confirm the 26th September or 4th October for the price change and the prices Richmond KS [ITL brand] will move to. The Imperial Tobacco price support will cease on the date on which the brands are moved to their natural prices.'

6.1212 In an e-mail dated 14 May 2002, ITL provided a response to a request from Shell to check for any errors in its price file:1014

‘As per telecon conversation on Friday I have looked at differential errors only. I have done this across all companies. Rather than bullet point I have highlighted the errors on the price file itself, all those in red are the ones I have changed.’ [Emphasis added]

Shell's response on 16 May 2002, confirmed that it had accepted the changes made by ITL to the retail prices in its price file:1015

'Just to let you know, we have made the necessary changes to the Shell UK price file which will be effective 23/5.'

6.1213 An e-mail dated 9 July 2002 from ITL to Shell followed an earlier telephone discussion regarding Shell’s price file:1016

‘As per our telephone conversation this morning I agree with Wes’s [of Gallaher] recommendations for the price file

The Shell RRP price tier ranges from +10p to +19p over and above the Manufacturers RRPs, the Maximum Shell price tier ranges from +13p to +24p over and above the Manufacturers RRPs.

I have taken the liberty to take your current price file and highlight on there the current differences between the Shell prices and the Manufacturers RRPs (highlighted in red).

On the second spreadsheet I have set a strategy of plus +14p on the Shell RRP tier and +20p on the Shell Maximum tier. I have done this across all lines. By having a clear policy across all brands

1016 Document 50, Annex 19. The OFT understands that ITL was referring to Wes Feeney of Gallaher.
6.1214 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Shell regarding Shell’s retail prices for ITL’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 1 to 4, 13, 17, 19, 29, 31, 32, 34, 35, 36, 39, 41, 42, 48, 49, 52 to 54 and 58 to 61 of Annex 19 (which are listed in Annex C).

Contact between ITL and Shell regarding Shell’s retail prices for ITL’s competitors’ brands

6.1215 In addition to the documents above, which concern contact between ITL and Shell regarding Shell’s retail prices for ITL’s brands, there were contacts between ITL and Shell in relation to Shell’s retail prices for ITL’s competitors’ brands. Set out below are examples of such contacts which demonstrate that in relation to Shell’s retail prices for ITL’s competitors’ brands:

- ITL communicated to Shell what Shell’s retail prices should be; and/or
- Shell informed ITL about, or discussed with ITL, Shell’s current or proposed retail prices.

6.1216 Shell accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1217 The examples of such contacts are as follows.

6.1218 In a letter dated 4 October 2001 from ITL to Shell following an earlier meeting, ITL corrected errors on Shell’s price file for ITL’s competitors’ brands:

'I pointed out that the price file received by e-mail the previous week contained what appear to be errors along all manufacturers prices. I left a revised copy of what I believe the prices were intended to be.'

The letter attached a revised copy of the 'Price Requirements' as at October 2001. The OFT infers that the hand written comment ‘Action’ demonstrates that Shell agreed to correct the price file errors.

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1017 Document 35 and 36, Annex 19 are copies of the same letter that have each been annotated by hand by ITL and Shell (one version was provided to the OFT by ITL and the other by Shell).
6.1219 In an e-mail dated 13 December 2001 from ITL to Shell, ITL provided Shell with pricing corrections for other tobacco manufacturers' brands:1019

'Looking through the price list there seem to be a number of errors. I have gone through all the manufacturers and changed all the prices I think maybe incorrect.'

6.1220 In doing so, ITL referred to changes made to an attached copy of Shell’s retail price list which in addition to ITL’s brands included a comprehensive list of Gallaher’s brands.

6.1221 On 13 December 2001, Shell sent an e-mail to a number of addressees including ITL and Gallaher. This e-mail forwarded the text of an internal Shell e-mail (which had also been copied to ITL and Gallaher) which stated:1020

'Would you mind forwarding the entire price list for MG 40, 41 and 42 to Breda [of ITL], Wes [of Gallaher], and... (so that they can sense check the info for range inclusions and correct price parities and differentials.)'

6.1222 The ‘price list’ entitled ‘Tobacco Price 01.12.01’ was forwarded from Shell to all of the parties later on 13 December 2001. The OFT considers that this exchange demonstrates Shell’s acceptance of ITL’s pricing policy, as Shell forwarded the price file for ITL to correct parity and differential errors.

6.1223 A letter dated 28 June 2002 from ITL to Shell headed ‘Price Increases’ set out a list of manufacturer price increase dates, including those of Gallaher. Attached to the letter were ITL’s ‘Price Requirements’ setting out the parity and differential requirements between ITL and Gallaher competing linked brands. In addition, ITL stated:1021

'It would be much appreciated if you could ensure that these differentials are maintained'.

6.1224 In an e-mail exchange dated 5, 9 and 12 August 2002, ITL sent details of a price increase and a revised price file to Shell. Shell then forwarded that to Gallaher for the latter to check that the parity and differentials were correct:1022

'Subject: FW: ITL Price Increase – September 2002'

‘Thanks for your assistance, could you please check price list diffs, and parities, and please detail any queries …’

Gallaher responded on 12 August 2002 stating:

‘The ‘Price Requirements’ (parities/differentials) are in order.’

6.1225 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Shell regarding Shell’s retail prices for ITL’s competitors’ brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 31, 33, 42 45, 46\textsuperscript{1023}, 47\textsuperscript{1024}, 49, 50, and 59 of Annex 19 (which are listed in Annex C).

Conclusion on the contacts between ITL and Shell

6.1226 In conclusion in relation to all the contacts between ITL and Shell regarding retail prices, the above paragraphs demonstrate that there were regular contacts between ITL and Shell, which related to the retail prices of Shell as well as other Retailers. The evidence of such contacts, together with the context of ITL’s strategy, demonstrates that ITL’s retail pricing strategy was for Shell to maintain specified parities and differentials between ITL’s brands and competing linked brands. The contacts between ITL and Shell assisted the implementation of that strategy, through communications from ITL in relation to Shell’s retail prices for ITL’s brands and in some cases ITL’s competitors’ brands, the aim of which was to ensure that ITL’s desired parity and differential requirements were maintained or realigned. The contacts between ITL and Shell also demonstrate that Shell accepted and/or indicated its willingness to implement the directions contained in communications from ITL to Shell in that connection.

6.1227 The OFT notes that ITL and Shell submitted that there were instances where Shell did not implement instructions and/or requests in ITL’s pricing communications.

6.1228 However, the OFT considers that, notwithstanding that there may have some instances where Shell did not implement, did not implement

\textsuperscript{1023} Described above in paragraph 6.1212. The OFT notes that this document also demonstrates ITL checking Shell’s price file and making changes to the prices of ITL’s competitors’ brands.

\textsuperscript{1024} See paragraph 6.1212. This is the response to Document 46, Annex 19, in which Shell confirmed to ITL that the price changes had been made.
fully, or delayed the implementation of instructions and/or requests in ITL’s pricing communications, that does not negate the existence of the Infringing Agreement between ITL and Shell, as there is sufficient evidence over a period of time of Shell’s compliance, or intention to comply, with ITL’s retail pricing strategy (see for example the sections entitled ‘Trading agreements between ITL and Shell’ and ‘Contacts between ITL and Shell regarding retail prices’ above).

iv Bonuses

6.1229 As set out above, ITL paid an ongoing bonus to Shell on the condition that Shell maintained ITL’s retail pricing strategy of specified parities and differentials between competing linked brands. In addition ITL requested that Shell raise invoices in relation to the periods of TA1 and TA2 for compliance with ‘Pricing’ under the ‘Business Plan Investment’.

6.1230 ITL also agreed to supply and store pre-bought stock on the condition that Shell complied with ‘differentials against other manufacturer’s products’.

6.1231 The evidence demonstrates that ITL paid bonuses to Shell in order to ensure that ITL’s retail pricing strategy was maintained. Shell accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by ITL.

v Monitoring of retail prices by ITL

6.1232 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated ‘errors’ to Shell. Shell participated in this monitoring by providing ITL with details of its proposed retail prices for ITL’s brands and/or ITL’s competitors’ brands.

6.1233 As noted above, monitoring was formalised in TA1 and TA2, whereby ITL and Shell agreed that ‘Price lists (files) must be provided (to ITL) and any errors corrected within 2 weeks of notification to head office’.

6.1234 Further examples of documents in relation to monitoring are as follows.

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1025 For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.

1026 See also Section 7.B.II: ‘Shell’ in relation to the ownership and operation of Shell’s petrol forecourts.
An internal ITL e-mail dated 1 October 2000 forwarded an e-mail from Shell of the same date with attached 'current retail prices' for ITL, Gallaher and other competitor’s brands. An ITL employee requested (of an ITL colleague): 1027

‘Will you please do the differential check spreadsheet & fax results to me’.

In a letter from ITL to Shell dated 4 October 2001, ITL stated: 1028

‘I pointed out that the price file I received by e-mail the previous week contained what appear to be errors along all manufacturers prices. I left a revised copy of what I believe the prices were intended to be. It was agreed that you would look into this and re-send the price file to me once the corrections have been made. I have attached a revised Required Differential sheet, this is to be used in conjunction with the Imperial Tobacco Business Plan.’

In an e-mail dated 13 May 2002 from Shell to ITL, Shell provided ITL with a copy of its price file for checking: 1029

‘Please find attached our latest Tobacco price file for May 2002. Could I please ask you to cast your eyes over and advise any obvious errors in bullet point format so that I can amend for this week’s download before end of business Wednesday 13/5. Your assistance is much appreciated …’

In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of Shell’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 1 to 5, 6, 9 to 12, 16, 21 to 25, 26, 32 to 34, 36 to 39, 41, 42, 44, 46, 47, 50, 52 to 54, 58 to 60 and 62 of Annex 19 (which are listed in Annex C).

These documents demonstrate that ITL would monitor Shell’s retail prices of both ITL and Gallaher brands to ensure that parity and differential requirements were maintained and would point out pricing errors to Shell.

Conclusion on the agreement and/or concerted practice between ITL and Shell

The evidence described above demonstrates the existence of the Infringing Agreement between ITL and Shell which had the object of restricting competition, in the manner set out in Section 6.A.1: ‘The anti-

competitive object of the Infringing Agreements’ and, given that the remaining constituent elements of the statutory test are also met (see Section 7: 'Legal assessment’), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.1241 In addition to the above, the existence of the Infringing Agreement between ITL and Shell is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- ITL and each of the other Retailers, which evidence ITL’s approach towards the Retailers as a collective; and between
- Gallaher and Shell (see below), which is part of the context of the Infringing Agreement between ITL and Shell.

6.1242 The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and Shell) lends further support to the fact that there was an agreement and/or concerted practice between ITL and Shell which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or concerted practice between Gallaher and Shell

6.1243 When considered together with the evidence of Gallaher’s overall strategy for retail prices described in Section 6.B: 'Manufacturers' retail pricing strategies', the evidence referred to below demonstrates that, from 20 August 2001\(^{1030}\) to 15 August 2003, an Infringing Agreement existed between Gallaher and Shell whereby Gallaher co-ordinated with Shell the setting of Shell’s retail prices for tobacco products in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements', the Infringing Agreement between Gallaher and Shell restricted the ability of Shell to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1244 The following elements evidence the Infringing Agreement between Gallaher and Shell:\(^{1031}\)

\(i\) Gallaher’s strategy in relation to Shell’s retail prices

6.1245 The trading agreements and contacts set out between Gallaher and Shell below should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: 'Manufacturers’ retail pricing strategies’, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.1246 In addition, the following documents demonstrate that Gallaher’s objective was that Shell should set the retail price for Gallaher’s brands and/or Gallaher’s competitors’ brands in accordance with Gallaher’s retail pricing strategy and that such strategy was communicated to Shell. An

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\(^{1030}\) This is the date of the earliest document relied on.

\(^{1031}\) The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
undated 'DR Briefing Document for Shell UK (Group 607)', recorded that:

'The agreement also states that normal price list parities, and differentials will be maintained.'

6.1247 In an e-mail dated 9 August 2002, Shell forwarded Gallaher an e-mail and attachment from ITL to Shell (dated 5 August 2002) headed 'ITL Price Increases - September 2002' which stated:

'please find attached the new ITL price list effective from the 2nd September.'

Shell asked Gallaher:

'Could you please check the proposed price points and provide any feedback.'

To this Gallaher responded to Shell on 12 August 2002, stating:

'The 'Price Requirements' (parities/differentials) are in order.'

6.1248 An e-mail dated 18 March 2003 from Gallaher to Shell requested:

'As just discussed, would it be possible to circulate a reminder to all stores that B&H Silver [Gallaher brand] should be the same price as L&BKS [ITL brand]. This is the second outlet in a week.'

Trading agreement between Gallaher and Shell

6.1249 Gallaher and Shell entered into a trading agreement on 28 November 2001 in relation to the period of 1 January 2002 to 31 December 2003. The agreement was a relevant aspect of the ongoing commercial dealing between Gallaher and Shell and formalised the basis for certain aspects of the trading relationship between them. The trading agreement is assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between Gallaher and Shell in relation to retail prices.

6.1250 In the trading agreement, Gallaher and Shell agreed, among other matters, that:

1032 The OFT notes that although the document is undated, it was provided in response to a section 26 notice dated 15 August 2003, which requested documents from 1 March 2000 to the date of the notice.
1033 Document 56, Annex 9. Although headed with the Shell logo, Document 56 was provided to the OFT by Gallaher.
'1. **PRICING**

a) Account agrees to maintain the price differentials/price parities between Gallaher’s brands and their respective competitive brands as set out in Appendix 1, at all times. Gallaher reserves the right to amend Appendix 1 from time to time after consultation with Account. \(^{1037}\); and

b) Where Account is involved in the promotion of a brand by a competitor of Gallaher, Gallaher shall be offered the opportunity to conduct similar promitional activity on a brand to be selected by mutual agreement with Account as soon as reasonably requested by Gallaher following that competitor’s promotion.

6.1251 In consideration for compliance with the ‘Pricing’ requirements the trading agreement stated: \(^{1038}\)

‘4. **PAYMENT**

a) In return for compliance with the provisions in paragraph 1 above Gallaher shall pay Account retrospective discount of:

[C]pence per outer of all Gallaher cigarettes sold by Account during the term of this Trading Agreement, based on sales statistics received from Palmer & Harvey’.

6.1252 In addition, the trading agreement set out how the monitoring of compliance with the provisions of the trading agreement was to be achieved, along with the sanctions for non-compliance. The trading agreement provided, among other matters, that:

‘4 d) The said payments shall be made every 16 weeks in arrears and shall at all times be subject to adjustment as described below in the event of non compliance with any of the terms of this Trading Agreement.

5. **GENERAL CONDITIONS**

a) If any store within the Account store group does not comply with any term or terms of this Trading Agreement Gallaher reserves the right to reduce the relevant payment referred to in paragraph 4 above by an amount which it considers appropriate in the circumstances to compensate it for the non-compliance. In such a circumstance Gallaher will notify Account of the reduction to be made and the reason for such reduction.

\(^{1037}\) Paragraph 1a of the trading agreement was removed by Gallaher and was notified to Shell in a letter from Gallaher to Shell dated 15 October 2003 (Document 54, Annex 9).

\(^{1038}\) The OFT notes that, although paragraph 1a was removed by Gallaher, the corresponding obligation on the part of Gallaher, as set out in paragraph 4a of the trading agreement, was not removed.
b) Performance and compliance with the terms of this Trading Agreement will be judged by Gallaher from a selection of store visits conducted by Gallaher personnel or contracted sales representatives from time to time and which visits shall be designed to monitor results.

c) If after such store visit(s) it is apparent that Account is not complying with the terms of this Trading Agreement Gallaher will advise Account of this fact and provided remedial action is taken immediately via outlet or head office, no reduction in the relevant payment shall be made by Gallaher.

d) Account to supply Gallaher with EPOS data for the tobacco sector each month to enable Gallaher to substantiate Account’s sales of product and so determine the level of payments referred to in this Trading Agreement. Gallaher to review EPOS data, and provide Account every [C]months with a full tobacco category analysis, with recommendations for changes and opportunities to exploit the profitability of the sector.

6.1253 Appendix 1 to the trading agreement set out the required parities and differentials that had to be maintained:

**APPENDIX 1**

**Gallaher vs Competitors**

**Price Parities/Differentials**

**CIGARETTES**

**Parities**

Berkeley Superkings House [Gallaher brand] vs John Player Superkings House [ITL brand] …

Dorchester King Size House [Gallaher brand] vs Richmond King Size House [ITL brand]

**Differentials**

Benson & Hedges King Size, Silk Cut King Size and Camel Houses [Gallaher brands] vs Embassy No1 [ITL brand] …

**CIGARS**

**Parities**

Hamlet [Gallaher brand] vs Classic [ITL brand]

Hamlet Miniatures [Gallaher brand] vs Café Crème [ITL brand]

**Differentials**

Hamlet Aromatic & Hamlet Miniature Filters [Gallaher brand] vs Café Crème [ITL brand]

**TOBACCO (HRT)**

**Differentials**

Old Holborn [Gallaher brand] vs Golden Virginia [ITL brand]

1039 Document 9, Annex 9 (page 8).
Amber Leaf [Gallaher brand] vs [another manufacturer's brand]
Samson [Gallaher brand] vs Drum [ITL brand]
Mayfair HRT [Gallaher brand] vs [another manufacturer's brand]

6.1254 An e-mail dated 6 November 2001 from Gallaher to Shell (which attached the unsigned final draft trading agreement) demonstrates that the contents of the trading agreement were previously discussed and agreed by the parties:

‘...please find attached the trading agreement incorporating all the changes discussed and agreed during our last two meetings.’

6.1255 The OFT also notes that a letter dated 20 August 2001 from Gallaher to Shell referred to a recent meeting at which it was agreed that Gallaher would pay Shell for implementing price list differentials for cigarettes:

'Trading Agreement

...

1. Price list differentials were agreed at [C] pence per outer of cigarettes'.

6.1256 In conclusion, the evidence demonstrates that there was a formal agreement, pursuant to which Shell would set its retail prices in accordance with the parity and differential requirements set by Gallaher and that Shell was rewarded with the payment of a bonus for compliance with Gallaher’s parity and differential requirements.

iii Contacts between Gallaher and Shell regarding retail prices

6.1257 A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and Shell regarding (i) Shell’s retail prices for Gallaher’s brands; (ii) Shell’s retail prices for Gallaher’s competitors’ brands; and (iii) the retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

6.1258 The documents evidencing the contacts between Gallaher and Shell demonstrate that: (i) in relation to Shell’s retail prices for Gallaher’s brands (sometimes by reference to Shell’s retail prices for Gallaher’s competitors’ brands); and/or (ii) in relation to Shell’s retail prices for Gallaher’s competitors’ brands:

- Gallaher communicated to Shell what Shell’s retail prices should be; and/or

• Gallaher asked and/or incentivised Shell to hold or alter Shell's retail prices; and/or

• Shell informed Gallaher about, or discussed with Gallaher, Shell’s current or proposed retail prices.

6.1259 Shell accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1260 In addition, Gallaher and Shell informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

6.1261 The contacts between Gallaher and Shell took place in the context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent by Gallaher and received and implemented by Shell1043 on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together with Shell’s desired pricing position relative to other Retailers and Shell’s desired margin.

6.1262 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1263 Various examples of contacts between Gallaher and Shell regarding retail prices are set out below.

Contact between Gallaher and Shell regarding Shell’s retail prices for Gallaher’s brands

6.1264 Set out below are examples of contact between Gallaher and Shell in relation to Shell’s retail prices for Gallaher’s brands, which demonstrate that in relation to Shell’s retail prices for Gallaher’s brands (sometimes by reference to the retail prices of competing linked brands):

• Gallaher communicated to Shell what Shell’s retail prices should be; and/or

• Gallaher asked and/or incentivised Shell to hold or alter Shell’s retail prices; and/or

1042 See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.

1043 See paragraph 6.1300 to 6.1301 in relation to implementation.
• Shell informed Gallaher about, or discussed with Gallaher, Shell’s current or proposed retail prices.

6.1265 Shell accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1266 The examples of such contacts are as follows.

6.1267 An e-mail dated 1 October 2001 from Gallaher to Shell regarding prices included Gallaher’s comments on Shell's prices:1044

‘Please find attached my comments re: your current prices, you will note that there are several discrepancies versus Price List differentials, and as this area is part of the proposed trading agreement, I would ask that these can be remedied as soon as possible’.

The attachments indicated the following:

‘Maximum prices should reflect the price list parities & differentials’

‘Sovereign 20s [Gallaher brand] – There should be a 10p differential between L&BKS [ITL brand] and Sovereign [Gallaher brand]...’

‘Dorchester [Gallaher brand] should be the same price as Richmond [ITL brand]...’

The OFT considers that the annotations on this document were made by Shell and that they demonstrate Shell’s agreement to comply, or at least intention to comply, with Gallaher’s communications. For example, one annotation stated:

‘Put Dorchester [Gallaher brand] down to £3.69
And Richmond [ITL brand] up to £3.69’.

6.1268 An e-mail dated 21 November 2001 from Gallaher to Shell attached a list of Gallaher’s parity and differential requirements:1045

‘APPENDIX 1
Gallaher vs Competitors
Price Parities/Differentials

CIGARETTES
Parities
Berkeley Superkings House [Gallaher brand] Vs John Player
Superkings House [ITL brand] (Same Price)

1045 Document 7, Annex 9 (pages 2 and 3).
**Benson & Hedges Superkings House [Gallaher brand] Vs John Player Superkings [ITL brand] (Same Price)**

**Dorchester King Size House [Gallaher brand] Vs Richmond King Size House [ITL brand] (Same Price) same for SK ranges**

**Differentials**

Benson & Hedges King Size, Silk Cut King Size and Camel Houses [all Gallaher brands] vs Embassy No.1 [ITL brand] (Currently RRP\s £4.39 v £4.36, differential +3p. Tens packs differentials +2p) ...

6.1269 In an e-mail dated 4 January 2002 from Shell to Gallaher, Shell stated:1046

'Bernie [of Shell] will be actioning your price issues at the end of next week once we have touched base on them on Monday – we will send you the Jan price file for your records.'

The OFT infers that this is evidence that Shell had agreed to action pricing requirements from Gallaher.

6.1270 In an internal Shell e-mail dated 13 December 2001, copied to Gallaher and ITL, a Shell employee was asked:1047

'Would you mind forwarding the entire price list for MG 40, 41 and 42 to Breda [of ITL], Wes [of Gallaher]... (so that they can sense check the info for range inclusions and correct price parities and differentials).'

6.1271 Following receipt of Shell's price file, in an e-mail from Gallaher to Shell, dated 20 December 2001, Gallaher provided the following response:

'Please find attached the price file you recently sent me. I have noted down the right hand side where prices still need amending as per the agreement. I would appreciate if these amendments could be made as soon as possible...I would also add that parities and differentials apply to both Rec, and max prices.'

6.1272 In an internal Shell e-mail of the same date, a Shell employee confirmed that prices would be amended to reflect Gallaher’s amendments:

'I’m happy to action the comments Wes [of Gallaher] has made.'

6.1273 In an e-mail dated 13 May 2002 from Gallaher to Shell (in response to a request from Shell that Gallaher check Shell’s price file), Gallaher communicated desired changes to Shell’s retail prices for Gallaher’s brands:1048

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1) - Club 20s should be £4.38, currently £4.33 (19p less than B&HKS & SCKS) [Gallaher brands]

2) – Dorchester SK and Dorchester SK should be £3.99, 2p more than KS [Gallaher brand]

6.1274 In an e-mail dated 10 June 2002, Shell communicated to Gallaher:1049

'Could you please review the attached recommended retail prices I have put together for the upcoming price increases and pass back your immediate thoughts.'

The attached price file included Gallaher’s and ITL’s brands.

6.1275 In an e-mail response dated 12 June 2002, Gallaher responded to Shell stating:1050

'I have had a good look, and can see what you have tried to do, however my advice would be to increase prices by MPI rates only at this stage.

All manufacturers look to achieve price list differentials between competitor brands and also their own price list. If you move one product to a price point, and not the competitor brand also because it is already at a favourable price point, then obviously parities and differentials will be affected.

As already suggested at this stage, increase only by MPI (recommendations emailed on Monday), as the current Shell prices are correct at this stage. Once all MPIs are in place I will look at the whole picture, and carefully move prices bearing in mind other brands.'


'Please find attached the above, plus a revised list of parities and differentials. Please have a look, and if Ok please sign & date and return to me'.

6.1277 An e-mail dated 14 May 2003 from Gallaher to Shell included an attached letter following a previous meeting and a schedule of parities and differentials. Details of the meeting included:1052

'4. Having checked your post budget price file we discussed that there were the odd discrepancy. Please find attached the

spreadsheet detailing what changes are required for both RSP, and Maximum price files.’

6.1278 The attached spreadsheet detailed changes with RSP, and Maximum price files for Gallaher brands, and also made reference to competing linked brands:

'B&H KS [Gallaher brand] Vs
... Regal max - should be £4.73 [ITL brand]
...

MAYFAIR KS [Gallaher brand] Vs
... Richmond Max should be £3.95 [ITL brand]’.

6.1279 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and Shell regarding Shell’s retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 2, 5, 11, 12, 13, 17, 18, 19, 20, 21, 22, 23, 26, 27, 28, 31, 32, 33, 35, 38, 40, 42, 43, 47, 48, 51 to 52, 53 and 55 of Annex 9 (which are listed in Annex C).

Contact between Gallaher and Shell regarding Shell’s retail prices for Gallaher’s competitors’ products

6.1280 In addition to the documents above, which concern contact between Gallaher and Shell regarding Shell’s prices for Gallaher’s brands, there were contacts between Gallaher and Shell in relation to Shell’s retail prices for Gallaher’s competitors’ brands. Set out below are examples of such contacts, which demonstrate that in relation to Shell’s retail prices for Gallaher’s competitors’ brands:

• Gallaher communicated to Shell what Shell’s retail prices should be; and/or

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1053 Document 49, Annex 9 (page 8).
1054 This document appears to contain details of price differentials of cigarette brands compared to competing brands. Given the fact that this page bears fax markings and was provided to the OFT by Shell, the OFT considers that this fax was sent by Gallaher to Shell.
1055 The OFT notes that this document is actually dated 6 November 2001.
1056 Given the covering email and the text of Document 19, the OFT considers that this document was created by Gallaher.
1057 This document is a follow-up to Document 51 in which Gallaher asked for confirmation of price changes.
• Shell informed Gallaher about, or discussed with Gallaher, Shell’s current or proposed retail prices.

6.1281 Shell accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1282 The examples of such contacts are as follows:

6.1283 In an e-mail dated 13 May 2002 from Gallaher to Shell (referred to in paragraph 6.1273 above) in relation to a request from Shell that Gallaher check Shell’s price file, Gallaher communicated changes to the prices for ITL’s brands:1058

‘3) – Golden Virginia 12.5g [ITL brand] should be £2.41 same as Old Holborn 12.5g [Gallaher brand]

4) – JPS KS 10s should be £2.14 same as L&BKS 10s [both ITL brands]

5) – JPS Lights 20s should be £4.08 same as JPS KS & L&BKS [ITL brands]

6) – JPSK 10s should be £2.27, same as BSK 10s [Both ITL brands]

7) – L&BKS 10s [ITL brand] should be £2.14

8) - Marlboro menthol 20s [ITL brand] should be £4.57, same as Marlboro KS.

9) - Richmond SK & Richmond SK lights [ITL brands] should be £3.99, 2p more than KS, and same as Dorch SK. [Gallaher brand] …’

6.1284 In an e-mail dated 8 July 2002 from Gallaher to Shell, Gallaher explained its reasons for making changes to Shell’s prices for ITL’s brands:1059

‘1) … the Gallaher agreement is for price list parities & differentials to be maintained.

2) I note you are proposing to increase some ITL prices even though they are not having an MPI yet, I would think their agreement also stipulates parities and differentials to be maintained, and with this in mind I have moved their prices in the attached as well as mine. Breda [of ITL] will be on the phone I would think if the above is not maintained.

3) The attached highlights the parities and diffs which apply to each brand and if you bear this in mind, and indeed use when changing prices, it would be a good guide.

4) I have made suggestions to either increase or decrease to re-instate differentials, and have also suggested premium pricing some 10s by a further ...p\textsuperscript{1060} per packet. This I believe is the easiest way to improve your margin mix, consumers generally do not know the price of 10s, and yet it is circa [C]% on all sales. We did say we would do this'.

6.1285 In the same e-mail, Gallaher referred to an attached document. The attached 'Parity Audit Record' listed the price differentials that existed between Gallaher brands and competing ITL brands in Shell outlets and stated what changes were needed to 're-instate differentials'.\textsuperscript{1061}

<table>
<thead>
<tr>
<th>'Brands [Gallaher]...</th>
<th>Brands [ITL]...</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>....</td>
<td>Lambert &amp; Butler 10</td>
<td>Mayfair by 1p – Move both up a further 4p, once parities have been restored</td>
</tr>
<tr>
<td>Mayfair 10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dorchester 10</td>
<td>Richmond 10</td>
<td>Decrease Richmond by 2p – Move both up a further 3p, once parities have been restored ...'</td>
</tr>
</tbody>
</table>

The OFT considers that the hand annotated ticks on this document were made by Shell and demonstrate Shell’s agreement to comply, or at least intention to comply, with Gallaher’s requirements.

6.1286 Shell responded to the above e-mail on 8 July 2002, stating:\textsuperscript{1062}

‘Thanks, Wes [of Gallaher]. I appreciate your time on this and your thoughts.'

\textsuperscript{1060} The number of pence per packet is not clear in the document provided to the OFT.
\textsuperscript{1061} Document 31, Annex 9.
\textsuperscript{1062} Document 32, Annex 9.
I will run through them and the margin mix tomorrow morning taking into consideration your comments re differentials and parities.'

6.1287 As noted in paragraph 6.1224 above, in an e-mail exchange dated 5, 9 and 12 August 2002, ITL sent details of a price increase and a revised price file to Shell. Shell then forwarded that to Gallaher for the latter to check that the parity and differentials were correct: 1063

'Subject: FW: ITL Price Increase – September 2002'

'Thanks for your assistance, could you please check price list diffs, and parities, and please detail any queries …'

Gallaher responded on 12 August 2002 stating:

'The ‘Price Requirements’ (parities/differentials) are in order.'

6.1288 An e-mail dated 30 June 2003 from Gallaher to Shell attached a spreadsheet headed 'Shell Prices July 2003' and stated: 1064

'Please find attached the parity and differential worksheet based on the prices you sent through late last week. You will note that there are several discrepancies particular on [another manufacturer’s brand], A/Leaf 25g, and Hamlet Aromatic [Gallaher brands].

Could you please have a look and if need be update your price file.'

The attached spreadsheet set out retail price parities and differentials applicable as between Gallaher and ITL brands. For example:

'B&H KS [Gallaher brand] vs 4.65
RRP +/-
Silk Cut [Gallaher brand] 4.65 0
Malboro Lights [ITL brand] 4.65 0
Embassy [ITL brand] 4.65 0
Regal [ITL brand] 4.63 -0.02
...
Mayfair KS [Gallaher brand] vs 3.89

6.1289 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and Shell regarding Shell’s retail prices for Gallaher’s competitors’ brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 3, 12, 13, 15 to 17, 27 to 30, 33, 38, 44, 49, 53, 55 of Annex 9 (which are listed in Annex C).

Contact between Gallaher and Shell regarding the retail prices being charged by Shell’s competitors

6.1290 In addition to the documents above, there were contacts between Gallaher and Shell in which Gallaher and Shell informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands and/or Gallaher’s competitors’ brands.

6.1291 The documents referred to under this subheading contain price surveys of Gallaher’s and other manufacturers’ products, across a number of retailers. The following are examples.

6.1292 In an e-mail dated 12 April 2002, Gallaher forwarded to Shell a 'Price Comparison Report' and commented:¹⁰⁶⁵

As discussed at our meeting on Wednesday, please find the above attached.

6.1293 The 'Comparison Report' compared Shell’s retail prices for a range of Gallaher’s brands to eight of Shell’s competitors.

6.1294 An e-mail dated 25 October 2002 from Gallaher to Shell headed 'Tobacco Pricing Survey' attached a spreadsheet which compared Shell’s retail prices over a range of Gallaher’s brands to five of Shell’s competitors.\(^\text{1066}\)

6.1295 Similarly an e-mail dated 20 March 2003 from Gallaher to Shell attached a 'Pricing Survey March 03' and Gallaher stated:\(^\text{1067}\)

‘Please find the above attached as requested. Please note I have used Shell Max prices for comparison as the majority of sites are now using these it would seem.’

The ‘Pricing Survey’ also compared Shell’s retail prices for a range of Gallaher brands to five of Shell’s competitors.

6.1296 In an e-mail dated 12 August 2003 from Shell to Gallaher, Shell requested:\(^\text{1068}\)

‘Could you please provide an up to date price comparison on the top selling SKU’s in the UK Tobacco category vs our competition as soon as possible.’

6.1297 Gallaher responded to Shell in an e-mail dated 14 August 2003 by sending a price survey of Gallaher’s (and ITL’s) brands at Shell’s competitors. Gallaher also provided Shell with details of the future pricing of Shell’s competitors:\(^\text{1069}\)

‘Note [C] [other petrol retailers] – Moving to £2.09 p/m A/Leaf [Gallaher brand] once stock of standard are exhausted.’

6.1298 The OFT infers from the above that references by Gallaher to the retail prices of other Retailers would have provided an assurance to Shell that retail prices put to Shell by Gallaher would not cause Shell to be out of step with its retail competitors.

**Conclusion on the contacts between Gallaher and Shell**

6.1299 In conclusion in relation to all the contacts between Gallaher and Shell regarding retail prices, the above paragraphs demonstrate that there were regular contacts between Gallaher and Shell, which related to the retail prices of Shell as well as other Retailers. The evidence of such contacts, together with the context of Gallaher’s strategy, demonstrates that Gallaher’s retail pricing strategy was for Shell to maintain specified parities and differentials between Gallaher’s brands and competing linked

\(^\text{1066}\) Document 38, Annex 9.
brands. The contacts between Gallaher and Shell assisted the implementation of that strategy, through communications from Gallaher in relation to Shell’s retail prices for Gallaher’s brands and in some cases also Gallaher’s competitors’ brands, the aim of which was to ensure that Gallaher’s desired parities and differential requirements were maintained or realigned. The contacts between Gallaher and Shell also demonstrate that Shell accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher to Shell in that connection.

6.1300 The OFT notes that Shell submitted that there were instances where Shell did not implement instructions and/or requests in Gallaher’s pricing communications.

6.1301 However, the OFT considers that, notwithstanding that there may have been some instances where Shell did not implement, did not implement fully\(^{1070}\), or delayed the implementation of instructions and/or requests in Gallaher’s pricing communications, that does not negate the existence of the Infringing Agreement between Gallaher and Shell, as there is sufficient evidence over a period of time of Shell’s compliance, or intention to comply, with Gallaher’s retail pricing strategy (see for example the sections entitled ‘Trading agreement between Gallaher and Shell’ and ‘Contacts between Gallaher and Shell regarding retail prices’ above)\(^{1071}\).

### iv Bonuses

6.1302 As set out above, in accordance with the trading agreement Gallaher rewarded Shell with an ongoing bonus, subject to Shell maintaining ‘\textit{price differentials/price parities between Gallaher’s brands and their respective competitive brands as set out in Appendix 1}’.

6.1303 This demonstrates that Gallaher paid bonuses to Shell in order to ensure that Gallaher’s retail pricing strategy was maintained. Shell accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

\(^{1070}\) For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested. \(^{1071}\) See also Section 7.B.II: ‘Shell’ in relation to the ownership and operation of Shell’s petrol forecourts.
Monitoring of retail prices by Gallaher

6.1304 The documents set out below demonstrate that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its retail pricing strategy) and communicated 'errors' to Shell. Shell participated in this monitoring by providing Gallaher with details of its proposed retail prices for Gallaher’s brands and/or Gallaher’s competitors' brands.

6.1305 As set out above, the trading agreement made express provision for monitoring and also provided a general requirement for Shell to provide 'EPOS data for the tobacco sector each month'.

6.1306 Examples of other documents in relation to monitoring are as follows.

6.1307 An e-mail dated 27 November 2001 from Gallaher to Shell attached the 'Shell [C] Briefing Document'. The document was prepared for Gallaher staff/representatives who were to conduct store visits on Shell outlets and included guidance that staff should:1072

7. Check that all Gallaher brands have the correct pricing parities and differentials...

6.1308 An internal Shell e-mail dated 22 January 2003 regarding new line forms for B&H Silver and Mayfair HRT [Gallaher brands] stated:1073

The RRP and MRP for the two B&H products [Gallaher brands] will be exactly the same as Lambert & Butler 10s and 20s [ITL brands]

The Mayfair HRT [Gallaher brand] should be 22p less than Golden Virginia 12.5gm HRT [ITL brand].

Shell’s internal e-mail was forwarded to Gallaher on 23 January 2003 'FYI'.

6.1309 An e-mail dated 22 July 2003 from Gallaher to Shell stated:1074

Some time ago I forwarded the amendments required to maintain differentials. The main brands for amendment were A/Leaf 25g & Hamlet Aromatic [Gallaher brands]. Can you confirm that these changes have now been made, and also forward your amended price files.

6.1310 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring

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by Gallaher of Shell’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 1, 3, 5, 9, 10, 12 to 15, 24, 25, 27 to 31, 32 to 35, 38, 39, 42, 43, 46, 49 and 51 of Annex 9 (which are listed in Annex C).

6.1311 These documents demonstrate that Gallaher would monitor Shell’s retail prices of both Gallaher’s and ITL’s brands to ensure that parity and differential requirements were maintained and would point out pricing errors to Shell.

vi Conclusion on the agreement and/or concerted practice between Gallaher and Shell

6.1312 The evidence described above demonstrates the existence of the Infringing Agreement between Gallaher and Shell which had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and, given that the remaining constituent elements of the statutory test are also met (see Section 7: ‘Legal Assessment’), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.1313 In addition to the above, the existence of the Infringing Agreement between Gallaher and Shell is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of this Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher’s approach towards the Retailers as a collective; and between
- ITL and Shell (see above), which is part of the context of the Infringing Agreement between Gallaher and Shell.

6.1314 The existence of the further supporting evidence described above (and in particular the relationship between ITL and Shell) lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and Shell which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.1315 As is noted in the sections above relating to the existence of an Infringing Agreement between each of ITL/Shell and Gallaher/Shell, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.1316 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Shell, and that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements, reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d) above).
VIII Agreement and/or concerted practice between ITL and Somerfield and between Gallaher and Somerfield

Summary

6.1317 As set out in 6.C.VIII.(a) below, ITL and Somerfield\textsuperscript{1075} were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby ITL co-ordinated with Somerfield the setting of Somerfield’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.1318 As set out in 6.C.VIII.(b) below, Gallaher and Somerfield were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby Gallaher co-ordinated with Somerfield the setting of Somerfield’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher, in pursuit of Gallaher’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.1319 Each of the Infringing Agreements between ITL/Somerfield and Gallaher/Somerfield amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Somerfield and that each Manufacturer must have been aware\textsuperscript{1076} of each other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of the Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and

\textsuperscript{1075} As noted in Section 2.A.II: ‘The Retailers’, throughout the period of infringement, Somerfield operated both Somerfield and KwikSave fascias.

\textsuperscript{1076} See also 6.A.I.(b) above in relation to the Manufacturers’ awareness of each other’s parallel and symmetrical parity and differential requirements.
increased the inherently restrictive nature of each Infringing Agreement, as set out in 6.A.I.(d) above.

6.1320 On 11 July 2008, each of Gallaher and Somerfield concluded an early resolution agreement with the OFT, pursuant to which each admitted its involvement in each Infringing Agreement to which it was party in breach of the Chapter I Prohibition. In addition, in a corporate statement Somerfield accepted the existence of and its involvement in the Infringing Agreements.1077

(a) Agreement and/or concerted practice between ITL and Somerfield

6.1321 When considered together with the evidence of ITL's overall strategy for retail prices described in Section 6.B: 'Manufacturers' retail pricing strategies' above, the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between ITL and Somerfield, whereby ITL co-ordinated with Somerfield the setting of Somerfield's retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL's retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements', the Infringing Agreement between ITL and Somerfield restricted the ability of Somerfield to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1322 The following elements evidence the Infringing Agreement between ITL and Somerfield:1078

i. ITL’s strategy in relation to Somerfield’s retail prices

6.1323 The trading agreements and contacts set out between ITL and Somerfield below should be considered in the context of ITL's retail pricing strategy as set out in Section 6.B: 'Manufacturers' retail pricing strategies' above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

1077 Document 83, Annex 20 (paragraph 2.6 of the Somerfield Supplementary Statement which is dated 16 May 2005 but should in fact refer to 16 May 2006).

1078 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
ii  Trading agreements between ITL and Somerfield

6.1324 There were three trading agreements between ITL and Somerfield, which were known as 'Trade Development Programmes', dated 16 May 2000, 13 September 2001 and 21 June 2002. Those agreements were a relevant aspect of the ongoing commercial dealing between ITL and Somerfield and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and Somerfield in relation to retail prices.

6.1325 The first trading agreement ('TA1'), signed by ITL on 11 May 2000 and by Somerfield on 16 May 2000,\(^ {1079} \) was in relation to the period 1 January 2000 to 31 December 2000. The second trading agreement ('TA2'), signed by ITL on 12 February 2001 and by Somerfield on 13 September 2001,\(^ {1080} \) was in relation to the period 1 January 2001 to 31 December 2001. The third trading agreement ('TA3'), signed by ITL on 14 May 2002 and by Somerfield on 21 June 2002,\(^ {1081} \) was in relation to the period 1 January 2002 to 31 December 2002.

6.1326 The trading agreements each included clauses whereby Somerfield agreed to implement ITL's retail pricing strategy. Subject to the number of stores in which compliant pricing was applied by Somerfield, ITL would pay a monthly bonus. The requirement to implement ITL's pricing strategy was expressed as follows in TA1:\(^ {1082} \)

'Requirements and Rewards for 2000

Requirements:
ITL brands at strategy pricing in a minimum of 90% of Somerfield stores

...

Rewards:

Pricing Strategy

\(^{1079} \) Document 5, Annex 20. The document included separate trading agreements for Somerfield and Kwik Save branded stores. Both trading agreements contain the same retail pricing strategy requirements.

\(^{1080} \) Document 20, Annex 20.

\(^{1081} \) Document 48, Annex 20.

\(^{1082} \) Document 5, Annex 20 (pages 4 and 8 for Somerfield and Kwik Save branded stores respectively).
90% correct = £[C] per month
88% correct = £[C] per month
86% correct = £[C] per month...

6.1327 The same layout as above (with reference to an attached Payment Matrix in substitution for the reward figures) appeared in TA2¹⁰⁸³ and TA3¹⁰⁸⁴.

6.1328 The term 'Strategy Pricing Requirements', or 'SPRs' was used to describe the parity and differential requirements sought in pursuit of ITL’s retail pricing strategy. ITL sent updates to its parity and differential requirements to Somerfield from time to time.¹⁰⁸⁵

6.1329 In a letter dated 12 February 2001 from ITL to Somerfield entitled 'Trade Development Programme - 2001', ITL noted that its Strategic Pricing Requirements were one of the three key factors in developing its business:

'The key factors to the development of our business are:-

...Maintaining our Strategic Pricing Requirements which are designed to maintain price list differentials ...

The Programme addresses each of these key areas and offers Somerfield the opportunity to [C£][C]

A copy of ITL’s parity and differential requirements were attached to this letter, under the heading 'ITL Strategy Pricing Requirements'.

6.1330 TA3 set out details of the required parities and differentials between the retail prices of certain ITL brands and certain Gallaher brands under the heading 'ITL Strategy Pricing Requirements'.¹⁰⁸⁷

'[ITL brands] [Gallaher brands]

JPS Lights not more than 70p more expensive than Mayfair

¹⁰⁸³ Document 20, Annex 20 (pages 4 and 9 for Somerfield and Kwik Save branded stores respectively).
¹⁰⁸⁴ Document 48, Annex 20 (Pages 6 and 13 for Somerfield and Kwik Save branded stores respectively).
¹⁰⁸⁵ ITL periodically reminded or notified Somerfield of its retail pricing strategy requirements in various forms of correspondence: Documents 13, 15, 18, 29, 31, 46 and 48 of Annex 20.
Richmond King
Size 20s
no more expensive than
Dorchester K S

Panama 5x6s
at least 15p less expensive than
Hamlet

..."

6.1331 Although it was not mentioned explicitly in the trading agreements, in order to facilitate the implementation of its pricing requirements ITL also required Somerfield to allow ITL an opportunity to respond to other manufacturers’ fully-funded retail price reductions. In a letter dated 14 May 2001 from ITL to Somerfield, ITL stated: 1088

‘Whenever another manufacturer initiates and fully funds an additional price reduction on a ‘competing’ brand then ITL are to be given the opportunity to match the additional price reduction on their relevant lines. If ITL elect not to match the additional price reduction then no penalty will be incurred against the pricing payment due for the period. When no ‘additional price reductions’ are being funded by another manufacturer selling prices should be in line with the Strategic Pricing Requirements and payments will be based on store adherence to this’.

6.1332 Although the parity and differential requirements communicated by ITL to Somerfield purportedly provided that the Retailer was to maintain maximum differential requirements between competing linked brands, the OFT infers from the following evidence that such provisions were in fact implemented as parity or fixed differential requirements, rather than maximum differential requirements: (i) evidence of ITL’s retail pricing strategy; (ii) evidence regarding the way in which the trading relationship between ITL and Somerfield operated in practice (that is, evidence of the contacts between the Manufacturer and the Retailer); and (iii) the existence of an Infringing Agreement between Gallaher and Somerfield pursuant to which Gallaher communicated parallel and symmetrical parity and differential requirements to Somerfield (see further 6.C.VIII.(b)). The restrictive nature of parity or fixed differential requirements and maximum differential requirements is described above in Section 6.A.I.(d).

6.1333 In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which Somerfield would set its retail prices in accordance with the parity and differential requirements set by ITL, and that Somerfield was rewarded with the payment of a bonus for compliance with ITL’s parity and differential requirements.

1088 Document 18, Annex 20 (page 1).
As regards Somerfield’s view of the agreements, the OFT notes that a series of e-mails between ITL and Somerfield, dated between 17 June 2003 and 20 June 2003, refer to discussion between Somerfield and ITL relating to the former’s apparent concerns that certain requirements may be inconsistent with competition law. In particular, Somerfield asked for a severability clause to be inserted in a proposed trading agreement, on the basis that:

‘...if the agreement is found to be anti-competitive Somerfield will still be entitled to a full rebate.’

iii Contacts between ITL and Somerfield regarding retail prices

A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and Somerfield regarding: (i) Somerfield’s retail prices for ITL’s brands; (ii) Somerfield’s retail prices for ITL’s competitors’ brands; and (iii) the retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

The documents evidencing the contacts between ITL and Somerfield demonstrate that: (i) in relation to Somerfield’s retail prices for ITL’s brands (sometimes by reference to Somerfield’s or other Retailers’ retail prices for ITL’s competitors’ brands) and/or (ii) in relation to Somerfield’s retail prices for ITL’s competitors’ brands:

- ITL communicated to Somerfield what Somerfield’s retail prices should be; and/or
- ITL asked and/or incentivised Somerfield to hold or alter Somerfield’s retail prices; and/or
- Somerfield informed ITL about, or discussed with ITL, Somerfield’s current or proposed retail prices.

Somerfield accepted and/or indicated its willingness to implement the directions contained in such communications.

In addition, ITL and Somerfield informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors’ brands.

The contacts between ITL and Somerfield took place in the context of ITL’s retail pricing strategy for Retailers to maintain specified parities and differentials between ITL’s brands and competing linked brands.

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1089 Documents 75 and 76, Annex 20.
1090 See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.
Communications in relation to retail prices were sent by ITL, and were received and implemented by Somerfield\(^{1091}\) on the understanding that the notified retail prices took into account ITL’s retail pricing strategy, together with Somerfield’s desired pricing position relative to other Retailers and Somerfield’s desired margin.

6.1340 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1341 Various examples of contacts between ITL and Somerfield regarding retail prices are set out below.

**Contact between ITL and Somerfield regarding Somerfield’s retail prices for ITL’s brands**

6.1342 Set out below are examples of contact between ITL and Somerfield in relation to Somerfield’s retail prices for ITL’s brands, which demonstrate that, in relation to Somerfield’s retail prices for ITL’s brands (sometimes by reference to the retail prices of competing linked brands):

- ITL communicated to Somerfield what Somerfield’s retail prices should be; and/or
- ITL asked and/or incentivised Somerfield to hold or alter Somerfield’s retail prices; and/or
- Somerfield informed ITL about, or discussed with ITL, Somerfield’s current or proposed retail prices.

6.1343 Somerfield accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1344 The examples of such contacts are as follows.

6.1345 In an e-mail dated 11 August 2000, from ITL to Somerfield, ITL attached a price increase/decrease form and stated:\(^{1092}\)

> ‘Please find attached the Price Increase/Decrease Forms for Somerfield and Kwik Save…

> I have included any retro bonuses that are ongoing currently to achieve specific price points so that you can see the true margins.

> On Embassy No.1, Embassy Mild, and Regal King Size Multipacks [ITL brands] there are new retro bonuses that commence on 21

\(^{1091}\) See paragraph 6.1386 and 6.1387 in relation to implementation.

\(^{1092}\) Document 6, Annex 20.
August so that we maintain our relative differentials against Benson & Hedges [Gallaher brand].'

6.1346 In a letter dated 17 August 2000, from ITL to Somerfield, ITL stated:1093

'Further to our meeting on 15th August I would like to confirm our discussion.

Pricing

We reviewed all of the new selling prices and revised Price Increase/Decrease Forms are enclosed which include all of the changes that we agreed.

You also confirmed that Benson & Hedges [Gallaher brand] King Size 20s would be moving to £4.10 in Somerfield from 23rd August.'

The OFT infers that this document supports the existence of an agreement, as the letter confirms the agreement reached at a previous meeting.

6.1347 In a letter dated 19 October 2000 from ITL to Somerfield regarding the launch of Richmond Superkings, ITL stated:1094

'Our pricing strategy for Richmond Superkings [ITL brand] will be to match the shelf price for Dorchester Superkings [Gallaher brand] wherever it is stocked. It is very definitely not our intention to drive prices in the Ultra Low Price sector down; indeed it is our long term hope that we will be able to encourage prices within the sector up slightly.'

6.1348 In an e-mail dated 6 November 2000 from ITL to Somerfield, ITL pointed out to Somerfield that it was not following ITL's retail pricing strategy, as ITL's brands were priced below the competing linked brands:1095

'...I note that you have reduced the selling prices for Café Crème and Small Classic [ITL brands] to £2.52 from 1st November. Our strategy on miniature cigars is normally to match Hamlet Miniatures [Gallaher brand] which appear to be unchanged at £2.62.'

6.1349 In an e-mail dated 15 October 2001 between ITL and Somerfield about retail prices for ITL's brands, ITL provided Somerfield with details of how to restore strategy pricing on certain brands:1096

'can I please draw your attention to the following pricing problems ...

You appear to have reduced Hamlet Miniatures Multipacks [Gallaher brand] from £13.04 to £12.95 which leaves Cafe Creme and Cafe Creme Mild Multipacks [ITL brands] 5p higher than Hamlet Miniatures [Gallaher brand]. To bring our miniature Multipacks into line for strategy pricing will mean moving Cafe Creme and Cafe Creme Mild Multipacks [ITL brand] to £12.95 and Small Classic and Small Classic Filter Multipacks [ITL brand] (on which we are fully funding a £1.50 reduction) to £11.45.'

Somerfield's implementation of a number of the pricing requests in this e-mail is confirmed in the e-mail described in the paragraph below.

6.1350 In an e-mail dated 2 November 2001 from ITL to Somerfield, ITL stated:

'Firstly, thank you for adjusting a number of prices in response to Grahams [of ITL] email of Monday 15th October. However there are still a number of problems that it would be appreciated if you could correct ...

...Amber Leaf 12.5g [Gallaher brand] appears to have been increased to £2.18 whilst Drum 12.5g [ITL brand] is still priced at £2.12. Amber Leaf 25g pouch [Gallaher brand] is priced at £4.26 and Drum 25g pouch [ITL brand] only £4.15. If Amber Leaf [Gallaher brand] has increased in price as it appears to have done then ITL would wish to increase the price of Drum [ITL brand] to match Amber Leaf [Gallaher brand] and achieve parity pricing. Please advise your intentions'

Kwiksave

Once again Amber Leaf [Gallaher brand] appears to have increased in price... it would be appreciated if the price of Drum [ITL brand] could be increased to achieve parity pricing with Amber Leaf [Gallaher brand].'

6.1351 In an internal ITL e-mail relating to Kwiksave, dated 11 January 2002, ITL reported a conversation with a market researcher employed by Kwiksave on the legitimacy of strategic pricing requirements, noting Kwiksave’s concern that the retailer should be free to charge whatever the retailer wanted. ITL noted that the market researcher:

'...spent some time challenging the legality of our strategy pricing requirements suggesting that the retailer should have the right to charge whatever he wanted for our products when he has

1098 Document 29(b), Annex 20.
purchased them from us. Eventually he accepted that if the manufacturer is paying bonuses and offering an incentive for strategy pricing then the retailer should be prepared to run with it although he continued to express some reservations about the price fixing aspect!'

6.1352 In an e-mail exchange on 14 and 15 May 2002 between ITL and Somerfield, ITL asked Somerfield to reduce the prices of Richmond [ITL brand], stating:1099

‘Our strategy pricing requirements apply across all price tiers and the strategy is that Richmond King Size [ITL brand] matches Dorchester [Gallaher brand] and Richmond Superkings [ITL brand] matches Dorchester Superkings [Gallaher brand].’

Somerfield replied:

‘I will change the prices as advised.’

6.1353 In a letter dated 25 June 2002 from ITL to Somerfield, ITL stated:1100

‘The ITL Strategy Pricing Requirements apply across all trade channels. In some instances we offer an incentive within Trade Development Programmes to meet these requirements as is the case for both Somerfield and Kwik Save.’

6.1354 In an e-mail exchange dated 11 July 2002 between ITL and Somerfield, ITL informed Somerfield that retail prices for Richmond [ITL brand] should be higher:1101

‘I note that you have reduced Richmond Superkings [ITL brand] to £3.46 and Richmond King Size [ITL brand] to £3.45 in Somerfield. However, as shown on our Price File the selling prices should be £3.52 for Richmond Superkings [ITL brand] and £3.49 for Richmond King Size [ITL brand].’

Somerfield replied:

‘I have changed Richmond [ITL brand] back in SF as of tomorrow.’

6.1355 In an e-mail exchange on 3 and 4 March 2003, Somerfield provided details of a weekly retail price file to a group of recipients including ITL and Gallaher and asked for any amendments to the retail price file. ITL responded to Somerfield:1102

'Just a few adjustments on Somerfield (unless Gallaher reduce prices on their lines to match ours!).'

In the attached pricing file, the amendments made by ITL were increases to the prices of ITL brands in order to meet parity and differential requirements.

6.1356 In a similar e-mail exchange dated between 7 and 9 July 2003, Somerfield again provided details of a weekly retail price file to a group of recipients including ITL and Gallaher and asked for any amendments to the retail price file. ITL responded to Somerfield:1103

'Somerfield prices all alright.

However, in Kwik Save I note that you have only increased B & H K S 20s [Gallaher brand] by 5p (instead of the full 6p) and I assume that this is to match [another Retailer]. If that is correct then there are four amendments on the Embassy brands [ITL brand] to match [another Retailer] (and meet our strategy pricing requirements) unless of course you intend moving B & H [Gallaher brand] 20s up another 1p to £4.52.'

6.1357 In addition to the documents quoted above a number of other documents contain evidence of contacts of the same or similar nature between ITL and Somerfield regarding Somerfield’s retail prices for ITL’s brands which demonstrate the same matters as set out in respect of the documents quoted above: documents 1 to 4, 11 to 14, 16, 17, 19, 23, 25 to 28, 33 to 38, 40, 43, 45 to 47, 51 to 67, 71, 72, 74, 77 and 79 of Annex 20 (which are listed in Annex C).

Contact between ITL and Somerfield regarding Somerfield’s retail prices for ITL’s competitors’ brands

6.1358 In addition to the documents above, which concern contact between ITL and Somerfield regarding Somerfield’s retail prices for ITL’s brands, there were contacts between ITL and Somerfield in relation to Somerfield’s retail prices for ITL’s competitors’ brands. Set out below are examples of such contacts which demonstrate that, in relation to Somerfield’s retail prices for ITL’s competitors’ brands:

- ITL communicated to Somerfield what Somerfield’s retail prices should be; and/or
- Somerfield informed ITL about, or discussed with ITL, Somerfield’s current or proposed retail prices.

6.1359 Somerfield accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1360 The examples of such contacts are as follows.

6.1361 In an e-mail dated 11 August 2000 from ITL to Somerfield, ITL stated:1104

"In Kwik Save I have put Superkings 100s [ITL brand] up by an additional 4p so that they match Berkeley [Gallaher brand] which Barry1105 [of Somerfield] has already told me will be £19.14. In Somerfield however I have capped them at £19.15 so that you will be matching the Sainsburys prices'.

6.1362 In a fax dated 7 December 2000 from ITL to Somerfield, ITL stated:1106

'There are also a few instances where Superkings 20s [ITL brand] are disadvantaged by 2p against Berkeley [Gallaher brand]. This is in stores where Berkeley [Gallaher brand] are at £3.95 but Superkings [ITL brand] are at £3.97 instead of £3.95. Again, I trust that this information will enable you to make the necessary correction.'

6.1363 In an e-mail dated 23 October 2001 from ITL to Somerfield, ITL stated:1107

'Although you said when we met that both Drum [ITL brand] and Amber Leaf [Gallaher brand] 12.5g are both at £2.12 currently in Kwik Save I have to beg to differ.

Our Merchandisers have visited 50 Kwik Save stores stocking Amber Leaf [Gallaher brand] in the past three days and 49 stores have a shelf price of £2.18 and 1 store has a shelf price of £2.05 whilst 99 stores have Drum [ITL brand] at £2.12...

...We would like to have Drum [ITL brand] at the same price as Amber Leaf [Gallaher brand] whatever that is for each packing in each fascia.' [Emphasis added]

6.1364 In an e-mail from ITL to Somerfield dated 4 March 2002, ITL stated:1108

'We have picked up from another retailer that Gallaher are moving prices up on Sterling Superkings and Dorchester Superkings [Gallaher brands]. If you are moving these prices up at all could you please let me know by how much and when.'

6.1365 The following day (5 March 2002), ITL forwarded the above e-mail to Somerfield and stated:1109

\[1104\] Document 6, Annex 20.
\[1105\] The OFT considers that ‘Barry’ refers to Barry McNally, [of Somerfield].
‘Is anything happening on Sterling and or Dorchester Prices [Gallaher brands] please?’

6.1366 On the same day (5 March 2002) Somerfield sent an e-mail to ITL which provided details of a planned future price increase on Dorchester [Gallaher brand] and a recent price change on Sterling [Gallaher brand] in Somerfield:1110

‘Dorchester [Gallaher brand]
12/03/02
Superkings – increase from £3.45 to £3.47
Sterling [Gallaher brand]
03/03/02
King Size 100 mp’s – increase from £16.45 to £16.75.’

6.1367 ITL responded to this e-mail on the same day (5 March 2002) stating:1111

‘Thanks for this. I note that you have in fact already moved Sterling [Gallaher brand] prices up.

I will be in touch shortly regarding a minor change on Richmond Superkings [ITL brand] to take effect from 20th March – i.e. will need to be keyed on 12th March.’

6.1368 In an e-mail dated 29 April 2002 from ITL to Somerfield, ITL stated:1112

‘Superkings Multipacks [ITL brand] are correctly matching Berkeley Multipacks [Gallaher brand] as requested but I believe that both brands really ought to be up at £20.40 rather than £20.29 unless you are looking to take a lower cash margin!’

At paragraph 5.4 of the Somerfield Company Statement dated 15 March 20061113, Somerfield confirmed that the pricing requirements detailed in this document were subsequently implemented.

6.1369 In e-mails dated 2 September 2002, Somerfield provided details of a weekly retail price file to a group of recipients including ITL and Gallaher and asked for any alterations to the retail price file. Among other things, ITL’s response stated:1114

‘...Is there any news on when Gallaher will be increasing Berkeley, Dorchester, Hamlet and even Sterling [Gallaher brands]?’

6.1370 In e-mails dated 30 June 2003, Somerfield provided details of a weekly retail price file to a group of recipients including ITL and Gallaher and asked for any amendments to the retail price file. ITL informed Somerfield of apparent errors in the prices for certain Gallaher brands:1115

‘No problems on the pricing of our brands. However, it would appear that in Somerfield you have overlooked the Gallaher increase on Berkeley Superkings Multipacks and Berkeley Smooth Multipacks [Gallaher brands] which are still at £21.10 and therefore 30p less than in Kwik Save.’

6.1371 The ‘Draft Witness Statement of Liz Smith [Somerfield Tobacco Buyer] 27 February 2004’1116 annexed to the 'Somerfield Company Statement' dated 15 March 2006, explained that ITL would note changes that were required to its competitors' retail prices: 1117

‘I would sometimes verify the prices provided by the suppliers at my local Asda but mostly I just accepted what the suppliers said. I felt that because both Imperial and Gallaher were watching each other so eagerly, they wouldn’t try it on like that and provide the wrong pricing information as the other supplier would tell you very quickly if a price was out, even if it wasn’t their brand.’

6.1372 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Somerfield regarding Somerfield’s retail prices for ITL’s competitors’ brands which demonstrate the same matters as set out in respect of the documents quoted above: documents 3, 7 to 9, 11 to 14, 16, 17, 19, 24, 25, 28, 29, 34, 36, 40, 43, 45 to 47, 56, 58, 60, 61, 63 to 69, 71, 72, 74 and 79 of Annex 20 (which are listed in Annex C).

Contact between ITL and Somerfield regarding the retail prices of Somerfield’s competitors

6.1373 In addition to the documents above, there were contacts between ITL and Somerfield in which ITL and Somerfield informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL competitors' brands.

1116 Liz Smith was a Somerfield tobacco buyer between October 2001 and July 2002 and between July 2003 and March 2004.
6.1374 The examples of such contacts are as follows.

6.1375 In an e-mail dated 2 March 2000 from ITL to Somerfield, ITL stated:1118

’… Given your concerns about some of your competitors pricing it is more than a little disconcerting to find that 64 Somerfield stores are actually undercutting Asda and [another retailer] by 9p on Sovereign [Gallaher brand]!’

6.1376 An e-mail exchange on 24 and 26 April 2002 between ITL and Somerfield discussed a customer complaint about the respective retail prices of certain ITL and Gallaher brands in Somerfield and the Co-operative Group. In one e-mail in the chain ITL stated:1119

‘I am passing details of the Co-op pricing to my colleague responsible and doubtless he will be taking action to move the price up as soon as possible.’

6.1377 In e-mails dated 30 April and 1 May 2002 between ITL and Somerfield, ITL requested details of Somerfield’s pricing policy:1120

‘Can I suggest that it might actually be helpful to me (and my Gallaher and [another manufacturer] counterparts) if you could give us a definitive statement on what your ‘normal pricing’ policy is for each fascia in terms of which of your competitors you are trying to match.’

Somerfield responded:

‘Somerfield V [C]

Kwik Save V [C].’

6.1378 In an e-mail dated 19 August 2002, Somerfield provided details of a weekly retail price file to a group of recipients including ITL and Gallaher and asked for any alterations to the retail price file. ITL responded as follows:1121

‘On Kwik Save I have put in all of the 10s prices I believe you would need to change if you wish to match [C].

Unfortunately our Merchandisers do not report on 10s pricing and I cannot therefore get at the comparison for Somerfield (i.e. [C]).’

6.1379 In an e-mail dated 20 January 2003 from ITL to Somerfield, ITL indicated that if Kwik Save agreed to remove a low pricing tier designed to compete

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1118 Document 1, Annex 20.
with Supercigs\textsuperscript{1122}, it could then seek to persuade Supercigs to do likewise:\textsuperscript{1123}

'My understanding is that around half the Supercigs estate, i.e. circa 70 stores, are still running the deep discount tier to compete against your Kwik Save discount tier.

If there were a will to end this battle on the part of kwik save I am sure that Supercigs could be persuaded to move up in price'.

6.1380 In an e-mail dated 19 May 2003 from ITL to Somerfield, ITL discussed respective retail prices for a number of brands in Somerfield and Sainsbury. For example:\textsuperscript{1124}

'EMBASSY No. 1 KING SIZE 20s [ITL brand]

This very definitely at £4.44 in [another Retailer], whoever has reported it to you at £4.41 has probably taken the price for Embassy Filter [ITL brand] which is at £4.41 in both [another Retailer] and Somerfield.

...

Our strategy requirement is to match the Amber Leaf [Gallaher brand] prices on each packing which is exactly where we are in Somerfield. The [another Retailer] price for Drum [ITL brand] 12.5g at £2.07 is matching Amber Leaf [Gallaher brand] in their stores.'

6.1381 In its Statement, Somerfield also confirmed that it received from ITL (and Gallaher):\textsuperscript{1125}

'details of its retail competitors’ pricing policies and future price moves.'

6.1382 In its Statement, Somerfield advised that in addition to the documents noted above, similar discussions also took place by telephone:\textsuperscript{1126}

'SC \textsuperscript{1127} [of Somerfield] would sometimes be told by a supplier that a competitor has said 'Somerfield was out of line’ or would be told 'if you move your price on 'X’ by ‘Y’p, so will Asda or Sainsbury'. Such conversations went on from time to time. If Somerfield moved on price due to a supplier’s suggestion then the supplier

\textsuperscript{1122} Supercigs was a business owned by T&S Stores.
\textsuperscript{1123} Document 70, Annex 20.
\textsuperscript{1124} Document 74, Annex 20.
\textsuperscript{1125} Document 82, Annex 20 (paragraph 2.1.3 of the 'Somerfield Company Statement' dated 15 March 2006).
\textsuperscript{1127} The OFT considers that the initials SC refer to Stephen Clarke, Somerfield Tobacco Buyer.
would sometimes say that Asda/Sainsbury would also move. These sorts of conversation would take place by phone.'

In addition:¹¹²⁸

'The suppliers would indicate to Somerfield over the phone when its competitors would be moving up in price (as a result of an MPI) and Somerfield would ask them. If one competitor did not move the others would get agitated'.

6.1383 It can be seen from the above (and also the documents referred to at paragraphs 6.1401 and 6.1402) below that references to the retail prices of other Retailers were used by ITL as a means to encourage the implementation by Somerfield of ITL's parity and differential requirements. In particular, such references provided an assurance to Somerfield that retail price changes put to Somerfield by ITL would not cause Somerfield to be out of step with its retail competitors.¹¹²⁹ The function of references to the retail prices of other Retailers was to assist in the implementation of ITL's pricing strategy and to ensure that ITL's desired parities and differential requirements were maintained or, where need be, realigned.

6.1384 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and Somerfield which demonstrate the same matters as set out in respect of the documents quoted above: documents 1, 30, 32, 37, 41, 53, 56 to 58, 60 to 63, 70, 74, 78 and 79 of Annex 20 (which are listed in Annex C).

**Conclusion on the contacts between ITL and Somerfield**

6.1385 In conclusion in relation to all the contacts between ITL and Somerfield regarding retail prices, the above paragraphs demonstrate that there were regular contacts between ITL and Somerfield, which related to the retail prices of Somerfield as well as other Retailers. The evidence of such contacts together with the context of ITL's strategy demonstrates that ITL's retail pricing strategy was for Somerfield to maintain specified parities and differentials between ITL's brands and competing linked

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¹¹²⁹ Likewise there is evidence that Somerfield acquiesced to the Manufacturers' actions with regard to other retailers. In the 'Somerfield Limited - Company Statement' (Document 82, Annex 20) it was acknowledged that: 'on at least five occasions that it [Somerfield] has been able to identify it [Somerfield] acquiesced to a tobacco supplier, either on its behalf or at its request, seeking to influence the retail pricing activity of a competing retailer.'
brands. The contacts between ITL and Somerfield assisted the implementation of that strategy, through communications between ITL and Somerfield in relation to Somerfield’s retail prices for ITL’s brands and in some cases ITL’s competitors’ brands, the aim of which was to ensure that ITL’s desired parities and differential requirements were maintained or realigned. The contacts between ITL and Somerfield also demonstrate that Somerfield accepted and/or indicated its willingness to implement the directions contained in communications from ITL to Somerfield in that connection.

6.1386 The OFT notes that ITL submitted that there were instances where Somerfield did not implement instructions and/or requests in ITL’s pricing communications.

6.1387 However, the OFT considers that the fact that there may have been some instances where Somerfield did not implement, did not implement fully\(^{1130}\), or delayed the implementation of instructions and/or requests in ITL’s pricing communications, does not negate the existence of the Infringing Agreement between ITL and Somerfield, as there is sufficient evidence over a period of time of Somerfield’s compliance, or intention to comply, with ITL’s retail pricing strategy (see for example the sections entitled ‘Trading agreements between ITL and Somerfield’ and ‘Contacts between ITL and Somerfield regarding retail prices’ above).

6.1388 Furthermore, in the witness statement of Liz Smith [Somerfield Tobacco Buyer], it was acknowledged that Somerfield would typically adhere to the pricing communications received from suppliers, including ITL:\(^{1131}\)

> ‘I confirm that if Imperial rang and suggested that a price be changed (up or down), Somerfield would generally do so as they had signed the contract and did not want to risk losing bonus payments...’

> ‘Across the board with all suppliers, I advise that I generally changed price[s] when it was suggested or at least that was my intention even if my inefficiency meant it didn’t happen straight away.’

\(^{1130}\) For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.

\(^{1131}\) Document 82, Annex 20 (page 61, Section 7 of the draft witness statement of Liz Smith [Somerfield Tobacco Buyer], 27 February 2004).
iv Bonuses

6.1389 As set out above, ITL paid an ongoing bonus to Somerfield on the condition that, among other matters, Somerfield set prices for ITL brands in accordance with ITL’s ‘Strategy Pricing Requirements’. As also noted above, the term ‘Strategy Pricing Requirements’, or ‘SPRs’ were used to describe the parity and differential requirements sought in pursuit of ITL’s retail pricing strategy.

6.1390 As further noted above, the ‘Draft Witness Statement of Liz Smith [Somerfield Tobacco Buyer] 27 February 2004’ stated:

'I confirm that if Imperial rang and suggested that a price be changed (up or down), Somerfield would generally do so as they had signed the contract and did not want to risk losing bonus payments.'

6.1391 There are also documents relating to the provision of tactical bonuses from ITL to Somerfield, examples of which are set out in the section entitled 'Contacts between ITL and Somerfield regarding retail prices' above.

6.1392 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by Somerfield. In particular, the bonuses ensured that Somerfield’s margin was not significantly affected by the changes in retail prices requested by ITL to achieve ITL’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of Somerfield’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.1393 The evidence demonstrates that ITL paid bonuses to Somerfield in order to ensure that ITL’s retail pricing strategy was maintained. Somerfield accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by ITL.

v Monitoring of retail prices by ITL

6.1394 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the

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prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to Somerfield.

6.1395 Somerfield participated in this monitoring by providing ITL with details of its proposed retail prices for ITL's brands and/or for ITL's competitors' brands.

6.1396 In a letter dated 3 March 2000 from ITL to Somerfield, ITL enclosed Price Tracker reports and identified a number of retail pricing errors:

>'Classic 5x5s [ITL brand] and Hamlet 5x5s [Gallaher brand] both appear to have been reduced by 5p to £12.24. This has left Panama 5x6s [ITL brand] at only -10p differential against the Hamlet 5x5s [Gallaher brand] pack instead of the required 15p differential.'

6.1397 In a similar letter dated 19 December 2000 from ITL to Somerfield, ITL identified Somerfield retail pricing errors:

>'Our Merchandisers visited 36 Somerfield stores yesterday of which the differentials against Benson & Hedges King Size [Gallaher brand] were incorrect in [C]% of stores for Embassy No. 1 King Size and in [C]% of stores for Regal King Size [ITL brands].

A full list of the problems by store is enclosed.'

6.1398 In a letter dated 21 December 2000 from ITL to Somerfield, ITL stated:

>'Of the 25 Somerfield stores visited there were still differential errors in [C]% of them on Embassy No.1 [ITL brand] and in [C]% of them on Regal King Size [ITL brand] relative to Benson & Hedges King Size [Gallaher brand]. Details by store are enclosed.

As I mentioned to Sarah [of Somerfield] a couple of days ago the problems on Embassy No.1 [ITL brand] are also applicable to Embassy Mild 20s [ITL brand]. As you will see from the reports [C]% of the stores visited yesterday had incorrect differentials for Embassy Mild [ITL brand] v. Benson & Hedges [Gallaher brand]. No doubt you will be able to take the necessary action to correct this.'

6.1399 In an e-mail dated 30 November 2002, ITL pointed out to Somerfield that the price of Mayfair [Gallaher brand] had not changed as expected. Somerfield responded on 2 December 2002, stating:

'I have investigated this and for some reason the price had been locked (as if it were on promotion)... I have now had the lock removed and price should change tomorrow'.

6.1400 In an e-mail dated 17 February 2003, Somerfield presented details of a weekly retail price file to a group of recipients including ITL and Gallaher and asked for any amendments to the retail price file. ITL responded to Somerfield:

'Four changes in Somerfield on Drum and Golden Virginia [ITL brands] to meet our strategy pricing requirements please.'

6.1401 In e-mails dated 11 and 12 August 2003 Somerfield detailed their weekly retail price file to a group of recipients including ITL and Gallaher and asked for any amendments to the retail price file. Following receipt of the price file, ITL stated:

'Please find attached the Price List with some amendments on Kwik Save as agreed with Liz [of Somerfield] earlier this morning (no changes in Somerfield)'.

The agreed changes included lowering the price of Embassy Filter by 1p and increasing the Regal KS price by 4p [ITL brands].

6.1402 In response to a Somerfield question as to whether such retail prices were to ensure consistency with its own strategy (that is, to match [C]'s retail prices), ITL responded:

'Yes and to also meet the Strategy Pricing Requirement of the Trade Development Programme we have with you'.

6.1403 The 'Draft Witness Statement of Liz Smith [Somerfield Tobacco Buyer] 27 February 2004' stated:

'When on the phone (2-3 times a week pre April '02), GH Graham Hall, [of ITL ] would advise where Somerfield was out of line with its requirements under the strategic pricing arrangements and its price matching policy and would give a suggested price. This suggested price would usually be implemented as LS [Liz Smith] [of Somerfield] was concerned to avoid Somerfield losing its bonuses under the strategic pricing agreement.'

6.1404 In the 'Somerfield Limited – Company Statement' dated 15 March 2006, Somerfield acknowledged that:

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‘from 29 April 2002, it [Somerfield] disclosed its current pricing to [the] tobacco suppliers on a weekly basis including a request to each supplier that it immediately inform Somerfield if its retail pricing was out of line with its stated retail pricing policy’.

6.1405 In its statement Somerfield also noted that:1143

‘The Suppliers strictly monitored the operation of the retro and off invoice bonuses and, in Imperial’s case, the SPR [Strategic Pricing Requirements]’

6.1406 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of Somerfield’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 3, 4, 6, 9, 10, 13, 19, 20, 21 to 25, 28, 30, 32, 34 to 36, 38 to 40, 43 to 45, 49, 50, 51 to 53, 55, 56, 60, 61, 63, 64, 66, 67, 69, 71 to 73 and 77 of Annex 20 (which are listed in Annex C).

6.1407 These documents demonstrate that ITL would monitor Somerfield’s retail prices of both ITL and Gallaher brands to ensure that parity and differential requirements were maintained and would point out pricing errors to Somerfield.

**Conclusion on the agreement and/or concerted practice between ITL and Somerfield**

6.1408 The evidence described above demonstrates the existence of the Infringing Agreement between ITL and Somerfield which had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and given that the remaining constituent elements of the statutory test are also met (see Section 7: ‘Legal assessment’) amounted to a breach of the Chapter I Prohibition.

vi Further Supporting Evidence

6.1409 In addition to the above, the existence of the Infringing Agreement between ITL and Somerfield is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of the

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Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationship between:

- ITL and each of the other Retailers, which evidence ITL's approach towards the Retailers as a collective; and between

- Gallaher and Somerfield (see below), which is part of the context of the Infringing Agreement between ITL and Somerfield.

6.1410 The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and Somerfield) lends further support to the fact that there was an agreement and/or concerted practice between ITL and Somerfield which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or concerted practice between Gallaher and Somerfield

6.1411 When considered together with the evidence of Gallaher’s overall strategy for retail prices described in Section 6.B: 'Manufacturers’ retail pricing strategies' above, the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between Gallaher and Somerfield, whereby Gallaher co-ordinated with Somerfield the setting of Somerfield’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between Gallaher and Somerfield restricted the ability of Somerfield to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1412 The following elements evidence the Infringing Agreement between Gallaher and Somerfield:1144

i Gallaher’s strategy in relation to Somerfield’s retail prices

6.1413 The contacts set out below between Gallaher and Somerfield should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: 'Manufacturers’ retail pricing strategies’ above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.1414 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher’s multiple grocer channel, demonstrate that Gallaher’s objective was that multiple grocers, of which Somerfield was one such grocer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

6.1415 A good example is an internal Gallaher document headed ‘Promotional Policy - Retail Promotion Contributions – March 2000’, which listed the 'pricing objectives’ in relation to the following brands amongst others:

1144 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
‘Camel [Gallaher brand] – Parity with Marlboro [competitor brand]’


_B&B_ [Gallaher brand] – _5p above Regal_ [ITL brand], _3p above Embassy No 1_ [ITL brand]

_Berkeley and B&B Superkings_ [both Gallaher brands] – _parity with JP Superkings_ [ITL brand]

_Club_ [Gallaher brand] _14p below Regal_ [ITL brand]

_Sovereign_ [Gallaher brand] _10p below L&B_ [ITL brand]

_Mayfair 7p below Sovereign_ [both Gallaher brands] _and at least parity with Richmond_ [ITL brand]...

6.1416 Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s multiple grocer channel, is set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, which refer to a number of other documents containing evidence of the same or similar nature.1147

**ii Trading agreement between Gallaher and Somerfield**

6.1417 Gallaher and Somerfield entered into one trading agreement dated 5 February 1999. The agreement was a relevant aspect of the ongoing commercial dealing between Gallaher and Somerfield and formalised the basis for certain aspects of the trading relationship between them. The trading agreement is assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between Gallaher and Somerfield in relation to retail prices.

6.1418 The trading agreement, signed by Gallaher on 5 February 1999, was in relation to the period 1 September 1998 to 31 August 2003. In the terms of the trading agreement, Gallaher and Somerfield agreed that, among other matters:1148

‘Where Somerfield or Kwik Save is involved in the promotion of a brand by a competitor of Gallaher, Gallaher shall be offered the

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1145 ITL has distributed Marlboro since 12 September 2001.
1146 Document 1, Annex 3 (page 2). This document also set out parity and differential requirements for cigars and hand rolled tobacco.
1147 See, in particular, documents 2 to 10, 13 and 14 of Annex 3.
1148 Document 1, Annex 10. The trading agreement submitted to the OFT was not signed by Somerfield.
opportunity to conduct similar promotional activity with Somerfield / Kwik Save on a brand to be selected by Gallaher as soon as reasonably requested by Gallaher providing Somerfield / Kwik Save trading criteria are met.

6.1419 Although parity and differential requirements were not part of the formal trading agreement between Gallaher and Somerfield, correspondence between Gallaher and Somerfield illustrated that there was nevertheless general agreement between Gallaher and Somerfield that Somerfield would implement Gallaher’s parity and differential requirements. In an e-mail dated 27 May 2002 from Gallaher to Somerfield, Gallaher confirmed that it made payments to Somerfield in order to ensure Somerfield’s adherence to Gallaher’s parity and differential requirements:1149

‘…we have in place off invoice support for price cutting and to maintain strategically Gallaher v Competitor brands at price list differentials. This has bee[n] confirmed in writing by me several times’.

6.1420 In view of the foregoing, the OFT has concluded that there was general agreement between Gallaher and Somerfield that Somerfield would implement Gallaher’s parity and differential requirements and that Gallaher would pay a bonus to Somerfield to ensure that its parity and differential requirements were implemented.

iii Contacts between Gallaher and Somerfield regarding retail prices

6.1421 A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and Somerfield regarding: (i) Somerfield’s retail prices for Gallaher’s brands; (ii) Somerfield’s retail prices for Gallaher’s competitors’ brands; and (iii) the retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

6.1422 The documents evidencing the contacts between Gallaher and Somerfield demonstrate that: (i) in relation to Somerfield’s retail prices for Gallaher’s brands (sometimes by reference to Somerfield’s or other Retailers’ retail prices for Gallaher’s competitors’ brands) and/or (ii) in relation to Somerfield’s retail prices for Gallaher’s competitors’ brands:

- Gallaher communicated1150 to Somerfield what Somerfield’s retail prices should be; and/or

1150 See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’. 
• Gallaher asked and/or incentivised Somerfield to hold or alter Somerfield’s retail prices; and/or
• Somerfield informed Gallaher about, or discussed with Gallaher, Somerfield’s current or proposed retail prices.

6.1423 Somerfield accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1424 In addition, Gallaher and Somerfield informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

6.1425 The contacts between Gallaher and Somerfield took place in the context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent by Gallaher, and were received and implemented by Somerfield1151 on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together with Somerfield’s desired pricing position relative to other Retailers and Somerfield’s desired margin.

6.1426 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1427 Various examples of contacts between Gallaher and Somerfield regarding retail prices are set out below.

Contact between Gallaher and Somerfield regarding Somerfield’s retail prices for Gallaher’s brands

6.1428 Set out below are examples of contacts between Gallaher and Somerfield in relation to Somerfield’s retail prices for Gallaher’s brands, which demonstrate that, in relation to Somerfield’s retail prices for Gallaher’s brands (sometimes by reference to the Somerfield’s or other Retailers’ retail prices of competing linked brands):

• Gallaher communicated to Somerfield what Somerfield’s retail prices should be; and/or
• Gallaher asked and/or incentivised Somerfield to hold or alter Somerfield’s retail prices; and/or
• Somerfield informed Gallaher about, or discussed with Gallaher, Somerfield’s current or proposed retail prices.

1151 See paragraph 6.1463 and 6.1464 in relation to implementation.
6.1429 Somerfield accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1430 The examples of such contacts are as follows.

6.1431 In an e-mail from Gallaher to Somerfield dated 30 July 2001, Gallaher stated:  

‘...can you please increase the retails of Amber Leaf [Gallaher brand] as follows:-

Somerfield

12.5g £2.09
25g £4.10
50g £7.99
...

nb retros will be adjusted to reflect the above from next week.’

6.1432 In a subsequent e-mail exchange dated 2 August 2001 between Somerfield and Gallaher, Somerfield confirmed that it would make the above changes, with a slight delay. In addition, Gallaher informed Somerfield that:

‘...Dorchester KS [Gallaher brand] 100mp should be = Richmond KS [ITL brand] @ £16.75 but is showing at £17.15?’

6.1433 In an e-mail exchange dated 5 December 2001 between Somerfield and Gallaher, Gallaher informed Somerfield of certain retail price changes it was to implement. These included the following:

‘...

* Berkeley SK 20’s [Gallaher brand] & B&H SK 20’s [Gallaher brand] (+lights and menthol - Berkeley only) is 1p more expensive in Somerfield at 4.05 than the market which is 4.04 ~ I pay an off invoice bonus for parity pricing...

* Hamlet Mins 5x10mp [Gallaher brand] ~ you moved retails up from 12.95 to 12.99 but left Cafe Crème [ITL brand] down? Asda, [another retailer] & JS are 12.99 for both packings...

* Golden Virginia 50g [ITL brand] ~ you have this +4p v Old Holborn [Gallaher brand], usually the same retail applies? You have

1152 Document 6, Annex 10.
followed JS as for B&H/Berkeley SK 20’s [Gallaher brands] no doubt!’

To which Somerfield responded:

‘Bit of a mess then really isn’t it! Will resolve effective in store 12 December. Thank you’

6.1434 In an e-mail exchange dated 12 and 13 August 2002, Somerfield e-mailed details of a weekly retail price file to recipients including Gallaher and ITL and requested confirmation that prices were ‘correct and in line with the competition.’ Gallaher responded to Somerfield:1155

‘... we have no changes to enact at this stage however on the 2nd September (or soon thereafter) and inline with ITL I will move certain lines up as there retails increase but not before.

And there price marked packs for Richmond [ITL brand] continue to be available then Dorchester [Gallaher brand] will not be increased until such time as they increase. Equally there have been no moves by Asda / JS to impact on KS / Somerfield pricing.’

6.1435 In an e-mail dated 11 November 2002 from Gallaher to Somerfield, Gallaher stated:1156

‘…Old Holborn [Gallaher brand] (Kwik Save) - 25g needs to be reduced to £4.41 to match Golden Virginia [ITL brand] (retro bonus being paid) and to maintain parity with Asda’

6.1436 In an e-mail exchange dated 2 December 2002, Somerfield e-mailed details of a weekly retail price file to a group of recipients including Gallaher and ITL. Gallaher responded:1157

‘... on the proviso that there are no competitor moves then there are no Gallaher adjustments to advise.’

6.1437 In an e-mail exchange dated 19 December 2002 between Gallaher and Somerfield, Gallaher requested that Somerfield increase retail prices for its Silk Cut and Benson and Hedges brands and Somerfield indicated its intention to do so. Gallaher wrote to Somerfield:1158

‘Please note that from the 1st January 2003 the bonus on 20’s for Silk Cut KS house and Benson and Hedges SK [Gallaher brands] (off invoice) will be adjusted. The retail price will need to increase by +2p for 20...’

6.1438 The Somerfield tobacco buyer later responded to that e-mail and stated that, despite a general retail price freeze within Somerfield, he had been given permission to make an exception and implement the requested retail price increase:  

'I have talked to our pricing people and have convinced them to let us change the prices as advised.'

6.1439 On one occasion Somerfield initiated its own price cut on certain brands. Gallaher complained that its brands were disadvantaged and threatened to withdraw all bonuses as a result. Gallaher stated:

'You have off invoice bonuses for strategic pricing and marinating [maintaining] price list differentials with competitors is essential...

If we are disadvantage (it seems to me that we clearly are) then our bonus support will be withdrawn completely as then [there] is now [no] benefit'

6.1440 This document is an example of an occasion where Somerfield apparently indicated its intention not to price according to Gallaher’s retail pricing strategy. However, such conduct appears to be exceptional (see paragraph 6.1464 below).

6.1441 In the 'Somerfield Limited - Supplementary Statement' dated 16 May 2005 Somerfield referred to the e-mail correspondence above and stated:

'The email from Chris Halford of Gallaher to Liz Smith [of Somerfield] of 27 May 2002 appears to demonstrate that an intention of Gallaher in offering the bonus was ‘for price cutting and to maintain strategically [Gallaher] v Competitor brands at price list differentials’. This would suggest that there was no expectation on the part of Gallaher that prices would be below the supplier suggested price. Indeed, this exchange of emails between Liz Smith [of Somerfield] and Chris Halford shows a hostile reaction from Gallaher to a Somerfield funded price reduction that impacts on the differentials.'

6.1442 In addition to the documents quoted above a number of other documents contain evidence of contact of the same or similar nature between Gallaher and Somerfield regarding Somerfield’s retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the

documents quoted above: documents 4, 8, 9, 11, 12, 14, 16\textsuperscript{1162}, 18, 20 to 22, 27 to 30, 33, 35, 36, 40, 43 to 46, 49, 53, 57, 58, 63 and 64\textsuperscript{1163} of Annex 10 (which are listed in Annex C).

Contact between Gallaher and Somerfield regarding Somerfield's retail prices for Gallaher's competitors' brands

6.1443 In addition to the documents above, which concern contact between Gallaher and Somerfield regarding Somerfield’s retail prices for Gallaher’s brands, there were contacts between Gallaher and Somerfield in relation to Somerfield’s retail prices for Gallaher’s competitors’ brands. Set out below are examples of such contacts which demonstrate that, in relation to Somerfield's retail prices for Gallaher's competitors’ brands:

- Gallaher communicated to Somerfield what Somerfield's retail prices should be; and/or
- Somerfield informed Gallaher about, or discussed with Gallaher, Somerfield’s current or proposed retail prices.

6.1444 Somerfield accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1445 The examples of such contacts are as follows.

6.1446 There was an e-mail chain dated 4 March 2002 between Gallaher and Somerfield. Somerfield e-mailed a group of recipients including ITL and Gallaher under the heading ‘multipacks’ and noted:\textsuperscript{1164}

\textit{I am looking to do some pricing activity on the above in both fascias before financial year end.}

\textit{Could you confirm asap promotion ideas and possible funding for such activity?}

Gallaher responded:

\textit{…we are trying to normalize retails in the run-up to the budget (hence advice on Sterling 20's/100mp / Dorchester SK 20's)}

\textsuperscript{1162} This e-mail chain includes a statement from Somerfield indicating its intention to implement the price changes requested by Gallaher.
\textsuperscript{1163} For Documents 11, 16, 18, and 32, there was no attachment, but the relevant text suggests that the missing price and margin attachments are comparable to those attached to, for example, Documents 4, 5, 6, 9 and 14. For Document 36, the 'price file' is assumed to be comparable to the 'price file' attached to, for example, Document 57. The text within Document 46 suggests that the missing attachment contained information on Somerfield’s tobacco retail prices.
\textsuperscript{1164} Document 22, Annex 10.
[Gallaher brands] and ITL have confirmed (in another account) following us up (can you comment?).

Somerfield responded:

'...I have been out of the office and have not seen or heard anything yet.

If they asked then I would take the attitude of how would they feel if you asked me the same question with regard to pricing on their products... If you don't mind me telling them then I will and vice-versa when they have promotional activity but I would have thought that this would defeat both companies objectives with regard to Imperial V Gallahers!'

Gallaher then responded:

'... , given the nature of the market (I would guess) that probably we both think it's fair to take a more relaxed view and that unless either say 'please keep this confidential' assume that the information will be discussed in the context of 'pricing / normal trading'. Given that the increases are already in place for both Gallaher and ITL brands in some of... competitors it's not 'news sensitive' ... especially when you email us all at the same time!'

6.1447 In an e-mail exchange dated 30 April 2002, Somerfield e-mailed a group of recipients including Gallaher and ITL and stated that it would be sending current in store retail prices to them and asked for amendments. Gallaher responded to Somerfield:1165

'... , I raised this already but see I see... that there no change on the above(?) – Old Holborn [Gallaher brand] & Golden Virginia [ITL brand] 12.5g should be = (as for 25g &50g) - Somerfield applies. Suggest you have BOTH at £2.31.'

6.1448 In an e-mail exchange dated 5 August 2002, Somerfield e-mailed details of a retail price file to a group of recipients including Gallaher and ITL and asked for any amendments to the retail price file. Gallaher responded to Somerfield:1166

'...I have no changes to advise, however as ITL have today announced there MPI today perhaps you can confirm when retail will move up as I will need to adjust the Gallaher retails which are being held and retro bonussed ...'

6.1449 In an e-mail dated 6 August 2002 from Gallaher to Somerfield, Gallaher stated:1167

'You need to be careful of price relationships between suppliers because if you move + / - on a competitor brands this will impact on the Gallaher brand and visa versa and this will also potentially effect retro payments for price cuts that are in place.

If you have some changes to make then I would appreciate some notice so that I can comment, it may save some yo yo moves ……'

6.1450 The 'Draft Witness Statement of Liz Smith [Somerfield Tobacco Buyer] 27 February 2004' annexed to the 'Somerfield Company Statement' dated 15 March 2006, explained that Gallaher would note changes that were required to its competitors' retail prices:1168

'I would sometimes verify the prices provided by the suppliers at my local Asda but mostly I just accepted what the suppliers said. I felt that because both Imperial and Gallaher were watching each other so eagerly, they wouldn’t try it on like that and provide the wrong pricing information as the other supplier would tell you very quickly if a price was out, even if it wasn’t their brand.'

6.1451 In the 'Draft Witness Statement of Liz Smith' [Somerfield Tobacco Buyer] it was also acknowledged that Somerfield would typically adhere to the pricing requirements received from suppliers, including Gallaher:1169

'Across the board with all suppliers, I advise that I generally changed price when it was suggested or at least that was my intention even if my inefficiency meant it didn’t happen straight away.'

Contact between Gallaher and Somerfield regarding the retail prices charged by Somerfield’s competitors

6.1452 In addition to the documents above, there were contacts between Gallaher and Somerfield in which Gallaher and Somerfield informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.

6.1453 The examples of such contacts are as follows.


In an e-mail dated 21 September 2001 from Gallaher to Somerfield, Gallaher suggested retail prices for various Gallaher and ITL brands, noting the relative pricing in Somerfield’s competitors:

'Since the implementation of the MPI there are currently some brands/packings either less or more expensive than your competitors and given Kwik Save’s consumers sensitivity to retail prices I thought you might want to realign retails (where Kwik Save is uncompetitive) sooner rather than latter…

I have set through retails by group which are the most common… most of the majors (i.e. Asda, [another retailer], JS & Morrison) have one price tier so the retails shown apply globally…

…KWIK SAVE

Cigarettes

20’s

all retails to plan (i.e. = to Asda / current policy confirmed by Steve [of Somerfield])…

...

Cigars

To increase Hamlet [Gallaher brand] (+5p) and Classic 5x5mp [ITL brand] to decrease £13.54 (-1p)

Hand Rolling tobacco

12.5g - both Old Holborn [Gallaher brand] (-3p) and Golden Virginia [ITL brand] (+1p) need adjusting to £2.22, Amber Leaf [Gallaher brand] -6p to £2.12 … Drum [ITL brand] 12.5g +1p to £2.12.’

In an e-mail dated 1 July 2002 from Gallaher to Somerfield, Gallaher again referred to the setting of Somerfield’s prices by reference to Somerfield’s competitors’ prices:

'I know you have gone-up on Somerfield but are holding Kwik Save retails to follow [another Retailer], [another Retailer] will now be up from WEDNESDAY ~ (3/7/02) this week.

Can you please action the following additional price hold asap …..Hamlet range [Gallaher brand] (5’s £2.78, 10’s £5.51 and 5x5mp £13.64) as confirmed on the attached…

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nb please let me know when retail will move down when set-up. [another Retailer] Hamlet [Gallaher brand] price will reflect the additional advice confirmed above.

6.1456 In an e-mail from Gallaher dated 11 November 2002, Gallaher stated:1172

‘…Old Holborn [Gallaher brand] (Kwik Save) - 25g needs to be reduced to £4.41 to match Golden Virginia [ITL brand] (retro bonus being paid) and to maintain parity with Asda,’

6.1457 In e-mail correspondence dated 19 December 2002 (referred to at paragraph 6.1437 above) between Gallaher and Somerfield; before agreeing to implement the requested retail price increase, Somerfield asked whether the same retail price increase would be implemented in other 'multiples'.1173

‘Is this price change going to affect other multiples? If so I have an argument for getting these change on the 1st.’

Gallaher then confirmed that the retail price change would occur in such accounts:1174

‘It effect all customers, and applies from the first invoicing date (2nd).’

6.1458 In its statement Somerfield also noted that it received from Gallaher (and ITL):1175

‘details of its retail competitors’ pricing policies and future price moves.’

6.1459 In addition to the documents noted above Somerfield emphasised that similar discussions would also have taken place by telephone:1176

‘SC [Stephen Clarke of Somerfield] would sometimes be told by a supplier that a competitor had said 'Somerfield was out of line' or would be told 'if you move your price on 'X' by 'Y'p, so will Asda or Sainsbury'. Such conversations went on from time to time. If Somerfield moved on price due to a supplier’s suggestion then the supplier would sometimes say that Asda/Sainsbury would also move. These sorts of conversation would take place by phone.’

6.1460 It can be seen from the above that references by Gallaher to the retail prices of other Retailers were used by Gallaher as a means to encourage

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the implementation by Somerfield of Gallaher's parity and differential requirements. In particular, such references provided an assurance to Somerfield that retail price changes put to Somerfield by Gallaher would not cause Somerfield to be out of step with its retail competitors. \(^{1177}\) The function of references to the retail prices of other Retailers was to assist in the implementation of Gallaher's pricing strategy and to ensure that Gallaher's desired parities and differential requirements were maintained or, where need be, realigned.

6.1461 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and Somerfield which demonstrate the same matters as set out in respect of the documents quoted above: documents 35, 38, 40, 42, 60 and 63 of Annex 10 (which are listed in Annex C).

**Conclusion on the contacts between Gallaher and Somerfield**

6.1462 In conclusion in relation to all the contacts between Gallaher and Somerfield regarding retail prices, the above paragraphs demonstrate that there were regular contacts between Gallaher and Somerfield, which related to the retail prices of Somerfield as well as other Retailers. The evidence of such contacts, together with the context of Gallaher's strategy demonstrates that Gallaher's retail pricing strategy was for Somerfield to maintain specified parities and differentials between Gallaher's brands and competing linked brands. The contacts between Gallaher and Somerfield assisted the implementation of that strategy, through communications from Gallaher in relation Somerfield's retail prices for Gallaher's brands (and in some cases also Gallaher's competitors' brands). The contacts between Gallaher and Somerfield also demonstrate that Somerfield accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher to Somerfield in that connection.

6.1463 The OFT notes that there were instances where Somerfield did not implement instructions and/or requests in Gallaher's pricing communications.\(^{1178}\)

\(^{1177}\) Likewise there is evidence that Somerfield acquiesced to the Manufacturers' actions with regard to other retailers. In the 'Somerfield Limited - Company Statement' (document 82, Annex 20) it was acknowledged that: 'on at least five occasions that it [Somerfield] has been able to identify it [Somerfield] acquiesced to a tobacco supplier, either on its behalf or at its request, seeking to influence the retail pricing activity of a competing retailer'.

\(^{1178}\) See paragraphs 6.1439 to 6.1441 above.
6.1464 However, the OFT considers that the fact that there may have been some instances where Somerfield did not implement, did not implement fully\textsuperscript{1179}, or delayed the implementation of instructions and/or requests in Gallaher’s pricing communications, does not negate the existence of the Infringing Agreement between Gallaher and Somerfield, as there is sufficient evidence over a period of time of Somerfield’s compliance, or intention to comply, with Gallaher’s retail pricing strategy (see for example the sections entitled ‘Trading agreement between Gallaher and Somerfield’ and ‘Contacts between Gallaher and Somerfield regarding retail prices’ above).

6.1465 Furthermore, as noted above in paragraph 6.1451 above, in the witness statement of Liz Smith [Somerfield Tobacco Buyer], it was acknowledged that Somerfield would typically adhere to the pricing communications received from suppliers, including Gallaher.\textsuperscript{1180}

\textit{iv} Bonuses

6.1466 As noted above, Gallaher paid an ongoing bonus to Somerfield:\textsuperscript{1181}

‘…we have in place off invoice support for price cutting and to maintain strategically Gallaher v Competitor brands at price list differentials’.

6.1467 There are documents relating to the provision of tactical bonuses from Gallaher to Somerfield, examples of which are set out in the section entitled ‘Contacts between Gallaher and Somerfield regarding retail prices’ above.

6.1468 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged bySomerfield. In particular, the bonuses ensured that Somerfield’s margin was not significantly affected by the changes in retail prices requested by Gallaher to achieve Gallaher’s retail pricing strategy (see Section 6.A.I.(a).\textit{iv} above). The manipulation of Somerfield’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

\textsuperscript{1179} For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.


\textsuperscript{1181} Document 32, Annex 10.
6.1469 The evidence demonstrates that Gallaher paid bonuses to Somerfield in order to ensure that Gallaher’s parity and differential strategy was maintained. Somerfield accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

v  Monitoring of retail prices by Gallaher

6.1470 The documents set out below demonstrate that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the retail prices communicated (and thereby from its retail pricing strategy) and communicated 'errors' to Somerfield.

6.1471 Somerfield participated in this monitoring by providing Gallaher with details of its proposed retail prices for Gallaher’s brands and/or Gallaher’s competitors’ brands.

6.1472 In an e-mail dated 11 July 2002 from Gallaher to Somerfield, in relation to Richmond [ITL brand] prices, Gallaher stated: 1182

'I think you have unknowingly enacted a price cut on both KS and SK, KS were 3.52 now 3.46 and SK were 3.49 now 3.45.

Dorchester 20’s [Gallaher brand] track Richmond 20’s [ITL brand] so the implications are that these lines should also be reduced.

No other account has moved down and none have been advised. Please can you therefore advise if this was a planned/confirmed reduction?'

6.1473 In an e-mail dated 28 August 2002 between Gallaher and Somerfield, Gallaher asked why the correct differential was not being applied between Golden Virginia [ITL brand] and Old Holborn [Gallaher brand]: 1183

'The attached [price file] illustrates that you have a 10p gap for the 12.5g pack whereas it should be 4p. You are also below JS (-6p) which has a 4p gap between OH and GV. When will this be corrected?'

In an e-mail dated 2 September 2002, Somerfield responded and agreed to make the necessary retail price change: 1184

'This is being adjusted.'

In the 'Draft Witness Statement of Liz Smith [Somerfield Tobacco Buyer] 27 February 2004' annexed to the 'Somerfield Limited - Company Statement' dated 15 March 2006; Liz Smith [Somerfield Tobacco Buyer] noted that similar instructions would be received from Gallaher by telephone:1185

'Chris Halford [of Gallaher] would ring me and say that a price was out of line and I would generally change it'.

Moreover, in the 'Somerfield Limited - Company Statement' dated 15 March 2006, Somerfield acknowledged that it facilitated the suppliers' monitoring by providing them with retail price files:1186

'from 29 April 2002, it [Somerfield] disclosed its current pricing to [the] tobacco suppliers on a weekly basis including a request to each supplier that it immediately inform Somerfield if its retail pricing was out of line with its stated retail pricing policy'.

An example of such an occasion when Somerfield sent its price file to Gallaher (and ITL) can be found in an e-mail dated 6 May 2003.1187

In addition to the documents quoted above a number of other documents contain evidence of the same or similar nature in relation to the monitoring by Gallaher of Somerfield’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 10, 13, 23 to 26, 31, 36, 38, 461188, 47, 52, 56, 59 and 62 of Annex 29 (which are listed in Annex C).

These documents demonstrate that Gallaher would monitor Somerfield’s retail prices of both ITL and Gallaher brands, to ensure that parity and differential requirements were maintained and would point out the pricing errors to Somerfield.

vi Conclusion on the agreement and/or concerted practice between Gallaher and Somerfield

The evidence described above demonstrates the existence of the Infringing Agreement between Gallaher and Somerfield, which had the object of restricting competition, in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' above and, given that the remaining constituent elements of the statutory test are

1186 Document 82, Annex 20 (paragraph 2.1.5).
also met (see Section 7: 'Legal assessment'), amounted to a breach of the Chapter I Prohibition.

vii  Further Supporting Evidence

6.1479 In addition to the above, the existence of the Infringing Agreement between Gallaher and Somerfield is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of the Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher's approach towards the Retailers as a collective; and between
- ITL and Somerfield (see above), which is part of the context of the Infringing Agreement between Gallaher and Somerfield.

6.1480 The existence of the further supporting evidence described above (and in particular the relationship between ITL and Somerfield) lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and Somerfield which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.

(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.1481 As is noted in the sections above relating to the existence of an Infringing Agreement between each of ITL/Somerfield and Gallaher/Somerfield, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.1482 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to Somerfield and that each Manufacturer must have been aware of the other Manufacturer's parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d) above).
IX Agreement and/or concerted practice between ITL and T&S Stores and between Gallaher and T&S Stores

Summary

6.1483 As set out in Section 6.C.IX.(a), ITL and T&S Stores were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby ITL co-ordinated with T&S Stores the setting of T&S Stores' retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL's retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.1484 As set out in Section 6.C.IX.(b), Gallaher and T&S Stores were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby Gallaher co-ordinated with T&S Stores the setting of T&S Stores' retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher, in pursuit of Gallaher's retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.1485 Each of the Infringing Agreements between ITL/T&S Stores and Gallaher/T&S Stores amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to T&S Stores and that each Manufacturer must have been aware\(^\text{1189}\) of the other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of the Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement as set out in Section 6.A.I.(d) above.

\(^{1189}\) See also Section 6.A.I.(b) above in relation to the Manufacturers’ awareness of each other’s parallel and symmetrical parity and differential requirements.
On 11 July 2008, each of Gallaher and T&S Stores concluded an early resolution agreement with the OFT, pursuant to which each admitted its involvement in each Infringing Agreement to which it was party, in breach of the Chapter I Prohibition.

(a) Agreement and/or concerted practice between ITL and T&S Stores

When considered together with the evidence of ITL’s overall strategy for retail prices described in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, the evidence referred to below demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between ITL and T&S Stores, whereby ITL co-ordinated with T&S Stores the setting of T&S Stores’ retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. For the reasons set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between ITL and T&S Stores restricted the ability of T&S Stores to determine its retail prices for competing linked brands and had the object of restricting competition.

The following elements evidence the Infringing Agreement between ITL and T&S Stores:1190

i ITL’s strategy in relation to T&S Stores’ retail prices

The trading agreements and contacts set out between ITL and T&S Stores below should be considered in the context of ITL’s retail pricing strategy as set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

ii Trading agreements between ITL and T&S Stores

Formal trading agreements existed between ITL and T&S Stores which pre-dated the coming into force of the Chapter I Prohibition.

1190 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.

'Subject to the pricing of the ITL range being in line with our strategy requirements in a minimum of 90% of stores ITL will make payment up to a maximum of £[C] per month.'

6.1492 There was also correspondence sent by ITL to T&S Stores which indicates they entered into a trading agreement of a similar nature between 1998 and 1999, in which T&S Stores agreed to maintain pricing differentials on tobacco brands.1192

6.1493 The continuation of the agreement is shown by the 'T&S Stores/Imperial Tobacco Business Agreement 1999/2000 effective 1 October 1999' 1193 in which T&S Stores agreed to implement the required ITL pricing differentials during the period of 1 October 1999 to 30 September 2000.

6.1494 Three trading agreements between ITL and T&S Stores covered the period from 1 October 1999 to 31 December 2002. Those agreements were a relevant aspect of the ongoing commercial dealing between ITL and T&S Stores and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and T&S Stores in relation to retail prices.

6.1495 The first trading agreement ('TA1'), signed by both parties but undated,1194 appears to be in relation to the period 1 October 1999 to 30 September 2000. The second trading agreement ('TA2'), signed by both parties and dated 27 June 2001,1195 was in relation to the period 1 October 2000 to 30 September 2001. The period of this agreement was subsequently extended to 31 December 2001.1196 The third trading

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1191 Document 1, Annex 29, which together with Documents 2-11, Annex 29 (which also pre-date the Act) show that an agreement whereby ITL incentivised T&S Stores to implement ITL's retail pricing policy was in existence before the Chapter I Prohibition came into force generally on 1 March 2000.

1192 Documents 5, 6 and 7, Annex 29.


agreement (‘TA3’), undated and signed by T&S Stores only, was in relation to the period 1 January 2002 to 31 December 2002.

6.1496 In terms of TA1, TA2 and TA3, ITL and T&S Stores agreed, among other matters, to the following:

‘Pricing Policy

The overall requirement is that ITL products are treated no worse than equally, in terms of selling prices, compared with other manufacturers similar products. A full requirement is shown on the attached listing’.

and

‘Subject to head office price sheets and a minimum of [C]% of branches following these guidelines a quarterly payment of [C] p[C] cigarettes will be made’.

6.1497 According to each of TA1, TA2 and TA3, the ‘overall requirement’ was that ITL products should be treated ‘no worse than equally, in terms of selling prices, compared with other manufacturers’ similar products’. Each trading agreement set out the ‘full requirement’ agreed between the parties in an ‘attached listing’ headed ‘Price Requirements’, for example TA2:

‘Embassy Number 1; Embassy Mild; Embassy Lights [ITL brands]:

20s packings at least 3p less than the price of Benson & Hedges King Size 20s [Gallaher brand]

100s packings at least 15p less than the price of Benson & Hedges King Size 100s [Gallaher brand]

200s packings at least 30p less than the price of Benson & Hedges King Size 200s [Gallaher brand]

........

John Player Special; John Player Special Lights [ITL brands]:

1199 TA1 (Documents 11, Annex 29 (page 3)), TA2 (Document 32, Annex 29 (page 3)) and TA3 (Document 40, Annex 29 (page 3)).
1201 TA2 (Document 32, Annex 29 (pages 6 and 7)), TA1 (Document 11, Annex 29 (page 6)), and TA3 (Document 40, Annex 29 (pages 6 and 7)).
20s packings no more than 9p above the price of Sovereign King Size 20s [Gallaher brand]

100s packings no more than 45p above the price of Sovereign King Size 100s [Gallaher brand]

20s packings no more than 16p above the price of Mayfair King Size 20s [Gallaher brand]

100s packings no more than 80p above the price of Mayfair King Size 100s [Gallaher brand]

......

6.1498 TA1, TA2 and TA3 also required that T&S Stores correct any errors highlighted by ITL and advise ITL of manufacturers’ pricing 'activity' that would affect ITL’s pricing requirements:1202

'T&S head office will correct any errors highlighted by ITL of price tiers and allow ITL to react to pricing activity undertaken by other manufactures, although ITL may not take any action.'

6.1499 In addition, in TA21203 and TA31204, ITL and T&S Stores agreed to the following:

'T&S head office will supply new price files as requested for the full estate.'

'ITL merchandisers will continue to visit all stores approximately every 8 weeks to monitor '.1205

6.1500 The documents below evidencing payments made by ITL to T&S Stores indicate that T&S Stores performed its obligation to comply with the differentials set by ITL.

6.1501 Thus, a fax dated 8 August 2000 titled 'T and S Stores 1 October 1999 – 30 June 2000'1206 amongst other matters, detailed volume and bonus payments for 'Pricing Policy' compliance owed by ITL to T&S Stores during the period of TA1.

1202 TA1 (Document 11, Annex 29 (page 3)), TA2 (Document 32, Annex 29 (page 3)), TA3 (Document 40, Annex 29 (page 3)).
1205 TA2 (Document 32, Annex 29 (page 3)) and TA3 (Document 40, Annex 29 (page 3)).
6.1502 A document with the date reference '1/10/00 – 30/9/01' and titled 'T&S Business Plan Summary' detailed payments for 'Pricing Policy' compliance for the TA2 period.\textsuperscript{1207}

6.1503 A fax dated 18 January 2002 titled 'Business Plan Support'\textsuperscript{1208} detailed 'Pricing allowance' payments to be made by ITL to T&S Stores for compliance with TA2.

6.1504 A document titled 'Imperial T&S Agreement 2002'\textsuperscript{1209} set out 'Pricing Policy' compliance payments owed by ITL to T&S Stores for the 'Current Position' and for different scenarios based on potential sales for the 2002 and 2003 periods.

6.1505 In a fax dated 8 July 2002 from ITL to T&S Stores, ITL agreed to pay the 'Price policy allowance' for the 6 months to 30 June 2002 to T&S Stores.\textsuperscript{1210}

6.1506 An email dated 18 July 2003 included a scanned document titled 'T and S Bonus File 03 07 21, ITL Cigarettes, Cigars etc'\textsuperscript{1211} and detailed bonuses paid to T&S Stores.

6.1507 Although some of the differential requirements contained in TA1, TA2 and TA3 purportedly provided that T&S Stores was to maintain maximum differential requirements between competing linked brands, the OFT infers from the following evidence that such provisions were in fact implemented as fixed differential requirements, rather than maximum differential requirements: (i) evidence of ITL's retail pricing strategy; (ii) evidence regarding the way in which the trading relationship between ITL and T&S Stores operated in practice (that is, evidence of the contacts between ITL and T&S Stores); and (iii) the existence of an Infringing Agreement between Gallaher and T&S Stores pursuant to which Gallaher communicated parallel and symmetrical parity and differential requirements to T&S Stores (see further Section 6.C.IX.(b) below). The restrictive nature of both fixed differential requirements and maximum differential requirements is described above at Section 6.A.I.(d).

6.1508 In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which T&S Stores would set its retail prices in accordance with the differential requirements set by ITL, and that T&S Stores was rewarded with the payment of a bonus for compliance with ITL's differential requirements.

\textsuperscript{1207} Document 66, Annex 29.
\textsuperscript{1208} Document 41, Annex 29.
\textsuperscript{1209} Document 67, Annex 29.
\textsuperscript{1210} Document 47, Annex 29.
\textsuperscript{1211} Document 65, Annex 29.
Contacts between ITL and T&S Stores regarding retail prices

6.1509 A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and T&S Stores regarding: (i) T&S Stores' retail prices for ITL's brands; (ii) T&S Stores' retail prices for ITL's competitors' brands; and (iii) the retail prices of other Retailers for ITL's brands and/or for ITL's competitors' brands.

6.1510 The documents evidencing the contacts between ITL and T&S Stores demonstrate that: (i) in relation to T&S Stores' retail prices for ITL's brands (sometimes by reference to T&S Stores' or other Retailers' retail prices for ITL's competitors' brands) and/or (ii) in relation to T&S Stores' retail prices for ITL's competitors' brands:

- ITL communicated\(^{1212}\) to T&S Stores what T&S Stores' retail prices should be; and/or
- ITL asked and/or incentivised T&S Stores to hold or alter T&S Stores' retail prices; and/or
- T&S Stores informed ITL about, or discussed with ITL, T&S Stores' current or proposed retail prices.

6.1511 T&S Stores accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1512 In addition, ITL and T&S Stores informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL's brands and/or for ITL's competitors' brands.

6.1513 The contacts between ITL and T&S Stores took place in the context of ITL's retail pricing strategy for Retailers to maintain specified parities and differentials between ITL's brands and competing linked brands.

Communications in relation to retail prices were sent by ITL, and were received and implemented by T&S Stores\(^{1213}\) on the understanding that the notified retail prices took into account ITL's retail pricing strategy, together with T&S Stores' desired pricing position relative to other Retailers and T&S Stores' desired margin.

6.1514 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1515 Various examples of contacts between ITL and T&S Stores regarding retail prices are set out below.

\(^{1212}\) See paragraphs 6.108 and 6.109 above in relation to the nature of such 'communications'.

\(^{1213}\) See paragraphs 6.1546 to 6.1547 in relation to implementation.
Contacts between ITL and T&S Stores regarding T&S Stores’ retail prices for ITL’s brands

6.1516 Set out below are examples of contacts between ITL and T&S Stores in relation to T&S Stores’ retail prices for ITL’s brands, which demonstrate that, in relation to T&S Stores’ retail prices for ITL’s brands (sometimes by reference to the retail prices of competing linked brands):

• ITL communicated to T&S Stores what T&S Stores’ retail prices should be; and/or
• ITL asked and/or incentivised T&S Stores to hold or alter T&S Stores’ retail prices; and/or
• T&S Stores informed ITL about, or discussed with ITL, T&S Stores’ current or proposed retail prices.

6.1517 T&S Stores accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1518 The examples of such contacts are as follows.

6.1519 In an email exchange dated 17 March 2000 between T&S Stores and ITL, T&S Stores confirmed that it would purchase pre-Budget stock from ITL subject to ITL’s conditions. In particular, ITL stipulated:1214

‘I need by 12:30 at the latest your confirmation to the following:

…

2) ITL prices will change, if any change, on same day as other manufacturers

3) The correct differentials will be maintained, as per our business plan

…’

And T&S confirmed:

‘I confirm payment due to you on 14th April 2000 for pre Budget purchases subject to the below 3 conditions.’

6.1520 A fax dated 27 June 2000 from ITL to T&S Stores referred to retail pricing in Day & Nite stores:1215

‘We both agreed to price policy and bonus structure needed to be brought to a correct ‘natural level’. I have send a recommended

\[1214\] Document 12, Annex 29.
\[1215\] Document 18, Annex 29.
start point to you by e-mail today showing prices and retro support levels which will be paid on EPOS sales out data.

*The date for implementation of the above has been suggested as mid-July...*

6.1521 In a related fax dated 12 July 2000 from ITL to T&S Stores, ITL again referred to retail pricing in Day & Nite stores:1216

‘Thank you for informing me that the prices charged will be in line with the suggested price list I produced. This gives a clear start point for retail prices and long term bonus support in the cut price outlets.

...

From branch visits we have now noticed the following differential errors, could you please arrange to correct them next week:

<table>
<thead>
<tr>
<th>Change required</th>
</tr>
</thead>
<tbody>
<tr>
<td>[ITL brand]</td>
</tr>
<tr>
<td>[Gallaher brand]</td>
</tr>
</tbody>
</table>

...

**Band 3 – Classic Twin is set at £5.44** Change to £5.54 (equal to Hamlet 10s?)

...

6.1522 In a letter dated 18 September 2000, ITL confirmed details of the agreed pricing on ITL’s Richmond brand:1217

‘The agreed selling out prices are as below, which are not above the selling out price of Dorchester King Size [Gallaher brand]:

....

[the letter then set out lists of absolute prices in all tiers]

The above cost price will cover all stock supplied to ... in return you for implementing the above selling out prices from 1st October as agreed’

6.1523 In a letter dated 12 March 2001 from ITL to T&S Stores, following earlier telephone conversations, ITL requested:1218

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‘... will you please arrange to implement the January MPI increase, 5p for 20, on the Richmond family [ITL brand] with effect from 25 March, subject to the Richmond KS and SK [ITL brand] price not being higher than Dorchester KS and SK [Gallaher brand]. The new prices should be.... The [C]p per outer post MPI support will therefore end...’

ITL then provided further explanation of the changes:

‘The above prices are in effect the 'natural’ pre-budget prices, after the ending of the MPI support. In return for maintaining the above until further notice ITL will pay a retro allowance of....’

6.1524 The OFT notes that elsewhere in the letter dated 12 March 2001 and in certain instances in some other documents, ITL instructed or requested that T&S Stores change the maximum prices of its products. However, although ITL’s language may have on occasion changed from that used in other correspondence (which did not refer to maximum prices), the OFT considers that in reality there was no change from the nature of such other communications and therefore this correspondence nonetheless supports the existence of the Infringing Agreement between ITL and T&S Stores.

6.1525 In a fax dated 22 October 2001 from ITL to T&S Stores, ITL confirmed details of an earlier discussion concerning the pricing of ITL’s Richmond brand:

‘RICHMOND KING SIZE and SUPERKINGS

Will you please arrange to increase the prices of 20s in all stores/tiers by 10p for King Size and 11p for Superkings. The new prices will therefore be as follows: ....’

‘These new prices will be implemented on 4 November, assuming Dorchester KS/Superkings [Gallaher brand] is not on sale at a lower price in any store/tier. '

‘The post budget support [C]p per outer (and the post MPI support [C]p KS & [C]p SK per outer) will therefore end on ITL invoice date 31 October 2001.’

6.1526 In a fax from ITL to T&S Stores dated 8 July 2002, ITL stated:

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1219 See other correspondence such as Documents 30, 37, 45, 59, 61 and 64, Annex 29.
1220 See also the OFT’s conclusions regarding communications referring to maximum pricing in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’
‘Thank you for the latest price sheets, my office is currently checking to ensure the correct differentials are maintained, as part of our business plan.

I have noticed you have a flat price on Berkley Superkings [Gallaher brand] multipack at £19.99. Will you change the following brands in Supercigs tiers 1 to 4 to £19.99 with immediate effect:…

[list of ITL’s Superkings & Raffles brands follows]

You have also introduced a flat price on Berkeley [Gallaher brand] multipacks in all CTN stores of £19.99. Will you therefore change the above five SKU’s to £19.99 in all CTN tiers.

The above Supercigs and CTN price changes will be effective from 15 July you confirmed. The additional retro allowance we agreed for this activity is [C]p per outer on all T&S Stores volume of the above 5 SKU’s…

On a quick look I also noticed the following prices should be amended to bring Raffles [ITL brand] into line, as raised at our meeting in May, will you please ensure these are changed with effect from 23 July:…

[list of ITL’s Raffles brand prices follows]

Where no price is shown the correct differentials are already in place against Berkeley Superkings [Gallaher brand].

6.1527 In a fax dated 1 May 2003 from ITL to T&S Stores, amongst other matters, ITL under ‘Retail Prices’ stated:1224

‘Thank you for confirming the few price errors had now been corrected. Please forward a new price list for all three stores directly to my office early next week’.

The OFT also notes the hand annotated tick next to the text.

6.1528 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and T&S Stores regarding T&S Stores’ retail prices for ITL’s brands which demonstrates the same matters as set out in respect of the documents

1223 This document contained manuscript ticks against each pricing instruction made by ITL. The OFT infers that these show that T&S Stores agreed to implement ITL’s price instructions.

quoted above: documents 3 to 10, 13, 16, 18, 20, 21, 23, 24, 26, 29, 31, 34, 37, 43, 44, 45, 46, 48, 49, 50, 51, 52, 55, 56, 57, 58, 59, 61, 62, 64, 65, 66 and 67 of Annex 29 (which are listed in Annex C). Documents 45, 47, 51, 52, 55, 56, 57, 61 and 63 all contain manuscript ticks and/or comments such as 'done' and the OFT infers from those that T&S Stores had agreed to implement the price changes requested by ITL in those documents.

Contact between ITL and T&S Stores regarding T&S Stores’ retail prices for ITL’s competitors’ brands

6.1529 In addition to the documents above, which concern contact between ITL and T&S Stores regarding T&S Stores’ retail prices for ITL’s brands, there were contacts between ITL and T&S Stores in relation to T&S Stores’ retail prices for ITL’s competitors’ brands. Set out below are examples of such contacts which demonstrate that in relation to T&S Stores’ retail prices for ITL’s competitors’ brands:

- ITL communicated to T&S Stores what T&S Stores’ retail prices should be; and/or
- T&S Stores informed ITL about, or discussed with ITL, T&S Stores’ current or proposed retail prices.

6.1530 T&S Stores accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1531 The examples of such contacts are as follows.

6.1532 An email dated 27 April 2000 from ITL to T&S Stores stated:1230

‘At one of our recent meeting I highlighted the ‘odd’ prices being charged at this store … This store is now charging £3.59 for

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1225 These documents pre-date the period of infringement under the Act but are relied upon by the OFT to demonstrate that T&S Stores fully understood ITL’s pricing strategy, including the operation of bonuses and maintaining parity and differential pricing requirements. In some of these documents, ITL confirmed that T&S Stores had agreed to make the necessary changes to its prices (see Documents 7, 9 and 10, Annex 29).
1226 This document shows ITL confirming details of T&S Stores’ price changes on ITL products post-MPI, as previously discussed with T&S Stores.
1227 This document shows ITL sending T&S Stores a revised price differential requirements sheet which applies post Gallaher’s MPI (see also Documents 50, 51 and 57, Annex 29).
1228 In this document ITL refers to various price changes that have been agreed with T&S Stores.
1229 In an email sent to ITL, T&S Stores confirmed that selling prices of three ITL brands in its system had been checked and ‘are correct as per your letter with Ken [of ITL] some time ago’.
Richmond [ITL brand] ... The correct price should be £3.39 the same as Mayfair KS [Gallaher brand].’

6.1533 In a letter dated 19 May 2000 from ITL to T&S Stores, ITL stated: 1231


With effect from 28th May you informed me all Gallaher & ITL premium brands will revert to their ‘natural price’ in Supercigs.’

6.1534 In a letter dated 27 June 2000 from ITL to T&S Stores in relation to the launch of Small Classic [ITL brand], ITL instructed that there should be parity with Hamlet [Gallaher brand]: 1232

‘The selling out price should be set at the same price as Small Classic/Café Crème/Hamlet Mins [the first and second are ITL brands and the third is a Gallaher brand] in all formats and tiers.’

6.1535 In a fax dated 6 October 2000 from ITL to T&S Stores, ITL stated: 1233

‘... following the move of Mayfair [Gallaher brand] and [C] [other manufacturer’s brand] to ‘normal prices’ will you please implement the following prices on L&B and JPS 20s [ITL brands] and multipacks with effect from 22nd October 2000. ’

It is noted that ITL’s request was to increase prices to an absolute level.

6.1536 In a fax dated 30 November 2000 from ITL to T&S Stores, ITL stated: 1234

‘Following our meeting last week ... You confirmed that the £3.49 special flat price for Mayfair [Gallaher brand] in CTNs and C Stores would end on 27 November restoring all the correct agreed differentials’.

6.1537 In an email dated 12 October 2001 from T&S Stores to ITL, T&S Stores informed ITL of a future price increase in a Gallaher brand, which would happen ‘subject to’ the same increase in ITL’s competing linked brand: 1235

‘I tried you by phone as you had earlier sent me an e-mail ... Dorchester [Gallaher brand] are increasing on 4th November by 10p subject to Richmond increasing [ITL brand] …’

6.1538 Subsequently, in a letter dated 22 October 2001 from ITL to T&S Stores, ITL confirmed that Richmond Kingsize prices would also increase by 10p on 4th November: 1236

1232 Document 18, Annex 29 (page 3).
1236 Document 38, Annex 29.
‘RICHMOND KING SIZE and SUPERKINGS [ITL brand]

Will you please arrange to increase the prices of 20s in all stores/tiers by 10p for King Size and 11p for Superkings. The new prices will therefore be as follows: .....’

‘These new prices will be implemented on 4 November, assuming Dorchester KS/Superkings [Gallaher brand] is not on sale at a lower price in any store/tier.’

6.1539 A letter dated 2 September 2002 from ITL to T&S Stores following a ‘recent meeting’ 'noted the main items' covered which included price increases for both ITL and Gallaher brands:1237

‘The ITL prices in your stores will increase on 1 September, along with the prices of Hamlet, King Six, and Berkeley families [Gallaher brands]’.

6.1540 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between ITL and T&S Stores regarding T&S Stores' retail prices for ITL’s competitors' brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 4 to 9, 12, 16, 19, 22, 24, 26, 27, 29, 30, 33, 34, 37, 38, 46, 48, 51, 55, 56, 57, 58, 59, 61, 62 and 64 of Annex 29 (which are listed in Annex C).

Contact between ITL and T&S Stores regarding the retail prices charged by T&S Stores' competitors

6.1541 In addition to the documents above, there were contacts between ITL and T&S Stores in which ITL and T&S Stores informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for ITL’s brands and/or for ITL’s competitors' brands.

6.1542 In an email dated 12 October 2001 from T&S Stores to ITL, T&S Stores stated:1238

‘Mayfair [Gallaher brand] in the independants will be 15p off so mult’s are being bonused down to £3.59.’

6.1543 In a letter dated 2 September 2002 from ITL to T&S Stores, ITL noted the main items covered at a recent meeting and stated:1239

‘MPI – 2 September 2002

The ITL prices in your stores will increase on 1 September, along with the prices of Hamlet, King Six, and Berkeley families [Gallaher brands].

I understand stores competing with local Kwiksave outlets may change at different times.'

6.1544 The OFT infers from the above documents that ITL received information from T&S about the prices of a Gallaher brand across a number of retail outlets and that ITL and T&S Stores discussed the current or proposed prices of T&S Stores, by reference to the current or proposed retail prices of other retailers for ITL’s products and/or ITL’s competitors’ products.

Conclusion on the contacts between ITL and T&S Stores

6.1545 In conclusion in relation to all the contacts between ITL and T&S Stores regarding retail prices, the above paragraphs demonstrate that there were regular contacts between ITL and T&S Stores, which related to the retail prices of T&S Stores as well as other Retailers. The evidence of such contacts together with the context of ITL’s strategy, demonstrates that ITL’s retail pricing strategy was for T&S Stores to maintain specified parities and differentials between ITL’s brands and competing linked brands. The contacts between ITL and T&S Stores assisted the implementation of that strategy, through communications between ITL and T&S Stores in relation to T&S Stores’ retail prices for ITL’s brands and in some cases ITL’s competitors’ brands, the aim of which was to ensure that ITL’s desired parities and differential requirements were maintained or realigned. The contacts between ITL and T&S Stores also demonstrate that T&S Stores accepted and/or indicated its willingness to implement the directions contained in communications from ITL to T&S Stores in that connection.

6.1546 The OFT notes that ITL submitted that there were instances where T&S Stores did not implement instructions and/or requests in ITL’s pricing communications.

6.1547 However, the OFT considers that the fact that there may have been some instances where T&S Stores did not implement, did not implement fully\(^{1240}\), or delayed the implementation of instructions and/or requests in ITL’s pricing communications, does not negate the existence of the

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\(^{1240}\) For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.
Infringing Agreement between ITL and T&S Stores, as there is sufficient evidence over a period of time of T&S Stores’ compliance, or intention to comply, with ITL’s retail pricing strategy (see for example the sections entitled ‘Trading agreements between ITL and T&S Stores’ and ‘Contacts between ITL and T&S Stores regarding retail prices’ above).

iv  Bonuses

6.1548 As noted in relation to TA1, TA2 and TA3 above, ITL rewarded T&S Stores with an ongoing bonus on the condition that, among other matters, T&S Stores complied with ITL’s retail pricing strategy and maintained the differential requirements between ITL’s brands and competing linked brands as set out in the ‘Price Requirements’ attachment to the trading agreements.

6.1549 There are also documents relating to the provision of tactical bonuses from ITL to T&S Stores, examples of which are set out in the section entitled ‘Contacts between ITL and T&S Stores regarding retail prices’ above.

6.1550 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by T&S Stores. In particular, the bonuses ensured that T&S Stores’ margin was not significantly affected by the changes in retail prices instructed or requested by ITL to achieve ITL’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of T&S Stores’ retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.1551 In addition to those documents referred to in the contacts sections above, which specifically refer to tactical bonuses, the following documents also evidence the use of tactical bonuses.

6.1552 In a fax dated 6 October 2000 from ITL to T&S Stores, following ITL’s request to lift Richmond [ITL brand] prices in response to Dorchester [Gallaher brand], ITL stated:1241

‘The retro discount …will change to [C]p…to take account of the above higher selling out prices’.

6.1553 In a fax dated 12 March 2001 from ITL to T&S Stores, ITL stated:1242

‘… will you please arrange to implement the January MPI increase, 5p for 20, on the Richmond family [ITL brand] with effect from 25

March subject to Richmond KS and SK [ITL brand] price not being higher than Dorchester KS and SK [Gallaher brand] ...

The above prices are in effect the ‘natural’ pre-budget prices ... In return for maintaining the above until further notice ITL will pay a retro allowance of [C]p per outer.’

6.1554 In a fax dated 3 September 2001 from ITL to T&S Stores, ITL stated:1243

‘Further to my letter dated 20 August and our telephone conversations the following change has been agreed:

**PANAMA 6’s** [ITL brand]

You have moved to the natural price of £2.68 in all stores and tiers from 3 September

*The bonus payment with therefore be £[C] per outer ...*

ITL will review this price during September and may decide to alter it then’.

6.1555 In a fax dated 8 July 2002 from ITL to T&S Stores, ITL stated:1244

‘You have also introduced a flat price on Berkeley [Gallaher brand] multipacks in all CTN stores of £19.99. **Will you therefore change the above five SKU’s** [ITL brands] to £19.99 in all CTN tiers.

...

*The additional retro allowance we agreed for this activity is [C]p per outer on all T&S volume of the above 5 SKUs’ [emphasis as in source document].

6.1556 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the provision of bonuses by ITL to T&S Stores which demonstrates the same matters as set out in respect of the documents quoted above: documents 16, 18, 19, 26, 30, 34, 35, 45, 62 and 64 of Annex 29 (which are listed in Annex C).

6.1557 The evidence demonstrates that ITL paid bonuses to T&S Stores in order to ensure that ITL’s retail pricing strategy was maintained. T&S Stores accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parties and differentials set by ITL.

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Monitoring of retail prices by ITL

6.1558 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated 'errors' to T&S Stores.

6.1559 T&S Stores participated in this monitoring by providing ITL with details of its proposed retail prices for ITL's brands.

6.1560 In addition, monitoring was formalised in TA2 and TA3. As noted above in relation to TA2 and TA3, T&S Stores had agreed to 'supply ITL with new price files as requested' and ITL would 'continue to visit all stores approximately every 8 weeks to monitor prices'.

6.1561 In an email dated 28 March 2000 from ITL to T&S Stores stated:1245

'We are still waiting for the new price sheets to check all the required differentials, can you please ensure these are sent …'

6.1562 In a letter dated 19 May 2000 from ITL to T&S Stores, ITL, having communicated price changes to T&S Stores, requested:1246

'Will you please ask Paul to send the new price files to Lorraine next week, with the above changes implemented'.

6.1563 In a fax dated 10 June 2000 from ITL to T&S Stores, ITL requested that T&S Stores correct a pricing error:1247

'There is one slight error in the C Store differentials we have noticed.

Would you please arrange to alter the price of Lambert & Butler and John Player Special families 100s [ITL brands] to £17.75 in tier 8 only to achieve the required differentials. Brands to be changed:

…'

6.1564 A fax dated 12 July 2000 from ITL to T&S Stores demonstrates the active monitoring by ITL:1248

'From branch visits we have now noticed the following differential errors, could you please arrange to correct them next week.'

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Change required

Band 3 – B&H KS 100’s is set at £20.70
Regal KS 100s to change to £20.45

[Gallaher brand] [ITL brand]

…'

The OFT notes that the listed changes required to correct the errors included both decreases and an increase to the price of ITL's brands in order to maintain differentials.

6.1565 A fax dated 6 October 2000 from ITL to T&S Stores stated:¹²⁴⁹

'Day & Nite stores were not undertaking the 'special' Mayfair [Gallaher brand]/[another manufacturer brand] or L&B/JPS prices [ITL brands] ... there should be no changes needed ...

If this is not correct for ITL to achieve the correct differentials please ring me'.

6.1566 In a fax dated 30 November 2000 from ITL to T&S Stores, ITL stated:¹²⁵⁰

'I informed you that it seems Day & Nite stores are charging a different price for Drum [ITL brand] and Amber Leaf [Gallaher brand]. Although the price file you gave me shown both products at the same price, the stores are not following the same, could you please look into this?'

6.1567 An email dated 4 August 2002 from T&S Stores to ITL stated:¹²⁵¹

'Just to confirm that I have checked the selling prices in our system and I am happy to say that Panama 6's, Raffles, Superkings [ITL brands] are correct as per your letter and as agreed with Ken [of ITL] some time ago. I will take the necessary action on those stores you outlined to me'.

6.1568 In a fax dated 1 May 2003 from ITL to T&S Stores, ITL stated:¹²⁵²

'Thank you for confirming the few price errors had now been corrected. Please forward a new price list for all three stores direct to my office early next week.'

6.1569 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of T&S Stores’ retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 3, 5, 6, 7, 9, 10, 18, 24, 29, 31, 521253 and 64 of Annex 29 (which are listed in Annex C).

6.1570 These documents demonstrate that ITL would monitor T&S Stores’ retail prices of both ITL and Gallaher brands to ensure that parity and differential requirements were maintained and would point out pricing errors to T&S Stores.

vi Conclusion on the agreement and/or concerted practice between ITL and T&S Stores

6.1571 The evidence described above demonstrates the existence of the Infringing Agreement between ITL and T&S Stores, which had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and, given that the remaining constituent elements of the statutory test are also met (see Section 7: ‘Legal assessment’), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.1572 In addition to the above, the existence of the Infringing Agreement between ITL and T&S Stores is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of the Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- ITL and each of the other Retailers, which evidence ITL’s approach towards the Retailers as a collective; and between
- Gallaher and T&S Stores (see below), which is part of the context of the Infringing Agreement between ITL and T&S Stores.

6.1573 The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and T&S Stores) lends further support to the fact that there was an agreement and/or concerted practice

1253 This document shows ITL confirming receipt of T&S Stores’ price file (see also Documents 56 and 58, Annex 29).
between ITL and T&S Stores which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or concerted practice between Gallaher and T&S Stores

6.1574 When considered together with the evidence of Gallaher’s overall strategy for retail prices described in Section 6.B: 'Manufacturers’ retail pricing strategies’ above, the evidence referred to below, demonstrates that, at least from 1 March 2000\textsuperscript{1254} to 15 August 2003 an Infringing Agreement existed between Gallaher and T&S Stores whereby Gallaher co-ordinated with T&S Stores the setting of T&S Stores’ retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher’s retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between Gallaher and T&S Stores restricted the ability of T&S Stores to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1575 The following elements evidence the Infringing Agreement between ITL and T&S Stores:\textsuperscript{1255}

\begin{enumerate}
\item Gallaher’s strategy in relation to T&S Stores’ retail prices
\end{enumerate}

6.1576 The contacts set out below between Gallaher and T&S Stores should be considered in the context of Gallaher’s retail pricing strategy as set out in Section 6.B: 'Manufacturers’ retail pricing strategies’, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.1577 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher’s convenience channel, demonstrate that Gallaher’s objective was that retailers within that channel, of which T&S Stores was one such retailer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

\footnote{1254}{The OFT concludes that the Infringing Agreement between Gallaher and T&S Stores was in existence before the Chapter I Prohibition came into force on 1 March 2000. The existence of an agreement to that effect (whether formally written down or not) is inferred from the date of, and language used in, Documents 1 and 2 of Annex 27 (which pre-date the Chapter I Prohibition).}

\footnote{1255}{The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.}
6.1578 A good example is an internal Gallaher document headed 'Promotional Policy - Retail Promotion Contributions – March 2000', which listed the 'Pricing Objectives' in relation to the following brands amongst others:

'Camel [Gallaher brand] – Parity with Marlboro [competitor brand]'\textsuperscript{1256}

*Camel Lights/Ultra Lights* [Gallaher brand] – *Parity with Marlboro Lights* [competitor brand]

*B&H* [Gallaher brand] – *5p above Regal* [ITL brand], *3p above Embassy No 1* [ITL brand]

*Berkeley and B&H Superkings* [Gallaher brands] – *parity with JP Superkings* [ITL brand]

*Club* [Gallaher brand] *14p below Regal* [ITL brand]

*Sovereign* [Gallaher brand] *10p below L&B* [ITL brand]

*Mayfair* *7p below Sovereign* [both Gallaher brands] and at least *parity with Richmond* [ITL brand]…\textsuperscript{1257}

6.1579 Further evidence in relation to Gallaher's retail pricing strategy for all retail channels, and in particular Gallaher's convenience channel, is set out in Section 6.B: 'Manufacturers' retail pricing strategies' above, which refer to a number of other documents containing evidence of the same or similar nature.\textsuperscript{1258}

\textit{ii Trading agreements between Gallaher and T&S Stores}

6.1580 There were three trading agreements between Gallaher and T&S Stores dated 16 November 2000, 27 September 2001 and 12 December 2001. Those agreements were a relevant aspect of the ongoing commercial dealing between Gallaher and T&S Stores and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between Gallaher and T&S Stores in relation to retail prices.

6.1581 The first trading agreement ('TA1') signed and dated 16 November 2000 was in relation to the 2000 'calendar year'.\textsuperscript{1259} The second trading

\textsuperscript{1256} ITL has distributed Marlboro since 12 September 2001.

\textsuperscript{1257} Document 1, Annex 3 (page 2). This document also set out parity and differential requirements for cigars and hand rolled tobacco.

\textsuperscript{1258} See, in particular, Documents 5, 10, 13, 15 and 17, Annex 3.

\textsuperscript{1259} Document 9, Annex 27.
agreement (‘TA2’), signed and dated 27 September 2001, was in relation to the period 1 January 2001 for a fixed period of one year. The third trading agreement (‘TA3’), signed and dated 12 December 2001 was in relation to the period 1 January 2002 to 31 December 2004.

6.1582 In terms of TA1, TA2 and TA3, Gallaher and T&S Stores agreed among other matters that Gallaher would make certain volume based payments to T&S Stores, subject to:

'all relevant price list parities/differentials are maintained on Gallaher brands against competitor brands …’

6.1583 In addition, TA2 and TA3 referenced the ‘price lists parity/differential’:

'… as agreed from time to time (see Appendix 1)…'

'… as set out in Appendix 1…'

6.1584 TA2 and TA3 each included ‘Appendix 1: Gallaher vs. Competitors’, a page that outlined price parity and differential requirements by listing competitor brands next to ITL brands including the following:

1. Price parity for:

<table>
<thead>
<tr>
<th>Gallaher brands</th>
<th>v</th>
<th>ITL brands</th>
</tr>
</thead>
<tbody>
<tr>
<td>Berkeley SK Range</td>
<td>v</td>
<td>JP SK Range</td>
</tr>
<tr>
<td>Dorchester Range</td>
<td>v</td>
<td>Richmond Range</td>
</tr>
<tr>
<td>Hamlet mins</td>
<td>v</td>
<td>Café Crème &amp; Small Classic</td>
</tr>
</tbody>
</table>

2. Agreed RRP Differentials for:

| Sovereign KS | v | L&B KS |

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1260 Document 18, Annex 27.
1261 Document 21, Annex 27 is a ‘Letter of Agreement’ that is said to apply ‘during 2001’. Under its terms, T&S agreed to price Dorchester [Gallaher brand] as follows: (i) in Supercigs, at a ‘flat price of no more than 2p above [another manufacturer’s brand]’; (ii) in Dillons/One Stop, ‘Dorchester to be no more than 2p above [another manufacturer’s brand] across all Tiers’; and (iii) these requirements would not be applied ‘where Gallaher’s MPIs are out of line with the timing of any increase on [another manufacturer’s brand], and the price of Dorchester is not supported down by Gallaher’.
1263 Documents 9, 18 and 23, Annex 27 (Clause 1(a)) and Documents 18 and 23, Annex 27 (Appendix 1).
1264 Document 18, Annex 27 (TA2).
1265 Document 23, Annex 27 (TA3).
1266 Document 18, Annex 27 (page 5) (TA2) and Document 23, Annex 27 (page 6) (TA3).
In TA1, TA2 and TA3 Gallaher and T&S Stores also agreed that volume related payments would be made from Gallaher to T&S Stores on the condition that:

'Where T&S is involved in a promotion of a brand by a competitor of Gallaher, Gallaher shall be offered an opportunity to conduct similar promotional activity with T&S'.

TA2 and TA3 also stated:

'T&S agrees to provide its Price File information as early as possible, so that discrepancies and pricing issues can be followed up at all times'.

In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which T&S Stores would set its retail prices in accordance with the parity and differential requirements set by Gallaher and that T&S Stores was rewarded with the payment of a bonus for compliance with Gallaher’s parity and differential requirements.

### iii Contacts between Gallaher and T&S Stores regarding retail prices

A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and T&S Stores regarding: (i) T&S Stores' retail prices for Gallaher’s brands; (ii) T&S Stores' retail prices for Gallaher's competitors' brands; and (iii) the retail prices of other Retailers for Gallaher's brands and/or for Gallaher’s competitors’ brands.

The documents evidencing the contacts between Gallaher and T&S Stores demonstrate that: (i) in relation to T&S Stores’ retail prices for Gallaher’s brands (sometimes by reference to T&S Stores’ or other Retailers’ retail prices of competing linked brands) and/or (ii) in relation to T&S Stores' retail prices for Gallaher’s competitors’ brands:

- Gallaher communicated to T&S Stores what T&S Stores’ retail prices should be; and/or

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1267 Documents 18 and 23, Annex 27 (Clause 1(c)) and Document 9, Annex 27 (Clause (b)).
1268 Document 18 and 23, Annex 27 (Clause 1(b)).
1269 See paragraphs 6.108 and 6.109 above in relation to the nature of such 'communications'.

474
• Gallaher asked and/or incentivised T&S Stores to hold or alter T&S Stores' retail prices; and/or
• T&S Stores informed Gallaher about, or discussed with Gallaher, T&S Stores' current or proposed retail prices.

6.1590 T&S Stores accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1591 In addition, Gallaher and T&S Stores informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands and/or for Gallaher’s competitors’ brands.\textsuperscript{1270}

6.1592 The contacts between Gallaher and T&S Stores took place in the context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent by Gallaher, and were received and implemented by T&S Stores\textsuperscript{1271} on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together with T&S Stores’ desired pricing position relative to other Retailers and T&S Stores’ desired margin.

6.1593 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1594 Various examples of contacts between Gallaher and T&S Stores regarding retail prices are set out below.

\textit{Contact between Gallaher and T&S Stores regarding T&S Stores’ retail prices for Gallaher’s brands}

6.1595 Set out below are examples of contacts between Gallaher and T&S Stores in relation to T&S Stores’ retail prices for Gallaher’s brands, which demonstrate that, in relation to T&S Stores' retail prices for Gallaher’s brands (sometimes by reference to the retail prices for competing linked brands):

• Gallaher communicated to T&S Stores what T&S Stores' retail prices should be; and/or
• Gallaher asked and/or incentivised T&S Stores to hold or alter T&S Stores’ retail prices; and/or

\textsuperscript{1270} See Document 30, Annex 27.
\textsuperscript{1271} See paragraph 6.1624 in relation to implementation.
• T&S Stores informed Gallaher about, or discussed with Gallaher, T&S Stores' current or proposed retail prices.

6.1596 T&S Stores accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1597 The examples of such contacts are as follows.

6.1598 In an email dated 20 April 2000 from Gallaher to T&S Stores, Gallaher stated:1272

'In response to [another manufacturer’s brand], we would like to move the Mayfair 20’s [Gallaher] brands (including variants) to the same price … Can you advise me if you are doing the same reduction in Dillons, in which case we would follow suit.'

6.1599 In an email dated 9 June 2000 from Gallaher to T&S Stores, Gallaher stated:1273

'As discussed yesterday it is important for us to try and retain a normal price list parity against Richmond [ITL brand] /[another manufacturer’s brand] …would ask you please to implement the 1p differential with [another manufacturer’s brand] we all agreed upon.'

6.1600 In a fax dated 15 August 2001 from Gallaher to T&S Stores, Gallaher communicated:1274

'1. We would not expect to see our prices be increased prior to the MPI, and would wish to keep our prices in line with competitor increases on all major brands and packings.

... 

3. In return for this co-operation we are able to provide T&S with:
   a. An allocation of [C] stock (value), commencing 1st August …'

6.1601 In a letter dated 28 March 2002 from Gallaher to T&S Stores regarding 'Budget Allocation', Gallaher stated:1275

'Conditions of above deal:

...

1) T&S agree to ensure that prices of all key products are kept in line with competitors in the post-budget period.'

1272 Document 7, Annex 27.
1273 Document 8, Annex 27.
1274 Document 17, Annex 27.
1275 Document 26, Annex 27 (page 1 (l)).
6.1602 An email dated 27 June 2002 from Gallaher to T&S Stores provides further evidence of the direct link between compliance with Gallaher’s pricing strategy and the payment of bonuses:1276

‘In the light of some excellent performances on Hamlet [Gallaher brand], we would now like to implement a ‘price hold’ on 5’s, 10’s, and MP’s, and hold the price or reduce the price to the same level as Classic [ITL brand] ... I propose to pay you a retro... UFN or until ITL increase Classic.’

6.1603 In an internal T&S Stores email dated 27 July 2002, T&S Stores outlined its intention to adhere to the pricing requirements specified by Gallaher:1277

‘You may be aware that a large part of the ORD earnings for Tobacco are based on in store compliance both to pricing and POS. I have recently had a meeting with Gallahers who unfortunately have presented me with a depressing set of figures based on their own store visits. This in turn is going to cost us about £C during this year alone.

I would be grateful if we could get together to discuss this and see what steps can be taken to improve the situation.’

6.1604 A letter dated 29 August 2002 entitled ‘Pricing/Retro Amendments from 2nd September’ from Gallaher to T&S Stores stated:1278

‘Further to your discussions with Sean [of Gallaher], and our subsequent telephone conversation may I confirm the amendments to your pricing ...

[all Gallaher brands]

1. Dorchester KS: Price to move to move from £3.49 to £3.54 ...
2. Dorchester SK: Price to move to from £3.51 to £3.58 ...
3. Mayfair KS: Price to move to £3.55 from 15th September …’

6.1605 A letter dated 12 December 2002 from Gallaher to T&S Stores stated:1279

‘a. Mayfair KS and SK [Gallaher brand]: During January please continue with your current ‘flat pricing’ across all Tiers (i.e. KS £3.65/SK £3.69)’.

6.1606 A letter dated 16 January 2003 from Gallaher to T&S Stores regarding ‘Gallaher New Lines’ including ‘B&H Silver’ [Gallaher brand], stated:1280

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1276 Document 31, Annex 27.
1277 Document 33, Annex 27.
1280 Document 50, Annex 27.
‘Pricing:

Price as per L&B [ITL brand]’

6.1607 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and T&S Stores regarding T&S Stores’ retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 4, 6, 14, 15, 16, 19, 20, 22, 25, 26, 27, 29, 32, 34 to 44, 46, 47 and 50 to 53 of Annex 27 (which are listed in Annex C).

Contact between Gallaher and T&S Stores regarding T&S Stores’ retail prices for Gallaher’s competitors’ brands

6.1608 In addition to the documents above, which concern contact between Gallaher and T&S Stores regarding T&S Stores’ retail prices for Gallaher’s brands, there were contacts between Gallaher and T&S Stores in relation to T&S Stores’ retail prices for Gallaher’s competitors’ brands. Set out below are examples of such contacts which demonstrate that, in relation to T&S Stores’ retail prices for Gallaher’s competitors’ brands:

• Gallaher communicated to T&S Stores what T&S Stores' retail prices should be; and/or

• T&S Stores informed Gallaher about, or discussed with Gallaher, T&S Stores' current or proposed retail prices.

6.1609 T&S Stores accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1610 The examples of such contacts are as follows.

6.1611 In a letter dated 15 March 2000 from Gallaher to T&S Stores, Gallaher stated:\(^{1281}\)

'It was agreed that Gallaher would have the freedom to market its brands v our competitors. In principal we would at least have the price list differential v target brands such as L&B [ITL brand], [another manufacturer’s brand], and Richmond [ITL brand], as well as having the opportunity to respond to competitive pricing activity, as long as in so doing this did not bring Dorchester [Gallaher brand] closer to [another manufacturer’s brand] than 1p. This should apply across all Price Tiers.

Today's differential in the lowest price tier (Supercigs) is 4p'.

\(^{1281}\) Document 3, Annex 27.
6.1612 In an email dated 25 June 2002 from Gallaher to T&S Stores, Gallaher provided T&S Stores with requested details on its competitors' pricing, however in doing so Gallaher noted:\textsuperscript{1282}

'We would not wish to see our 10's disadvantaged against competitor brands, and would ask that you keep the 'price list parities' for brands such as:

[Gallaher brands] v [ITL brands]

\begin{itemize}
  \item BHKS/SCKS v Marlboro, Embassy No 1, Regal
  \item Sov v L&B
  \item Mayfair v L&B
  \item Dorchester v Richmond...
  \item BSK v JPSK
\end{itemize}

Therefore, if say BSK [Gallaher brand] is going to be eg rrp + 4, then JPSK [ITL brand] should be the same etc etc.\textsuperscript{1282}

6.1613 In a letter dated 28 November 2002 from Gallaher to T&S Stores, Gallaher summarised the following from a recent meeting:\textsuperscript{1283}

'Gallaher currently querying T&S Supercigs pricing support on L&B, Richmond, GV [Golden Virginia] 12.5g [all ITL brands] (You agreed to amend the latter shortly).'

6.1614 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and T&S Stores regarding T&S Stores' retail prices for Gallaher's competitors' brands which demonstrates the same matters as set out in respect of the documents quoted above: documents 7, 8, 13, 20, 26, 31, and 50 of Annex 27 (which are listed in Annex C).

\begin{flushright}
Contact between Gallaher and T&S Stores regarding the retail prices charged by T&S Stores' competitors
\end{flushright}

6.1615 In addition to the documents above, there were contacts between Gallaher and T&S Stores in which Gallaher and T&S Stores informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher's brands and/or for Gallaher's competitors' brands.

\textsuperscript{1282} Document 30, Annex 27.  
\textsuperscript{1283} Document 43, Annex 27.
In an email dated 23 March 2001 from Gallaher to T&S Stores entitled ‘Sterling and Dorchester’ [Gallaher brands], Gallaher stated:\textsuperscript{1284}

‘I understand that Asda and others will be increasing the 20’s of these lines [Gallaher brands] by 5p from the 2nd April. Clearly this will give you an opportunity to increase your Own Label.

(NB I hear that the MP’s will stay down pending Richmond [ITL brand] PM’s MP’s selling through). PS we don’t want Dorchester [Gallaher brand] to go up any further just yet, and will continue to hold the pre-Budget price levels/bonusing.’

An email dated 22 June 2001 from Gallaher to T&S Stores stated:\textsuperscript{1285}

‘Due to certain initiatives that have led to [another manufacturer’s brand] reduction in the trade notably in First Quench and Coops we would very much like to go with a flat price of £3.60 across all tiers in Dillon’s/One Stop UFN.’

An email dated 31 May 2002 from Gallaher to T&S Stores attached a ‘Price Survey 29/5/02 as requested’. The survey listed Gallaher brands and the ‘Price differentials’ and ‘Recorded Prices’ for T&S Stores’ competitors, including Asda, Kwiksave, Sainsbury, Safeway, Somerfield, Morrisons, First Quench, TM Retail.\textsuperscript{1286}

In an email dated 25 June 2002 from Gallaher to T&S Stores (also quoted above), Gallaher stated:\textsuperscript{1287}

‘You asked me to look at 10’s pricing, and as a result I have carried out the attached survey, to give you a picture as to where you stand v other Convenience Channel accounts.

My view is that T&S could well ‘tweak’ a few 10’s prices to make extra margin, as you will note some of the main accounts currently do...

1. ‘We would not wish to see our 10’s disadvantaged against competitor brands, and would ask that you keep the ‘price list parities’ for brands such as:

<table>
<thead>
<tr>
<th>Gallaher brands</th>
<th>v</th>
<th>ITL brands</th>
</tr>
</thead>
<tbody>
<tr>
<td>BHKS/SCKS</td>
<td>v</td>
<td>Marlboro, Embassy No 1, Regal</td>
</tr>
<tr>
<td>Sov</td>
<td>v</td>
<td>L&amp;B</td>
</tr>
<tr>
<td>Mayfair</td>
<td>v</td>
<td>L&amp;B</td>
</tr>
</tbody>
</table>

Therefore, if say BSK [Gallaher brand] is going to be eg rrp + 4, then JPSK [ITL brand] should be the same etc etc.’

2. I think that the Premium brands can stand increase more than the cheaper and economy brands, which tend to be more price sensitive.’

6.1620 In a letter dated 13 September 2002 from Gallaher to T&S Stores, Gallaher set out new pricing for two brands:¹²⁸⁸

‘1. Amber Leaf 50g [Gallaher brand]: …

f) Pricing:…

iii) Proposed price for 50g £7.80 (ie 34p off RSP) (NB Asda £7.89/Kwiksave £7.87)…

2. Samson 25g [Gallaher brand]: …

f) Pricing:…

c. Proposed price is therefore £3.91 (20p off RRP) UFN. (NB Asda £3.94/Kwiksave £3.92)’.

6.1621 It can be seen from the above that references by Gallaher to the retail prices of other Retailers were used by Gallaher as a means to encourage the implementation by T&S Stores of Gallaher’s parity and differential requirements. In particular, such references provided an assurance to T&S Stores that retail price changes put to T&S Stores by Gallaher would not cause Sainsbury to be out of step with its retail competitors. The function of references to the retail prices of other Retailers was to assist in the implementation of Gallaher’s pricing strategy and to ensure that Gallaher’s desired parities and differential requirements were maintained or, where need be, realigned.

6.1622 In addition to the documents quoted above, other documents contain evidence of contacts of the same or similar nature between Gallaher and T&S Stores regarding the retail prices charged by T&S Stores’ competitors which demonstrates the same matters as set out in respect of the documents quoted above: documents 38 and 48 of Annex 27 (which are listed in Annex C).

¹²⁸⁸ Document 36, Annex 27.
Conclusion on the contacts between Gallaher and T&S Stores

6.1623 In conclusion in relation to all the contacts between Gallaher and T&S Stores regarding retail prices, the above paragraphs demonstrate that there were regular contacts between Gallaher and T&S Stores, which related to the retail prices of T&S Stores as well as other Retailers. The evidence of such contacts together with the context of Gallaher’s strategy, demonstrates that Gallaher’s retail pricing strategy was for T&S Stores to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. The contacts between Gallaher and T&S Stores assisted the implementation of that strategy, through communications from Gallaher in relation to T&S Stores’ retail prices for Gallaher’s brands and in some cases Gallaher’s competitors’ brands, the aim of which was to ensure that Gallaher’s desired parity and differential requirements were maintained or realigned. The contacts between Gallaher and T&S Stores also demonstrate that T&S Stores accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher to T&S Stores in that connection.

6.1624 The OFT does not exclude the possibility that there may have been some instances where T&S Stores did not implement, did not implement fully\(^{1289}\), or delayed the implementation of instructions and/or requests in Gallaher’s pricing communications. However, the OFT considers that does not negate the existence of the Infringing Agreement between Gallaher and T&S Stores, as there is sufficient evidence over a period of time of T&S Stores’ compliance, or intention to comply, with Gallaher’s retail pricing strategy (see for example the sections entitled ‘Trading agreements between Gallaher and T&S Stores’ and ‘Contacts between Gallaher and T&S Stores regarding retail prices’ above).

iv   Bonuses

6.1625 As noted above in relation to TA1, TA2 and TA3, Gallaher paid T&S Stores an ongoing bonus per volume of sales, subject to T&S Stores maintaining, "all relevant price list parities/differentials… on Gallaher’s brands against competitor brands"\(^{1290}\).

\(^{1289}\) For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.

\(^{1290}\) Documents 9, 18 and 23, Annex 27 (Clause 1(a)) and Documents 18 and 23, Annex 27 (Appendix 1).
6.1626 In a letter dated 17 July 2002 from Gallaher to T&S Stores, there are handwritten annotations recording ‘done’ in relation to the following two points:1291

‘Some outstanding invoices remain: ie … 2002 Trading Agreement payments due as advised.’

And:

£[C] per month for Dorchester [Gallaher brand] pricing 2p above [C] [other manufacturer’s brand] …’

6.1627 There are also numerous documents relating to the provision of tactical bonuses from Gallaher to T&S Stores, examples of which are set out in the section entitled ‘Contacts between Gallaher and T&S Stores regarding retail prices’ above.

6.1628 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by T&S Stores. In particular, the bonuses ensured that T&S Stores’ margin was not significantly affected by the changes in retail prices instructed or requested by Gallaher to achieve Gallaher’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of T&S Stores’ retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.1629 In addition to those documents referred to in the contacts sections above, which specifically refer to tactical bonuses, the following documents also evidence the use of tactical bonuses.

6.1630 The attachment to the email dated 5 April 2002 from Gallaher to T&S Stores headed ‘GALLAHER RETRO BONUS’ listed seventeen of Gallaher’s brands along with the corresponding amounts owed to T&S Stores as retro bonuses.1292


‘Current Retro Monthly Bonus on these brands to cease from 1st March. You will need to alter your pricing in the current 5p or more price cut tiers in order to compensate your cash margin.’

6.1632 A letter dated 22 January 2003 from Gallaher to T&S Stores in relation to ‘Normal Monthly % Retro Payments’ stated:1294

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1291 Document 32, Annex 27.
1292 Document 6, Annex 27.
1293 Document 51, Annex 27.
‘Following today’s meeting may I confirm as follows:

**Prices from 1st February**

[all Gallaher brands]

*Dorchester KS MP’s: Move to £17.75; New Retro [C]p/00*

*Dorchester SK MP’s: Move to £17.95; New Retro [C]p/00*

*Mayfair SK MP’s: Current £18.20; Retro confirmed as [C]p/00*

...

As discussed, from the 1st March our retro bonus support will cease on the following brands:

...

*All Tiers currently pricing at 5p or more below RRP will need prices adjusted to compensate for this loss of cash margin*.  

The OFT notes that there were manuscript ticks next to each pricing communication made by Gallaher and therefore infers that T&S Stores had agreed to implement Gallaher’s pricing communication.

6.1633 A letter dated 13 February 2003 from Gallaher to T&S Stores under the heading, ‘3. Pricing and Retros’ confirmed that *additional pricing retro* bonuses were in existence:1295

‘c. Please note the following proposed changes to our pricing post-budget:

[all Gallaher brands]

i. *Dorchester KS and SK (20’s/100’s):* Unless otherwise advised we intend to end all additional pricing retro’s …

ii. *Mayfair KS and SK (20’s/100’s):* As for Dorchester

…’

6.1634 The evidence demonstrates that Gallaher paid bonuses to T&S Stores in order to ensure that Gallaher’s retail pricing strategy was maintained. T&S Stores accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parties and differentials set by Gallaher.

1295 Document 55, Annex 27.
In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the provision of bonuses by Gallaher to T&S Stores which demonstrates the same matters as set out in respect of the documents quoted above: documents 4, 7, 13, 20, 24, 25, 32, 38, 39, 46, 47, 54, 55 and 56 of Annex 27 (which are listed in Annex C). References to invoice bonuses made to T&S Stores can be seen in documents 4, 22, 24, 32 and 43.

vi Monitoring of retail prices by Gallaher

The documents set out below demonstrate that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its retail pricing strategy) and communicated 'errors' to T&S Stores.

In addition, monitoring was formalised in trading agreements. As noted previously in relation to TA2 and TA3, 'T&S agree to provide its Price File information as early as possible, so that discrepancies and pricing issues can be followed up at all times.' T&S Stores participated in this monitoring by providing Gallaher with details of its proposed retail prices for Gallaher's brands.

Examples of documents in relation to monitoring are as follows:

An email dated 29 March 2000 from Gallaher to T&S Stores stated: 'On our latest Price Survey it seems that in Dillons Café Crème [ITL brand] is 263 v Ham Min's [Gallaher brand] 275. Is this a mistake? PS haven’t yet received your Price Files.'

An email dated 15 December 2000 from Gallaher to T&S Stores stated: 'Please can you check that King Six [Gallaher brand] is correctly priced at 10p below Panama [ITL brand].'

An email dated 11 June 2001 from Gallaher to T&S Stores stated: 'What is the situation with Small Classic [ITL brand]. Our price survey is showing up a large number of differentials that do not reflect your Price File.'

These documents demonstrate that Gallaher would monitor T&S Stores' retail prices of both ITL and Gallaher brands, to ensure that parity and

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1296 Documents 18 and 23, Annex 27 (Clause 1(b)).
1297 Document 5, Annex 27.
1298 Document 10, Annex 27.
1299 Document 12, Annex 27.
differential requirements were maintained and would point out the pricing
errors to T&S Stores.

vi Conclusion on the agreement and/or concerted practice between
ITL and T&S Stores

6.1643 The evidence described above demonstrates the existence of the
Infringing Agreement between Gallaher and T&S Stores, which had the
object or restricting competition, in the manner set out in Section 6.A.I:
'The anti-competitive object of the Infringing Agreements' and, given that
the remaining constituent elements of the statutory test are also met (see
Section 7: 'Legal assessment'), amounted to a breach of the Chapter I
Prohibition.

vii Further Supporting Evidence

6.1644 In addition to the above the existence of the Infringing Agreement
between Gallaher and T&S Stores is also supported by the pattern of
conduct in the market as a whole as revealed by the existence of similar
agreements and/or concerted practices as detailed throughout this section
of the Decision and likewise supported by documents which are similar in
content, tone and nature to those pleaded above in relation to the
Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher's
  approach towards the Retailers as a collective; and between
- ITL and T&S Stores (see above), which is part of the context of the
  Infringing Agreement between Gallaher and T&S Stores.

6.1645 The existence of the further supporting evidence described above (and in
particular the relationship between ITL and T&S Stores) lends further
support to the fact that there was an agreement and/or concerted practice
between Gallaher and T&S Stores which had the object of restricting
competition and, given that the remaining constituent elements of the
statutory test are also met, amounted to a breach of the Chapter I
Prohibition.
(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.1646 As is noted in the sections above relating to the existence of an Infringing Agreement between each of ITL/T&S Stores and Gallaher/T&S Stores, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.1647 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to T&S Stores and that each Manufacturer must have been aware of the other Manufacturer's parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d)).
X  Agreement and/or concerted practice between ITL and TM Retail and between Gallaher and TM Retail

Summary

6.1648 As set out in 6.C.X.(a) below, ITL and TM Retail were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby ITL co-ordinated with TM Retail the setting of TM Retail’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.1649 As set out in 6.C.X.(b) below, Gallaher and TM Retail were party to an agreement and/or concerted practice at least from 1 March 2000 to 15 August 2003 (‘the Infringing Agreement’) whereby Gallaher co-ordinated with TM Retail the setting of TM Retail’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher, in pursuit of Gallaher’s retail pricing strategy. The Infringing Agreement had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’ and amounted to a breach of the Chapter I Prohibition.

6.1650 Each of the Infringing Agreements between ITL/TM Retail and Gallaher/TM Retail amounted to a breach of the Chapter I Prohibition in its own right. However, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to TM Retail and that each Manufacturer must have been aware\(^{1300}\) of the other’s parallel and symmetrical parity and differential requirements is part of the context of each Infringing Agreement. Further, the existence of the Infringing Agreement between each Manufacturer and the same Retailer and the fact that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement, as set out in 6.A.I.(d) above.

\(^{1300}\) See also 6.A.I.(b) above in relation to the Manufacturers’ awareness of each other’s parallel and symmetrical parity and differential requirements.
6.1651 On 11 July 2008, each of Gallaher and TM Retail concluded an early resolution agreement with the OFT, pursuant to which each admitted its involvement in each Infringing Agreement to which it was party, in breach of the Chapter I Prohibition.

(a) Agreement and/or Concerted Practice between ITL and TM Retail

6.1652 When considered together with the evidence of ITL’s overall strategy for retail prices described in Section 6.B: ‘Manufacturers’ retail pricing strategies’, the evidence referred to below, demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between ITL and TM Retail, whereby ITL co-ordinated with TM Retail the setting of TM Retail’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by ITL, in pursuit of ITL’s retail pricing strategy. For the reasons set out in Section 6.A.1: ‘The anti-competitive object of the Infringing Agreements’, the Infringing Agreement between ITL and TM Retail restricted the ability of TM Retail to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1653 The following elements evidence the Infringing Agreement between ITL and TM Retail:

<table>
<thead>
<tr>
<th>i</th>
<th>ITL’s strategy in relation to TM Retail’s retail prices</th>
</tr>
</thead>
</table>

6.1654 The trading agreements and contacts set out between ITL and TM Retail below should be considered in the context of ITL’s retail pricing strategy as set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by ITL.

6.1655 The following internal ITL documents demonstrate that ITL’s objective was that TM Retail should set the retail price for ITL’s brands and/or for ITL’s competitors’ brands in accordance with ITL’s retail pricing strategy. There are four documents headed ‘National Accounts Business Development Plan’ in relation to ‘Account TM Retail’ that covered the periods from:

- 1 October 1999 to 30 September 2000

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1301 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT’s finding of infringement is based on the evidence as a whole, including its context.
- 1 October 2000 to 30 September 2001\textsuperscript{1303}
- 1 October 2001 to 30 September 2002\textsuperscript{1304}
- 1 October 2002 to 30 September 2003\textsuperscript{1305}

Each stated under the heading 'Pricing':

'Maintain pricing in line with agreed current ITL policy. Monthly payment by store, provided prices are in line with strategy'.

6.1656 Two of the National Accounts Business Development Plans refer in brackets to 'Appendix 2', which is entitled 'ITL Strategy Pricing Sheet' and sets out parity and differential provisions.\textsuperscript{1306}

\textit{ii} Trading agreements between ITL and TM Retail

6.1657 There were three trading agreements between ITL and TM Retail, dated 9 July 1999, 20 December 2001 and 6 October 2002. Those agreements were a relevant aspect of the ongoing commercial dealing between ITL and TM Retail and formalised the basis for certain aspects of the trading relationship between them. The trading agreements are assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between ITL and TM Retail in relation to retail prices.

6.1658 The first trading agreement ('TA1'), signed and dated on 9 July 1999\textsuperscript{1307}, was in relation to the period 1 June 1999 to 31 May 2001. The second trading agreement ('TA2'), signed and dated 20 December 2001\textsuperscript{1308}, was

\textsuperscript{1302} Document 2, Annex 22 (page 4, point 1 and Page 8), signed 17 August 2000.
\textsuperscript{1303} Document 8, Annex 22 (pages 6 and 10).
\textsuperscript{1304} Document 18, Annex 22 (page 6).
\textsuperscript{1305} Document 33, Annex 22 (page 7). See also Page 9.
\textsuperscript{1306} Document 2, Annex 22 (page 8) and Document 8, Annex 22 (page 10).
\textsuperscript{1307} Document 1, Annex 22 is headed ‘I.T.L. Trading Agreement 1999/2001 TM Retail Group’ and was signed ‘on behalf of TM Retail Group’ on 9 July 1999. In view of the inferences drawn in relation to Documents 12, 19, 31 and 32 (see footnotes 1308 and 1309 below), the OFT infers that the legal entity which signed the agreement was TM Retail Limited and/or Martin McColl Retail Group.
\textsuperscript{1308} Document 19, Annex 22; See also Document 12, Annex 22, a letter from ITL to TM Retail dated 16 August 2001, which is described as a trading agreement proposal for the period of 1 September 2001 to 30 August 2002. Also, apparently attached to Document 12, is a document entitled ‘Imperial Tobacco / TM Retail Trading Agreement, Period 1st October 2001 to 20 September 2002’ which was signed by ITL and TM Retail on 18 September 2001. The OFT has no information as to why the signature dates should be later than the covering letter. Documents 12 and 19, Annex 22 were signed ‘on behalf of TM Retail’ and ‘TM Retail Group’ respectively. The OFT infers that the legal entity which signed the agreements was TM Retail Limited and/or Martin McColl Retail Group. The TM Retail signatory in Documents 12 and 19, Annex 22 is the same as in the
in relation to the period 1 September 2001 to 31 August 2002. The third trading agreement (‘TA3’), signed and dated 6 October 2002, was in relation to the period 1 October 2002 to 31 August 2004.

6.1659 The trading agreements contained the following clauses, among other matters.

6.1660 Under the terms of TA1, ITL and TM Retail agreed to the following:  

1) Pricing
ITAL agree to maintain levels of bonus in line with appendix 1, provided ITL prices are in line with the current strategy. (appendix 2)

...  

Overall levels of bonus on 20s packings have been set at [C] in recognition of TM Retail’s current pricing policy.

...

ITAL reserve the right to review the levels of bonus payment should there be a change in policy.’

In addition, TA1 stated:

‘In addition to the retro dealing, ITL agree to pay £[C] per store each calendar month provided outlets are selling all Imperial Tobacco products at the correct pricing levels. Payment will be calculated by the percentage of stores correctly priced, by the total outlet universe, by £[C].’

6.1661 Under the terms of TA2 and TA3, ITL and TM Retail agreed to the following under the heading ‘Pricing’:  

a) Imperial Tobacco agrees to maintain levels of bonus in line with appendix 1 ... Overall levels of bonus on 20s packings have been set at [C] in recognition of TM Retail’s (‘TM’) current pricing policy.

...
ITL reserve the right to review the levels of bonus payment should there be a change in policy.

In addition, TA2 and TA3 stated:

'b) TM agrees to retail Imperial Tobacco products in line with agreed pricing differentials in all tiers\textsuperscript{1312}, provided it is noted and agreed that should any other manufacturer activity negate the current pricing differentials, Imperial Tobacco shall be given the opportunity to adjust the differentials to ensure parity is maintained. (see appendix 2)'.

In return for compliance with the pricing requirements in TA2 and TA3, ITL and TM Retail agreed that:

'd) In consideration for adherence to the above Imperial agree to pay the following:

\begin{center}
\begin{tabular}{lccc}
\textbf{Payments} & (C) \\
\hline
\hline
\end{tabular}
\end{center}

6.1662 A letter dated 12 October 2001 from ITL to TM Retail also discusses payments due to TM Retail subject to its adherence to the terms of the relevant trading agreement.\textsuperscript{1313}

6.1663 Appendix 2 of each of TA1, TA2 and TA3 was headed 'ITL Strategy Pricing Sheet' and set out parity and differential provisions between ITL and competitor brands, including:\textsuperscript{1314}

\begin{center}
\begin{tabular}{ccc}
\textbf{20s} & \textbf{100s} & \textbf{200s} \\
\hline
\end{tabular}
\end{center}

\begin{center}
\begin{tabular}{lll}
\textbf{SUPERKINGS FAMILY} & \textbf{Level with on} & \textbf{Against} \\
\hline
\hline
\end{tabular}
\end{center}

\begin{center}
\textbf{Berkeley, B&H Superkings … [Gallaher brands]}
\end{center}

\begin{center}
\textbf{...}
\end{center}

\textsuperscript{1312} TM Retail had certain tiers of stores priced at or below RRP and other tiers of stores priced above RRP.

\textsuperscript{1313} Document 17, Annex 22. See paragraph 6.1690.

\textsuperscript{1314} Document 1, 19, 31 and 32, Annex 22.
<table>
<thead>
<tr>
<th>REGAL KINGSIZE</th>
<th>At least -5p -25p -50p Less than B&amp;H Kingsize</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gallaher brand</td>
</tr>
</tbody>
</table>

...  

<table>
<thead>
<tr>
<th>CLASSIC</th>
<th>Level with on = Parity pricing on range</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Against Hamlet [Gallaher brand]</td>
</tr>
</tbody>
</table>

...  

<table>
<thead>
<tr>
<th>CAFÉ CRÈME &amp; MILD</th>
<th>= Parity on Range Against</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Hamlet Miniatures [Gallaher brand]’</td>
</tr>
</tbody>
</table>

In addition, TA2 and TA3 included the following provisions:

‘Richmond KS [ITL brand] Level with on = = = Against Dorchester KS [Gallaher brand]

Richmond SK [ITL brand] Level with on = = = Against Dorchester SK [Gallaher brand]’

6.1664 Although some of the parity and differential requirements contained in TA1, TA2 and TA3 purportedly provided that TM Retail was to maintain maximum parity and differential requirements between competing linked brands, the OFT infers from the following evidence that such provisions were in fact implemented as parity or fixed differential requirements, rather than maximum differential requirements: (i) evidence of ITL’s retail pricing strategy; (ii) evidence regarding the way in which the trading relationship between ITL and TM Retail operated in practice (that is, evidence of the contacts between ITL and TM Retail); and (iii) the existence of an Infringing Agreement between Gallaher and TM Retail pursuant to which Gallaher communicated parallel and symmetrical parity and differential requirements to TM Retail (see further 6.C.X.(b)). The restrictive nature of both parity or fixed differential requirements and maximum differential requirements is described above at Section 6.A.I.(d).

6.1665 In conclusion, the evidence demonstrates that there were formal trading agreements, pursuant to which TM Retail would set its retail prices in accordance with the parity and differential requirements set by ITL, and that TM Retail was rewarded with the payment of a bonus for compliance with ITL’s parity and differential requirements.
Contacts between ITL and TM Retail regarding retail prices

6.1666 A further element of the Infringing Agreement was a series of contacts over a period of time between ITL and TM Retail regarding TM Retail’s retail prices for ITL’s brands.

6.1667 The documents evidencing the contacts between ITL and TM Retail demonstrate that, in relation to TM Retail’s retail prices for ITL’s brands (sometimes by reference to the retail prices for ITL’s competitors’ brands):

- ITL communicated\(^{1315}\) to TM Retail what TM Retail’s retail prices should be; and/or
- ITL asked and/or incentivised TM Retail to hold or alter TM Retail’s retail prices; and/or
- TM Retail informed ITL about, or discussed with ITL, TM Retail’s current or proposed retail prices.

6.1668 TM Retail accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1669 The contacts between ITL and TM Retail took place in the context of ITL’s retail pricing strategy for Retailers to maintain specified parities and differentials between ITL’s brands and competing linked brands. Communications in relation to retail prices were sent by ITL, and were received and implemented by TM Retail\(^{1316}\) on the understanding that the notified retail prices took into account ITL’s retail pricing strategy, together with TM Retail’s desired pricing position relative to other Retailers and TM Retail’s desired margin.

6.1670 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1671 Various examples of contacts between ITL and TM Retail regarding retail prices are set out below.

6.1672 In a letter dated 25 September 2000 from ITL to TM Retail, ITL stated:\(^{1317}\)

> ‘Following our meeting I agreed to update as discussed … Many thanks for your positive response to our new initiatives. We agreed that from 1/10/00 Richmond King Size 20s [ITL brand], will

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\(^{1315}\) See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.

\(^{1316}\) See paragraph 6.1687 and 6.1688 in relation to implementation.

\(^{1317}\) Document 7, Annex 22.
receive a retro bonus of £[C] per outer. The selling price agreed for all tiers is £3.29\textsuperscript{1318}.

6.1673 In a letter dated 5 July 2001 from ITL to TM Retail entitled 'Pricing Differentials. L&B/JPS KS range [ITL brands] vs Mayfair K/S [Gallaher brand]', ITL stated:\textsuperscript{1319}

‘Further to our telephone conversation I wish to confirm that the Lambert & Butler K/S 20s and JPSKS 20s [ITL brands] retails are requested to be reduced to a flat price £3.76’.

ITL also communicated that the same retail prices should apply to certain L&B brands and JPS Lights 20s [ITL brand] and added:\textsuperscript{1320}

‘Implementation of these retails will ensure price differentials will be maintained and associated payments will be made.

Bonus levels to support these retails will be confirmed Wednesday 11th July’.

6.1674 In addition, evidence that the prices were implemented by TM Retail is provided by a manuscript addition to the 5 July 2001 letter by ITL:\textsuperscript{1321}

‘S Wright [of TM Retail] has confirmed retails and will implement from 19th July. Please update brief’.

6.1675 In a related letter dated 5 July 2001 from ITL to TM Retail, and headed 'Pricing Differentials L&B/JPSKS [ITL brands] v Mayfair K/S [Gallaher brands]', in relation to the bonus levels of L&B/JPS, ITL stated:\textsuperscript{1322}

‘…This activity is likely to remain in place until Mayfair King Size [Gallaher brand] £3.60 flat price is removed’.

6.1676 In a letter dated 20 August 2001 from ITL to TM Retail, ITL set out the following retail price changes with reference to two Gallaher brands:\textsuperscript{1323}

‘Further to our discussion on Friday re pricing for Amber Leaf [Gallaher brand] and King Six [Gallaher brand], I write to advise that Drum [ITL brand] 1.5gm and 25gm should move to same retails from 3rd September 2001. Panama 6 [ITL brand] should also be adjusted as shown.

\textsuperscript{1318} The use of the words ‘positive response’ in relation to a discussion of retail prices is evidence of acceptance by TM Retail of ITL’s pricing instructions, as is the use of the word ‘agreed’.

\textsuperscript{1319} Document 9, Annex 22.

\textsuperscript{1320} Document 9, Annex 22.

\textsuperscript{1321} Document 9, Annex 22.

\textsuperscript{1322} Document 10, Annex 22.

\textsuperscript{1323} Document 15, Annex 22.
Drum 12.5gm @ £2.05. New bonus rate of [C]p per outer.
Drum 25gm @ £4.07. New bonus rate of [C]p per outer.
Panama 6s should take a new retail from 3rd September of £2.65, with an increase in bonus of [C]p per outer, to a new bonus of [C] per outer.

Should you require any further details please do not hesitate to contact me.’ [Emphasis as in source document]

6.1677 In a letter dated 11 October 2001 from ITL to TM Retail, ITL set out increased retail prices for Richmond [ITL brand] which ITL had agreed to confirm following a recent meeting:\textsuperscript{1324}

‘Richmond KS and SK 20s’ [ITL brands]

From the 8th November 2001 we agreed to raise the retail price of the Richmond KS 20s and Richmond Superkings 20s by 10p per pack. This applies to all tiers. The selling price from the 7th should be:
Richmond King Size 20s £3.49
Richmond Superkings 20s £3.50
I will update the promotional schedule, adjusting the selling price and bonus rates and forward a copy. I understand this move in price will be in line with competing brands. Please let me know should this position should change.’

6.1678 In a fax dated 21 January 2002 from ITL to TM Retail headed '10s pricing relativities', ITL set out 'the RRPs and the expected price differential between brands competing with Imperial packings':\textsuperscript{1325}

<table>
<thead>
<tr>
<th>Brand</th>
<th>[ITL/Gallaher brands]</th>
<th>RRP</th>
<th>Differential</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>B&amp;H 10s</strong></td>
<td>[Gallaher brand]</td>
<td><strong>RRP £2.21</strong></td>
<td>Differential</td>
</tr>
<tr>
<td><strong>Malboro KS</strong></td>
<td>[ITL brand]</td>
<td><strong>RRP £2.21</strong></td>
<td>level</td>
</tr>
<tr>
<td><strong>Embassy No 1 10s</strong></td>
<td>[ITL brand]</td>
<td><strong>RRP £2.19</strong></td>
<td>-2p</td>
</tr>
<tr>
<td><strong>Regal KS 10s</strong></td>
<td>[ITL brand]</td>
<td><strong>RRP £2.18</strong></td>
<td>-3p</td>
</tr>
<tr>
<td><strong>Superkings/Berkeley/Raffles</strong></td>
<td>[ITL/Gallaher brands]</td>
<td><strong>RRP £2.08</strong></td>
<td>level</td>
</tr>
<tr>
<td><strong>Richmond/Dorchester KS 10s</strong></td>
<td>[ITL/Gallaher brands]</td>
<td><strong>RRP £1.81</strong></td>
<td>level</td>
</tr>
</tbody>
</table>

\textsuperscript{1324} Document 16, Annex 22.
\textsuperscript{1325} Document 21, Annex 22.
Richmond/Dorchester
(SK)10s
[ITL/Gallaher brands] RRP £1.82 level

... 

L&B and JPS 10s [ITL brands] RRP £1.96 + 7p

The above shows the RRP$s and the expected price differential between brands competing with Imperial packings. If you have any queries please let me know.' [Emphasis added]

The OFT notes that the pricing relativities are set out as parity and fixed differentials.

6.1679 In a letter dated 5 August 2002 from ITL to TM Retail, ITL referred to its announcement of an MPI and attached an updated 'ITL Strategy Pricing Sheet' that set out parity and differential provisions between ITL and competitor brands, including:¹³²⁶

<table>
<thead>
<tr>
<th>'ITL BRAND</th>
<th>STRATEGY PRICING</th>
<th>COMPARISON BRANDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>SUPERKINGS FAMILY</td>
<td>Level with on = = = Against Berkeley, B&amp;H Superkings ... [Gallaher brands]</td>
<td></td>
</tr>
<tr>
<td>RICHMOND KS</td>
<td>Level with on = = = Against Dorchester KS [Gallaher brand]</td>
<td></td>
</tr>
<tr>
<td>RICHMOND SK</td>
<td>Level with on = = = Against Dorchester SK [Gallaher brand]</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CLASSIC</th>
<th>Level with on</th>
<th>= Parity pricing on range</th>
<th>Against</th>
<th>Hamlet</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>[Gallaher brand]</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>CAFÉ CRÈME &amp; MILDE ...</th>
<th>= Parity on Range</th>
<th>Against</th>
<th>Hamlet Miniatures [Gallaher brand]</th>
</tr>
</thead>
</table>

6.1680 In the letter, ITL summarised for TM Retail the 'main areas' related to the updated pricing strategy document which included:

- 'Embassy and Regal [ITL] brands have been raised by 7p giving a 2p difference for Embassy No 1 20s against the RRP of B&H 20s [Gallaher brand]
- L&B, JPS and Richmond King Size [ITL brands] 20s have risen by 4p, which means that the RRP tier should be selling L&B and JPS at £3.99 for 20
- Richmond KS [ITL brand] should move to £3.54 and the Richmond Superkings 20s at £3.58...

6.1681 Another example of contacts between ITL and TM Retail regarding retail prices is a letter dated 2 October 2002 from ITL to TM Retail in which ITL set out the following retail price increases in relation to its Richmond brand: 1327

> 'From 14th October I would like to raise the price of Richmond 20s packs [ITL brand]. The new selling price for Richmond KS 20s variants should be £3.59 and the Richmond Superkings variants should be £3.63. Could you please arrange implementation from the 14th October? This price rise will be reflected in the trade in general.'

6.1682 In a letter dated 28 February 2003 from ITL to TM Retail, ITL stated: 1328

> 'I understand that Mayfair [Gallaher brand] pricing may change during March to tiered pricing. I would expect, at that stage, to see L&B 20's [ITL brand] at no more than + 24p against Mayfair 20's [Gallaher brand]. If there are any further changes to TM prices please let me know as per our trading agreement. Should I

1328 Document 34, Annex 22.
In a letter dated 6 June 2003 from ITL to TM Retail, ITL confirmed the following retail prices in relation to its Drum brand, which ITL stated had been discussed at a recent meeting:

'Price file from June MPI. Could you please make the following adjustments from the price file discussed on Wednesday:

_Drum Gold [ITL brand] to move to £2.09 - In line with Samson [Gallaher brand].'

In a memorandum dated 13 June 2003 from ITL to TM Retail with the heading 'TM Retail – Price and Tactical Bonus Update', ITL listed by tier increased retail prices for Richmond [ITL brand] to apply from 16 July 2003:

<table>
<thead>
<tr>
<th>Tier 1</th>
<th>Tier 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Richmond KS 20s</td>
<td>£3.77</td>
</tr>
<tr>
<td>Richmond SK 20s</td>
<td>£3.83</td>
</tr>
</tbody>
</table>

In addition to the documents quoted above a number of other documents contain evidence of contacts of the same or similar nature between ITL and TM Retail regarding TM Retail's retail prices for ITL's brands which demonstrates the same matters as set out in respect of the documents quoted above: Documents 3 to 6, 13, 14, 20, 22 to 24, 26 and 27 of Annex 22 (which are listed in Annex C below).

Conclusion on the contacts between ITL and TM Retail

In conclusion in relation to all the contacts between ITL and TM Retail regarding retail prices, the above paragraphs demonstrate that there were regular contacts between ITL and TM Retail, which related to the retail prices of TM Retail. The evidence of such contacts, together with the context of ITL’s strategy, demonstrates that ITL’s retail pricing strategy was for TM Retail to maintain specified parities and differentials between ITL’s brands and competing linked brands. The contacts between ITL and TM Retail assisted the implementation of that strategy, through communications between ITL and TM Retail in relation to TM Retail’s

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1330 Document 36, Annex 22.
1331 This document contains evidence of pricing instructions and related bonuses, following a previous telephone conversation. The OFT infers that the fact that the instructions are in confirmation of earlier discussions is evidence of acceptance by TM Retail of ITL’s instructions.
retail prices for ITL’s brands (and in some case ITL’s competitors’ brands),
the aim of which was to ensure that ITL’s desired parity and differential
requirements were maintained or realigned. The contacts between ITL and
TM Retail also demonstrate that TM Retail accepted and/or indicated its
willingness to implement the directions contained in communications from
ITL to TM Retail in that connection.

6.1687 The OFT notes that ITL submitted that there were instances where TM
Retail did not implement instructions and/or requests in ITL’s pricing
communications.

6.1688 The OFT considers that the fact that there may have been some instances
where TM Retail did not implement, did not implement fully\(^{1332}\), or delayed
the implementation of instructions and/or requests in ITL’s pricing
communications, does not negate the existence of the Infringing
Agreement between ITL and TM Retail, as there is sufficient evidence
over a period of time of TM Retail’s compliance, or intention to comply,
with ITL’s retail pricing strategy (see for example the sections entitled
‘Trading agreements between ITL and TM Retail’ and ‘Contacts between
ITL and TM Retail regarding retail prices’ above).

iv  **Bonuses**

6.1689 As set out above, ITL paid an ongoing bonus to TM Retail in TA1 on the
condition that, among other matters:\(^{1333}\)

‘…ITL prices are in line with the current strategy. (Appendix 2)’.

As also noted above, ITL paid an ongoing bonus to TM Retail in TA2 and
TA3 on condition that, among other matters:\(^{1334}\)

‘TM agrees to retail Imperial Tobacco products in line with agreed
pricing differentials in all tiers…’

6.1690 In a letter dated 12 October 2001 from ITL to TM Retail, ITL stated the
following in relation to payments under the trading agreement:\(^{1335}\)

‘I note below the anticipated payments for the year December
2001 to end November 2002.

*Volume bonus payments – Pricing £[C]*

\(^{1332}\) For these purposes, the OFT considers that a price instruction and/or request was
not fully implemented where the relevant retail price increased or decreased following
the instruction and/or request, but not by the exact amount instructed and/or requested.

\(^{1333}\) Document 1, Annex 22 (Clause 1, Page 2).

\(^{1334}\) Document 19, 31 and 32, Annex 22 (Clause 1(b)).

\(^{1335}\) Document 17, Annex 22.
Actual payments will depend on volumes, adherence and price fluctuations …’

6.1691 There are also documents relating to the provision of tactical bonuses from ITL to TM Retail, examples of which are set out in the section entitled ‘Contacts between ITL and TM Retail regarding retail prices’ above.

6.1692 The payment of a tactical bonus was made to support a specific price movement in the retail price of a brand and was therefore directly linked to the retail prices to be charged by TM Retail. In particular, the bonuses ensured that TM Retail’s margin was not significantly affected by the changes in retail prices requested by ITL to achieve ITL’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of TM Retail’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.1693 The evidence demonstrates that ITL paid bonuses to TM Retail in order to ensure that ITL’s retail pricing strategy was maintained. TM Retail accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by ITL.

vi Monitoring of retail prices by ITL

6.1694 The documents set out below demonstrate that ITL monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its parity and differential strategy) and communicated ‘errors’ to TM Retail.

6.1695 Examples of documents in relation to monitoring are as follows.

6.1696 In a letter from ITL to TM Retail dated 12 March 2002, ITL cited ITL brands that TM Retail was not pricing in accordance with ITL’s pricing strategy. The letter stated:¹³³⁶

‘I also note that following your recent price file changes, dated 10th March, a large proportion of our brands are not achieving the agreed strategy pricing differentials against their competing brands. I will adjust the Trading Payments accordingly’.

The fact that the trading payments could be adjusted for not achieving the pricing strategy, and that manuscript notes on the letter also suggest that there could be 'possible' deductions in payments, indicate that ITL used the possibility of withholding payments as a sanction if TM Retail failed to adhere to ITL’s pricing strategy.

6.1697 In addition, ITL stated:\textsuperscript{1337}

‘You have suggested that these anomalies are a temporary measure and that you will be looking at the position within 2 weeks ... I understand the background to the changes, but I need to ensure that Imperial Tobacco is not disadvantaged against its own competition. I would welcome the restoration of our brands back to their strategy pricing position as soon as possible’.

6.1698 A letter from ITL to TM Retail dated 25 June 2002 demonstrates how ITL monitored TM Retail’s pricing closely and that pricing payments agreed in trading agreements were linked inextricably to TM Retail’s level of adherence to ITL’s pricing strategy:\textsuperscript{1338}

‘I have today received pricing information for calls made yesterday on the TM estate. ...As you are aware, it remains important that our pricing differentials are in place at all times. Indeed, an integral part of our trading agreement relates to pricing adherence. I would like the correct differentials restored as soon as possible. I will adjust the trading payments accordingly. For your information I attach a current ‘Pricing Differentials’ sheet for you guidance’.

6.1699 In the ITL ‘National Accounts Business Development Plan’ for TM Retail dated November 2002, ITL stated the following in relation to the objectives and strategy in relation to pricing:\textsuperscript{1339}

‘Maintain pricing in line with agreed current ITL policy. Monthly payment by store, provided prices are in line with strategy. A weekly check is run each Tuesday by T/A showing actual pricing and differentials. Reductions in payment are made for non-adherence to policy. (see T/A)’

6.1700 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by ITL of TM Retail’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: Documents 11 and 22 of Annex 22 (which are listed in Annex C).

6.1701 These documents demonstrate that ITL would monitor TM Retail’s retail prices of both ITL and Gallaher brands to ensure that parity and

\textsuperscript{1337} Document 23, Annex 22.\textsuperscript{1338} Document 25, Annex 22.\textsuperscript{1339} Document 33, Annex 22 (page 7).
differential requirements were maintained and would point out pricing errors to TM Retail.

vi Conclusion on the agreement and/or concerted practice between ITL and TM Retail

6.1702 The evidence described above demonstrates the existence of the Infringing Agreement between ITL and TM Retail, which had the object of restricting competition, in the manner set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements' and, given that the remaining constituent elements of the statutory test are also met (see Section 7: 'Legal assessment'), amounted to a breach of the Chapter I Prohibition.

vii Further Supporting Evidence

6.1703 In addition to the above, the existence of the Infringing Agreement between ITL and TM Retail is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of the Decision and likewise supported by documents which are similar in content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- ITL and each of the other Retailers, which evidence ITL’s approach towards the Retailers as a collective; and between
- Gallaher and TM Retail (see below), which is an important part of the context of the Infringing Agreement between ITL and TM Retail.

6.1704 The existence of the further supporting evidence described above (and in particular the relationship between Gallaher and TM Retail) lends further support to the fact that there was an agreement and/or concerted practice between ITL and TM Retail which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.
(b) Agreement and/or Concerted Practice between Gallaher and TM Retail

6.1705 When considered together with the evidence of Gallaher's overall strategy for retail prices described at Section 6.B: 'Manufacturers' retail pricing strategies', the evidence referred to below, demonstrates that, at least from 1 March 2000 to 15 August 2003, an Infringing Agreement existed between Gallaher and TM Retail, whereby Gallaher co-ordinated with TM Retail the setting of TM Retail's retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by Gallaher in pursuit of Gallaher's retail pricing strategy. For the reasons set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements', the Infringing Agreement between Gallaher and TM Retail restricted the ability of TM Retail to determine its retail prices for competing linked brands and had the object of restricting competition.

6.1706 The following elements evidence the Infringing Agreement between Gallaher and TM Retail:

i Gallaher's strategy in relation to TM Retail's retail prices

6.1707 The contacts set out below between Gallaher and TM Retail should be considered in the context of Gallaher's retail pricing strategy as set out in Section 6.B: 'Manufacturers' retail pricing strategies', and as demonstrated below, namely to achieve the parity and differential requirements between competing linked brands that were set by Gallaher.

6.1708 In particular, the OFT notes that a number of internal Gallaher documents for all retail channels, and in particular Gallaher's convenience channel,

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1340 The OFT has noted the fact that TM Retail entered into a formal trading agreement with ITL, signed and dated 9 July 1999, in relation to the period 1 June 1999 to 31 May 2001 (Document 1, Annex 22), which includes Gallaher products as 'comparison brands' in ITL's 'Strategy Pricing Sheet'. Although the trading agreement between Gallaher and TM Retail, signed and dated 29 October 2001 (Document 9, Annex 12), is in relation to the period 1 December 2000 to 31 December 2004 and the first exchange of correspondence between Gallaher and TM Retail listed is dated 28 June 2001 (Document 3, Annex 12), the OFT infers that this trading agreement formalised arrangements between Gallaher and TM Retail which were already in place and which, in terms of pricing, corresponded with requirements to which TM Retail had agreed formally with ITL. The OFT therefore infers that the starting date for the Infringing Agreement is at least from 1 March 2000.

1341 The analysis of the evidence by reference to the elements of the Infringing Agreements is purely for presentational purposes. The OFT's finding of infringement is based on the evidence as a whole, including its context.
demonstrate that Gallaher’s objective was that retailers within that channel, of which TM Retail was one such retailer, should set the retail price for Gallaher’s brands in accordance with Gallaher’s retail pricing strategy.

6.1709 A good example is an internal Gallaher document headed ‘Promotional Policy - Retail Promotion Contributions – March 2000’, which listed the ‘Pricing Objectives’ in relation to the following brands amongst others:

‘Camel [Gallaher brand] – Parity with Marlboro [competitor brand]’


_B&H [Gallaher brand] – 5p above Regal [ITL brand], 3p above Embassy No 1 [ITL brand]

_Berkeley and B&H Superkings [both Gallaher brands] – parity with JP Superkings [ITL brand]

_Club [Gallaher brand] 14p below Regal [ITL brand]

_Sovereign [Gallaher brand] 10p below L&B [ITL brand]

_Mayfair 7p below Sovereign [both Gallaher brands] and at least parity with Richmond [ITL brand]…

6.1710 Further evidence in relation to Gallaher’s retail pricing strategy for all retail channels, and in particular Gallaher’s convenience channel, is set out in Section 6.B: ‘Manufacturers’ retail pricing strategies’ above, which refer to a number of other documents containing evidence of the same or similar nature.1344

6.1711 In addition, in an undated internal Gallaher document headed ‘TM Retail: Strategic Analysis’, Gallaher stated:1345

‘We need to maintain normal price parities, and price promote key brands and packs in line with Channel and Company Objectives, seeking good price points wherever possible’.

6.1712 In an internal Gallaher document dated 6 April 2001, Gallaher stated the following in relation to TM Retail under the heading ‘Pricing’:1346

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1342 ITL has distributed Marlboro since 12 September 2001.
1343 Document 1, Annex 3 (page 2). This document also set out parity and differential requirements for cigars and hand rolled tobacco.
1344 See, in particular, Documents 5, 10, 13, 15 and 17 of Annex 3.
1345 Document 12, Annex 12 (Clause (e)).
6.1713 Furthermore, in an internal Gallaher e-mail dated 26 February 2001 headed 'Price Survey Queries', Gallaher stated: 1347

'Forbouys\textsuperscript{1348} shows Richmond [ITL brand] SK MP’s (5x20) @£16.25 for 3 of the 6 branches monitored. Having checked this out with TM in view of the discrepancy against Mayfair and Dorchester [Gallaher brands], I am categorically advised by TM that Richmond [ITL brand] MP’s are not listed. If this is the case then there is a big hole in the credibility of this survey, which many of us are now using as ammunition to reduce payment on Trading Agreements etc. for 'non-compliance'. '

6.1714 In addition to the documents quoted above, other documents contain evidence of the same or similar nature regarding Gallaher’s strategy towards TM Retail which demonstrates the same matters as set out in respect of the documents quoted above: documents 13 and 23 of Annex 12 (which are listed in Annex C).

\textit{\textbf{ii} Trading agreement between Gallaher and TM Retail}

6.1715 There was one trading agreement between Gallaher and TM Retail, dated 29 October 2001. That agreement was a relevant aspect of the ongoing commercial dealing between Gallaher and TM Retail and formalised the basis for certain aspects of the trading relationship between them. The trading agreement is assessed in light of how the trading relationship operated in practice, for example as evidenced by the frequent contacts between Gallaher and TM Retail in relation to retail prices.

6.1716 The trading agreement was signed and dated 29 October 2001\textsuperscript{1349}, in relation to the period 1 December 2000 to 31 December 2004. The payment rates in the trading agreement were updated from 1 January 2002.\textsuperscript{1350} In the trading agreement, Gallaher and TM Retail agreed, among other matters, to the following in relation to pricing:\textsuperscript{1351}

\begin{itemize}
\item Document 1, Annex 12.
\item Forbouys\textsuperscript{1348} Fourboys was a trading name of TM Retail Limited (see footnote 1349)
\item Document 9 was signed ‘for and on behalf of TM Retail Limited trading as Forbouys, TM Retail, Martins, McColls and R.S. McColl or any other trading name that TM Retail Limited may adopt during the term of this Trading Agreement’ on 16 October 2001. The legal entity which signed the agreement was therefore TM Retail Limited.
\item Documents 17 and 33, Annex 12. The OFT has assumed that the unsigned trading agreement (Document 33) is the revised trading agreement referred to in Document 17. Document 33 was to be signed ‘for and on behalf of TM Retail Limited’ and the agreement was stated to be between Gallaher and TM Retail Limited trading as
\end{itemize}
1. PRICING

a) TM Retail agrees to supply relevant Price File information ahead of issue\(^{1352}\);

b) TM Retail agrees to maintain the price differentials/price parities between Gallaher’s brands/variants and their respective competitive brands as set out in Appendix 1, at all times. Gallaher reserves the right to amend Appendix 1 from time to time after consultation with TM Retail.

c) Where TM Retail is involved in the promotion of a brand of competitor of Gallaher, Gallaher shall be offered the opportunity to conduct similar promotional activity on a brand to be selected by Gallaher as soon as reasonably requested by Gallaher following that competitor’s promotion.’

6.1717 Appendix 1 of the trading agreement was entitled 'Gallaher vs. Competitors Price Parities/Differentials' and set out price parity and differential provisions. For example:\(^{1353}\)

'1. Cigarettes

- Price parity for:
  Berkeley range [Gallaher brand] \(v\) JP SK range [ITL brand]
  B&H Superkings range [Gallaher brand] \(v\) JP SK range [ITL brand]
  …

Agreed differential for:
  …
  Dorchester House [Gallaher brand] \(v\) Richmond [ITL brand] (Dorchester [Gallaher brand] to have one tier pricing)
  …

2. Cigars

- Price parity for:

\(^{1351}\) Document 9, Annex 12 (Clauses 1(a) – 1(c), Page 1) and Document 33, Annex 12 (Clauses 1(a) – 1(c), Page 1).

\(^{1352}\) At a meeting on 23 January 2006 (see Document 18, Annex 3) Gallaher confirmed to the OFT that only Gallaher retail price file information was covered by this clause.

\(^{1353}\) Document 9 and 33, Annex 12.
Under the terms of the trading agreement, Gallaher and TM Retail agreed that Gallaher would pay TM Retail a retrospective bonus for compliance with the provisions concerning pricing set out above:

'In return for compliance with the provisions of paragraph 1 above Gallaher shall pay TM Retail a retrospective discount of \( \mathcal{C} \) per 1000 on all Gallaher cigarettes sold by TM Retail during the term of this Trading Agreement.'

In conclusion, the evidence highlighted in this section demonstrates that there was a formal trading agreement, pursuant to which TM Retail would set its retail prices in accordance with the parity and differential requirements set by Gallaher, and that TM Retail was rewarded with the payment of a bonus for compliance with Gallaher's parity and differential requirements.

iii Contacts between Gallaher and TM Retail regarding retail prices

A further element of the Infringing Agreement was a series of contacts over a period of time between Gallaher and TM Retail regarding (i) TM Retail's retail prices for Gallaher's brands; (ii) TM Retail's retail prices for Gallaher's competitors' brands; and (iii) the retail prices of other Retailers for Gallaher's brands.

The documents evidencing the contacts between Gallaher and TM Retail demonstrate that: (i) in relation to TM Retail's retail prices for Gallaher's brands (sometimes by reference to TM Retail's or other Retailers' retail prices for Gallaher's competitors' brands) and/or (ii) in relation to TM Retail's retail prices for Gallaher's competitors' brands:
• Gallaher communicated to TM Retail what TM Retail’s retail prices should be; and/or

• Gallaher asked and/or incentivised TM Retail to hold or alter TM Retail’s retail prices; and/or

• TM Retail informed Gallaher about, or discussed with Gallaher, TM Retail’s current or proposed retail prices.

6.1722 TM Retail accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1723 In addition, Gallaher and TM Retail informed each other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands.

6.1724 The contact between Gallaher and TM Retail took place in context of Gallaher’s retail pricing strategy for Retailers to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. Communications in relation to retail prices were sent by Gallaher, and were received and implemented by TM Retail on the understanding that the notified retail prices took into account Gallaher’s retail pricing strategy, together with TM Retail’s desired pricing position relative to other Retailers and TM Retail’s desired margin.

6.1725 The content, tone and repeated nature of the said contacts and conduct are in each case, and collectively, consistent with the existence of the Infringing Agreement.

6.1726 Various examples of contacts between Gallaher and TM Retail regarding retail prices are set out below.

Contact between Gallaher and TM Retail regarding TM Retail’s retail prices for Gallaher’s brands

6.1727 Set out below are examples of contacts between Gallaher and TM Retail in relation to TM Retail’s retail prices for Gallaher’s brands, which demonstrate that in relation to TM Retail’s retail prices for Gallaher’s brands (sometimes by reference to the retail prices for competing linked brands):

• Gallaher communicated to TM Retail what TM Retail’s retail prices should be; and/or

1354 See paragraphs 6.108 and 6.109 above in relation to the nature of such ‘communications’.

1355 See paragraph 6.1748 in relation to implementation.
• Gallaher asked and/or incentivised TM Retail to hold or alter TM Retail’s retail prices; and/or
• TM Retail informed Gallaher about, or discussed with Gallaher, TM Retail’s current or proposed retail prices.

6.1728 TM Retail accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1729 The examples of such contacts are as follows.

6.1730 In a letter dated 13 August 2001 regarding 'September 2001- Pricing' from Gallaher to TM Retail, Gallaher stated:1356

‘As you have been notified, Gallaher is to have an MPI on Tuesday 11th September. With regards to prices, would you please take account of the following:

Gallaher brands should increase from the MPI date or after, by the amounts of the MPI, with the exception of:

Mayfair Range 20’s: Please increase to £3.65 across all tiers in line with MPI. We will continue to support this price UFN with current retro bonus. I will advise MP’s shortly.

Dorchester Range 20’s: Please increase by MPI, and we will continue to support with current bonuses.

…

Amber Leaf and Samson 12.5g: Go to £2.05. Bonuses will be adjusted accordingly.

Amber Leaf 25g: Go to £3.99. Bonuses will be adjusted accordingly.

King Six: Please increase by MPI to £2.55. Retro bonus to continue UFN.’

6.1731 In a letter dated 21 September 2001 from Gallaher to TM Retail, Gallaher stated:1357

‘BSK & BSK 20’s: [Gallaher brand] Maintain current price in line with JPSK [ITL brand].’

6.1732 In addition, in a letter dated 14 November 2001 from Gallaher to TM Retail, Gallaher stated:1358

1356 Document 5, Annex 12.
1358 Document 11, Annex 12 (paragraph 4(c)).
‘Dorchester KS & SK 10’s [Gallaher brand]: would you please amend to [C]p below Richmond [ITL brand].’

6.1733 In a letter dated 5 August 2002 from Gallaher to TM Retail, Gallaher stated:\textsuperscript{1359}

‘With the impending ITL MPI, would you please hold the current Gallaher pricing until further notice. We will continue to support with agreed Retro payments until such times as we agree date to increase’.

6.1734 Furthermore, an e-mail dated 7 November 2002 from Gallaher to TM Retail suggests that TM Retail was complying with Gallaher’s pricing strategy on a consistent basis:\textsuperscript{1360}

‘As discussed, we would like TM to withdraw the current price hold on Mayfair KS brands, and Dorchester brands [Gallaher brands], and to move prices up in line with previous discussions sooner than anticipated, and certainly no later than Weds 20th November. … In the light of the current excellent co-operation between our two companies … we would be very appreciative of your help on this one’.

6.1735 In a letter dated 19 February 2003 from Gallaher to TM Retail, Gallaher stated:\textsuperscript{1361}

‘Further to our recent meeting I confirm as follows …

6. Pricing/Retro


The OFT notes the use of the word ‘agreed’, that the agreed bonus was ‘in return’ for parity, and the fact that this followed a ‘recent meeting’ between Gallaher and TM Retail. That all provides evidence that TM Retail discussed prices with Gallaher, and that TM Retail accepted and agreed to implement Gallaher’s pricing instruction, and would continue to receive a bonus for doing so.

6.1736 In a letter dated 6 May 2003 from Gallaher to TM Retail, Gallaher stated:\textsuperscript{1362}

‘BH Silver: The £[C] Price Deal is now concluded, so please amend in line with L&B [ITL brand] …

\textsuperscript{1359} Document 19 (1(b)), Annex 12.
\textsuperscript{1360} Document 24, Annex 12.
\textsuperscript{1361} Document 28, Annex 12.
\textsuperscript{1362} Document 29, Annex 12.
Dorchester Range KS and SK: Please move to tiered prices subject to Richmond [ITL brand] also moving'.

6.1737 A subsequent letter dated 13 June 2003 from Gallaher to TM Retail further demonstrates Gallaher’s pricing strategy in operation:1363

‘2. Dorchester Range: [Gallaher brand] Price in line with Richmond [ITL brand]. Our retro’s will be adjusted in line with the increase.

3. BH Silver [Gallaher brand]: Cease £3.99 promotion and revert to normal pricing.’

6.1738 In a letter dated 23 June 2003 from Gallaher to TM Retail, Gallaher stated:1364

‘In the meantime, following our previous correspondence and discussions on pricing issues, and a couple of further price point opportunities, could I request the following:

1. Mayfair KS and SK: [Gallaher brands] With the forthcoming change in Richmond [ITL brand] and Dorchester [Gallaher brand] pricing as you advised, Mayfair should now be 6p above these brands by tier...

2. Dorchester [Gallaher brand] will move in line with Richmond [ITL brand], and will necessitate a retro bonus amendment, which we can determine when I receive your new Price File.

…

5. Hamlet Min’s and Filter: [Gallaher brand] Please hold as current, until Café Crème MPI [ITL brand], at which time we will increase by our MPI to be in line.’

6.1739 In addition to the documents quoted above, a number of other documents contain evidence of contacts of the same or similar nature between Gallaher and TM Retail regarding TM Retail’s retail prices for Gallaher’s brands which demonstrates the same matters as set out in respect of the documents quoted above: documents1365 3, 4, 6, 8, 14, 15, 16, 18, 20, 21, 22, 25, 261366, 27 and 32 of Annex 12 (which are listed in Annex C).

1365 Where these or any other documents are noted as being an ‘unsigned file copy’ in Annex 12, the OFT infers, on the basis of the discussions with Gallaher at a meeting held with the OFT on 23 January 2006, that signed copies of the documents were actually sent by Gallaher to TM Retail.
1366 This document contains evidence of pricing instructions and related bonuses and refers to ‘All other pricing as per recent price advice and discussions’. See also Document 27.
Contact between Gallaher and TM Retail regarding TM Retail’s retail prices for Gallaher’s competitors’ brands

6.1740 In addition to the documents above, which concern contact between Gallaher and TM Retail regarding TM Retail’s retail prices for Gallaher’s brands, there was contact between Gallaher and TM Retail in relation to TM Retail’s retail prices for Gallaher’s competitors’ brands. Set out below is an example of such contact which demonstrates that in relation to TM Retail’s retail prices for Gallaher’s competitors’ brands:

- Gallaher communicated to TM Retail what TM Retail’s retail prices should be; and/or
- TM Retail informed Gallaher about, or discussed with Gallaher, TM Retail’s current or proposed retail prices.

6.1741 TM Retail accepted and/or indicated its willingness to implement the directions contained in such communications.

6.1742 In a letter dated 20 September 2002 from Gallaher to TM Retail, Gallaher stated:1367

‘Further to our recent meeting … may I confirm the undernoted:

1. Pricing:
   a. We identified the following pricing as needing some adjustment:
      ...
   ii. BHKS 10’s [Gallaher brand] being ‘disadvantaged’ v Embassy No. 1 [ITL brand] (RRP difference only 1p v TM 2p in Tiers 6 & 7.
   iii. Marlboro Lts 10’s [ITL brand] 3p below BHKS & SCKS 10’s [Gallaher brands]: RRP is the same.
   iv. Marlboro Lts 20’s [ITL brand] you advised have been increased by 1p in line with above.
   v. Sovereign [Gallaher brand] v L&B 20 [ITL brand]: RRP difference is 10p. TM is 9p in T5-7’.

Contact between Gallaher and TM Retail regarding the retail prices of TM Retail’s competitors

6.1743 In addition to the documents above, there were contacts between Gallaher and TM Retail in which Gallaher and TM Retail informed each

other about, or discussed with each other, the current or proposed retail prices of other Retailers for Gallaher’s brands.

6.1744 In an e-mail dated 7 November 2002 from Gallaher to TM Retail, Gallaher stated:\textsuperscript{1368}

‘As discussed, we would like TM to withdraw the current price hold on Mayfair KS brands, and Dorchester brands [both Gallaher brands], and to move prices up in line with previous discussions sooner than anticipated, and certainly no later than Weds 20th November. You are aware that most of your competitors are already up on these brands, and therefore your price hold until the 20th is very much an advantage over the general market price’.

6.1745 In a letter dated 19 February 2003 from Gallaher to TM Retail, Gallaher stated in relation to a suggested ‘minimum’ 2p price increase for Silk Cut and Benson & Hedges [both Gallaher brands] that:\textsuperscript{1369}

‘We have already seen most accounts increase prices by 2p as this bonus is withdrawn across the trade’.

6.1746 It can be seen from the above that references by Gallaher to the retail prices of other Retailers provided an assurance to TM Retail that retail price changes put to TM Retail by Gallaher would not cause TM Retail to be out of step with its retail competitors.

\textit{Conclusion on the contacts between Gallaher and TM Retail}

6.1747 In conclusion in relation to all the contacts between Gallaher and TM Retail regarding retail prices, the above paragraphs demonstrate that there were regular contacts between Gallaher and TM Retail, which related to the retail prices of TM Retail as well as other Retailers. The evidence of such contacts together with the context of Gallaher’s strategy demonstrates that Gallaher’s retail pricing strategy was for TM Retail to maintain specified parities and differentials between Gallaher’s brands and competing linked brands. The contacts between Gallaher and TM Retail assisted the implementation of that strategy, through communications between Gallaher and TM Retail in relation to TM Retail’s retail prices for Gallaher’s brands, the aim of which was to ensure that Gallaher’s desired parities and differential requirements were maintained or realigned. The contacts also demonstrate that TM Retail accepted and/or indicated its willingness to implement the directions contained in communications from Gallaher in that connection.

\textsuperscript{1368} Document 24, Annex 12.
\textsuperscript{1369} Document 28, Annex 12 (paragraph 6 iv).
6.1748 The OFT does not exclude the possibility that there may have been some instances where TM Retail did not implement, did not implement fully\textsuperscript{1370}, or delayed the implementation of instructions and/or requests in Gallaher’s pricing communications. However, the OFT considers that does not negate the existence of the Infringing Agreement between Gallaher and TM Retail, as there is sufficient evidence over a period of time of TM Retail’s compliance, or intention to comply, with Gallaher’s retail pricing strategy (see for example the sections entitled ‘Trading agreement between Gallaher and TM Retail’ and ‘Contacts between Gallaher and TM Retail regarding retail prices’ above).

\textit{iv} Bonuses

6.1749 As set out above, Gallaher paid an ongoing bonus to TM Retail on the condition that, among other things, TM Retail:\textsuperscript{1371}

\textit{maintain the price differentials/price parities between Gallaher’s brands/variants and their respective competitive brands.}

6.1750 There are also documents relating to the provision of tactical bonuses from Gallaher to TM Retail, examples of which are set out in the sections entitled ‘Contacts between Gallaher and TM Retail regarding retail prices’ above.

6.1751 The payment of tactical bonuses was directly linked to the retail prices to be charged by TM Retail. In particular, the bonuses ensured that TM Retail’s margin was not significantly affected by the changes in retail prices instructed or requested by Gallaher to achieve Gallaher’s retail pricing strategy (see Section 6.A.I.(a).iv above). The manipulation of TM Retail’s retail prices through the payment of bonuses in this way is consistent with the existence of the Infringing Agreement.

6.1752 In addition to those documents referred to in the contacts sections above, which specifically refer to tactical bonuses, the following documents also evidence the use of tactical bonuses.

6.1753 For example, in a letter dated 28 June 2001 from Gallaher to TM Retail, Gallaher stated:\textsuperscript{1372}

\begin{flushright}
\textsuperscript{1370} For these purposes, the OFT considers that a price instruction and/or request was not fully implemented where the relevant retail price increased or decreased following the instruction and/or request, but not by the exact amount instructed and/or requested.\textsuperscript{1371} Document 9, Annex 12 (Clause 1(b), Page 1) and Document 33, Annex 12 (Clause 1(b), Page 1).\textsuperscript{1372} Document 3, Annex 12.
\end{flushright}
'Retro support: June-Sept: - In line with our discussions I attach an update showing actual agreed retro’s and pricing, and also proposed for August and September’.

6.1754 In a letter dated 17 September 2001 from Gallaher to TM Retail, Gallaher stated:\textsuperscript{1373}

‘Could I please request that you implement the following levels of pricing during October (UFN). I will forward you details of retro payments to compensate shortly:

[all Gallaher brands]

\textit{Dorchester KS: Maintain £3.39}

\textit{Dorchester KS MP’s: Maintain £16.74}

\textit{Dorchester SK: Maintain £3.40}

…

\textit{BSK & BHSK Range 20’s/MP’s: Price as per JPSK [ITL brand]…’}

6.1755 The evidence demonstrates that Gallaher paid bonuses to TM Retail in order to ensure that its parity and differential strategy was maintained. TM Retail accepted bonuses on the understanding that they were paid for compliance with, or in order to maintain, the parities and differentials set by Gallaher.

\vspace{1em}

\textbf{Monitoring of retail prices by Gallaher}

6.1756 The documents set out below demonstrate that Gallaher monitored the implementation of the Infringing Agreement to spot deviations from the prices communicated (and thereby from its retail pricing strategy) and communicated 'errors' to TM Retail.

6.1757 In addition, monitoring was formalised in the trading agreement. As noted above in relation to the trading agreement, Gallaher agreed to pay TM Retail a bonus for compliance with the pricing provisions and also on the basis that:\textsuperscript{1374}

‘TM Retail agrees to supply relevant Price File information ahead of issue’.

6.1758 TM Retail participated in this monitoring by providing Gallaher with details of its proposed retail prices for Gallaher’s brands.

\vspace{1em}

\textsuperscript{1373} Document 6, Annex 12.
\textsuperscript{1374} Document 9 and document 33, Annex 12.
Examples of documents in relation to monitoring are as follows.

In a letter dated 13 August 2001 from Gallaher to TM Retail, Gallaher stated:

'I reminded you of the 'non-compliance penalties' and will update you with the YTD situation shortly'.

An internal Gallaher e-mail, dated 1 November 2001, stated that TM Retail had advised Gallaher that:

'From 8th November, TM's new Price File comes into effect with Dorchester [Gallaher brand] moving up by 10p as agreed. However, in this account I have now discovered that they intend to keep the [another manufacturer’s] brands at £3.44 for KS/3.45 for Sk, and therefore we [and Richmond [ITL brand]] will now be severely disadvantaged by the 5p and 6p respectively.

...their strategy is to drop all the [another manufacturer’s brand] packs except SK and SK Lights ... by selling them through at this price, and that the intention is to move the rest up probably in December/Jan'.

In a letter dated 19 June 2002 from Gallaher to TM Retail, entitled 'Post MPI Pricing: 10’s/Cigars/Pipe' Gallaher stated:

'I have carried out an analysis of your pricing by tier, incorporating our MPI, and have compared your price relativities against the RRP of key brands, including our competitors.

I have tried to indicate with the shaded areas where I believe your prices should/could be adjusted for consistency and for profitability, as well as for correct pricing relativities from our point of view.

Additionally, I would like to query both Mayfair KS 10’s and BSK 10’s pricing, on the basis that we are not supporting these levels of pricing'.

In a letter dated 9 July 2002 from Gallaher to TM Retail, Gallaher stated:

'Could you please let me have your new Price File for the 21st July as soon as possible.'

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1375 Document 4, Annex 12 (5).
1378 The OFT does not have on file a copy of the attachment to which this document appears to refer.
1379 Document 18, Annex 12 (paragraph 4(b)).
When viewed together with the pattern of documents for the other time periods, the OFT infers that TM Retail was providing Gallaher (in response to the latter’s requests) with price files in advance of implementation of the relevant prices, as required under the trading agreement.\textsuperscript{1380} In a letter dated 28 November 2002\textsuperscript{1381}, Gallaher thanked TM Retail for providing ‘Price File for December’ and stated that ‘these prices/retro’s to continue into January UFN’.

6.1764 In addition to the documents quoted above, a number of other documents contain evidence of the same or similar nature in relation to the monitoring by Gallaher of TM Retail’s retail prices which demonstrates the same matters as set out in respect of the documents quoted above: documents 2, 13, 19 to 21, 25\textsuperscript{1382} and 31 of Annex 12 (which are listed in Annex C).

6.1765 These documents demonstrate that Gallaher would monitor TM Retail’s retail prices to ensure that the parity and differential requirements were maintained and would point out pricing errors to TM Retail.

\textit{vi} Conclusion on the agreement and/or concerted practice between Gallaher and TM Retail

6.1766 The evidence described above demonstrates that there was an Infringing Agreement between Gallaher and TM Retail which had the object of restricting competition, in the manner set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’, and given that the remaining constituent elements of the statutory test are also met (see Section 7: ‘Legal assessment’), amounted to a breach of the Chapter I Prohibition.

\textit{vii} Further Supporting Evidence

6.1767 In addition to the above the existence of the Infringing Agreement between Gallaher and TM Retail is also supported by the pattern of conduct in the market as a whole as revealed by the existence of similar agreements and/or concerted practices as detailed throughout this section of the Decision and likewise supported by documents which are similar in

\textsuperscript{1380} Document 21, Annex 12 is a similar example, in which Gallaher asked, on 20 September 2002, for TM Retail to ‘… please let me have your new Price File for October when available’.

\textsuperscript{1381} Document 25, Annex 12.

\textsuperscript{1382} The OFT does not have on file a copy of the TM Retail price file to which this document refers.
content, tone and nature to those pleaded above in relation to the Infringing Agreement and which concern the relationships between:

- Gallaher and each of the other Retailers, which evidence Gallaher’s approach towards the Retailers as a collective; and between

- ITL and TM Retail (see above), which is part of the context of the Infringing Agreement between Gallaher and TM Retail.

6.1768 The existence of the further supporting evidence described above (and in particular the relationship between ITL and TM Retail) lends further support to the fact that there was an agreement and/or concerted practice between Gallaher and TM Retail which had the object of restricting competition and, given that the remaining constituent elements of the statutory test are also met, amounted to a breach of the Chapter I Prohibition.

(c) The impact of the existence of symmetrical Infringing Agreements between both Manufacturers and the same Retailer

6.1769 As is noted in the sections above relating to the existence of Infringing Agreements between each of ITL/TM Retail and Gallaher/TM Retail, each of those Infringing Agreements amounted to a breach of the Chapter I Prohibition in its own right.

6.1770 In addition to the above, the fact that both Manufacturers communicated parallel and symmetrical parity and differential requirements to TM Retail and that each Manufacturer must have been aware of the other Manufacturer’s parallel and symmetrical parity and differential requirements reinforced and increased the inherently restrictive nature of each Infringing Agreement (see Section 6.A.I.(d) above).
D ROLE OF ITL AND GALLAHER IN RELATION TO BRANDS DISTRIBUTED FOR THIRD PARTIES

6.1771 As described in Section 2.A: 'The Parties', ITL and Gallaher also distributed brands ('the Distributed Brands') for other manufacturers ('the Third Party Manufacturers') in addition to manufacturing and distributing their own brands. ITL distributed Marlboro, Chesterfield and Raffles cigarettes on behalf of Philip Morris, and Café Crème cigars on behalf of Henri Wintermans. Gallaher distributed Camel and More cigarettes on behalf of Japan Tobacco International ('JTI'), and Samson HRT and Clan pipe tobacco on behalf of Theodorus Niemeyer BV ('Niemeyer').

6.1772 The most significant of the Distributed Brands in terms of share of sales was Marlboro, which is one of the leading cigarette brands in the UK. According to ITL, its arrangements with [C] were [C] and [C]. ITL calculated the price parity and differential requirements that applied to the Philip Morris brands by comparing the RRP for Philip Morris brands, as notified to ITL by Philip Morris, with the RRP for competing linked brands. ITL concluded that '[i]n effect, [ITL] are [C] and [ITL] is rewarded on the basis of [C]'. ITL also noted that '[C]' and that '[C]'. However, there is no evidence on the OFT’s file of contacts between the Retailers and Philip Morris. Also, Fiona Bayley’s Witness Statement stated that she 'never spoke directly with Philip Morris' but to 'Imperial when they took over the distribution [of Marlboro and Raffles]'. ITL stated that the nature of its relationship with Henri Wintermans was similar to its relationship with

1383 ITL distributed Marlboro since 12 September 2001 and Chesterfield and Raffles since 1 January 2002. Raffles is distributed and manufactured by ITL in the UK although Philip Morris is the owner of the trademark (Document 1, Annex 13 (page 12)).

1384 The importance of Marlboro, and to a much lesser extent the other cigarettes ITL distributed for Philip Morris, is demonstrated by a comparison of ITL’s share of UK duty paid cigarette sales (by volume) in 2003 excluding these cigarettes, at 44.1 per cent, with ITL’s share including these cigarettes, at 51.5 per cent. In contrast, the equivalent difference in Gallaher’s share in relation to the cigarettes it distributed for JTI, is much smaller: 38.1 per cent excluding these cigarettes and 38.5 per cent including these cigarettes (source: AC Nielsen (RAL) Industry Estimates reported at http://ir.gallaher-group.com/ir/statistics/uk_market_information.asp).

1385 Minutes of meeting between ITL and the OFT on 10 February 2005 (Document 4, Annex 13 (page 8)).

1386 ITL script for the meeting in footnote 1385 above (Document 3, Annex 13 (page 1)).

1387 Document 4, Annex 13 (page 8).

1388 Document 2, Annex 2 (paragraph 75).
Philip Morris. However, there is no evidence on the OFT’s file that any of the Retailers had any contact with Henri Wintermans.

6.1773 Gallaher has informed the OFT that it determined the RRPs and parity and differential requirements for the brands it distributed for JTI and Niemeyer. There is no evidence on the OFT's file that any of the Retailers had any contact with JTI or Niemeyer. The Retailers were in contact with Gallaher regarding all of its Distributed Brands.

6.1774 The OFT considers that the documents referred to in Section 6.C: 'The Infringing Agreements' clearly demonstrate that the Distributed Brands were included in the Infringing Agreements in the same way as ITL's and Gallaher's own brands. In relation to ITL's Distributed Brands, this is demonstrated by, for example, the following documents:

- ITL requested Sainsbury to sell Marlboro products at price parity with Gallaher’s Benson & Hedges King size (Marlboro King Size) and Silk Cut (Marlboro Lights) products;
- ITL requested Somerfield to match the price of Café Crème products with the price of Gallaher’s Hamlet Miniatures products;
- ITL’s trading agreement with TM Retail for the period from 1 October 2002 to 31 August 2004 required Marlboro products to be priced at parity with Gallaher’s Benson & Hedges products and Café Crème products to be priced at parity with Gallaher’s Hamlet Miniatures products; and
- ITL’s internal business development plan for the period from 1 October 2002 to 30 September 2003 stated under the heading 'Philip Morris – Business Development Plan – TM Retail' that 'there is a verbal understanding that selling prices of Marlboro and Raffles will be as such that they compete with like bands.' Under the sub-heading 'Pricing' ITL stated 'Maintain pricing in line with agreed current ITL policy. A weekly check run each Tuesday by T/A showing actual pricing and differentials'.

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1389 ITL’s submission of 24 October 2003 in response to the OFT’s section 26 notice of 15 August 2003 (Document 1, Annex 13 (paragraph 4.43)).
1390 Gallaher’s response of 17 October 2003 to the OFT’s section 26 notice of 15 August 2003 (Document 16, Annex 3 (paragraph 62)).
1391 ITL/Sainsbury: 2 October 2001 (Document 45, Annex 18), also Fiona Bayley’s Witness Statement (Document 2, Annex 2 (Exhibit FB7)).
Similarly, in relation to Gallaher’s Distributed Brands, it is demonstrated that these brands were part of the Infringing Agreements by, for example, the following documents:

- an internal Gallaher document headed 'Promotional Policy – Retail Promotion Contributions – March 2001' included 'pricing objectives' referring to parity between Camel products and ITL’s Marlboro products, and between Samson products and ITL’s Drum products;\textsuperscript{1395}
- Gallaher asked Safeway to increase the price of Samson as part of its monitoring of store prices; and\textsuperscript{1396}
- Gallaher’s trading agreement with Shell for the period from 1 January 2002 to 31 December 2003 required Camel products to be priced at a differential with ITL’s Embassy No 1 and Regal products and Samson products to be priced at parity with ITL’s Drum products.\textsuperscript{1397}

The OFT has not further investigated the nature of the relationship between ITL and Gallaher on the one hand and the Third Party Manufacturers on the other. However, it is clear that the Distributed Brands were part of the Infringing Agreements and that ITL and Gallaher made no, or no significant, distinction between their own brands and the Distributed Brands in this respect. The OFT therefore considers that ITL and Gallaher (rather than each Third Party Manufacturer), as the undertakings that entered into the Infringing Agreements with each of the Retailers, are liable (together with each Retailer as applicable) for the resulting infringements of the Chapter I Prohibition in relation to the Distributed Brands.

This applies irrespective of how the relationship between ITL and Gallaher and the Third Party Manufacturers is characterised. Although Gallaher has stated that it determined the pricing of its Distributed Brands, ITL has stated that it only acted as [C] and that [C] determined the commercial aspects of its brands, including pricing (see paragraphs 6.1772 and 6.1773 above). There is limited evidence on the OFT’s file that ITL did on occasion inform Retailers that decisions regarding funding for Philip Morris brands required Philip Morris’ approval.\textsuperscript{1398} Also, there was one instance during the infringement period when an MPI took place on different dates

\textsuperscript{1395} Gallaher internal: March 2001 (Document 4, Annex 3)
\textsuperscript{1396} Gallaher/Safeway: 26 October 2001 (Document 36, Annex 26).
\textsuperscript{1397} Gallaher/Shell: trading agreement dated 28 November 2001 (Document 10, Annex 9)
\textsuperscript{1398} ITL/Sainsbury: 2 October 2001 (Document 45, Annex 18), also Fiona Bayley’s Witness Statement (Document 2, Annex 2, (Exhibit FB7)).
for Philip Morris’ brands and ITL’s own brands (8 July 2002 and 2 September 2002 respectively).\textsuperscript{1399}

6.1778 However, even if ITL and Gallaher entered into the Infringing Agreements (to the extent they related to the Distributed Brands) pursuant to a request from a Third Party Manufacturer under their respective distribution arrangements, that would not be relevant in absolving ITL or Gallaher from liability for the resulting infringement of the Chapter I Prohibition. It is also not relevant in this respect if ITL and/or Gallaher are genuine agents for the Third Party Manufacturers.\textsuperscript{1400} An analogy can be made with the case law regarding the relationship between parents and subsidiaries. As set out in Section 3: ‘Legal Background’, a subsidiary and a parent generally form a single economic entity within which the subsidiary has no real freedom to determine its course of action independently. As a result, the subsidiary and the parent may be held jointly and severally liable for the subsidiary’s conduct. A similar relationship may exist between a company and its commercial representative and a principal and an agent.\textsuperscript{1401} Hence, ITL and Gallaher, as commercial representatives or agents, can be held liable for their conduct in relation to the Distributed Brands in addition to, or instead of, the Third Party Manufacturers, even if this conduct resulted from the Third Party Manufacturers’ requests (which in any event Gallaher acknowledged it did not).

6.1779 It was open to the OFT to investigate the role of the Third Party Manufacturers in the Infringing Agreements to the extent that they related to the Distributed Brands. However, the OFT considered that it was neither necessary nor appropriate to devote its limited resources to such investigation given the evidence set out in this Decision. In this respect, the OFT notes in particular that ITL and Gallaher included the Distributed Brands in the Infringing Agreements in exactly the same way as their own

\textsuperscript{1399} 8 July 2002 and 2 September 2002 respectively. The OFT notes that when in this context ITL informed Retailers of the change in the price parity and differential requirements that would result from the MPIs, including Gallaher’s MPI on 25 June 2002, it included a Philip Morris brand (Marlboro) in the list of changing parity and differential requirements among its own brands: ITL/Asda: 11 June 2002 (Document 54, Annex 14); ITL/Morrisons: 11 June 2002 (Document 58, Annex 17); ITL/Shell: 28 June 2002 (Document 48, Annex 19); ITL/Somerfield: 11 June 2002 (Document 46, Annex 20).

\textsuperscript{1400} See, the Commission’s \textit{Guidelines on Vertical Restraints}, OJ 2000 C291/1 (paragraphs 12 to 20). The OFT notes that it is doubtful that ITL or Gallaher can be characterised as genuine agents, as according to case law the existence of agency is not generally suggested if an entity conducts a very considerable amount of business for its own account on the market on which it conducts business for the principal’s account (see Case T-66/99 \textit{Minoan Lines SA v Commission} [2003] ECR II-5515, paragraph 128.

brands and that there was no specific evidence regarding the Third Party Manufacturers’ involvement in the Infringing Agreements.

6.1780 The OFT therefore considers that the Infringing Agreements between ITL and Gallaher extended to the Distributed Brands and that each of ITL and Gallaher should be held liable for the resulting infringements.
7 LEGAL ASSESSMENT

A INTRODUCTION

7.1 This section sets out the OFT’s conclusions concerning the legal assessment of the Infringing Agreements described above by reference to the applicable constituent elements of the Chapter I Prohibition. It also sets out the OFT’s analysis and conclusions on the issues of exclusion and exemption from the Chapter I Prohibition.

B UNDERTAKINGS

7.2 The meaning of the word ‘undertaking’ is set out above at Section 3.D: ‘Undertakings’. As noted, the key consideration in establishing whether an entity is an undertaking is whether it is engaged in an ‘economic activity’. The ECJ has described economic activities as being ‘of an industrial or commercial nature by offering goods and services on the market’.

7.3 Accordingly, and in view of the evidence in this case, the OFT considers that each of ITL, Gallaher, Asda, the Co-operative Group, First Quench, Morrisons, Safeway, Sainsbury, Shell, Somerfield, and TM Retail constituted an undertaking for the purposes of the Act at the time of the agreements and/or concerted practices that are the subject of this Decision.

7.4 The legal entities to which this Decision is addressed, as described in more detail in Section 2.A: ‘The Parties’, comprise the entities within the relevant undertakings to which liability for the infringements has been attributed.

7.5 Specific additional considerations relating to the nature of the role of each of the Co-operative Group and Shell in the Infringing Agreements to which each was party are addressed below.

i The Co-operative Group

7.6 As noted in paragraphs 2.20 to 2.26, the Co-operative Group is a member of the CRTG, which the Co-operative Group stated is ‘a consumer co-operative sector-wide buying group, whose members wish to take

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1403 Safeway was acquired by Morrisons on 8 March 2004.
1404 Somerfield was acquired by the Co-operative Group on 2 March 2009.
1405 T&S Stores was acquired by Tesco plc on 6 January 2003.
advantage of the better buying terms which can be brokered as a result of the aggregation of their purchasing requirements'.\textsuperscript{1406} All the major co-operative societies that are engaged in grocery retailing are members of CRTG. The Co-operative Group is the largest member of CRTG.\textsuperscript{1407}

7.7 The Co-operative Group informed the OFT that CRTG had no legal personality of its own. The Co-operative Group acts as CRTG’s ‘representative member’. As such its employees negotiate and agree the terms on which suppliers, including tobacco manufacturers, will deal with all of CRTG’s members. For tobacco products, the Co-operative Group and some other members with their own warehouses buy the products directly from the Manufacturers on the terms brokered by the Co-operative Group in its capacity as the representative member of CRTG. Those members that do not have their own warehouses buy supplies from the Co-operative Group, which in that situation acts as a wholesaler, buying the products from the Manufacturers on the CRTG terms and selling the products on to these members.\textsuperscript{1408}

7.8 The written trading agreements that are referred to in Sections 6.C.II.(a).ii and 6.C.II.(b).ii above were signed by the Co-operative Group’s employees on behalf of CRTG. They are expressed to apply to all of CRTG’s members. For example, in the trading agreement with Gallaher for 2000, 2001 and 2002 a penalty clause applies if ‘CRTG or society does not implement the pricing agreement’.\textsuperscript{1409} Similarly, the trading agreement with ITL for 2000 provides for a payment ‘to reward the consistent price control offered by CRTG’.\textsuperscript{1410} However, it appears that in some cases the Co-operative Group was subject to certain obligations in its own right as a retailer as well as in its capacity as a member of the CRTG.\textsuperscript{1411}

7.9 The Co-operative Group informed the OFT that for those CRTG members that purchase products directly from the Manufacturers, ‘there is no formal programme designed to enforce CRTG members’ compliance with the brokered terms but there is a high expectation that they will so comply and further that suppliers will report to the Co-operative Group

\textsuperscript{1406} The Co-operative Group’s response to the OFT’s section 26 Notice, dated 29 April 2005, paragraph 5.2 (Document 1, Annex 23).
\textsuperscript{1407} A full list of CRTG’s members is in the letter from the Co-operative Group to the OFT of 28 March 2006 (Document 2, Annex 23).
\textsuperscript{1408} The Co-operative Group’s response to the OFT’s section 26 Notice, dated 29 April 2005, sections 5 and 6 (Document 1, Annex 23).
\textsuperscript{1409} The Co-operative Group/Gallaher, Document 7, Annex 5 (page 8).
\textsuperscript{1410} The Co-operative Group/ITL, Document 4, Annex 15 (page 1).
\textsuperscript{1411} See, for example, the trading agreement with Gallaher for 2000, 2001 and 2002 (Document 7, Annex 5).
any CRTG member looking to depart from the brokered terms.

However, the Co-operative Group acknowledged that it purchased tobacco products directly from ITL and Gallaher on the terms brokered by it in its capacity as the representative member of CRTG.

Moreover, the OFT considers that it is extremely unlikely that as a Retailer it would not have adhered to those terms. It had first-hand knowledge of the terms, as it was the same member of staff of the Co-operative Group, Peter Newton, who signed the written trading agreements acting on behalf of CRTG and acted as the tobacco buyer for the Co-operative Group as a Retailer. The ‘high expectation’ that the Co-operative Group refers to in relation to members that buy tobacco products directly from the Manufacturers must have applied even more strongly as regards the Co-operative Group’s own retailing operation.

In addition, the documents referred to in Section 6.C.II: ‘Agreement and/or concerted practice between ITL and the Co-operative Group and between Gallaher and the Co-operative Group’ confirm that the Co-operative Group, as a Retailer, did implement ITL’s parity and differential requirements, which were set out in the written trading agreements. There is evidence that the payment for compliance with ITL’s strategy of retail price parity and differential requirements for 2000 would be paid in full. This confirms that at least the Co-operative Group complied with that strategy. There is no evidence to suggest that this was different for the other written trading agreements with both ITL and Gallaher. In addition, the matrices with cost prices and proposed retail prices that the Co-operative Group regularly provided to ITL and Gallaher reflected the cost prices and price-related bonuses that the Co-operative Group had agreed with ITL and Gallaher in its capacity as CRTG’s representative member in combination with the Co-operative Group’s own retail prices.

The Co-operative Group also took active steps to ensure that CRTG’s members adhered to the retail price parity and differential requirements it had agreed with ITL. For example, a letter from the Co-operative Group (presumably written in its capacity as representative member of CRTG, although the letter is on paper with the Co-operative Group’s letterhead) to ITL of 9 July 2002 stated:

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1412 Letter from the Co-operative Group to the OFT, dated 28 March 2006, response to question 7(b) (Document 2, Annex 23).
1415 Letter from the Co-operative Group to the OFT, dated 7 April 2006, response to question 9(a) (Document 3, Annex 23).
'Further to our recent integration negotiations in respect of the 2002 trading terms, I can confirm that with regard to price positioning the following general guidelines will be adopted by CRTG in establishing retail prices across the various store brands. In terms of the price differentials we are currently putting together a price matrix for CRTG which defines our strategic pricing position. This document will recognise the need to maintain price differentials across the competing segments of the tobacco category.

In addition the price guidelines will ensure consistent price disciplines are applied by CRTG across the price bands currently operated. … we are confident that we have satisfied the requirements to ensure the payment of … the negotiated central payments in respect of pricing and promotion.'

7.13 These ‘central payments’ included payments for the achievement of pricing in line with ITL’s parity and differential requirements.

7.14 In view of the above, the OFT considers that the Co-operative Group:

- entered into the written trading agreements on behalf of CRTG (CRTG having no legal personality of its own) and implicitly on behalf of itself as a Retailer and/or as a CRTG member;
- was subject to certain obligations under the written trading agreements in its own right as a Retailer as well as in its capacity as a member of CRTG;
- purchased tobacco products directly from ITL and Gallaher on the terms brokered by it (albeit in its capacity as the representative member of CRTG);
- in its capacity as a Retailer, did implement ITL’s parity and differential requirements, which were set out in the written trading agreements (in particular having first-hand knowledge of their terms, since the member of staff of the Co-operative Group (Peter Newton), who signed the written trading agreements acting on behalf of CRTG, was also the tobacco buyer for the Co-operative Group as a Retailer); and
- also took active steps to ensure that CRTG’s members adhered to the retail price parity and differential requirements it had agreed with ITL.

7.15 Therefore, the Co-operative Group was a party to the Infringing Agreements at least in its own right as a Retailer and/or as a member of

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Furthermore, it is also arguable that the Co-operative Group is jointly and severally liable for any infringement that may be attributable to CRTG for the Infringing Agreements in question.

7.16 However, for the purposes of this Decision, the OFT has made a finding only in respect of the Co-operative Group’s individual liability as a Retailer and/or as a member of CRTG (and in that respect is addressing this Decision only to the Co-operative Group), since:

- the Co-operative Group can be distinguished from the other CRTG member societies, because it is CRTG’s representative member and its employees were instrumental in entering into the written trading agreements with ITL and Gallaher; and

- the Co-operative Group is by a large margin the largest co-operative tobacco Retailer in the UK, representing about 54 per cent of the combined tobacco sales of CRTG’s members in the final year of the period under investigation. The next largest UK co-operative tobacco retailers represented only about 17 per cent and 5 per cent of those sales respectively. As set out in Section 2.B.V: ‘Reduction in the number of parties’, the OFT focused its investigation on those parties whose activities would be most likely to have caused the greatest consumer detriment, which in the context of the co-operative retailers was the Co-operative Group given the market share figures set out above. Therefore, in order to focus its resources most effectively, the OFT did not consider it necessary to address the SO and this Decision to the CRTG or other CRTG members in addition to the Co-operative Group.

ii Shell

7.17 As already discussed in paragraph 2.54 above, during the infringement period, Shell operated two types of petrol forecourts in the UK, that is those owned by independent dealers and those owned by Shell. All of the Shell-owned sites operate forecourt shops under the Shell Select brand.

7.18 Shell provided the OFT with some factual background information about the nature of Shell’s petrol forecourts in response to the OFT’s section 26 notices. That included an explanation by Shell of changes that took place to the operation of Shell-owned retail sites during the period under investigation. Further details of Shell’s responses are provided in this

1418 Email from the Co-operative Group to the OFT dated 19 June 2006.
1419 Shell’s responses to the OFT’s section 26 Notices dated 3 October 2003 and 11 March 2005 (Documents 4 and 5, Annex 23).
section of the Decision, together with an explanation of the approach taken by the OFT in relation to Shell in that connection.

7.19 Shell informed the OFT that so-called 'Dealer' sites principally operated under the Shell Dealer Sales Agreement. Dealers are independent from Shell and are free to decide the choice of products sold through their forecourts, apart from Shell motor fuel and certain other related Shell products. Shell stated that it had no specific knowledge of what tobacco products were sold by Dealers, the resale prices of such products and what relationships, if any, the Dealers had with the tobacco manufacturers.

7.20 Shell also informed the OFT that all Shell-owned sites (that is, those not owned and operated by Dealers) were operated by Shell only up to October 2000. The operation of those sites was then transferred (over a nine month period) to independent contractors (known as 'Retailers' within Shell but referred to in this Decision as 'Contractors' to avoid confusion with the term 'Retailers' used elsewhere in this Decision) who operated under the terms of the Shell Retail Business Agreement ('RBA').

7.21 Shell explained that under the RBA system, it had no direct contract for supply with tobacco manufacturers, nor did it sell products to Contractors. Contractor sites did, however, have an obligation to purchase a number of 'Core Range' goods, including tobacco products, from Shell’s approved distributor, P&H. Shell was entitled to a percentage of the Contractors' turnover from the sale of those products.

7.22 In addition, Shell submitted that, under the RBA, it was only able to suggest RRPs to Contractors for the sale of those products (including tobacco). Shell was also able to impose maximum retail prices but Contractors were entitled to set retail prices at any amount up to and including the relevant maximum price. Shell stated that it aimed to set the maximum retail prices at a level above which, in Shell’s opinion, prices would be considered 'insulting' (that is, excessive) by consumers.

7.23 It appears that lists of retail prices were provided to Shell-owned/operated sites by Shell up to October 2000. Once the transition period commenced, the price lists forwarded to retailers by Shell contained both recommended retail prices and maximum retail prices. However, during the transition period, Shell informed the OFT that Shell-operated sites were instructed to price at RRP.

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1420 See also Shell’s response to the SO, paragraphs 140 to 144.
1421 Shell’s response to the SO, paragraph 141.
1422 See paragraph 7.18 above.
7.24  Shell therefore maintained that Contractors decided their own retail prices subject to the maximum price in the RBA. It stated that it did not require, incentivise or pressurise Contractors to price in line with parity and differential requirements.1423 Nor did it monitor Contractors’ prices of Core Range products, although it may occasionally have verified whether products were being sold above the maximum retail price.

7.25  In addition, Shell submitted that the fact that it did not sell tobacco products or have control over Contractor’s pricing meant that no anti-competitive agreement between Shell and the Manufacturers was possible.1424

7.26  It is clear from the evidence at Section 6.C.VII:’Agreement and/or concerted practice between ITL and Shell and between Gallaher and Shell’ that Shell entered into an Infringing Agreement with each of ITL and Gallaher. It is equally clear that Shell was at all relevant times in a position to implement those Infringing Agreements, insofar as Shell had the power to specify or negotiate the terms under which the Contractors were to operate the Shell-owned sites, including terms as to the Contractors’ retail pricing policies. Indeed, the fact that Shell was able to impose maximum retail prices for tobacco products upon the Contractors illustrates the scope of Shell to influence the Contractors’ pricing policies.

7.27  Further, each Manufacturer monitored Shell’s compliance with the Infringing Agreements both centrally at Shell Head Office and also at individual Contractor sites.1425 In both cases, the evidence would seem to confirm that the Infringing Agreements related to the retail pricing of the Manufacturer’s products at Shell’s owned sites, irrespective of whether the sites were operated by Shell or by Contractors (following the change in operational status of sites from October 2000) at the time. As the OFT has found that the Infringing Agreements between Shell and each of ITL and Gallaher amount to restrictions of competition by object, it has proceeded on the basis that it is not necessary to demonstrate that in relation to the Infringing Agreements, Shell actually agreed terms as to pricing parities and differentials with the Contractors operating Shell-owned sites and enforced those terms (see paragraph 3.51 above). It is sufficient for the OFT to demonstrate that the terms of the Infringing Agreements between Shell and the Manufacturers infringe the Act and that Shell and the Manufacturers were in a position to implement the Infringing Agreements.

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1423 See also Shell’s response to the SO, paragraphs 140 to 163.
1424 Shell’s response to the SO, paragraph 148.
1425 Shell also indicates that it would monitor prices at individual contractor sites to ensure compliance with maximum pricing obligations. Shell’s response to the SO, paragraph 159.
7.28 It is perhaps also worth noting that up to October 2000 all Shell-owned sites were operated by Shell and that the transfer of the operation of those sites was not completed until approximately July 2001. Furthermore, in the period following the transfer of operation of Shell-owned sites, there is some evidence to suggest that Shell had agreed with Gallaher and ITL that it would ensure Contractors’ compliance with parity and differential requirements and/or that there was some expectation from the Manufacturers that Shell would do so, and that Shell received payments from the Manufacturers for doing so.1426

C AGREEMENT AND/OR CONCERTED PRACTICE

7.29 The applicable aspects of the law on agreements and concerted practices in relation to the present case are set out above at Section 3F: ‘Relevant case law in relation to agreements or concerted practices’.

7.30 On the basis of the evidence set out or referred to above in Section 6: ‘Analysis of Evidence’, and noting the concluding paragraphs set out in relation to each Infringing Agreement in that section, the OFT has decided that each Infringing Agreement amounted to an agreement and/or concerted practice within the meaning of the Act.

7.31 As stated in paragraphs 3.22 to 3.26 above, it is not necessary for the OFT to conclude as to whether each Infringing Agreement specifically constituted an agreement or a concerted practice in order to demonstrate an infringement of the Chapter I Prohibition. It is sufficient that the OFT has found that each Infringing Agreement amounted to one or the other.

D PREVENTION, RESTRICTION OR DISTORTION OF COMPETITION: THE ANTI-COMPETITIVE OBJECT OF THE INFRINGING AGREEMENTS

7.32 As set out in Section 6.A.I: ‘The anti-competitive object of the Infringing Agreements’, the OFT considers that each of the Infringing Agreements was, by its very nature, capable of restricting competition. The evidence on which the OFT relies in this Decision demonstrates that each Manufacturer co-ordinated with each Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing

strategy. The Infringing Agreement between each Manufacturer and each Retailer restricted the Retailer’s ability to determine its retail prices for competing linked brands. In the context in which it operated, the OFT has therefore concluded that each Infringing Agreement described in this Decision had as its object the prevention, restriction or distortion of competition.

E APPRECIABILITY

7.33 As set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements', each Infringing Agreement described in this Decision constituted a vertical agreement and/or concerted practice between non-competing undertakings, namely a Manufacturer and a Retailer, and restricted the Retailer’s ability to determine its retail prices for competing linked brands. Although an agreement or concerted practice between non-competing undertakings is not regarded as appreciably restricting competition where the market share of each of the parties on any of the relevant markets affected by the agreement or concerted practice does not exceed 15 per cent, that approach does not apply in certain cases. One such case is an agreement or concerted practice that limits a Retailer’s ability to determine its resale prices, which is regarded as being capable of appreciably restricting competition provided that it does not have only insignificant effects.1427

7.34 Given that the Infringing Agreements restricted the Retailer’s ability to determine its retail prices for competing linked brands and given the circumstances and context of the Infringing Agreements described in this Decision (in particular the market characteristics and the strong position of the Parties on the market), the OFT considers that each of the Infringing Agreements were capable of restricting competition appreciably whether or not each of the Parties' market share in the relevant market did not exceed 15 per cent. It cannot be argued that the Infringing Agreements would have produced only an insignificant effect on the market,1428 in particular in light of: (i) the market shares of each of ITL and Gallaher; (ii) the market shares of the Retailers; (iii) the importance of price competition in the tobacco market in the absence of advertising and promotion; and (iv) the fact that each Manufacturer entered into Infringing Agreements with a number of Retailers.

The OFT therefore considers that each of the agreements and/or concerted practices described in this Decision had the object of preventing, restricting, or distorting competition to an appreciable extent.

**F EFFECT ON TRADE**

7.36 As set out above at Section 3J: 'Effect on trade within the UK', the OFT considers that, by their very nature, agreements or concerted practices that restrict price competition are likely to affect trade. The OFT considers that each of the Infringing Agreements was likely to have affected trade in that it restricted the ability of the Retailer to determine its retail prices for competing linked brands.

7.37 Each of the agreements and/or concerted practices described in this Decision was implemented in the UK in that the tobacco products that were the subject of the Infringing Agreements were sold throughout the UK. As described above, the object of the Infringing Agreements was the prevention, restriction, or distortion of competition in the markets for those products and there was an Infringing Agreement between each Manufacturer (where collectively the Manufacturers accounted for approximately 90 per cent by volume\(^\text{1429}\) of the sale of those products) and each Retailer (where the Retailers comprised major retailers of the products in the UK).

7.38 The OFT therefore considers that each of the agreements and/or concerted practices described in this Decision was likely to have affected trade within the UK in breach of the Chapter I Prohibition.

**G DURATION OF THE INFRINGEMENTS AND THE INVOLVEMENT OF EACH PARTY**

7.39 As regards the question of the duration of each Infringing Agreement, the evidence obtained by the OFT under its powers of investigation is voluminous but not exhaustive. The Manufacturer's parity and differential requirements were first introduced with retailers in the mid 1990s for ITL.\(^\text{1430}\) As demonstrated in the documents that evidence the nature and existence of the Infringing Agreements, the content and tone of the language used in the various documents passing between the

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\(^{1429}\) Including the Distributed Brands.  
\(^{1430}\) ITL's response to the SO, paragraph 2.116. See also the first witness statement dated 8 August 2008 of Geoff Good (the ITL manager responsible for UK national account customers in 1990), provided as an Annex to ITL's response to the SO, at paragraph 16. There is no indication of when Gallaher's parity and differential requirements were first introduced.
Manufacturer and the Retailer is suggestive of longstanding, established retail price co-ordination between them that was already in place when the Chapter I Prohibition came into force on 1 March 2000.\textsuperscript{1431} Indeed, in relation to the Infringing Agreements between respectively ITL/First Quench and Gallaher/Asda,\textsuperscript{1432} further evidence was received by the OFT after it had issued the SO indicating that the Infringing Agreement between ITL/First Quench was in existence from 24 February 2000\textsuperscript{1433} and the Infringing Agreement between Gallaher/Asda was in existence from 12 January 2000.\textsuperscript{1434}

7.40 In view of the foregoing, the OFT has taken the view that, for each Party, the Infringing Agreement to which it was a party was in existence prior to 1 March 2000 (save in respect of the Infringing Agreement between Gallaher and Shell, which the evidence indicates existed from 20 August 2001). The consequence of that conclusion is that, pursuant to paragraph 19 of Schedule 13 to the Act, each Infringing Agreement (save Gallaher/Shell) benefits from a one-year transitional period during which the Chapter I Prohibition did not to apply such that the starting date of each Infringing Agreement (save Gallaher/Shell), for the purposes of a finding of infringement of the Chapter I Prohibition, is taken to be 1 March 2001. In these circumstances, it is not necessary for the OFT to identify the precise starting date of each Infringing Agreement, as the consequence of an Infringing Agreement being in existence before 1 March 2000 is that the infringement in each case in law is deemed as beginning on 1 March 2001.

7.41 For the purposes of this Decision, and save in relation to the three exceptions stated below, the OFT has elected to take 15 August 2003 as

\textsuperscript{1431} The one exception is the Infringing Agreement between Gallaher and Shell, in respect of which the evidence indicates that it existed from 20 August 2001.
\textsuperscript{1432} When the OFT issued the SO, the evidence in its possession in relation to the Infringing Agreement between ITL and First Quench was from 7 August 2000 and in relation to the Infringing Agreement between Gallaher and Asda, from at least 25 July 2000.
\textsuperscript{1433} First Quench/ITL, Documents 55 and 56, Annex 16. Document 55 was provided to the OFT by First Quench in response to a request from the OFT dated 12 November 2008, pursuant to the Early Resolution agreement that First Quench had concluded with the OFT. This document is relied on to demonstrate that the Infringing Agreement was in place before the Chapter I Prohibition came into force on 1 March 2000. Document 56, which was part of the OFT’s file, was highlighted by ITL in response to a request from the OFT dated 31 October 2008. This document is relied on to demonstrate that the Infringing Agreement was in place before the Chapter I Prohibition came into force on 1 March 2000.
\textsuperscript{1434} Asda/Gallaher, Document 18 and 19, Annex 4. These documents were provided by Gallaher in response to a request from the OFT dated 12 February 2009, pursuant to the Early Resolution agreement that Gallaher had concluded with the OFT. These documents are relied on by the OFT to demonstrate that the Infringing Agreement was in place before the Chapter I Prohibition came into force in 1 March 2000.
the cut-off point for the period of infringement. That was the cut-off date
for the various information and document requests made of the Parties.
Earlier end dates are applicable to the Infringing Agreement between
Gallaher and First Quench, which ended on 19 December 2002, (see
Section 6.C.III.(b) above), and the Infringing Agreements between
Sainsbury and ITL, and Sainsbury and Gallaher, which both ended on 9
March 2003 as part of Sainsbury’s application for leniency (see Section
6.C.VI.(a) and Section 6.C.VI.(b)).

7.42 In view of the foregoing, for the purposes of the OFT’s finding of an
infringement and determining consequential penalties (and except where
indicated otherwise in this section and summarised in paragraph 7.43
below), the OFT has decided to treat the duration of each Party’s
participation in the Infringing Agreements to which it was party as being
from 1 March 2001 to 15 August 2003.

7.43 That results in the Infringing Agreements having the following duration in
breach of the Chapter I Prohibition:

<table>
<thead>
<tr>
<th>Retailers</th>
<th>Manufacturers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ITL</td>
</tr>
<tr>
<td>Asda</td>
<td>1 March 2001 to 15 August 2003</td>
</tr>
<tr>
<td>The Co-operative Group</td>
<td>1 March 2001 to 15 August 2003</td>
</tr>
<tr>
<td>First Quench</td>
<td>1 March 2001 to 15 August 2003</td>
</tr>
<tr>
<td>Morrisons</td>
<td>1 March 2001 to 15 August 2003</td>
</tr>
<tr>
<td>Safeway</td>
<td>1 March 2001 to 15 August 2003</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>1 March 2001 to 9 March 2003</td>
</tr>
</tbody>
</table>
Shell | 1 March 2001 to 15 August 2003 | 20 August 2001 to 15 August 2003
---|---|---
Somerfield | 1 March 2001 to 15 August 2003 | 1 March 2001 to 15 August 2003
T&S Stores | 1 March 2001 to 15 August 2003 | 1 March 2001 to 15 August 2003
TM Retail | 1 March 2001 to 15 August 2003 | 1 March 2001 to 15 August 2003

**H EXCLUSION**

7.44 None of the exclusions from the Chapter I Prohibition provided for by section 3 or under section 50 of the Act applies in respect of the Infringing Agreements. In particular, although at the time of the Infringing Agreements, the Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000 excluded from the Chapter I Prohibition an agreement to the extent that it fell within the definition of a ‘vertical agreement’ set out in that Order, such exclusion did not apply where the agreement:

>'directly or indirectly, in isolation or in combination with other factors under the control of the parties [had] the object or effect of restricting the buyer’s ability to determine its sale price, without prejudice to the possibility of the supplier imposing a maximum sale price or recommending a sale price, provided that these [did] not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties'.

7.45 The OFT considers that the Infringing Agreements restricted the ability of the buyer (in this case, the Retailer) to determine its retail prices for competing linked brands and therefore the exclusion did not apply. In particular, that is because the restrictive nature of the Infringing Agreements involved the linking of the retail price of competing brands.

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1436 SI 2000/310, Article 4.
and was not by virtue of any imposition of an absolute maximum resale price to be observed by the Retailer.

I EXEMPTION

7.46 There is no block exemption order under section 6 of the Act or any order pursuant to section 11 of the Act pursuant to which the Infringing Agreements would have been exempt from the Chapter I Prohibition. Nor is there any applicable EU Council or Commission Regulation by virtue of which the Infringing Agreements would have been exempt from Article 81(1) EC at the time (now Article 101(1) TFEU) and would have benefited from a parallel exemption from the Chapter I Prohibition under section 10 of the Act. In particular, it is instructive to note that Article 4 of the VBER\[1437\] provides that the block exemption shall not apply to vertical agreements which:

'directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

(a) the restriction of the buyer’s ability to determine its sale price, without prejudice to the possibility of the supplier’s imposing a maximum sale price or recommending a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties …’

[emphasis added]

7.47 The OFT considers that the Infringing Agreements restricted the ability of the buyer (in this case, the Retailer) to determine its retail prices for competing linked brands. Therefore, for the reasons provided in paragraph 7.45 above in relation to the almost identical provisions of the Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000, the Infringing Agreements did not benefit from an EU block exemption or a UK parallel exemption.

7.48 In addition, ITL and the Co-operative Group made representations on the issue of individual exemption.\[1438\] Having considered those representations, and for the reasons set out below, the OFT considers that the Infringing Agreements would not have benefited from individual exemption from the Chapter I Prohibition by virtue of the operation of section 9 of the Act.


\[1438\] ITL’s response to the SO, pages 288 to 291 and the Report by RBB Economics for ITL, section 4. The Co-operative Group’s response to the SO, paragraphs 8.10 and 8.11.
An agreement or concerted practice which restricts competition is exempt from, and does not therefore infringe, the Chapter I Prohibition where it satisfies all of the following cumulative exemption conditions in section 9 of the Act ('the exemption conditions'), namely where it:

(i) contributes to improving production or distribution, or promoting technical or economic progress;
(ii) allows consumers a fair share of the resulting benefit;
(iii) does not impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives; and
(iv) does not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.

In assessing whether the exemption conditions are met, the OFT has had regard to the Commission's Guidelines on the application of Article 81(3) of the EC Treaty (now Article 101(3) TFEU (the 'Article 101(3) Guidelines'), as well as the relevant case law of the European Court.

The case law of the European Court makes clear that an agreement or concerted practice only meets the exemption conditions if it is demonstrated that it is more likely than not that the agreement or concerted practice must make it possible to obtain appreciable objective advantages of such a character as to compensate for the disadvantages for competition caused by the agreement or concerted practice. The burden of proof is on the party claiming the benefit of exemption and the claim must be substantiated.

ITL and the Co-operative Group made representations in response to the SO regarding the applicability of the exemption conditions to the Infringing Agreements to which they were party. Only ITL advanced specific representations and evidence in support with regard to each of the conditions.
exemption conditions. These are considered in the assessment of each of 
the four exemption conditions below.

7.53 The Co-operative Group made submissions of a more general nature to 
address the issue of exemption by arguing that the Infringing Agreements 
were pro-competitive or at worst benign. 1444 However, those submissions 
did not specifically consider whether or how each of the four exemption 
conditions was satisfied.1445 Neither did those submissions highlight 
particular arguments or evidence that the Co-operative Group would wish 
to be considered in relation to each of the four exemption conditions. In 
these circumstances, the OFT was not in a position to assess the 
application of each exemption condition in respect of the Co-operative 
Group’s perspective. However, it has assessed the Co-operative Group’s 
representations as to the pro-competitive nature of the Infringing 
Agreements in Section 6.A.II: 'The OFT’s response to arguments that the 
Infringing Agreements had a pro-competitive nature’.

7.54 In view of the foregoing and for the reasons set out below, the OFT has 
concluded that none of the Infringing Agreements in question benefited 
from exemption from the Chapter I Prohibition under section 9 of the Act. 
In particular, ITL, which has provided representations with regard to each 
of the exemption conditions, has not demonstrated that the Infringing 
Agreements contributed to improving production or distribution, or 
promoting technical or economic progress, or that the restrictions of 
competition under the Infringing Agreements were indispensable to the 
attainment of the efficiencies ITL has claimed were created by the 
Infringing Agreements.

I First exemption condition: contributing to improving 
production or distribution, or promoting technical or 
economic progress

7.55 The OFT notes that, for section 9 of the Act to apply to an agreement 
and/or concerted practice, the pro-competitive advantages flowing from 
the agreement or concerted practice must outweigh its anti-competitive 
disadvantages.1446 All efficiency claims must therefore be substantiated so 
that the following can be verified: (i) the nature of the claimed 

1444 The Co-operative Group’s response to the SO dated 26 September 2008, paragraph 
8.11 and in support Oxera Report entitled ‘An effects analysis of the Co-operative 
Group’s agreements with ITL and Gallaher’.
order for an application for individual exemption to be granted under Article 81(3) EC, 
the conditions set out in that article must be cumulatively fulfilled’.
1446 See footnote 1441 above.
efficiencies; (ii) the link between the agreement or concerted practice and the efficiencies; (iii) the likelihood and magnitude of each claimed efficiency; and (iv) how and when each claimed efficiency would be achieved.\textsuperscript{1447}

7.56 In its written representations, under the heading \textit{The first condition: economic and other benefits}, ITL submitted that it had provided arguments and evidence elsewhere in its representations to substantiate its efficiency claims. ITL’s representations stated, in particular that:\textsuperscript{1448}

i) The purpose of the trading agreements and the ancillary restrictions (including the differential provisions) was to offer significant amounts of funding to pay for and incentivise Retailers to reduce their shelf prices. That provided direct benefits to consumers in the form of lower retail prices;

ii) The economic background to those efficiencies lay in the specific characteristics of this market and the lack of incentives for Retailers to implement price reductions from their own margins, coupled with the 'double mark-up' problem;\textsuperscript{1449} and

iii) The evidence (derived from ITL’s study of a counterfactual) in support of the claimed efficiencies, was that retail price savings were passed on to the consumer. ITL submitted that the evidence was supported by the fact that ITL gained significant market share during the infringement period.

7.57 ITL’s arguments regarding the pro-competitive nature and objectives of the Infringing Agreements are addressed in Section 6.A.II: 'The OFT’s response to arguments that the Infringing Agreements had a pro-competitive nature'. The OFT does not consider that ITL’s submissions, summarised in paragraph 7.56 (i) to (iii) above, are sufficient to enable the OFT to identify the nature of the claimed efficiency/efficiencies put forward despite references in ITL’s representations to \textit{efficiency benefits}\textsuperscript{1450} and \textit{pricing efficiencies}.\textsuperscript{1451}

7.58 As noted above, ITL has submitted that the purpose of the Infringing Agreements was to offer funding to pay for and encourage Retailers to reduce shelf prices.\textsuperscript{1452} To the extent that ITL’s submissions in that connection amount to a claim that such funding constitutes a cost

\textsuperscript{1447} The Article 101(3) Guidelines, paragraph 51.
\textsuperscript{1448} ITL’s response to the SO, paragraph 4.677.
\textsuperscript{1449} This point is made with reference to the RBB Report at Annex 1 of ITL’s response, in particular paragraphs 84 and 88.
\textsuperscript{1450} Report by RBB Economics for ITL section 4.1 and paragraph 179.
\textsuperscript{1451} Report by RBB Economics for ITL, paragraph 164.
\textsuperscript{1452} ITL’s response to the SO, paragraph 4.677 and report by RBB Economics for ITL, paragraphs 4.1 and 4.2.10.
efficiency for the Retailer, the OFT would make the following points. First, it is recognised that the types of efficiencies for the purposes of the first exemption condition are broad categories and those listed in the Article 101(3) Guidelines are not intended to be exhaustive. However, and secondly, the Article 101(3) Guidelines clearly envisage that the notion of efficiencies, for the purposes of the first exemption condition, entails some creation of value resulting from an integration of assets and activities: 'In general efficiencies stem from an integration of economic activities whereby undertakings combine their assets to achieve what they could not achieve as efficiently on their own or whereby they entrust another undertaking with tasks that can be performed more efficiently by that other undertaking.' In the present case, the OFT does not consider that the funding in question constitutes an integration of assets and/or activities.

7.59 ITL also submitted that its parity and differential requirements would have addressed the double mark-up problem by encouraging the Retailers to set the retail price of a particular product lower than would otherwise have been the case. The double mark-up problem refers to a situation in which a manufacturer and a retailer each set a separate margin in order to maximise their profits independently. In that situation, a retailer will set a level of margin to maximise its profits without taking into account the effect that would have on the manufacturer’s profits or the level of the manufacturer’s sales overall. The overall effect of the double mark-up is higher prices and lower sales than would be the case were the manufacturer and retailer vertically integrated and able to set a retail price that maximised their joint profits.

7.60 If and to the extent that ITL is correct in its submission that the Infringing Agreements addressed the double mark-up problem by incentivising retailers to lower their prices, it is possible that this could be considered an economic efficiency relevant to the application of the first exemption condition. However, the OFT does not consider that this is correct. Further, even if this was correct, it would be necessary for ITL to show that the magnitude of any benefits from the Infringing Agreements, in terms of limiting the propensity of Retailers’ to apply a double mark-up

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1453 The Article 101(3) Guidelines, paragraph 59.
1454 The Article 101(3) Guidelines, paragraph 63.
1455 The Article 101(3) Guidelines, paragraph 60. See also at paragraph 49.
1456 Report by RBB Economics for ITL, paragraphs 76, 89 and 164.
1457 It is possible that limiting the double mark-up problem would fall within the general notion of efficiency contained in paragraph 60 of the Article 101(3) Guidelines which states 'In general, efficiencies stem from an integration of economic activities whereby undertakings ... entrust another undertaking with tasks that can be performed more efficiently by that other undertaking.'
to tobacco products, outweighed the anti-competitive disadvantages of the Infringing Agreements.

7.61 In response to the possible efficiency claim summarised above, the OFT makes the following points.

7.62 First, to the extent that a double mark-up problem existed in this market – and ITL has not provided evidence on the extent or magnitude of such a problem – it is not clear how such a double mark-up problem could be mitigated by the Infringing Agreements. As noted in Section 6.A.1.(d) above, the restrictive nature of the Infringing Agreements resulted from the linking of the retail price of competing brands. It was that link between competing linked brands that restricted the Retailer’s ability to set the relative prices of the competing brands, although it did leave a Retailer free to set the absolute level of prices in line with its overall pricing policy or position. In other words, the Retailer could still have chosen to set high or low levels of margins and thereby retail prices for both brands provided the relative price between them observed the stipulated parity and differential requirement. As such, the Manufacturers’ parity and differential requirements did not impose a limit on the absolute level of margin set by a Retailer in relation to competing linked brands and consequently were not capable of addressing the double mark-up problem insofar as it may have resulted in higher prices for consumers.

7.63 As ITL submitted in its response to the SO,\textsuperscript{1458}

\textit{'it is important to reiterate that there is nothing in the pricing differential schedules that constrains or influences the level of retail prices charged by any given retailer. If, say, Richmond and Dorchester both have an RRP of £3.83, any retailer with pricing differential schedules with both Gallaher and Imperial would have complete freedom as to whether to set retail prices at RRP, 5p below or indeed 15p below that level.'}

7.64 It is also not clear how a parity and differential requirement incentivised the Retailer to pass on bonuses paid by the Manufacturer in the form of lower retail prices for consumers. Since a parity or a differential requirement only concerns the relative price of competing linked brands, there is nothing in such a requirement that encourages the Retailer to lower its retail prices for the brands in question. For example, a Retailer could meet a parity requirement between competing linked brands by aligning the retail price of one linked brand upwards to meet the higher retail price of the other linked brand. In this context, it is particularly difficult to reconcile ITL’s efficiency arguments with the frequent examples of correspondence whereby the Manufacturer instructed or

\textsuperscript{1458} Report by RBB Economics for ITL, paragraph 83.
requested the Retailer to increase the retail price of a particular brand, in order to maintain specified parities and differentials between the Manufacturer’s brands and competing linked brands.

7.65 In the light of the above considerations, the OFT considers that ITL has not established the link between the Infringing Agreements and the double mark-up problem (to the extent that one existed).\(^\text{1459}\)

7.66 Second, in relation to the evidence that ITL claimed proved that retail price savings were passed on to the consumer with regard to the study of a counterfactual, ITL did not identify which of the evidence that it submitted in its representations it considered supported its claim that the Infringing Agreements resulted in pricing efficiencies.\(^\text{1460}\) The OFT assumes the evidence referred to consists of graphs showing retail price increases implemented by Asda for certain tobacco brands.\(^\text{1461}\) The graphs show weekly Asda national selling prices (excluding increases in excise duty, ad valorem tax and VAT) for certain brands during the infringement period, and compare these with weekly Asda national selling prices for the same brands for an equivalent period of time commencing at the end of the infringement period (‘ITL’s counterfactual period’).\(^\text{1462}\) ITL claimed that this data showed that retail prices rose by a smaller percentage during the period of the Infringing Agreement between ITL and Asda than they did in the period following the Infringing Agreement.

7.67 ITL also submitted that the evidence ‘is supported by the fact that ITL gained significant market share during the period’.\(^\text{1463}\)

7.68 The OFT does not consider that this evidence substantiates ITL’s claim that the Infringing Agreements resulted in lower price increases during the infringement period than during ITL’s counterfactual period.

7.69 In relation to the graphs showing Asda prices for certain brands during and after the infringement period, it is not clear on what basis ITL had chosen to show only Asda retail pricing data. The OFT does not consider this provides a representative sample of Retailer pricing. Moreover, with

\(^{1459}\) See paragraph 7.59 above and the Article 101(3) Guidelines, paragraph 51.

\(^{1460}\) Paragraph 179 of the Report by RBB Economics for ITL simply refers to ‘The counterfactual evidence on pricing during and after the termination of the pricing differential schedules that we present in section 3’.

\(^{1461}\) Figures 11, 12, 13 and 14 in the report by RBB Economics for ITL, pages 53 to 56. The brands are: Richmond and Dorchester KS, Lambert and Butler and Sovereign KS, Superkings and Berkeley Superkings, and Embassy No1 and Benson and Hedges Gold.

\(^{1462}\) ITL did not specify the dates it had taken for the two periods, although it would appear that it took the period 1 March 2000 to 31 August 2003 as the infringement period. An equivalent duration (182 weeks) starting on 1 September 2003 would last until 2 March 2007. To adjust for inflation, RBB re-based the two price series to the first week of each period.

\(^{1463}\) ITL’s response to the SO, paragraph 4.677(c).
the exception of the graph showing Asda’s retail prices for Richmond and Dorchester, the OFT does not consider that the graphs in fact show that retail prices in Asda rose by more during the infringement period than during ITL’s counterfactual period. Rather, the graphs show similar patterns of retail price increases during the two periods. Indeed, it was only by virtue of one retail price increase that Asda appears to have undertaken for all tobacco products right at the end of ITL’s counterfactual period that ITL was able to claim that retail prices rose by more in the period following the infringement. The OFT considers that the inclusion of this price increase is not appropriate in the circumstances.

7.70 In relation to the graph for Richmond and Dorchester, the OFT notes that this does appear to show that Asda’s prices for those brands increased by a greater amount in ITL’s counterfactual period than they increased during the infringement period. However, the OFT notes that ITL made the decision to reposition its Richmond brand in September 2000 to a new lower price point in the value and economy segment.\(^{1464}\) That downward adjustment of the Richmond brand explains to a large extent why the price increase for Richmond during the infringement period was lower than during ITL’s counterfactual period.

7.71 Furthermore, to the extent that there may have been different retail price trends across the two periods, these may have been caused by a variety of factors and ITL did not demonstrate how any such differences were attributable solely to the Infringing Agreements. As noted in paragraphs above, it is not clear to the OFT how the Infringing Agreements were capable of mitigating the double mark-up problem insofar as such a problem may have resulted in higher prices to consumers.

7.72 Finally, in relation to ITL’s argument that shifts in market share in ITL’s favour during the infringement period demonstrate vigorous inter-brand price competition, the OFT does not consider that this evidence supports ITL’s assertion that the Infringing Agreements were pro-competitive (see paragraph 6.289).

7.73 In conclusion, the OFT considers that ITL has not provided sufficient substantiated evidence to demonstrate that it was more likely than not that the Infringing Agreements made it possible to obtain efficiencies that constituted appreciable objective advantages. In any event, it is not sufficient that there is just an advantage to the parties to the relevant agreement or concerted practice. The claimed efficiencies must in particular display appreciable objective advantages of such a character as to compensate for the disadvantages or the restrictive effects which they

\(^{1464}\) Report by RBB Economics for ITL, paragraph 15.
cause.\textsuperscript{1465} In the present case, the OFT has therefore concluded that ITL has not demonstrated that the Infringing Agreements contributed to improving production or distribution, or promoting technical or economic progress and, consequently, the first exemption condition is not met.

II Third exemption condition: indispensability of the restrictions

7.74 According to the third exemption condition, an agreement must not impose restrictions which are not indispensable to the attainment of the efficiencies created by that agreement.\textsuperscript{1466}

7.75 In this Decision, analysis of the third exemption condition precedes the analysis of the second exemption condition because the analysis of whether a fair share of benefits of an agreement passes to consumers (that is, the second exemption condition) should not include analysis of the impact of any restrictions which are not indispensable to the attainment of the efficiencies created by the agreement and which for that reason infringe the Chapter I Prohibition.\textsuperscript{1467}

7.76 The Article 101(3) Guidelines note that the third exemption condition implies a two-fold test. First, a restrictive agreement must be reasonably necessary in order to achieve the efficiencies claimed under the first exemption condition.\textsuperscript{1468} In that connection, in the present case, the Parties would have to demonstrate that the claimed efficiencies were specific to the Infringing Agreements in the sense that there were no other economically practicable and less restrictive means of achieving the claimed efficiencies.\textsuperscript{1469} Secondly, the individual restrictions of competition that flow from the agreement must also be reasonably necessary for the attainment of those efficiencies.\textsuperscript{1470} Restrictions that are ‘black listed’ in block exemption regulations or identified as ‘hardcore’ restrictions in Commission guidelines and notices are unlikely to be considered indispensable.\textsuperscript{1471}

7.77 Since the OFT considers that ITL has not provided sufficient substantiated evidence under the first condition to support its submission that the Infringing Agreements made it possible to obtain efficiencies, it is not

\textsuperscript{1466} Section 9(1)(b)(ii) of the Act and the Article 101(3) Guidelines, paragraph 73.  
\textsuperscript{1467} The Article 101(3) Guidelines, paragraph 39.  
\textsuperscript{1468} The Article 101(3) Guidelines, paragraph 73.  
\textsuperscript{1469} The Article 101(3) Guidelines, paragraph 75.  
\textsuperscript{1470} The Article 101(3) Guidelines, paragraphs 73 and 78.  
\textsuperscript{1471} The Article 101(3) Guidelines, paragraph 79.
necessary to consider whether the restrictions in the Infringing Agreements were indispensable to the attainment of the claimed efficiencies. Nonetheless, the OFT has considered ITL’s key representations in respect of the third condition which are summarised as follows:

(i) The purpose of ITL’s parity and differential requirements was to provide funding to pay for lower shelf prices. To that end, ITL submitted, the restrictions employed were necessary to ensure that the funding provided by ITL to the Retailer was passed on to consumers in the form of lower retail prices.\textsuperscript{1472} In particular, ITL claimed that the objective behind the parity and differential requirements was to incentivise the Retailer to pass on the full depth of the price reductions funded by ITL to the consumer.\textsuperscript{1473}

(ii) ITL was not in a position to dictate terms to powerful Retailers. As such, ITL considers that the assumption may be made that the restriction employed was the least restrictive option available to secure ITL’s pro-competitive objectives.

(iii) ITL submitted that its parity and differential requirements stipulated maximum differentials and, in the circumstances, these were less restrictive than stipulating an absolute maximum retail price to be observed by the Retailer. Further, ITL submitted that maximum differentials permitted the Retailer to engage in a wide range of absolute price levels, leaving the Retailer free to employ its own pricing strategy.\textsuperscript{1474}

(iv) ITL submitted that the Retailer might employ a wide range of absolute retail prices for the same products in its different stores, with some Retailers using a number of different price tiers. Accordingly, it submitted that relative maxima were the most practical and flexible means of incentivising the Retailer to pass on price reductions to consumers.\textsuperscript{1475}

(v) ITL submitted that the evidence it had provided proved that the differentials led to lower prices. It submitted that in consequence there was a higher evidential burden upon the OFT to prove that another form of restriction would have led to lower prices.

\textsuperscript{1472} ITL’s response to the SO, paragraphs 4.684 and 4.685 (a).
\textsuperscript{1473} ITL’s response to the SO, paragraph 4.685 (c).
\textsuperscript{1474} ITL’s response to the SO, paragraph 4.685 (c).
\textsuperscript{1475} ITL’s supplementary response to the SO, Annex 1, paragraph 1.2(b).
The OFT does not accept ITL's argument, summarised in paragraph 7.77(i) above, that the restrictions were necessary to ensure that bonuses or wholesale price reductions were passed on to consumers. As noted in paragraph 7.64 above, the Manufacturers' parity and differential requirements in themselves did not impose a limit on the absolute level of margin set by a Retailer in relation to competing linked brands and consequently were not capable of adequately addressing the double mark-up problem, or of ensuring that bonuses or wholesale price reductions were passed on to consumers in the form of lower retail prices. In that sense, the OFT does not consider that parity and differential requirements were capable of, let alone necessary for, achieving the claimed efficiency. The OFT would note that ITL could have (but on the evidence it did not do so in this case) employ other less restrictive means of providing funding to pay for lower retail prices, for example making a bonus or similar funding conditional on the Retailer complying with an absolute maximum retail price without any linkage to the relative price of a competing brand.\textsuperscript{1476}

ITL's claim in (ii) above, that ITL was not in a position to dictate terms to powerful Retailers, is not substantiated in particular as both Manufacturers had large market shares and strong brands in the relevant markets. However, even if it were the case that ITL was limited in the pricing arrangements it could agree with the Retailers, such a situation would not justify the Infringing Agreements. Nor would it justify any assumption that the Infringing Agreements were the least restrictive option available to ITL to achieve the claimed efficiency. In particular, the OFT notes that other options such as particular temporary promotions or price marked packs (PMPs) were available to, and used by, ITL to achieve lower retail prices.\textsuperscript{1477}

In response to ITL's submissions at (iii) above, that relative price maxima were less restrictive on Retailers than absolute price maxima since they left Retailers free to employ their own pricing strategies, the OFT makes the following points. The restrictive nature of a parity, fixed or maximum differential requirement is set out at Section 6.A.I.(d) above. Further, as examined in Section 6.A.I.(c), the OFT considers that the Infringing Agreements in fact operated as imposing parity or fixed differential requirements rather than maximum differential requirements. In addition, as explained in Section 6.A.I.(d) above, there is an important distinction to be drawn between the restrictive nature of parity and differential requirements and the possible pro-competitive benefits of absolute

\textsuperscript{1476} For example, an agreement between a manufacturer and a retailer that the retail price of the manufacturer's brand X should be no more than £y.

\textsuperscript{1477} ITL's response to the SO, paragraph 2.113.
maximum prices. Relative maxima involve linking the retail price of a particular product to the price of a competing product, whereas absolute maxima would stipulate a price ceiling in relation to one product only. Because absolute maxima impose a cap on the absolute retail price of a particular product, thereby limiting the level of margin that a retailer is able to add to a particular product, they are not generally regarded as being restrictive of competition (see paragraphs 6.252 and 6.253). Therefore, it is not apt for ITL to juxtapose absolute maxima pricing with maximum relative pricing (the latter of which, the OFT considers to restrict competition) and then seek to argue that the latter is less restrictive than the former on the basis that it does not deal with absolute prices and thereby gives the retailer greater freedom.

7.81 Finally, ITL has not explained why it was not possible to agree absolute maxima pricing with Retailers that took into account their different pricing strategies. ITL makes the point in paragraph 7.77 (iv) above that pricing relativities were a more practical and flexible means of incentivising Retailers to pass on price reductions to consumers, given the different pricing strategies of the Retailers. However, that claim is not substantiated by evidence. Moreover, given the high degree of monitoring that ITL undertook of the Retailer’s pricing, as evidenced both by the correspondence between ITL and the Retailer and ITL’s representations,1478 it is not clear why ITL could not agree and monitor different absolute price maxima with an individual Retailer that were sensitive to that Retailer’s pricing strategy.

7.82 In relation to the pricing evidence that ITL adduced in 7.77 (v) above, the OFT has considered that evidence in paragraphs 7.66 to 7.72 and concluded that it does not substantiate ITL’s claimed efficiency.

7.83 In conclusion, for the reasons given above, the OFT considers that ITL has not demonstrated that there were no other economically practicable and less restrictive means of achieving the claimed efficiencies or that individual restrictions of competition that flowed from the Infringing Agreements were reasonably necessary for the attainment of those efficiencies. On that basis, the OFT considers that the Infringing Agreements were not indispensable to the attainment of any efficiencies claimed by ITL and the third exemption condition is therefore not met.

1478 ITL’s response to the SO, paragraphs 2.199 to 2.217.
III Second exemption condition: allowing consumers a fair share of the resulting benefit

7.84 According to the second exemption condition, consumers must receive a fair share of the efficiencies generated by the restrictive agreement.1479

7.85 Since the OFT has concluded that ITL has not provided sufficient substantiated evidence to support its argument that the Infringing Agreements gave rise to efficiencies such as to meet the first exemption condition, the OFT does not accept that there were consumer benefits resulting from the claimed efficiencies.

7.86 In addition, the OFT notes the following points in relation to the second exemption condition. First, the concept of 'consumers' encompasses all users of the products covered by the Infringing Agreements.1480 In this case, those products were ITL's brands and Gallaher's brands covered by each Infringing Agreement. Secondly, the concept of 'fair share' implies that the benefits passed on must at least compensate consumers for any actual or likely negative impact caused to them by the restriction of competition.1481

7.87 The OFT considers that even if the Infringing Agreements to which ITL was a party could be said to have generated benefits for consumers, any such benefits would not have met the requirements of the second exemption condition for the following reasons. First, any such benefits would have been only in respect of ITL's brands and not also Gallaher's brands. The restrictive nature of the Infringing Agreements resulted from the Manufacturer linking the retail price of competing brands, since that restricted the Retailer's ability to determine its retail prices for the Manufacturer's brands and those of competing linked brands to any extent that differed from the prescribed parity or differential. Therefore, the Infringing Agreements could not be said to have generated benefits for those competing linked brands that were covered by the Infringing Agreements. On that basis, it was not the case that the Infringing Agreements would have at least compensated consumers for any negative impact caused to them by the restriction of competition that they entailed.1482 Moreover, as set out above in paragraphs 7.66 to 7.72 and Section 6AII:'The OFT’s response to arguments that the Infringing Agreements had a pro-competitive nature’, ITL has not demonstrated that the Infringing Agreements resulted in lower retail prices for ITL's brands

1479 Section 9(1)(a) of the Act and the Article 101(3) Guidelines, paragraph 83.
1480 The Article 101(3) Guidelines, paragraph 84.
1481 The Article 101(3) Guidelines, paragraph 85.
1482 The Article 101(3) Guidelines, paragraph 85.
and Gallaher’s brands covered by the Infringing Agreements. Further, ITL’s submission is inconsistent with the existence of contacts between ITL and the Retailer which included instructions and/or requests in some instances to increase prices.

7.88 In conclusion, for the reasons given above, the OFT considers that the second exemption condition is not met.

IV Fourth exemption condition: no possibility of eliminating competition

7.89 According to the fourth exemption condition, an agreement must not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.\textsuperscript{1483} In relation to the fourth exemption condition ITL submitted that (i) there was intense price competition between the Manufacturers,\textsuperscript{1484} in particular that the pricing differential schedules did not prevent ITL from making significant market share gains at Gallaher’s expense\textsuperscript{1485} and (ii) the OFT had advanced no case to establish that price competition had been ‘eliminated’.\textsuperscript{1486}

7.90 In relation to (i) above, the OFT does not accept that there was intense price competition between the Manufacturers such that the fourth exemption condition would be met. To the extent that there was a degree of price competition between the Manufacturers during the infringement period, the Infringing Agreements nevertheless afforded the Manufacturer and the Retailer the possibility of eliminating competition at the retail level between competing linked brands through the operation of each Manufacturer’s parity and differential requirements. In addition, as noted in Section 6.A.I.(e) above, given that the Manufacturers entered into Infringing Agreements with the Retailers and that those agreements and/or concerted practices ensured in practice that the retail prices of competing linked brands would be set at either a parity or a fixed differential, the Manufacturers were able to maintain or achieve a degree of stability in relation to inter-brand competition in a similar way to that which would have resulted from horizontal price co-ordination between competitors.

7.91 In relation to ITL’s submission that shifts in market share in ITL’s favour during the infringement period demonstrate intense price competition, ITL

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\textsuperscript{1483} Section 9(1)(b)(ii) of the Act and The Guidelines, paragraph 105.

\textsuperscript{1484} ITL’s response to the SO, paragraph 4.686.

\textsuperscript{1485} Report by RBB Economics for ITL, paragraph 186.

\textsuperscript{1486} ITL’s response to the SO, paragraph 4.686.
submitted market share data showing that its share of all segments rose from 38 per cent in 1999 to 44 per cent in 2003, while the share of Gallaher was roughly constant over the same period and that of other manufacturers declined.\textsuperscript{1487} To the extent that ITL may have won market share from manufacturers other than Gallaher during the infringement period, the OFT does not consider that demonstrates a pro-competitive effect of the Infringing Agreements since the Infringing Agreements were in relation to Gallaher’s brands. Equally, the OFT does not consider that ITL’s increase in market share is necessarily evidence of a strategy of vigorous inter-brand price competition by ITL during the infringement period. Other factors, such as the structural shift in demand to the lower priced segments of the market (where ITL was comparatively strong and where it repositioned its Richmond brand) as a result of tax increases may explain ITL’s market share performance.\textsuperscript{1488} In addition, the OFT notes that the market shares of Gallaher and ITL were broadly static during the mid to late 1990s when, according to ITL, parity and differentials were also in place.\textsuperscript{1489}

7.93 In relation to (ii) above, the OFT notes that the test is not whether price competition had been eliminated, as submitted by ITL, but whether the Infringing Agreements afforded the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question. The OFT considers that ITL has not demonstrated that that part of the test is met. Moreover, for the reasons already given, the OFT has explained how the Infringing Agreements afforded the Manufacturer and the Retailer the possibility of eliminating competition at the retail level between competing linked brands.

7.94 In conclusion, for the reasons given above, the OFT considers that the fourth exemption condition is not met.

V Conclusion on exemption

7.95 It follows from the above conclusions that the case for exemption under section 9 of the Act in respect of the Infringing Agreements has not been made out.

\textsuperscript{1487} Report by RBB Economics for ITL, paragraphs 10 to 12.
\textsuperscript{1488} The OFT notes that excluding the value and economy segments, ITL’s market share increased from 48.6\% to 49.2\% over the infringement period. ITL’s supplementary response to the SO, Annex 1B.
\textsuperscript{1489} ITL’s response to the SO, figure 2.1, page 45.
8 THE OFT’S ACTION

8.1 This Section of the Decision sets out the enforcement action which the OFT is taking and its reasons for taking that action.

A DECISION

8.2 On the basis of the evidence set out above and for the reasons set out above, the OFT finds that the Infringing Agreements comprised in each case an agreement and/or concerted practice between each Manufacturer and each Retailer whereby the Manufacturer coordinated with the Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. The Infringing Agreements restricted the Retailer’s ability to determine its retail prices for competing tobacco products and had the object of preventing, restricting or distorting competition in the supply of tobacco products in the UK, in breach of the Chapter I Prohibition.

8.3 Each of the Infringing Agreements (save the Infringing Agreement between Gallaher and Shell, which existed from 20 August 2001), was entered into and took effect before 1 March 2000, when the Chapter I Prohibition came into force. Pursuant to paragraph 19 of Schedule 13 to the Act, the consequence of an Infringing Agreement being in existence before 1 March 2000 is that it benefitted from a one year transitional period during which the Chapter I Prohibition did not apply such that the starting date of that Infringing Agreement, for the purposes of a finding of infringement of the Chapter I Prohibition, is taken to be 1 March 2001. For the purposes of this Decision, and save in relation to the three exceptions set out below, the OFT has elected to treat the Infringing Agreements as having come to an end on 15 August 2003 when the OFT sent out the first request for documents and information under section 26 of the Act. The three exceptions are the Infringing Agreement between Gallaher and First Quench (which ended on 19 December 2002), Sainsbury and ITL (which ended on 9 March 2003) and Sainsbury and Gallaher (which ended on 9 March 2003).

B DIRECTIONS

8.4 Section 32(1) of the Act provides that if the OFT has made a decision that an agreement or concerted practice infringes the Chapter I Prohibition, it may give to such person or persons as it considers
appropriate such directions as it considers appropriate to bring the infringement to an end.

8.5 In the present case, having considered various submissions made by some Parties as to the removal of parity and differential provisions in the trading relationships between the Manufacturer and the Retailer, and taking into account the passage of time and changes made to those trading relationships, the OFT considers that it is not necessary in the circumstances of this case to give directions to any of the Parties.

C FINANCIAL PENALTIES

I General points

8.6 Section 36(1) of the Act provides that on making a decision that an agreement or concerted practice has infringed the Chapter I Prohibition, the OFT may require the undertaking concerned to pay it a financial penalty in respect of the infringement. In accordance with section 38(8) of the Act, the OFT must have regard to the guidance on penalties issued under section 38(1) of the Act, for the time being in force, when setting the amount of the penalty. Pursuant to section 36(8) of the Act, no penalty which has been fixed by the OFT may exceed 10 per cent of the turnover of the undertaking calculated in accordance with the provisions of the Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2000 (SI 2000/309) (‘the 2000 Order’), as amended by the Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2004 (SI 2004/1259) (‘the 2004 Order’).

8.7 In imposing a financial penalty under Section 36(1) of the Act, the OFT has identified the legal person or persons whom it considers to have been party to each infringement and therefore liable for the ensuing financial penalty. The addressees of this Decision are as set out in Section 2.A: ‘The Parties’ above.

(a) Section 60 of the Act

8.8 Section 60 of the Act is concerned with ensuring that, so far as possible and having regard to any relevant differences between the provisions concerned, questions arising under the Act are dealt with consistently with the treatment of corresponding questions arising under EU competition law, the principal concern being to ensure consistency in the

1490 See the OFT’s Guidance as to the Appropriate Amount of a Penalty (OFT 423, Edition 12/04) (the ‘Penalty Guidance’).
interpretation of the substantive UK and EU competition law provisions concerned.

8.9 Two Parties made submissions in relation to the application of section 60 of the Act in relation to financial penalties. The Co-operative Group submitted that the OFT had to act consistently with the Commission’s practice on penalties as a result of section 60 of the Act, stating that ‘EC practice and case law, therefore, clearly take precedence over the Penalty Guidelines’. 1491 The Co-operative Group submitted that, as a result, the OFT should base step 1 of the penalty calculation on the turnover in the business year preceding the date when the infringement ended. ITL referred to the case law of the European Court in the context of its submission that the OFT should not take into account all turnover generated in the relevant product markets, but should instead make a reduction in the turnover taken into account at step 1 ‘to reflect the fact that a substantial percentage of ITL’s trade was wholly unaffected by the alleged infringement’ (see further paragraphs 8.45 to 8.49 below).1492

8.10 The OFT does not consider, however, that it is required by section 60 of the Act to calculate the penalties it imposes under the Act in the same manner as penalties imposed by the Commission under Regulation 1/2003 for infringements of Articles 101 or 102 of the TFEU. Questions of procedure, investigation and enforcement, including the calculation of financial penalties, are not covered by section 60 of the Act (save as regards fundamental procedural safeguards).1493 Rather, specific provision is made for these under the Act.1494 The OFT’s primary obligation when calculating penalties under the Act is, therefore, to have regard to its Penalty Guidance.1495 Moreover, to the extent that that produces a different result from that which would arise from the approach adopted by the Commission, the OFT considers that such an outcome would be the consequence of a ‘relevant difference’ between the provisions concerned under section 60(1) of the Act.

1491 The Co-operative Group’s response to the SO, paragraph 9.56 et seq.
1492 ITL’s response to the SO, paragraph 7.24 to 7.27.
1493 See comments in Hansard at the time the Competition Bill was being debated, such as, for example, the comment on behalf of the Government that section 60 was intended to import ‘high level principles, such as proportionality, legal certainty and administrative fairness’ into domestic law (see Lord Simon of Highbury, Hansard, House of Lords’ debates, 25 November 1997: Column 961).
1494 See, in particular, sections 25 to 44, section 51 and Schedule 9 of the Act, together with the guidance and secondary legislation made under those provisions.
1495 This is consistent with Regulation 1/2003, which does not require national competition authorities to apply the same approach to sanctions as the Commission in respect of infringements of Article 101 or 102.
Furthermore, although the OFT’s approach will be broadly consistent with the general principles applied by the Commission – such as the need for appropriate punishment and deterrence as per the preamble to the Commission’s guidance – the OFT is not bound to adopt, in relation to the detail, the same methodology as the Commission, particularly where the Commission has itself a margin of appreciation under its own guidelines. That would be tantamount to arguing that the OFT should apply the Commission’s guidelines. The OFT considers that its duty under section 60(3) of the Act is, as stated in that sub-section, only to have regard to any relevant decision or statement of the Commission.

(b) The OFT’s margin of appreciation in determining the appropriate penalty

The OFT notes that, provided the penalties it imposes in a particular case are within the range of penalties permitted by section 36(8) of the Act and the 2000 Order (as amended by the 2004 Order) and the OFT has had regard to its Penalty Guidance under section 38 of the Act, the OFT has a margin of appreciation when determining the appropriate amount of a penalty under the Act.\footnote{Argos Ltd and Littlewoods Ltd v OFT [2005] CAT 13, at [168]; Umbro Holdings Ltd and Manchester United plc and JJB Sports plc and Allsports Ltd v OFT [2005] CAT 22, at [102].} Only limited conclusions can be drawn from the approach the OFT has adopted in relation to the calculation of penalties in previous cases. Each case is specific to its own facts and circumstances and it cannot be assumed that the level of penalty appropriate for a particular party in one case (or the manner in which the Penalty Guidance has been applied) will necessarily be the same in respect of another party in another case. In any event, the OFT is not bound by its decisions in relation to the calculation of penalties in previous cases. Rather, the OFT considers that, subject to the above, it is free to adapt its policy as appropriate having regard to all relevant circumstances and its overall policy objectives on financial penalties, as set out in its Penalty Guidance.

(c) Single penalty for each Party

In order to reflect: (i) the underlying commercial rationale and common aim of the Infringing Agreements, namely to enable the Manufacturers to specify the relativities between the retail prices of competing linked brands; and (ii) the restrictive nature of the Infringing Agreements, the
OFT considers it appropriate in this case to impose a single penalty on each Party for all of the Infringing Agreements to which it was party (that is, applying a single penalty calculation for each Party) notwithstanding that each Infringing Agreement in its own right amounts to a breach of the Chapter I Prohibition and could otherwise have resulted in the imposition of a separate penalty for each Infringing Agreement.

(d) Small agreements

8.14 Section 39(3) of the Act provides that, subject to the OFT withdrawing immunity, a party to a 'small agreement' is immune from the effect of section 36(1) of the Act. A 'small agreement' is defined, pursuant to section 39(1) of the Act (subject to one other condition) and the Competition Act 1998 (Small Agreements and Conduct of Minor Significance) Regulations 2000, \(^{1497}\) as the category of all agreements between undertakings the combined applicable turnover of which \(^{1498}\) for the business year ending in the calendar year preceding the one during which the infringement occurred does not exceed £20 million. \(^{1499}\)

8.15 The OFT notes that none of the Infringing Agreements qualify for the small agreement immunity as the turnover of each of ITL and Gallaher exceeded £20 million in the relevant business year and each was a party to an Infringing Agreement with each Retailer.

(e) No lack of legal certainty

8.16 Several Parties submitted that the OFT was not entitled to impose a penalty, or alternatively should only impose a symbolic penalty, due to the lack of legal certainty surrounding the compatibility of their conduct with the Act. \(^{1500}\) The OFT does not accept these arguments for the reasons set out below.

8.17 Under the Infringing Agreements, each Manufacturer and each Retailer coordinated the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of

\(^{1497}\) SI 2000/262.

\(^{1498}\) Calculated in accordance with the Schedule to the Regulations.

\(^{1499}\) SI 2000/262, paragraph 3.

\(^{1500}\) ITL’s response to the SO, paragraph 7.41; Safeway’s representations on the OFT’s proposed action, paragraphs 25 and 76; Morrisons’ representations on the OFT’s proposed action, paragraphs 25 and 76; Shell’s response to the SO, paragraph 305 et seq. and Shell’s supplementary response to the SO, paragraphs 24 and 25; the Co-operative Group’s response to the SO, paragraph 9.87 et seq.
the Manufacturer’s retail pricing strategy. As such, the Infringing Agreements restricted the Retailer’s ability to determine its retail prices for competing linked brands. The OFT considers that the fact that the coordination between each Manufacturer and each Retailer regarding the Retailer’s retail prices in this case related to the Retailer’s relative retail prices for competing products is not a matter that merits either the imposition of a symbolic penalty or no penalty at all.

8.18 Moreover, as set out in Section 3: 'Legal Background', it is instructive to note paragraph 47 of the Vertical Guidelines which specifically refers to 'linking the prescribed resale price to the resale prices of competitors' as an example of a so-called 'hardcore' restriction.

(f) Penalties imposed previously between parties in vertical RPM cases are not an appropriate benchmark

8.19 Some Parties submitted that in some previous RPM cases, where there were no horizontal or multilateral infringements, the OFT and the Commission had imposed fines only on the supplier responsible for imposing the RPM.1501

8.20 As set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements', under the Infringing Agreements each Manufacturer would co-ordinate with each Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. The OFT notes that, unlike the cases referred to by a number of Parties, the restrictive nature of the Infringing Agreements resulted from the linking of the retail prices of competing brands and operated at the retail point of sale, precluding a Retailer from making price changes within its own premises that would foster inter-brand competition.

8.21 In light of the considerations above, the OFT does not accept that any parallels, conclusions or meaningful inferences can be drawn from the relative penalties previously imposed on different parties by either the OFT or the Commission in the cases referred to by a number of Parties as they cannot serve as an appropriate benchmark for the purposes of calculating relative penalties between the Parties in this case.

1501 Safeway’s representations on the OFT’s proposed action, paragraph 32 see also Morrisons’ representations on the OFT’s proposed action, paragraph 32.
(g) Intention/negligence

8.22 The OFT may impose a penalty on an undertaking which has infringed the Chapter I Prohibition only if it is satisfied that the infringement has been committed intentionally or negligently\textsuperscript{1502}, although the OFT is not obliged to specify whether it considers the infringement to be intentional or merely negligent.\textsuperscript{1503}

i Intention

8.23 The CAT has stated in \textit{Napp} that:

‘an infringement is committed intentionally for the purposes of the Act if the undertaking must have been aware that its conduct was of such a nature as to encourage a restriction or distortion of competition ... It is sufficient that the undertaking could not have been unaware that its conduct had the object or would have the effect of restricting competition.’\textsuperscript{1504}

8.24 The OFT considers that serious infringements of the Chapter I Prohibition, which have as their object the restriction of competition, such as the Infringing Agreements, are likely to have been, by their very nature, committed intentionally. In this context, the OFT notes that ignorance or a mistake of law is no bar to a finding of intentional infringement under the Act.\textsuperscript{1505}

8.25 Some Parties submitted that the Infringing Agreements in which they were involved were not anti-competitive by object and had ‘pro-competitive effects’ and that they could not therefore be regarded as intentional infringements.\textsuperscript{1506}

8.26 The OFT does not accept these arguments. As noted in Section 6.A.II: ‘The OFT’s response to arguments that the Infringing Agreements had a pro-competitive nature’, the OFT has set out in detail the reasons why the OFT considers that the Infringing Agreements had an anti-competitive object and does not accept the arguments submitted by certain of the

\textsuperscript{1502} Section 36(3) of the Act.
\textsuperscript{1503} \textit{Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading} [2001] CAT 1, at [453] to [455]; see also \textit{Argos Ltd and Littlewoods Ltd v Office of Fair Trading} [2005] CAT 13, at [221].
\textsuperscript{1504} \textit{Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading} [2001] CAT 1, at [456].
\textsuperscript{1505} See the OFT’s Competition Law Guideline on \textit{Enforcement} (OFT407, Edition 12/04), at paragraphs 5.9-5.11.
\textsuperscript{1506} ITL’s response to the SO, paragraph 7.6; the Co-operative Group’s response to the SO, paragraph 9.22; and the Co-operative Group’s supplementary response to the SO, paragraphs 8.1 and 8.2.
Parties that the Manufacturer’s parity and differential requirements had a pro-competitive object. In addition, as noted in Section 7.I: 'Exemption', it has not been demonstrated by any Party that the Infringing Agreements were pro-competitive in terms of meeting the applicable exemption conditions. If and to the extent that the arguments raised by these Parties may demonstrate that the Infringing Agreements had other aims, the OFT notes that the fact that an agreement does not have the sole aim of restricting competition but simultaneously pursues other legitimate objectives will not affect the finding that the agreement has as its object the prevention, restriction or distortion of competition.1507

8.27 Some Parties submitted that it is not sufficient for the OFT to deduce intent from the alleged anti-competitive object of the Infringing Agreements.1508 The Co-operative Group submitted that the OFT was required to consider whether each individual Party could not have been unaware that the contested conduct had as its object the restriction of competition.'1509

8.28 The Co-operative Group also submitted that, even insofar as the Infringing Agreements could be considered to have as their object or effect the prevention, restriction or distortion of competition, their actual and potential consequences would not have been 'plainly foreseeable' given that the 'obvious object or effect' was to promote competition. Accordingly, neither intention nor negligence could be inferred.1510

8.29 In response to these submissions, the OFT notes that the Infringing Agreements can be regarded as intentional infringements, both on the basis of the Penalty Guidance as well as the case law of the CAT. In Napp, the CAT stated that:

‘while in some cases the undertaking’s intention will be confirmed by internal documents, in our judgment, and in the absence of any evidence to the contrary, the fact that certain consequences are

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1508 The Co-operative Group’s response to the SO, paragraph 9.19, Morrisons’ representations on the OFT’s proposed action, paragraph 19, Safeway’s representations on the OFT’s proposed action, paragraph 19.
1509 The Co-operative Group cited Case 246/86 SC Belasco and others v Commission, [1989] E.C.R. 2117 paragraph 41, in which the ECJ stated that for an infringement to be regarded as having been committed intentionally, "it is sufficient that it could not have been unaware that the contested conduct had as its object the restriction of competition".
1510 The Co-operative Group’s response to the SO, paragraph 9.22 and the Co-operative Group’s supplementary response to the SO, paragraphs 8.1 and 8.2.
8.30 In the present case, the OFT considers that the restrictive nature of the Infringing Agreements was obvious and, therefore, their anti-competitive consequences were plainly foreseeable. Under the Infringing Agreements each Manufacturer would co-ordinate with each Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. In these circumstances, the OFT considers that each of the Parties could not have been unaware that the Infringing Agreements entailed a restriction or distortion of competition.

8.31 It follows that the infringements can be regarded as having been committed intentionally.

**ii Negligence**

8.32 A number of Parties submitted that they were genuinely unaware that the Infringing Agreements had as their object the restriction or distortion of competition, and that any penalty could therefore, if at all, only be imposed on the basis of negligence. 1512

8.33 The CAT has further stated that:

‘[A]n infringement is committed negligently for the purposes of section 36(3) if the undertaking ought to have known that its conduct would result in a restriction or distortion of competition…’1513

8.34 Examined objectively, under the Infringing Agreements, each Manufacturer would co-ordinate with each Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. The OFT considers that it was clear to each Party to an Infringing Agreement that it restricted the ability of the Retailer to determine its retail prices for competing linked brands. As such, the OFT considers that, to the extent that any of the Parties may genuinely have been unaware of the anti-competitive nature of their conduct, the Parties

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1512 ITL’s response to the SO, paragraph 7.11, in which ITL also denied that it was negligent; the Co-operative Group’s response to the SO, paragraph 9.22.
1513 Argos Ltd and Littlewoods Ltd v Office of Fair Trading [2005] CAT 13, at [221].
at the very least ought to have known that the Infringing Agreements would result in a restriction or distortion of competition and that the Parties, therefore, at least negligently infringed the Chapter I Prohibition.

8.35 In any event, as stated above, ignorance of the law is irrelevant to the assessment of intent or negligence, and the OFT is not obliged to show that an undertaking knew that its conduct infringed the Act.1514

(h) Turnover of the undertaking

8.36 For the purpose of the penalty calculation, the OFT considers that the relevant turnover or total turnover as applicable, is the turnover of the undertaking that comprises the relevant single economic entity as described in more detail in Section 2.A: 'The Parties'.

8.37 An undertaking may comprise several legal entities within the same corporate group. In such cases, the OFT is basing its penalty calculations on the consolidated turnover of the legal entities to which the OFT has attributed liability for the Infringing Agreements to which each was party.

8.38 With regard to acquisitions and disposals made since the time of the Infringing Agreements, the OFT notes that although consolidated turnover may have increased due to acquisitions since that time, it may equally have decreased due to disposals. In order to ensure sufficient deterrence, the OFT considers it appropriate for a penalty to reflect the size of the undertaking on which it is imposed, for which the most recently available turnover is used as a proxy. In that respect, there is no basis for differentiating between acquisitions/disposals and 'organic' growth/decline.

II Calculation of penalties

8.39 In accordance with section 38(8) of the Act, the OFT must have regard to the guidance on penalties issued under section 38(1) of the Act, for the time being in force, when setting the amount of the penalty. The Penalty Guidance sets out five steps for determining the penalty.

(a) Step 1 – starting point

8.40 The starting point for determining the level of penalty is calculated having regard to the seriousness of the infringement and the relevant turnover of

1514 Napp Pharmaceutical Holdings v Director General of Fair Trading [2002] CAT 1, at [456].
the undertaking.\textsuperscript{1515} The relevant turnover is the turnover of the undertaking in the relevant product market and relevant geographic market affected by the infringement in the last business year.\textsuperscript{1516} Consistent with the calculation of the maximum penalty under section 36(8) of the Act,\textsuperscript{1517} the last business year is the business year preceding the date of the OFT’s infringement decision. Where, however, a Party concluded an Early Resolution agreement with the OFT, the relevant turnover in the last business year preceding the Early Resolution agreement was used to calculate the penalty. The starting point may be any amount up to a maximum of 10 per cent of each undertaking’s relevant turnover.\textsuperscript{1518}

\begin{itemize}
\item \textbf{i Relevant turnover}
\end{itemize}

8.41 The Infringing Agreements covered each relevant product market.

8.42 Some Parties submitted that the OFT had not sought to consider the impact of the Infringing Agreements on each of the relevant product markets.\textsuperscript{1519}

8.43 The OFT has considered the relevant product and geographic markets covered by the Infringing Agreements in Section 4: ‘Assessment of the relevant market’ and does not repeat them again here. The OFT considers that there is sufficient evidence to demonstrate that the Infringing Agreements covered each of the relevant product markets for UK duty-paid cigarettes, UK duty-paid HRT/RYO, UK duty-paid pipe tobacco and UK duty-paid cigars and cigarillos.

\textit{Turnover in the relevant product and geographic markets covered by the Infringing Agreements}

8.44 Some Parties submitted that the OFT could not refer to the turnover achieved in the relevant markets as a whole as a basis for the starting point of the penalty calculations.\textsuperscript{1520}

\begin{itemize}
\item \textsuperscript{1515} Penalty Guidance, at paragraph 2.3.
\item \textsuperscript{1516} Penalty Guidance, at paragraph 2.7.
\item \textsuperscript{1517} See the 2000 Order, as amended by the 2004 Order.
\item \textsuperscript{1518} Penalty Guidance, at paragraph 2.8.
\item \textsuperscript{1519} The Co-operative Group’s response to the SO, paragraph 9.52; Safeway’s representations on the OFT’s proposed action, paragraph 48; Morrisons’ representations on the OFT’s proposed action, paragraph 48.
\item \textsuperscript{1520} ITL’s response to the SO, paragraphs 7.20 to 7.26; Safeway’s representations on the OFT’s proposed action, paragraphs 46 to 51; Morrisons’ representations on the
Referring to the Court of Appeal’s and the CAT’s judgments in Argos\textsuperscript{1521} as well as the judgment of the General Court in Parker Pen\textsuperscript{1522}, ITL put forward arguments to the effect that turnover which may have been ‘affected only peripherally’ by the Infringing Agreements should not be taken into account even if it was generated in the relevant markets.\textsuperscript{1523} In ITL’s submission, a significant reduction should be made in the turnover to be taken into account at step 1 to reflect the fact that a substantial percentage of ITL’s trade was ‘wholly unaffected’ by the Infringing Agreements. In support of its submission, ITL stated that the Infringing Agreements did not extend to all of its brands or products and that a significant proportion of its turnover was generated through sales by retailers other than the Retailers named in the SO.\textsuperscript{1524}

Safeway and Morrisons submitted that the OFT had not sought to identify the proportion of their respective turnover that was attributable to products affected by the Infringing Agreements.\textsuperscript{1525} In Safeway’s and Morrisons’ submissions, the OFT should use a ‘more limited’ relevant turnover that more closely reflects the products affected by the Infringing Agreements or, alternatively, should adopt a starting point which reflects the limited number of products involved.\textsuperscript{1526}

In response, the OFT notes that in defining the relevant turnover to be taken into account, the Penalty Guidance refers to turnover in ‘the relevant product market and relevant geographic market affected by the infringement’.\textsuperscript{1527} The OFT notes, in particular, that the relevant turnover is not defined as turnover relating only to the products or sales affected by the infringement. Rather, the OFT considers that the Penalty Guidance

\textsuperscript{1521} Argos Ltd and Another v Office of Fair Trading [2006] EWCA Civ 1318, paragraph 173; Argos Ltd v Office of Fair Trading [2005] CAT 13, at [242]. ITL submitted that in this case the fine was reduced for the reason that ‘some turnover may have been affected only peripherally by the infringements’, see ITL’s response to the SO, paragraph 7.25. However, the OFT notes that the CAT merely stated that it ‘remained conscious’ of the argument advanced by Argos that […] the OFT did include as ‘relevant turnover’ some turnover which may have been affected only peripherally by the infringements. The CAT decided to reduce the penalties on Argos and Littlewoods ‘on the technical ground that the OFT’s method of calculation may have given rise to penalties that are slightly too high’.

\textsuperscript{1522} Case T-77/92 Parker Pen v Commission [1994] ECR II-549, paragraphs 94 and 95.

\textsuperscript{1523} ITL’s response to the SO, paragraphs 7.20 to 7.27.

\textsuperscript{1524} ITL’s response to the SO, paragraphs 7.26 to 7.27.

\textsuperscript{1525} Safeway’s representations on the OFT’s proposed action, paragraph 48; Morrisons’ representations on the OFT’s proposed action, paragraph 48.

\textsuperscript{1526} Safeway’s representations on the OFT’s proposed action, paragraph 50; Morrisons’ representations on the OFT’s proposed action, paragraph 50. The Co-operative Group also made similar points in its supplementary response to the SO, paragraph 8.6.

\textsuperscript{1527} Penalty Guidance, at paragraph 2.7.
makes it clear that the wording 'affected by the infringement' refers to the relevant market as opposed to merely the products or turnover in question. Accordingly, the narrow interpretation of relevant turnover put forward by these Parties is not consistent with the Penalty Guidance.

8.48 Having assessed the Parties' representations in this regard, the OFT does not consider that it would be appropriate to depart from its established decisional practice, according to which the entire turnover generated in the relevant market is to be taken into account. In particular, the OFT does not consider that the case law referred to by the Parties supports the contention that a more limited notion of relevant turnover should be used in this case. The Infringing Agreements were widespread, covering the relevant markets for UK duty-paid cigarettes, UK duty-paid HRT/RYO, UK duty-paid pipe tobacco and UK duty-paid cigars and cigarillos.

8.49 The OFT's conclusions are also not affected by the case law of the European Court and in particular the judgment of the General Court in Parker Pen. The OFT notes that, although the General Court found that the penalty imposed on Parker was 'inappropriate, having regard in particular to the low turnover to which the infringement relates', it reduced the penalty against the background that 'an appropriate fine cannot be fixed merely by a simple calculation based on the total turnover'. However, in this case, for the purposes of calculating the starting point at step 1 of the penalty calculations, the OFT has taken into account the turnover generated in the relevant product and geographic markets covered by the infringements, rather than the Parties' total turnover. Moreover, as noted above, the Infringing Agreements were widespread in their coverage across different relevant markets.

8.50 In any event, for the reasons set out in paragraph 8.10 and 8.11, the OFT does not consider that it is obliged to follow the European Court or the Commission's penalties practice.

8.51 In light of the considerations above, and consistent with the OFT's decisional practice as well as the Penalty Guidance, the OFT has used the entire turnover generated by the Parties in the relevant product and geographic markets affected by the Infringing Agreements as the relevant turnover for the purposes of the penalty calculations.

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Some Parties submitted that the OFT’s selection of the business year preceding the date of this Decision as the basis for relevant turnover would be inappropriate.\textsuperscript{1530}

The Co-operative Group submitted that any penalty calculated on the basis of turnover generated in the last financial year preceding the date of the decision was likely to be disproportionate and would not reflect the undertaking’s real economic situation at the time of the infringement, to the severe prejudice of the Co-operative Group and other parties.\textsuperscript{1531}

ITL also put forward the argument that the OFT had to apply the rules on penalties as they applied when the Infringing Agreements were in force, as it would otherwise infringe established rules against retroactive penalties, as enshrined in Article 7 of the European Convention on Human Rights (ECHR).\textsuperscript{1532} The Co-operative Group submitted that it had a legitimate expectation that the OFT guidelines in force at the time of the Infringing Agreements, that is those prior to the entry into force of the 2004 Order, would be applied.\textsuperscript{1533}

Moreover, it has been submitted that choosing the year prior to this Decision as the basis for the relevant turnover would be inconsistent with the practice of the European Commission and that the European Commission’s decisional practice should take precedence over the Penalty Guidance by virtue of section 60 of the Act.\textsuperscript{1534}

In response to those submissions, the OFT notes that section 38(8) of the Act requires the OFT, when setting the amount of a penalty, to have regard to the guidance for the time being in force under section 38 of the Act. The OFT has had regard to its Penalty Guidance, in particular at paragraph 2.7, which provides that the undertaking’s last business year is the year for the purpose of determining the relevant turnover.\textsuperscript{1535} It is entirely within the OFT’s discretion to choose the precise method by which it calculates penalties in any particular case, providing it has had regard to its Penalty Guidance.

\textsuperscript{1530} ITL’s response to the SO, paragraph 7.16; the Co-operative Group’s response to the SO, paragraph 9.58.
\textsuperscript{1531} The Co-operative Group’s response to the SO, paragraph 9.57.
\textsuperscript{1532} ITL’s response to the SO, paragraph 7.18.
\textsuperscript{1533} The Co-operative Group’s response to the SO, paragraph 9.58.
\textsuperscript{1534} The Co-operative Group’s response to the SO, paragraph 9.56 et seq.
\textsuperscript{1535} See paragraph 8.40 above for an explanation of the year that was used for Parties which concluded an Early Resolution agreement with the OFT.
8.57 The OFT’s policy has been to treat the last business year under Step 1 of the penalty calculation consistently with the corresponding definition used in Article 3 of the 2000 Order.\(^{1536}\) Thus, prior to the amendment of the 2000 Order in 2004, the relevant turnover calculation was applied to the turnover in the business year preceding the date on which the infringement ended. Following the amendment by the 2004 Order, the relevant turnover calculation was applied to the turnover in the business year preceding the infringement decision,\(^{1537}\) regardless of the time periods during which the infringements in question occurred.

8.58 As regards the Parties’ arguments in relation to Article 7 ECHR, the OFT considers that they are without foundation. In calculating the final penalties, the OFT has had regard to paragraph 2.18 of its Penalty Guidance, which ensures that any penalty imposed for an infringement of the Chapter I Prohibition that ended prior to 1 May 2004 does not exceed the maximum penalty applicable for such an infringement prior to 1 May 2004 (see further paragraph 8.111 below). Were Article 7 ECHR to be applicable to a case such as this, it would preclude only the retrospective imposition of a maximum penalty higher than that which was applicable at the time of the offence.\(^{1538}\) There could not therefore be any breach of Article 7 ECHR in this case, as the penalty imposed on each of the Parties is not higher than the maximum penalty which could lawfully have been imposed on it under the 2000 Order prior to amendment (that is, 10 per cent of the total turnover of the undertaking in question in the year prior to infringement).

8.59 As regards the Parties’ arguments in relation to section 60 of the Act, see paragraphs 8.8 to 8.11 above.

\(^{1536}\) See, for example, *Price-fixing of Replica Football Kit* decision (CA98/06/2003) where the OFT expressly stated that the approach to last business year in that decision was adopted in order ‘[t]o be consistent with the Penalties order...’ (at para 572); see also *Aluminium spacer bars* (CA98/04/2006): ‘Consistent with the provisions of the 2000 Penalties Order, as amended by the 2004 Penalties Order, an undertaking’s last business year is the business year preceding the date on which the OFT’s decision is taken or, if figures are not available for that business year, the one immediately preceding it.’ (at paragraph 553).

\(^{1537}\) The one exception was the decision in CA98/08/2004: *Agreement between UOP Limited, UKae Limited, Thermostal Supplies Ltd, Double Quick Supplyline Ltd and Double Glazing Supplies Ltd to fix and/or maintain prices for desiccant* was taken in November 2004 and used the ‘financial year preceding the date on which the infringement ended’ formulation. That was before the revised Penalties Guidance was adopted in December 2004 but after the penalties cap was changed in May 2004 in the amended Penalties Order. The rationale for this was that this formulation was used in the Statement of Objections, which was issued in March 2004, when the 2000 version of the 2000 Order was still in force.

\(^{1538}\) *R(Uttley) v Home Secretary* [2004] UKHL 38, [2004] 1 WLR 2278.
In any event, the OFT considers that by choosing the last business year prior to the decision for the purposes of calculating penalties, it is ensuring that the penalties have a deterrent effect on the Parties as they are at the time that the infringement finding is made.

**ii The seriousness of the infringement**

The actual percentage which is applied to the relevant turnover depends upon the nature of the infringement. The more serious and widespread the infringement, the higher the percentage rate likely to be applied.\(^{1539}\) When making this assessment in the present case, the OFT has considered a number of factors, including the impact of legislative requirements on the product, the structure of the market, the market shares of the undertakings involved in the Infringing Agreements and the fact that the Infringing Agreements by their very nature were restrictive of competition.

The Penalty Guidance notes that the damage caused to consumers (whether directly or indirectly) is also an important consideration. However, in the present case, the OFT has found that each Infringing Agreement had as its object the restriction of competition and the OFT is not therefore required to prove in addition that it had an anti-competitive effect. The OFT has nonetheless described above how, having regard to the legal and economic context, the Infringing Agreements were, by their very nature, capable of restricting competition (see Section 6.A.I: 'The anti-competitive object of the Infringing Agreements').

**General considerations relating to the seriousness of the Infringing Agreements**

Under the Infringing Agreements the Manufacturer coordinated with the Retailer the setting of the Retailer’s retail prices for tobacco products, in order to achieve the parity and differential requirements between competing linked brands that were set by the Manufacturer, in pursuit of the Manufacturer’s retail pricing strategy. In that way, the Infringing Agreements restricted the Retailer’s ability to determine its retail prices for competing tobacco products. Given that the Infringing Agreements restricted inter-brand competition, the OFT considers that they constituted serious infringements of the Chapter I Prohibition.

\(^{1539}\) Penalty Guidance, at paragraph 2.4.
In assessing the seriousness of the Infringing Agreements, the OFT has also taken into account a number of features of the relevant markets, including:

(i) the fact that the UK tobacco manufacturing markets are highly concentrated and in 2003 the two Manufacturers accounted for 90 per cent of cigarette sales (by volume);\textsuperscript{1540}

(ii) the existence of a series of similar Infringing Agreements, involving both Manufacturers and the same Retailers, which related to a significant proportion of the tobacco market at both the manufacturing and retailer level;\textsuperscript{1541} and

(iii) that advertising and promotion of tobacco products is restricted by law,\textsuperscript{1542} resulting in a so-called 'dark market', meaning that price competition is especially important.\textsuperscript{1543}

These factors,\textsuperscript{1544} being relevant features of the general tobacco industry context, further support the OFT's view of the serious nature of the Infringing Agreements. The fact that the two key players in 2003 accounted for 90 per cent of cigarette sales (by volume) and that there was a wide spread of Infringing Agreements involving both Manufacturers and the same Retailers are particularly relevant in this connection.

As regards their impact in respect of competing products, the OFT has not quantified the effects of the Infringing Agreements. Rather, the OFT has explained how, having regard to the legal and economic context in which they operated, the Infringing Agreements were, by their very nature, capable of restricting competition (as set out in Section 6.A.I: 'The anti-competitive object of the Infringing Agreements').

\textit{Different starting points for Manufacturers and Retailers}

Having established the serious nature of the Infringing Agreements, the OFT has also considered the extent to which it is appropriate to differentiate between the Manufacturers and the Retailers for the

\textsuperscript{1540} The UK tobacco industry is addressed in more detail in Section 4: 'Assessment of the relevant market' and Section 5 'The UK tobacco industry' above.

\textsuperscript{1541} This is discussed in further detail in Section 6.A.I.(e).

\textsuperscript{1542} See the Tobacco Advertising and Promotion Act 2002, which was in force at the end of the period of the infringement. Prior to that Act, television and certain other forms of advertising were already restricted by law and limited voluntary codes of practice, although to a lesser extent than is now the case (see Section 5: 'The UK tobacco industry').

\textsuperscript{1543} See also Section 5: 'The UK tobacco industry'.

\textsuperscript{1544} These market factors are addressed further in Section 6.A.I.(e).
purposes of determining the appropriate starting point.\textsuperscript{1545} The OFT considers, as a general proposition, that it is appropriate to apply a higher starting point to Parties who played a comparatively active role in leading or driving an infringement of the Chapter I Prohibition.

8.68 With regard to the Manufacturers’ role, the evidence set out in this Decision demonstrates that the Manufacturers sought to ensure that retail prices followed the parities and differentials that existed between the RRPs of their competing linked brands. Further, the evidence also demonstrates that both Manufacturers communicated parallel and symmetrical parity and differential requirements to the same Retailers and that each Manufacturer must have been aware of the other’s parallel and symmetrical parity and differential requirements with each such Retailer.

8.69 In order to reflect the comparative seriousness of the Manufacturers’ role in the infringements committed, in particular the Manufacturers’ greater role compared to the Retailers in driving and effecting the Infringing Agreements, the OFT has set the starting point for the Manufacturers at the higher end of the scale as a starting point. For Manufacturers, the starting point is therefore 7 per cent. Having assessed the facts and evidence for each individual infringement, the OFT considers that there are not material differences between the Manufacturers to justify any difference between them in the starting point at step 1.

8.70 The Retailers played a less active role in relation to the Infringing Agreements in comparison with the Manufacturers. Accordingly, the starting point for Retailers is lower, at 5 per cent.

8.71 Several Retailers submitted that the OFT should set the starting point individually for each Retailer, taking into account the seriousness of each Infringing Agreement on the basis of each Retailer’s involvement.\textsuperscript{1546}

8.72 Consistent with the Penalty Guidance\textsuperscript{1547}, the OFT has assessed the facts and evidence for each individual infringement and considers that there are not material differences between the Retailers to justify any difference between them in the starting point at step 1.

\textsuperscript{1545} The OFT notes that several Retailers have made representations to the effect that a distinction should be made between the Manufacturers and the Retailers in setting the starting point at step 1 of the penalty calculations, see for instance, the Co-operative Group’s response to the SO, paragraph 9.46; Safeway’s representations on the OFT’s proposed action, paragraph 55; Morrisons’ representations on the OFT’s proposed action, paragraph 55; Shell’s response to the SO, paragraph 258.

\textsuperscript{1546} See the Co-operative Group’s response to the SO, paragraph 9.47 et seq.; Shell’s response to the SO, paragraph 275; Safeway’s representations on the OFT’s proposed action, paragraphs 53 and 54; and Morrisons’ representations on the OFT’s proposed action, paragraph 53 and 54.

\textsuperscript{1547} Penalty Guidance, at paragraph 2.9.
8.73 The OFT considers that the different starting points for Manufacturers and Retailers are appropriate and proportionate in the particular circumstances of this case and adequately reflect the seriousness of the infringements committed by the Parties.

(b) Step 2 – adjustment for duration

8.74 The starting point under step 1 may be increased or, in exceptional circumstances, decreased to take into account the duration of the infringement. Penalties for infringements which last for more than one year may be multiplied by not more than the number of years of the infringement. Part years may be treated as full years for the purpose of calculating the number of years of the infringement.\textsuperscript{1548}

8.75 The OFT notes that the General Court has also endorsed the principle that where agreements and/or concerted practices are suspended for a short period, that constitutes only one of a number of factors to be taken into account in determining the consequences for the duration when calculating a financial penalty, such that the level of penalty does not therefore depend on a precise number of months during which the arrangement was suspended.\textsuperscript{1549}

8.76 In light of the considerations above, in the present case the OFT has taken account of duration not by counting precisely the months of each Party’s participation in the infringement, but by treating part years of less than six months as half years.

8.77 The OFT notes that insofar as the Infringing Agreements commenced prior to 1 March 2000 they benefitted from the transitional period lasting one year from 1 March 2000 during which the Chapter I Prohibition did not apply pursuant to paragraph 19 of Schedule 13 to the Act. Therefore, at step 2 of the penalty calculations, the penalty figure resulting from step 1 is multiplied by the following amounts: in the case of Sainsbury, which participated in Infringing Agreements with each of ITL and Gallaher at least from 1 March 2000 to 9 March 2003, the figure is multiplied by 2 (rather than 3); and in the case of the other Parties, which participated in Infringing Agreements at least from 1 March 2000 to 15 August 2003, the figure is multiplied by 2.5 (rather than 3.5).\textsuperscript{1550}

\textsuperscript{1548} Penalty Guidance, at paragraph 2.10.
\textsuperscript{1550} In relation to ITL and Gallaher, although it is the case that a small number of the Infringing Agreements to which each was a party with a Retailer were of a shorter duration (ITL/Sainsbury, Gallaher/First Quench, Gallaher/Sainsbury and Gallaher/Shell), the OFT considers it appropriate to apply a multiplier at step 2 of the penalty calculations.
(c) Step 3 – adjustment for other factors

8.78 The penalty may be adjusted as appropriate, after step 2 of the penalty calculation, to achieve the policy objectives outlined in paragraph 1.4 of the Penalty Guidance, in particular in order to ensure that the threat of penalties deters undertakings from engaging in anti-competitive practices.\textsuperscript{1551} Relevant considerations at this stage may also include, for example, the special characteristics, including the size and financial position, of the undertakings in question.\textsuperscript{1552}

8.79 The OFT considers that deterrence is an important part of its fining policy, vis-à-vis the Parties as well as other undertakings who are not addressees of this Decision but may be considering engaging in similar anti-competitive practices in breach of the Chapter I Prohibition. Effective deterrence is also essential in view of the seriousness of the infringements. In this case, the seriousness of the Infringing Agreements is accentuated by the fact that each Manufacturer was party to an Infringing Agreement with each of a number of Retailers and the Manufacturers were thereby able to maintain or achieve a degree of stability in relation to inter-brand competition which was similar to that which would have resulted from horizontal price co-ordination between competitors.

\textit{i Increase in penalties}

8.80 The OFT notes that where a Party is significantly engaged in economic activities outside of the relevant markets, that Party’s relevant turnover will form a relatively small proportion of its total turnover. In such a case, the financial penalty calculated at the end of step 2 of the penalty calculation may represent a relatively low proportion of that undertaking’s total turnover. Where that is the case, the OFT considers that the penalty to take account of the Infringing Agreements to which each was a party with a Retailer for a longer duration (1 March 2000 to 15 August 2003). Similarly, in relation to First Quench and Shell, although it is the case that the respective Infringing Agreement to which each was a party with Gallaher was of a shorter duration, the OFT considers it appropriate to apply a multiplier at step 2 of the penalty calculations to take account of the Infringing Agreement to which each was a party with ITL, which was for a longer duration (1 March 2000 to 15 August 2003).

\textsuperscript{1551} According to paragraph 1.4 of the Penalty Guidance, the twin objectives of the OFT’s policy on financial penalties are: to impose penalties on infringing undertakings which reflect the seriousness of the infringement; and to ensure that the threat of penalties will deter undertakings from engaging in anti-competitive practices.

\textsuperscript{1552} Penalty Guidance, at paragraph 2.11. See also, for example, \textit{Umbro Holdings Ltd and others v Office of Fair Trading} [2005] CAT 22 at [167] to [169], in which the application of a multiplier at step 3 was upheld by the CAT.
figure reached at the end of step 2 is unlikely to represent a significant sum for that Party for deterrence purposes. It will therefore be necessary to increase that Party’s penalty at step 3 to arrive at a sum that represents, in relation to that Party, a sufficient deterrent, having regard to the seriousness of the infringements and the ratio of that Party’s relevant turnover to its total turnover.

8.81 Those Parties whose circumstances are as set out in the foregoing paragraph have therefore received an increase in their penalty at step 3 in order to ensure that the penalty is sufficient to ensure deterrence. The penalty in each such case has been increased by applying a multiplier to the penalty at the end of step 2, in order to ensure that the penalty is a sufficient deterrent in relation to each such Party, having regard to the seriousness of the infringements and the ratio of that Party’s relevant turnover to its total turnover.

8.82 In this connection, the OFT notes that it has a margin of appreciation in assessing the appropriate penalty level for ensuring deterrence in any particular case. In the circumstances of this case, the OFT considers that the application of a multiplier at step 3 is appropriate for deterrence purposes given the relative spread as between the Parties in respect of relevant turnover as a proportion of total turnover (see Tables 8.1 and 8.2 below).

8.83 Where, however, the penalty at the end of step 2 is, in the OFT’s view, sufficient to ensure deterrence, it has not been subject to any increase at step 3.

8.84 For the purposes of the application of the multiplier at step 3 in the present case, Tables 8.1 and 8.2 below sets out each Party’s relevant turnover as a proportion of its total turnover.

Table 8.1 – Relevant turnover as a proportion of total turnover (Early Resolution Parties)

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<table>
<thead>
<tr>
<th>Party</th>
<th>Relevant turnover as a proportion of total turnover&lt;sup&gt;1554&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gallaher</td>
<td>[C]%</td>
</tr>
<tr>
<td>Asda</td>
<td>[C]%</td>
</tr>
<tr>
<td>First Quench</td>
<td>[C]%</td>
</tr>
<tr>
<td>Somerfield</td>
<td>[C]%</td>
</tr>
<tr>
<td>T&amp;S Stores</td>
<td>[C]%</td>
</tr>
<tr>
<td>TM Retail</td>
<td>[C]%</td>
</tr>
</tbody>
</table>

**Table 8.2 – Relevant turnover as a proportion of total turnover (Other Parties)**

<table>
<thead>
<tr>
<th>Party</th>
<th>Relevant turnover as a proportion of total turnover&lt;sup&gt;1555&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>ITL</td>
<td>[C]%</td>
</tr>
<tr>
<td>The Co-operative Group</td>
<td>[C]%</td>
</tr>
<tr>
<td>Morrisons</td>
<td>[C]%</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>[C]%</td>
</tr>
<tr>
<td>Safeway</td>
<td>[C]%</td>
</tr>
<tr>
<td>Shell</td>
<td>[C]%</td>
</tr>
</tbody>
</table>

8.85 The OFT considers that in the present case figures below [C] per cent represent a relatively low proportion of each undertaking’s total turnover. As demonstrated in tables 8.1 and 8.2 above, each of Asda’s, Morrisons’, Safeway’s, Sainsbury’s and Shell’s relevant turnover as a proportion of total turnover is below [C] per cent.

8.86 The OFT has therefore increased the penalty of each of these Parties at step 3 to arrive at a sum that represents, for each Party, a sufficient deterrent, having regard to the seriousness of the infringements and the ratio of that Party’s relevant turnover to its total turnover.

8.87 The OFT considers that a multiplier of [C] applied to the figure at the end of step 2 for each of Asda, Morrisons, Safeway and Sainsbury is

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<sup>1554</sup> The relevant year for the turnover data used to calculate each of these figures is as explained in paragraph 8.40.

<sup>1555</sup> The relevant year for the turnover data used to calculate each of these figures is as explained in paragraph 8.40.
appropriate in this case, given the ratio of relevant turnover to total turnover of each of these Parties at around [C] and [C] per cent.

8.88 In common with the above, the OFT would, as a starting point, apply a multiplier of [C] to the figure at the end of step 2 for Shell. However, in light of the extremely low proportion of Shell’s total turnover which is represented by its relevant turnover, the OFT considers that a further multiplier is warranted for Shell in order to arrive at a penalty that is sufficient to ensure deterrence in respect of Shell. In determining the level of that further multiplier, the OFT has had regard to the unique position of Shell and the fact that during much of the duration of the Infringing Agreements to which Shell was a party, Shell’s relevant turnover comprised, in the main, commission from its Contractors and bonuses from the Manufacturers; Shell did not receive the entirety of the sales revenue achieved in the relevant markets which were the subject of the Infringing Agreements to which it was party. In determining the appropriate multiplier at this stage of the penalty calculation, the OFT therefore had regard to the turnover of Shell’s Contractors in those relevant markets. That allowed the OFT to compare Shell’s relevant turnover with the total sales revenues in the relevant markets achieved by the Contractors. If the additional multiplier at this stage of the penalty calculation were based on the ratio of Shell’s turnover in the relevant markets to its Contractors’ turnover in the relevant markets\(^{1556}\), a multiplier of approximately [C] (in addition to the multiplier of [C]) would be an appropriate figure. However, in the circumstances of this case, the OFT considers that a multiplier of [C] (in addition to the multiplier of [C]) applied to the figure at the end of step 2 for Shell is sufficient to ensure deterrence in respect of Shell. Accordingly, a total multiplier of [C] has been applied to the figure at the end of step 2 for Shell.

\[ii\] Reduction of penalties

8.89 In some cases, the financial penalty calculated at the end of step 2 may be more than sufficient to ensure deterrence. That may be the case, for instance, for undertakings whose economic activities are relatively concentrated in the relevant markets. It may also be the case due to an undertaking’s special characteristics, including the size or financial position (including, for example, its business model). In such cases, the OFT has applied a downward adjustment at step 3.

8.90 In reducing the level of any financial penalties in such cases, the OFT has also considered whether the penalties at the end of step 2 are more than

\(^{1556}\) Shell’s relevant turnover was [C] and that of its Contractors was [C].
sufficient to ensure deterrence in light of the seriousness of the infringement and the penalties imposed on other Parties.\footnote{1557 This approach is consistent with the CAT’s judgment in \textit{Sepia Logistics Ltd and Precision Concepts v Office of Fair Trading}, [2007] CAT 13, at [111].}

\textit{Downward adjustment for the Manufacturers}

8.91 Tables 8.1 and 8.2 above demonstrate that relative to other Parties (with the exception of First Quench, TM Retail and T&S Stores which are addressed below) ITL’s and Gallaher’s relevant turnover accounts for a much higher proportion of their total turnover, namely [C] per cent and [C] per cent respectively. In these circumstances, the OFT considers that imposing a penalty on each Manufacturer without any adjustment would result in a penalty that would be more than sufficient to ensure deterrence, having regard to the seriousness of the infringements and the ratio of each Manufacturer’s relevant turnover to its total turnover.

8.92 The OFT considers that it is appropriate in the specific circumstances of this case to grant Gallaher a reduction of [C] per cent of the penalty at step 3 to take this into account. The OFT considers that any greater reduction for Gallaher would result in a penalty at step 3 that would not be sufficient to ensure deterrence.

8.93 In relation to ITL, the OFT considers that it is appropriate in the specific circumstances of this case to grant ITL a reduction of [C] per cent of the penalty at step 3. The OFT considers that any lower reduction for ITL would result in a penalty at step 3 that would be more than sufficient to ensure deterrence and any greater reduction would result in a penalty at Step 3 that would not be sufficient to ensure deterrence.

\textit{Downward adjustment for First Quench and TM Retail}

8.94 The OFT considers that a reduction of TM Retail’s and First Quench’s penalties is appropriate on the basis of a number of special characteristics of these undertakings which are inherent in their business models and which distinguish them from the other Retailers. In particular, the OFT notes that First Quench and TM Retail are convenience sector retailers, which typically have very different business models to the supermarket chains and do not typically benefit from the same economies of scale. The OFT also notes the significant reliance of convenience sector retailers, including TM Retail and First Quench, on tobacco sales, in contrast to the other Retailers.
In light of the foregoing considerations, the OFT considers that it is appropriate to grant each of First Quench and TM Retail a reduction of [C] per cent of the penalty at step 3. The OFT considers that the penalty at step 3 resulting from these downward adjustments is in each case sufficient to ensure deterrence.

The OFT acknowledges that, at some point in time, T&S Stores may have operated on a business model that was similar to that of TM Retail or First Quench. However, it is relevant to note that T&S Stores was acquired by Tesco plc on 6 January 2003 during the period of infringement. T&S Stores thereby became part of a large corporate group, the business model of which was not comparable to that of TM Retail or First Quench. As such, the OFT considers that a reduction of T&S Stores' penalty at step 3 would not be appropriate as it would result in a penalty at step 3 that would not be sufficient to ensure deterrence.

**Economic benefit**

Several of the Parties put forward the argument that they had derived no economic or financial benefit from the Infringing Agreements and that the penalties should therefore be adjusted downwards. The Co-operative Group’s response to the SO, paragraph 9.70; Shell’s response to the SO, paragraph 299 et seq.; ITL’s response to the SO, paragraph 7.40; Safeway’s representations on the OFT’s proposed action, paragraph 70; Morrisons’ representations on the OFT’s proposed action, paragraphs 70.

The OFT considers that whereas the existence of any economic or financial benefit from an infringement may warrant an upward adjustment to a financial penalty at step 3, its absence would not warrant a downward adjustment.

**(d) Step 4 – adjustment for aggravating and mitigating factors**

The OFT may increase the penalty at step 4 where there are aggravating factors, or decrease it where there are mitigating factors. In this case, the OFT does not consider that there are aggravating factors warranting an upward adjustment.

**i Mitigating factors**

In the present case, the OFT considers that in respect of some Parties there are mitigating factors that warrant a downward adjustment to their penalty.

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1558 The Co-operative Group’s response to the SO, paragraph 9.70; Shell’s response to the SO, paragraph 299 et seq.; ITL’s response to the SO, paragraph 7.40; Safeway’s representations on the OFT’s proposed action, paragraph 70; Morrisons’ representations on the OFT’s proposed action, paragraphs 70.

1559 Penalty Guidance, at paragraph 2.14.
penalties at step 4. The application of a reduction at step 4 is reflected in the relevant Parties' penalty calculations, set out below.

**Compliance**

8.101 Where a Party can demonstrate that it has taken adequate steps with a view to ensuring compliance with Chapter I of the Act that is a mitigating factor which may result in a decrease of the penalty.\(^{1560}\)

8.102 All Parties made submissions on the issue of compliance. Following its assessment of those submissions, the OFT is satisfied that each of the Parties has demonstrated that it has taken adequate steps to ensure compliance, specifically in this case to introduce or amend a formal compliance policy.

8.103 In the course of early resolution discussions with a number of the Parties, the OFT considered that a \([5-10]\) per cent reduction for compliance was appropriate and granted that to a number of the Parties at that time. The remainder of the Parties that satisfy the criteria have also been granted a \([5-10]\) per cent reduction for compliance at step 4 of the penalty calculation.

**Cooperation**

8.104 The OFT considers that cooperation which enables the enforcement process to be concluded more effectively and/or speedily is a mitigating factor which may result in a decrease of the penalty.\(^{1561}\) In the SO, the OFT noted that mere compliance with statutory requirements would not of itself merit any reduction in penalty. In addition, undertakings benefiting from leniency (a condition of which is their full co-operation) will not receive an additional reduction in penalties at step 4 to reflect general co-operation.\(^{1562}\)

8.105 Other than in the case of Gallaher and apart from the cooperation covered by Early Resolution and leniency, the OFT is not aware of any cooperation by any Party which would have enabled the process in this case to have been concluded more effectively and/or speedily, warranting a downward adjustment at step 4 of the penalty calculations. Although Early Resolution is a form of cooperation, the reduction in penalty resulting from that for those Parties that concluded Early Resolution agreements with the

\(^{1560}\) Penalty Guidance, at paragraphs 2.14 and 2.16.

\(^{1561}\) Penalty Guidance, at paragraphs 2.14 and 2.16.

\(^{1562}\) Penalty Guidance, at paragraph 2.16, footnote 19.
OFT is taken into account after step 5 of the penalty calculation and, where applicable, after any leniency discount.

8.106 The OFT has granted a [5-10] per cent reduction to Gallaher on the basis of co-operation. In particular, Gallaher provided the OFT with detailed information on the background to the tobacco market and the operation of its parity and differential provisions at an early stage of the investigation\textsuperscript{1563}, which materially assisted the OFT with its understanding and progression of the case. In addition, Gallaher assisted the OFT with the progression of its case by attending a meeting with the OFT in January 2006,\textsuperscript{1564} at which Gallaher provided detailed descriptions of various aspects of its trading relationships, including (amongst other things) bonuses, enforcement of parity and differential provisions, tiered pricing, price marked packs, price matrix tables and MPI announcements.

8.107 ITL made various submissions (including presentations) to the OFT during the course of the investigation prior to the issue of the SO. However, the OFT does not consider that these enabled the OFT to conclude the enforcement process more effectively and/or speedily. The submissions made by ITL were in the form of representations, for example as to the pro-competitive nature of ITL’s parity and differential provisions, rather than the provision of information which enabled the OFT to progress its understanding of the industry and the relevant agreements. Although ITL was entitled to make such representations (and the points arising have been taken into account by the OFT in reaching this Decision), in the OFT’s view, they do not qualify for any reduction specifically for cooperation.

\textit{Duress}

8.108 Some Retailers suggested that they were under severe duress or pressure to participate in the Infringing Agreements and that the OFT should treat that as a mitigating factor.\textsuperscript{1565} The Penalty Guidance recognises that severe duress or pressure is a potential mitigating factor. However, the Retailers in question did not provide sufficient evidence to substantiate their claims and the OFT does not therefore consider that any of those

\textsuperscript{1563} See the presentation given to the OFT by Gallaher in June 2004 (Document Unique ID 133SA on the OFT’s file).
\textsuperscript{1564} Document 18, Annex 3.
\textsuperscript{1565} See Safeway’s representations on the OFT’s proposed action, paragraph 76; Morrisons’ representations on the OFT’s proposed action, paragraph 76; the Co-operative Group’s response to the SO, paragraph 9.84 to 9.86 and the material provided by Asda in relation to this issue on 20 November 2008 in response to a request from the OFT pursuant to the Early Resolution agreement that Asda had concluded with the OFT.
Retailers can benefit from this mitigating factor within the meaning of the Penalty Guidance.

**Genuine uncertainty**

8.109 Several of the Parties submitted they had genuine uncertainty as to whether their conduct constituted an infringement.\textsuperscript{1566} The Penalty Guidance states that adjustments may be made at step 4 for this factor.\textsuperscript{1567} However, the OFT does not consider that it is appropriate in the present case for a discount to be given on that basis, since the Infringing Agreements restricted the Retailer’s ability to determine its retail prices for competing linked brands and since the restrictive nature of the Infringing Agreements obviously resulted from that linking of the retail prices of competing brands, such that each of the Parties must have been aware or ought to have known\textsuperscript{1568} that the Infringing Agreements entailed a restriction or distortion of competition.

(e) **Step 5 – adjustment to prevent the maximum penalty being exceeded and to avoid double jeopardy**

8.110 As stated above, the OFT may not fix a penalty that exceeds 10 per cent of the worldwide turnover of the undertaking\textsuperscript{1569} in its last business year before the date of the OFT’s decision, calculated in accordance with the provisions of the 2000 Order, as amended (‘the Section 36(8) Turnover’).\textsuperscript{1570} The Section 36(8) Turnover is not restricted to a party’s turnover in the relevant product market and relevant geographic market.\textsuperscript{1571}

8.111 In addition, where an infringement of the Chapter I Prohibition ended prior to 1 May 2004, any penalty must, if necessary, be further adjusted to ensure that it does not exceed the maximum penalty applicable prior to 1 May 2004, that is 10 per cent of the turnover in the UK of the

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\textsuperscript{1566} Shell’s response to the SO, paragraph 305 et seq. and Shell’s supplementary response to the SO, paragraphs 24 and 25; Safeway’s representations on the OFT’s proposed action, paragraph 76; Morrisons’ representations on the OFT’s proposed action, paragraph 76; ITL’s response to the SO, paragraph 7.41; and the Co-operative Group’s response to the SO, paragraph 9.87 et seq. and the Co-operative Group’s supplementary response to the SO, paragraph 8.3.

\textsuperscript{1567} Penalty Guidance, at paragraph 2.16.

\textsuperscript{1568} See Section 8.C.I.(g) above.

\textsuperscript{1569} Note that the statutory cap applies to the turnover of the undertaking, not separately to the turnover of each legal entity within the undertaking.

\textsuperscript{1570} Section 36(8) of the Act and the 2000 Order, as amended by the 2004 Order.

\textsuperscript{1571} Penalty Guidance, at paragraph 2.17.
undertaking in the financial year preceding the date when the infringement ended (multiplied pro rata by the length of the infringement where the length of the infringement was in excess of one year, up to a maximum of three years).\textsuperscript{1572}

8.112 The OFT has assessed each of the Parties' penalties against the tests set out in the preceding paragraphs (as applicable). This assessment has not necessitated any reductions to penalties at step 5 of the penalty calculations.

8.113 Also, the OFT must, when setting the amount of a penalty for a particular agreement (or concerted practice), take into account any penalty or fine that has been imposed by the Commission or by a court or other body in another Member State in respect of the same agreement (or concerted practice).\textsuperscript{1573} As there is no such applicable penalty or fine, no adjustments are necessary in this case in that connection.

D APPLICATION OF THE OFT’S LENIENCY POLICY

8.114 As stated in Section 2.B.II: 'Leniency' above, a number of Parties applied for, and were granted, conditional leniency. Having regard to the compliance by each of those Parties with its leniency agreement, the OFT has applied the following reductions to the penalty imposed.

8.115 Sainsbury is granted a 100 per cent reduction in penalty in accordance with its leniency agreement with the OFT.

8.116 T&S Stores was acquired by Tesco plc on 6 January 2003 and therefore benefits from Tesco plc’s leniency agreement with the OFT. T&S Stores is granted a 40 per cent reduction in penalty. The fact that the OFT has not made a finding of infringement in relation to Tesco plc does not affect either the position of T&S Stores as regards the finding of infringement made against it or the application of a leniency discount for T&S Stores.

8.117 Somerfield is granted a 30 per cent reduction in penalty in accordance with its leniency agreement with the OFT.

8.118 Asda is granted a 10 per cent reduction in penalty on the basis that Asda has obtained total immunity from financial penalties in respect of a completely separate infringement of the Chapter I Prohibition in relation to its activities in other, separate markets.\textsuperscript{1574}

\textsuperscript{1572} Penalty Guidance, at paragraph 2.18.
\textsuperscript{1573} Penalty Guidance, at paragraph 2.20 and section 38(9) of the Act.
\textsuperscript{1574} Penalty Guidance, paragraphs 3.16 and 3.17; and Leniency and no-action (OFT 803), November 2006, paragraphs 6.8 to 6.10 which was applicable at the time Asda
8.119 The reduction percentages for each of the above Parties are applied to the penalty after step 5 of the penalty calculations.

**EARLY RESOLUTION REDUCTION**

8.120 As noted in Section 2.B.IX: 'Early Resolution', each of the following Parties concluded an Early Resolution agreement with the OFT in which it admitted its participation in the Infringing Agreements to which it was party in breach of the Chapter I Prohibition and agreed, among other matters, to maintain continuous and complete co-operation throughout the investigation and until the conclusion of any resulting action by the OFT: Gallaher, Asda, First Quench, One Stop Stores (formerly named T&S Stores)\(^{1575}\), Somerfield and TM Retail.

8.121 None of these Parties has withdrawn from its Early Resolution agreement. Accordingly, the OFT has applied the 20 per cent Early Resolution reduction that was available to each Party that entered into an Early Resolution agreement. The reduction is applied at the end of step 5 of the penalty calculation and after any reduction for leniency as applicable.

**REDUCTION FOR LENGTH OF THE OFT’S INVESTIGATION**

8.122 In their written representations, Morrisons and Safeway submitted that there should be a reduction in penalties imposed to reflect the length of time taken in the OFT’s decision to issue the SO.\(^{1576}\)

8.123 The OFT would note that investigations under the Act can be complex and take some time. The fact that an investigation takes a number of years is therefore not necessarily an indication of any delay. However, in the exceptional circumstances of this case, the OFT acknowledges that the duration of this investigation (which has been ongoing since 10 March 2003) and in particular the time taken to issue the SO (approximately five years), was considerable. The length of this investigation has, in the main, been justified by the complex nature of the case, including the number of parties involved. The approach of some of the Parties to the investigation has also had a considerable effect on the time taken to come to this Decision. Nonetheless, the OFT acknowledges that, as one of the first

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1575 The Early Resolution agreement signed by One Stop Stores was also signed by Tesco plc in respect of T&S Stores.
1576 Morrisons’ representations on the OFT’s proposed action, paragraph 77; Safeway’s representations on the OFT’s proposed action, paragraph 77.
large investigations under the Act, lessons have been learned from this case which will be applied by the OFT in future cases. In particular, the OFT notes that the decision to reduce the number of parties subject to the investigation was taken around three years into the investigation, whereas cases commenced under the Act would now be prioritised more effectively at an earlier stage of the OFT’s investigation.

8.124 In order to acknowledge the length of time taken in the investigation in the exceptional circumstances of this case, the OFT has also applied a further reduction of 10 per cent to the penalty for each Party. Such reduction has been applied at the end of step 5 of the penalty calculations and after any reduction for leniency and/or Early Resolution as applicable.

G PAYMENT OF THE PENALTY

8.125 The OFT requires each of the Parties to pay the penalty applicable to it as set out in the tables below. The penalty calculation methodology explained in the preceding paragraphs of this section applies in respect of each Party. Both the individual figures and the final penalty figures are rounded to the nearest pound.

8.126 The penalties will become owed to the OFT in their entirety on 17 June 2010 and must be paid to the OFT by close of banking business on that date.¹⁵⁷⁷ If the penalty is not paid, and either an appeal against the imposition or amount of that penalty has not been made or such an appeal has been made and determined in the OFT’s favour, the OFT may commence proceedings to recover the amount as a civil debt.

Simon Williams for and on behalf of the Office of Fair Trading
Senior Director

15 April 2010

Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London EC4Y 8JX

¹⁵⁷⁷ Details of how to pay are notified in the letter accompanying this Decision.
### ANNEX A - PENALTY CALCULATIONS

#### 1. ITL

<table>
<thead>
<tr>
<th>Penalty component</th>
<th>Description</th>
<th>Amount</th>
</tr>
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<tbody>
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<td><strong>STEP 1</strong></td>
<td>Relevant turnover year end 30 September 2009</td>
<td>[C]</td>
</tr>
<tr>
<td></td>
<td>Starting point (7%)</td>
<td>[C]</td>
</tr>
<tr>
<td></td>
<td><strong>Penalty after Step 1</strong></td>
<td>[C]</td>
</tr>
<tr>
<td><strong>STEP 2</strong></td>
<td>Duration multiplier (x2.5)</td>
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</tr>
<tr>
<td></td>
<td><strong>Penalty after Step 2</strong></td>
<td>[C]</td>
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<tr>
<td><strong>STEP 3</strong></td>
<td>Adjustment ([C])</td>
<td>[C]</td>
</tr>
<tr>
<td></td>
<td><strong>Penalty after Step 3</strong></td>
<td>[C]</td>
</tr>
<tr>
<td><strong>STEP 4</strong></td>
<td>Mitigating factors</td>
<td>[C]</td>
</tr>
<tr>
<td></td>
<td>Compliance (-{5-10%})</td>
<td>[C]</td>
</tr>
<tr>
<td></td>
<td><strong>Penalty after Step 4</strong></td>
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<tr>
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<td></td>
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<td>[C]</td>
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<td>[C]</td>
</tr>
<tr>
<td></td>
<td>UK turnover for year preceding infringement end</td>
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</tr>
<tr>
<td></td>
<td>Pre-2004 s36(8) turnover (max. x3 years)</td>
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<tr>
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<tr>
<td></td>
<td>Starting point (7%)</td>
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<tr>
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<td><strong>Penalty after Step 1</strong></td>
<td>[C]</td>
</tr>
<tr>
<td><strong>STEP 2</strong></td>
<td>Duration multiplier (x2.5)</td>
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<td><strong>Penalty after Step 2</strong></td>
<td>[C]</td>
</tr>
<tr>
<td><strong>STEP 3</strong></td>
<td>Adjustment ([IC])</td>
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</tr>
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<td></td>
<td><strong>Penalty after Step 3</strong></td>
<td>[C]</td>
</tr>
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<td><strong>STEP 4</strong></td>
<td>Mitigating factors</td>
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<td>s.36(8) turnover</td>
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<td>Penalty after adjustment for s.36(8) cap</td>
<td>[C]</td>
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<td></td>
<td>UK turnover for year preceding infringement end</td>
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<td>Pre-2004 s36(8) turnover (max. x3 years)</td>
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<td>Duration multiplier (x2.5)</td>
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<td><strong>STEP 3</strong></td>
<td>Adjustment ([IC])</td>
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<td><strong>STEP 4</strong></td>
<td>Mitigating factors</td>
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<td>Compliance (-[5-10%])</td>
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<td></td>
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<td><strong>STEP 5</strong></td>
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<td>s.36(8) turnover</td>
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<td>Pre-2004 s36(8) turnover (max. x3 years)</td>
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## 4. The Co-operative Group

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<tr>
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<td>Duration multiplier (x2.5)</td>
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<td><strong>STEP 4</strong></td>
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<td><strong>STEP 5</strong></td>
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<td>s.36(8) turnover</td>
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<td>Pre-2004 s36(8) turnover (max. x3 years)</td>
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<td><strong>Length of</strong></td>
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The Co-operative Group acquired Somerfield on 27 February 2009. The Co-operative Group’s relevant and total turnover figures do not include any figures attributable to Somerfield.
5. First Quench

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<td>Adjustment ([C])</td>
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<td>[C]</td>
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</tr>
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<td>Pre-2004 s36(8) turnover (max. x3 years)</td>
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<tr>
<td>Length of Investigation</td>
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</table>
Morrisons acquired Safeway after the period of infringement. In order to avoid double-counting, that element of Morrisons’ relevant and total turnover figures that is attributable to Safeway is not included in the figures given that a financial penalty is also being imposed separately on Safeway.
7. Safeway

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<tr>
<td><strong>STEP 2</strong></td>
<td>Duration multiplier (x2.5)</td>
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</tr>
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<td></td>
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<tr>
<td><strong>STEP 3</strong></td>
<td>Adjustment ([IC])</td>
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</tr>
<tr>
<td></td>
<td><strong>Penalty after Step 3</strong></td>
<td></td>
</tr>
<tr>
<td><strong>STEP 4</strong></td>
<td>Mitigating factors</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Compliance (-[5-10%])</td>
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<td></td>
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</tr>
<tr>
<td><strong>STEP 5</strong></td>
<td>Total turnover year end 1 February 2009</td>
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</tr>
<tr>
<td></td>
<td>s.36(8) turnover</td>
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</tr>
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<td><strong>Penalty after adjustment for s.36(8) cap</strong></td>
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</tr>
<tr>
<td></td>
<td>UK turnover for year preceding infringement end</td>
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<td>Pre-2004 s36(8) turnover (max. x3 years)</td>
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</tr>
<tr>
<td>Length of Investigation</td>
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8. Sainsbury

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<td>[C]</td>
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<td>[C]</td>
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<td>Mitigating factors</td>
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<td>Adjustment (ICI)</td>
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<tr>
<td><strong>STEP 4</strong></td>
<td>Mitigating factors</td>
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</tr>
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<td>Compliance ([-5-10%])</td>
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<td>Pre-2004 s36(8) turnover (max. x3 years)</td>
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<tr>
<td><strong>Length of</strong></td>
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<p>| <strong>FINAL PENALTY</strong> | £3,354,615                  |</p>
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## 11. T&S Stores

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<td><strong>STEP 3</strong></td>
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<td><strong>STEP 4</strong></td>
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<td><strong>Early Resolution</strong></td>
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## 12. TM Retail

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<tr>
<td><strong>STEP 3</strong></td>
<td>Adjustment (ICI)</td>
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<tr>
<td><strong>STEP 4</strong></td>
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<td>Early Resolution</td>
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<tr>
<td>Investigation</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>FINAL PENALTY</strong></td>
<td></td>
<td>£2,668,991</td>
</tr>
</tbody>
</table>
ANNEX B - OFT ANALYSIS OF DATA ON THE RETAIL PRICES OF CERTAIN LINKED, COMPETING BRANDS DURING THE INFRINGEMENT PERIOD

1 This Annex sets out the pricing analysis undertaken by the OFT as referred to in Section 6.A.III: 'The Retailer’s adherence to the Manufacturers’ retail pricing strategy’ of this Decision.

2 The OFT sent a section 26 Notice to Retailers on 28 January 2005 requesting that they provide the daily price for a list of brands between the dates 1 March 2000 and 31 August 2003. A number of Retailers were not able to provide pricing data for all of the brands and/or for all of the period requested. Some Retailers provided pricing data for a shorter period between the two dates specified. The dates for which the OFT were supplied data are specified in the tables below. The OFT did not receive data for Safeway, Shell, or T&S Stores. First Quench provided data for a limited number of brands at the level of a number of individual stores. The OFT did not consider that this data could be compared with data provided by other Retailers.

3 In the course of its investigation, the OFT received pricing data from Retailers covering a number of the linked brands. The OFT therefore undertook a limited analysis of the pricing data it had received. Specifically, the OFT considered the pricing trends for those linked brands between which both Manufacturers sought pricing parity.¹ That enabled the analysis to focus on a consistent and straightforward parity requirement, and avoided the need for the analysis to identify precisely when, for each Retailer, a requirement may have changed. In addition, the OFT considers that absent the Infringing Agreements, price competition would otherwise have been at its most intense between brands in respect of which the Manufacturers sought pricing parity under the Infringing Agreements.

4 Tables B.1 to B.5 below set out for each linked brand pair the OFT's calculation of:
   - The percentage of days during the period for which the Retailer supplied data on which the Retailer was pricing the linked brands at parity and thereby reflecting the Manufacturer’s pricing requirements (Parity Adherence); and

¹ The OFT selected the linked brands set out in Annex B by identifying which brands were 'paired' or linked by both Manufacturers, as set out in the written trading agreements of Retailers who agreed written parity and differential requirements with each Manufacturer. The OFT considers that other Retailers which did not have written trading agreements with both Manufacturers also agreed similar requirements with both Manufacturers on the basis that the same brand pairings were frequently referred to in correspondence between the Manufacturer and the Retailer.
The number of retail price increases and price decreases for either of the relevant linked brands that occurred for that Retailer during the period for which they were able to supply data (Price increases/Price decreases). Only price changes that were sustained for a significant period were recorded as price increases or decreases. Where price changes returned to their previous level within a matter of days, they were assumed to have been made in error.

Table B.1 Richmond [ITL brand] and Dorchester [Gallaher brand]

<table>
<thead>
<tr>
<th>Retailer</th>
<th>Period for which the Retailer supplied data</th>
<th>Price Increases</th>
<th>Price Decreases</th>
<th>Parity Adherence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asda</td>
<td>27/11/00 to 15/08/03</td>
<td>6</td>
<td>0</td>
<td>78%</td>
</tr>
<tr>
<td>The Co-operative Group</td>
<td>01/03/00 to 11/08/03</td>
<td>6</td>
<td>0</td>
<td>77%</td>
</tr>
<tr>
<td>Morrisons</td>
<td>05/03/01 to 15/08/03</td>
<td>7</td>
<td>0</td>
<td>95%</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>01/04/01 to 12/08/03</td>
<td>6</td>
<td>0</td>
<td>95%</td>
</tr>
<tr>
<td>Somerfield</td>
<td>01/03/00 to 15/08/03</td>
<td>7</td>
<td>0</td>
<td>95%</td>
</tr>
<tr>
<td>TM Retail</td>
<td>27/11/00 to 15/08/03</td>
<td>8</td>
<td>1</td>
<td>97%</td>
</tr>
</tbody>
</table>
### Table B.2 Superkings [ITL brand] and Berkeley [Gallaher brand]

<table>
<thead>
<tr>
<th>Retailer</th>
<th>Period for which the Retailer supplied data</th>
<th>Price Increases</th>
<th>Price Decreases</th>
<th>Parity Adherence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asda</td>
<td>13/11/00 to 15/08/03</td>
<td>5(b²); 6(s³)</td>
<td>0</td>
<td>54%⁴</td>
</tr>
<tr>
<td>The Co-operative Group</td>
<td>01/03/00 to 11/08/03</td>
<td>9</td>
<td>0</td>
<td>87%</td>
</tr>
<tr>
<td>Morrisons</td>
<td>05/03/01 to 15/08/03</td>
<td>5</td>
<td>0</td>
<td>72%</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>n/a</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Somerfield</td>
<td>01/03/00 to 15/08/03</td>
<td>7(b); 10(s)</td>
<td>0(b); 1(s)</td>
<td>78%</td>
</tr>
<tr>
<td>TM Retail</td>
<td>27/11/00 to 15/08/03</td>
<td>8</td>
<td>0⁶</td>
<td>100%</td>
</tr>
</tbody>
</table>

² Where 'b' indicates that the price increases were relevant to Berkeley only.
³ Where 's' indicates that the price increases were relevant to Superkings only.
⁴ Between 12 March 2001 and 21 April 2002 there was limited parity adherence. According to the pricing data submitted by Asda, no price changes occurred during this period, and a pricing differential of 6p existed throughout.
⁵ The number of price decreases presented in the SO was eight. TM Retail submitted in its memorandum of factual inaccuracies provided pursuant to its Early Resolution agreement with the OFT, that there were no price decreases in the relevant period.
⁶ Where ‘cc’ indicates that the price increases were relevant to Café Crème only.
⁷ Where ‘hm’ indicates that the price increases were relevant to Hamlet Miniatures only.
⁸ Between 5 March 2001 and 29 August 2002 the parity was generally in place (79% parity adherence).

### Table B.3 Café Crème [ITL brand] and Hamlet Miniatures [Gallaher brand]

<table>
<thead>
<tr>
<th>Retailer</th>
<th>Period for which the Retailer supplied data</th>
<th>Price Increases</th>
<th>Price Decreases</th>
<th>Parity Adherence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asda</td>
<td>9/10/00 to 15/08/03</td>
<td>8(cc⁵); 4(hm⁷)</td>
<td>0</td>
<td>51%⁸</td>
</tr>
<tr>
<td>The Co-operative Group</td>
<td>01/03/00 to 11/08/03</td>
<td>8</td>
<td>0(cc); 1(hm)</td>
<td>63%</td>
</tr>
<tr>
<td>Morrisons</td>
<td>05/03/01 to 15/08/03</td>
<td>6(cc); 4(hm)</td>
<td>2(cc); 1(hm)</td>
<td>48%⁹</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>08/04/01 to 12/08/03</td>
<td>5</td>
<td>0</td>
<td>94%</td>
</tr>
<tr>
<td>Somerfield</td>
<td>n/a</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TM Retail</td>
<td>27/11/00 to 15/08/00</td>
<td>7</td>
<td>0</td>
<td>96%</td>
</tr>
</tbody>
</table>

² Where 'b' indicates that the price increases were relevant to Berkeley only.
³ Where 's' indicates that the price increases were relevant to Superkings only.
⁴ Between 12 March 2001 and 21 April 2002 there was limited parity adherence. According to the pricing data submitted by Asda, no price changes occurred during this period, and a pricing differential of 6p existed throughout.
⁵ The number of price decreases presented in the SO was eight. TM Retail submitted in its memorandum of factual inaccuracies provided pursuant to its Early Resolution agreement with the OFT, that there were no price decreases in the relevant period.
⁶ Where ‘cc’ indicates that the price increases were relevant to Café Crème only.
⁷ Where ‘hm’ indicates that the price increases were relevant to Hamlet Miniatures only.
⁸ The low levels of parity adherence largely reflect a differential that existed between 29 January 2001 and 21 April 2002. The OFT considers that this differential may reflect errors in the data submitted by Asda as, whilst the retail price of Café Crème changes three times during this period, it remains constant for Hamlet Miniatures.
⁹ The lack of parity adherence largely relates to the period from 30 August 2002 onwards. Between 5 March 2001 and 29 August 2002 the parity was generally in place (79% parity adherence).
Table B.4 Classics [ITL brand] and Hamlet [Gallaher brand]

<table>
<thead>
<tr>
<th>Retailer</th>
<th>Period for which the Retailer supplied data</th>
<th>Price Increases</th>
<th>Price Decreases</th>
<th>Parity Adherence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asda</td>
<td>05/03/01 to 15/08/03</td>
<td>6(c&lt;sup&gt;10&lt;/sup&gt;); 5(h&lt;sup&gt;11&lt;/sup&gt;)</td>
<td>0</td>
<td>95%</td>
</tr>
<tr>
<td>The Co-operative Group</td>
<td>01/03/00 to 11/08/03</td>
<td>9</td>
<td>0(c); 1(h)</td>
<td>72%</td>
</tr>
<tr>
<td>Morrisons</td>
<td>05/03/01 to 15/08/03</td>
<td>6(c); 5(h)</td>
<td>0</td>
<td>86%</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>11/03/01 to 12/08/03</td>
<td>5</td>
<td>0</td>
<td>95%</td>
</tr>
<tr>
<td>Somerfield</td>
<td>01/03/00 to 15/08/03</td>
<td>9(c); 8(h)</td>
<td>0</td>
<td>93%</td>
</tr>
<tr>
<td>TM Retail</td>
<td>27/11/00 to 15/08/03</td>
<td>9(c); 10(h)</td>
<td>0(c); 2(h)</td>
<td>90%</td>
</tr>
</tbody>
</table>

Table B.5 Golden Virginia [ITL brand] and Old Holborn [Gallaher brand]<sup>12</sup>

<table>
<thead>
<tr>
<th>Retailer</th>
<th>Period for which the Retailer supplied data</th>
<th>Price Increases</th>
<th>Price Decreases</th>
<th>Parity Adherence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asda</td>
<td>11/12/00 to 15/08/03</td>
<td>9(gv&lt;sup&gt;13&lt;/sup&gt;); 10(oh&lt;sup&gt;14&lt;/sup&gt;)</td>
<td>0(gv); 1(oh)</td>
<td>62%</td>
</tr>
<tr>
<td>The Co-operative Group</td>
<td>01/03/00 to 11/08/03</td>
<td>8(gv); 9(oh)</td>
<td>0(gv); 1(oh)</td>
<td>50%</td>
</tr>
<tr>
<td>Morrisons</td>
<td>05/03/01 to 15/08/03</td>
<td>4(gv); 5(oh)</td>
<td>0(gv); 1(oh)</td>
<td>76%</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>10/03/01 to 12/08/03</td>
<td>6(gv); 5(oh)</td>
<td>0(gv); 1(oh)</td>
<td>62%</td>
</tr>
<tr>
<td>Somerfield</td>
<td>01/03/00 to 15/08/03</td>
<td>9</td>
<td>1(gv); 2(oh)</td>
<td>82%</td>
</tr>
<tr>
<td>TM Retail</td>
<td>27/11/00 to 15/08/03</td>
<td>9(gv); 10(oh)</td>
<td>0(gv); 1(oh)</td>
<td>55%</td>
</tr>
</tbody>
</table>

<sup>10</sup> Where 'c' indicates that the price increases were relevant to Classics only.
<sup>11</sup> Where 'h' indicates that the price increases were relevant to Hamlet only.
<sup>12</sup> The parity adherence for these hand rolling tobacco brands shows a greater degree of variability than for cigarettes. This may be connected with the proportion of non-duty sales made of hand rolling tobacco, and the resulting added component of competition. For hand rolling tobacco, the 'illicit market share' (where duty is not paid) was 53 per cent in 2002-3 whereas for cigarettes the corresponding figure was 15 per cent.
<sup>13</sup> Where 'gv' indicates that the price increases were relevant to Golden Virginia only.
<sup>14</sup> Where 'oh' indicates that the price increases were relevant to Old Holborn only.
ANNEX C – LIST OF DOCUMENTS RELIED ON IN THIS DECISION

This Annex C contains lists of the documents relied on in this Decision which were contained in Annexes 1-29 of the SO. For ease of reference, the lists follow the numbering of the documents at Annexes 1-29 as used in the SO, save that for the purposes of this Decision, only those documents relied on in this Decision are listed in this Annex C. That means that in certain cases there are gaps in the numbering of documents and Annexes.

Annex 2: Witness evidence

<table>
<thead>
<tr>
<th>No.</th>
<th>Date</th>
<th>From</th>
<th>To</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>02-Sep-05</td>
<td>Sainsbury</td>
<td>OFT</td>
<td>Witness Statement of Ms Fiona Bayley</td>
</tr>
<tr>
<td>8</td>
<td>15-Mar-06</td>
<td>Somerfield</td>
<td>OFT</td>
<td>Somerfield Company Statement</td>
</tr>
<tr>
<td>9</td>
<td>16-May-03</td>
<td>Somerfield</td>
<td>OFT</td>
<td>Somerfield Supplementary Statement</td>
</tr>
</tbody>
</table>
### Annex 3: Gallaher’s operations and strategy

<table>
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<tr>
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<th>To</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>07-Feb-01</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Meeting minutes - Multiple Grocers Team Meeting</td>
</tr>
<tr>
<td>3</td>
<td>27-Feb-01</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>E-mail chain - Imperial multi-packs; MONP</td>
</tr>
<tr>
<td>5</td>
<td>08-May-01</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Memo - Multiple Grocer Report</td>
</tr>
<tr>
<td>6</td>
<td>14-May-01</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Table - Multiple Grocer Pricing</td>
</tr>
<tr>
<td>7</td>
<td>25-May-01</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Email chain - forward pricing with attached multiple grocer pricing tables</td>
</tr>
<tr>
<td>8</td>
<td>25-Jul-01</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Meeting minutes - Multiple Grocers Team Meeting</td>
</tr>
<tr>
<td>10</td>
<td>Dated ‘2001’</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Multiple Grocer Channel Plan</td>
</tr>
<tr>
<td>11</td>
<td>29-Jul-02</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Memo - Key Action Points Convenience Channel</td>
</tr>
<tr>
<td>12</td>
<td>21-Aug-02</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Email - pricing schedule to be implemented same time as ITL with attached schedule</td>
</tr>
<tr>
<td>13</td>
<td>13-Aug-03</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Gallaher Channel Marketing Plan - Project Kew Gardens</td>
</tr>
<tr>
<td>14</td>
<td>30-Sep-03</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Multiple Grocer Pricing</td>
</tr>
<tr>
<td>15</td>
<td>Dated</td>
<td>Gallaher</td>
<td>Gallaher</td>
<td>Gallaher Convenience Channel Strategic Plan</td>
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<td>2003</td>
<td></td>
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</tr>
<tr>
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<td>--------------------------------</td>
<td>------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>17-Oct-03 Gallaher OFT</td>
<td>Response to Section 26 Notice</td>
<td></td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>17-Mar-05 Gallaher OFT</td>
<td>Response to Section 26 Notice</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>23-Jan-06 Gallaher OFT</td>
<td>Note of meeting</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Annex 4: Documents relating to the agreement and/or concerted practice between Gallaher and Asda

<table>
<thead>
<tr>
<th>No.</th>
<th>Date</th>
<th>From</th>
<th>To</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>25-Jul-00</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Powerpoint presentation - 'Asda Review'</td>
</tr>
<tr>
<td>2</td>
<td>Dated 'Mar-01'</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Table - Gallaher Ltd / Asda Ltd Cost and Retail Prices List</td>
</tr>
<tr>
<td>3</td>
<td>22-Mar-01</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - price change re: Dorchester with attaching cost and retail price list</td>
</tr>
<tr>
<td>4</td>
<td>12-Sep-01</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - price changes</td>
</tr>
<tr>
<td>5</td>
<td>12-Dec-01</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - 2002 New Year Promotional Activity with attaching cost and retail price list</td>
</tr>
<tr>
<td>6</td>
<td>13-Feb-02</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - price changes</td>
</tr>
<tr>
<td>7</td>
<td>03-Sep-02</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - cost and retail details</td>
</tr>
<tr>
<td>8</td>
<td>05-Sep-02</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - prices changes with attaching cost and retail price list</td>
</tr>
<tr>
<td>9</td>
<td>17-Oct-02</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - prices changes with attaching cost and retail price list</td>
</tr>
<tr>
<td>10</td>
<td>07-Jan-03</td>
<td>Asda</td>
<td>Gallaher</td>
<td>Email - response by Asda re: price changes</td>
</tr>
<tr>
<td>11</td>
<td>10-Apr-03</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - price changes</td>
</tr>
<tr>
<td>12</td>
<td>02-Jun-03</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - MPI</td>
</tr>
<tr>
<td>13</td>
<td>23-Jun-03</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - Post MPI new retail prices</td>
</tr>
<tr>
<td>14</td>
<td>30-Jul-03</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Letter - bonus payments</td>
</tr>
<tr>
<td>15</td>
<td>28-Aug-03</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - reduced cost and RRP re: Mayfair</td>
</tr>
<tr>
<td>16</td>
<td>26-Sep-03</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email - price change and bonus re: Dorchester</td>
</tr>
<tr>
<td>17</td>
<td>10-feb-00</td>
<td>Gallaher</td>
<td>Asda</td>
<td>Email – Asda retails / Hamlet Miniatures¹</td>
</tr>
</tbody>
</table>

¹ This document was provided to the OFT by Gallaher in response to a request from the OFT dated 12 February 2009 pursuant to the Early Resolution agreement that Gallaher
had concluded with the OFT. This document was disclosed to Parties as Unique Document Reference 1959.

\(^2\) This document was provided to the OFT by Gallaher in response to a request from the OFT dated 12 February 2009 pursuant to the Early Resolution agreement that Gallaher had concluded with the OFT. This document was disclosed to Parties as Unique Document Reference 1959.
Annex 5: Documents relating to the agreement and/or concerted practice between Gallaher and the Co-operative Group

<table>
<thead>
<tr>
<th>No.</th>
<th>Date</th>
<th>From</th>
<th>To</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>15-May-00</td>
<td>Co-op</td>
<td>Gallaher</td>
<td>Email - pricing re: [another manufacturer’s brand] 20s</td>
</tr>
<tr>
<td>2</td>
<td>17-Aug-00</td>
<td>Gallaher</td>
<td>Co-op</td>
<td>Email chain - price support</td>
</tr>
<tr>
<td>3</td>
<td>18-Aug-00</td>
<td>Gallaher</td>
<td>Co-op</td>
<td>Email - price support</td>
</tr>
<tr>
<td>4</td>
<td>20-Sep-00</td>
<td>Gallaher</td>
<td>Co-op</td>
<td>Letter - bonus re: B&amp;H</td>
</tr>
<tr>
<td>5</td>
<td>20-Sep-00</td>
<td>Co-op</td>
<td>Gallaher</td>
<td>Email - price file</td>
</tr>
<tr>
<td>6</td>
<td>26-Sep-00</td>
<td>Co-op</td>
<td>Gallaher</td>
<td>Letter - trading agreement</td>
</tr>
<tr>
<td>7</td>
<td>02-Oct-00</td>
<td>Gallaher</td>
<td>Co-op</td>
<td>Trading Agreement</td>
</tr>
<tr>
<td>8</td>
<td>23-Oct-00</td>
<td>Gallaher</td>
<td>Co-op</td>
<td>Letter - price support with price file</td>
</tr>
<tr>
<td>9</td>
<td>09-Mar-01</td>
<td>Gallaher</td>
<td>Co-op</td>
<td>Email - budget pricing</td>
</tr>
<tr>
<td>10</td>
<td>12-Jul-01</td>
<td>Gallaher</td>
<td>Co-op</td>
<td>Letter - price support with price file</td>
</tr>
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Annex 6: Documents relating to the agreement and/or concerted practice between Gallaher and First Quench

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Annex 7: Documents relating to the agreement and/or concerted practice between Gallaher and Morrisons

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Annex 8: Documents relating to the agreement and/or concerted practice between Gallaher and Sainsbury

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Annex 9: Documents relating to the agreement and/or concerted practice between Gallaher and Shell

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Annex 10: Documents relating to the agreement and/or concerted practice between Gallaher and Somerfield

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Annex 12: Documents relating to the agreement and/or concerted practice between Gallaher and TM Retail

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### Annex 13: ITL’s operations and strategy

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#### Examples of National Accounts Business Development Plans

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**Examples of National Accounts Business Development Plans**

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## Annex 14: Documents relating to the agreement and/or concerted practice between ITL and Asda

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Annex 16 : Documents relating to the agreement and/or concerted practice between ITL and First Quench

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<sup>3</sup> This was provided to the OFT by First Quench in response to a request from the OFT dated 12 November 2008, pursuant to the Early Resolution agreement that First Quench had concluded with the OFT. This document was disclosed to Parties as Document Unique Reference 1753.

<sup>4</sup> This document, which was part of the OFT’s case file, was highlighted by ITL in response to a request from the OFT dated 31 October 2008.
Annex 17: Documents relating to the agreement and/or concerted practice between ITL and Morrisons

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Annex 18: Documents relating to the agreement and/or concerted practice between ITL and Sainsbury

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Annex 19 : Documents relating to the agreement and/or concerted practice between ITL and Shell

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Annex 20: Documents relating to the agreement and/or concerted practice between ITL and Somerfield

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Annex 22: Documents relating to the agreement and/or concerted practice between ITL and TM Retail

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### Annex 23: Miscellaneous documents

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Annex 26: Documents relating to the agreement and/or concerted practice between Gallaher and Safeway

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# Annex 27: Documents relating to the agreement and/or concerted practice between Gallaher and T&S Stores

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Annex 28: Documents relating to the agreement and/or concerted practice between ITL and Safeway

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Annex 29: Documents relating to the agreement and/or concerted practice between ITL and T&S Stores

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BY SPECIAL DELIVERY

Asda Stores Limited, Asda Group Limited, Wal-Mart Stores (UK) Limited and BroadStreet Great Wilson Europe Limited

FAO Eleanor Doohan,
Company Secretary

Your ref
Our ref CE/2596-03
Date 10 July 2008

Direct line (020) 7211 8707
Fax (020) 7211 8575
Email Sonya.Branch@oft.gsi.gov.uk

Dear Sirs

Asda Stores Limited, Asda Group Limited, Wal-Mart Stores (UK) Limited and BroadStreet Great Wilson Europe Limited (together 'Asda')

Case CE/2596-03: Tobacco

Competition Act 1998

As you are aware, the Office of Fair Trading (the 'OFT') proposes to make a decision in terms of the Statement of Objections issued on 24 April 2008 (the 'Statement') that Asda and other parties set out in paragraph 4 of the Statement infringed the Chapter I prohibition of the Competition Act 1998 through:

- agreements and/or concerted practices that restricted the Retailer's ability to determine its retail prices for the Manufacturer's products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003 as set out in the Statement;

You have indicated Asda's willingness to admit its involvement in relation to all of the infringements that are applicable to it (see the appendix). You have also indicated Asda's willingness to co-operate in the OFT's desire to expedite the process of concluding its investigation. Further to discussions between the OFT and Asda, this letter (the 'Agreement') sets out the terms upon which the OFT would be prepared to resolve its investigation of the infringements, were Asda to accept these terms.
1. Asda will, by signing the Agreement, admit its involvement in the infringements on an object basis.

2. Asda will maintain continuous and complete co-operation throughout the investigation and until the conclusion of any action by the OFT arising as a result of the investigation; and reference to such action includes any action taken by the OFT in any proceedings before the Competition Appeal Tribunal (the 'CAT') arising from a decision of the OFT in connection with the infringements.

3. In relation to the infringements, save as otherwise agreed by the OFT, such co-operation may include but may not be limited to, if requested by the OFT:

   a. Asda using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to voluntarily provide the OFT with specific and valuable information (directly or indirectly) by 11 November 2008, which supports Asda's admission and, if applicable, supports the OFT's findings in respect of the infringing conduct of the other parties to which the Statement addressed;

   b. Asda using reasonable endeavours to ensure that such information is closely referenced to any available contemporaneous evidence, states the identities of the individuals involved in the infringements (their names, job description, the name of their employer), clearly outlines the infringing conduct (i.e. outlining what was said and agreed) and specifies dates and venues relevant to the infringements;

   c. Asda using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to attend interviews in order to provide the OFT with specific and valuable information relevant to the infringements;

   d. Asda facilitating the ability of current and former directors, officers, employees and agents to appear for such interviews as the OFT may reasonably require at the times and places reasonably designated by the OFT;

   e. Asda using reasonable endeavours to ensure that current and former directors, officers, employees and agents who provide information to the OFT respond completely and truthfully to all questions asked in interviews;

   f. In relation to any CAT proceedings, Asda using reasonable endeavours to facilitate and secure the complete and truthful co-operation of its current and former directors, officers, employees and agents, even if Asda is not a party to those CAT proceedings in:

      i. assisting the OFT or its counsel in the preparation for those CAT proceedings;

      ii. if requested by the OFT or its counsel, attending those CAT proceedings; and

      iii. speaking to any relevant witness statements and being cross-examined on such witness statements in those CAT proceedings.
4. The OFT will accept from Asda a concise memorandum indicating any material factual inaccuracies in the Statement[ ], which should be received by the OFT by 23 July 2008. Should the memorandum, in the opinion of the OFT, go so far as to contest Asda’s liability for all or any part of the infringements or represent that the penalty should be other than as set out in the Agreement, or otherwise exceed the scope identified in the previous sentence, the OFT will notify Asda of its concerns. Should Asda not agree promptly to amend its representations in a manner which satisfies the OFT, the OFT may treat any agreement on the terms set out in the Agreement as ceasing to have effect and shall notify Asda accordingly.

5. In relation to the infringements, Asda will refrain from seeking access to documents on the OFT’s file, other than those documents directly relied on and referred to in the Statement[ ].

6. The OFT will adopt a decision in respect of the infringements which will:

   a. as to substance,

      i. set out the OFT’s findings of the facts which had taken place in materially the same form as set out in the Statement[ ], subject to any amendments deemed necessary and appropriate by the OFT as a result of the representations referred to in paragraph 4 or equivalent representations from other recipients of the Statement[ ];

      ii. note Asda’s admission as to involvement in the infringements and conclude that such infringements had been committed;

      iii. have a copy of the Agreement annexed to it.

   b. as to remedy,

      i. set out the OFT’s approach to calculating the penalty in accordance with its published guidance and note that for the purpose of applying its guidance on penalties in Competition Act 1998 cases the OFT would have adopted, in the absence of resolution on the terms of the Agreement, a 'starting point' of per cent of relevant turnover (in relation to the infringements described in paragraph 1 of the appendix to this Agreement);

      ii. set out clearly the factors considered in determining this 'starting point';

      iii. impose a penalty on Asda of £ before any discount for co-operation;

      iv. note that we anticipate that the penalty figure for Asda will, after any discounts for leniency under the OFT’s leniency programme, also include a reduction in recognition of the procedural co-operation as set out in the Agreement, which will enable the OFT to complete its investigation into the infringements more speedily and effectively. A reduction of up to 20 per cent
is available for procedural co-operation with the OFT’s investigation. If Asda co-operates fully as set out in the Agreement the OFT will therefore impose a penalty on Asda of £

7. In relation to the infringements, if Asda brings appeal proceedings before the CAT in respect of the OFT’s decision, the OFT reserves the right to make an application to the CAT:

   a. to increase the penalty imposed on Asda in relation to the infringements; and

   b. to require Asda to pay the OFT’s full costs of the appeal regardless of the outcome of the appeal.

8. The OFT reserves the right, without further notice, to adjust the figures in applying steps 1 to 5 of its guidance on penalties in Competition Act 1998 cases, provided the final penalty remains as set out in paragraph 6.b.iv above. In addition, the OFT reserves the right to make further adjustments that reduce the final penalty as set out in paragraph 6.b.iv above without further notice.

9. The OFT agrees that any press announcement by it concerning the Agreement shall not be made until a resolution agreement has either been signed by the last of the parties in resolution discussions or in any event no later than 31 July 2008.

10. In relation to the infringements, in the event that Asda wishes to withdraw its admission, seek access to documents on the file other than those relied on in the Statement[ ], or submit representations that exceed the scope envisaged by paragraph 4 above, Asda will notify the OFT that it is terminating the Agreement. All terms of the Agreement, including but not limited to the agreed final penalty and procedural co-operation reduction referred to at paragraph 6 above, will then cease to have effect and the OFT will pursue its investigation in accordance with the normal procedures.

11. The OFT may, subject to the provisions of paragraph 12 below, terminate the Agreement and impose a penalty in accordance with section 36 of the Competition Act 1998 in relation to the infringements if, at any time before the conclusion of the case including any proceedings before the CAT (whether by adopting a decision or otherwise), it determines that the conditions in paragraphs 1 to 8 above have not been complied with.

12. Before terminating the Agreement, the OFT shall serve written notice to Asda of the nature of the alleged non-compliance and that the OFT is considering terminating the Agreement with Asda. Asda will then be given a reasonable opportunity to respond to the notice and to remedy any breach within a reasonable period of time from the service of the notice.

13. All information, documents and other evidence provided by Asda to the OFT under the Agreement shall, notwithstanding the termination of the Agreement (whether by revocation, the conclusion of the case, including any proceedings before the CAT, in relation to the infringements or otherwise), remain the property of the OFT and may be used by the OFT to facilitate the performance of its functions by or under any enactment.

14. Nothing in the Agreement affects any of the OFT’s separate ongoing or future investigations into possible infringements of the Competition Act 1998 and/or Articles 81 and 82 of the
EC Treaty or of the Enterprise Act 2002 outside the scope of the Statement

If Asda accepts the terms set out in the Agreement, a duly authorised representative of Asda should sign the Agreement as indicated below and return a faxed copy to the OFT. The copy bearing the original signature of the duly authorised representative should then be returned to the OFT as soon as reasonably practicable thereafter. The OFT will send to Asda a counter-part of the Agreement bearing the original signature of the duly authorised representative of the OFT and will also send a faxed copy to Asda. The Agreement will become effective when Asda and the OFT have signed their respective counter-part of the Agreement.

Yours faithfully

Sonya Branch
Senior Director, Markets and Projects, Goods

cc Mark Jones, Norton Rose

SIGNED FOR AND ON BEHALF OF ASDA STORES LIMITED, ASDA GROUP LIMITED, WAL-MART STORES (UK) LIMITED AND BROADSTREET GREAT WILSON EUROPE LIMITED

Signature: [Signature]
Name: Eleanor Doohan
Position: Company Secretary
Date: 11/7/08

SIGNED FOR AND ON BEHALF OF THE OFFICE OF FAIR TRADING

Signature: [Signature]
Name: Sonya Branch
Position: Senior Director, M&F Goods
Date: 11/7/08
APPENDIX: The infringements

Asda has infringed the Chapter I prohibition of the Competition Act 1998 as set out in the Statement of Objections issued on 24 April 2008 by its involvement in:

1. an agreement and/or concerted practice with each of ITL and Gallaher that restricted the Retailer’s ability to determine its retail prices for the Manufacturer’s products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003.
Dear Sirs,

First Quench Retailing Limited, Thresher Wines Acquisitions Limited and Thresher Wines Holdings Limited (together 'First Quench')
Case CE/2596-03: Tobacco
Competition Act 1998

As you are aware, the Office of Fair Trading (the 'OFT') proposes to make a decision in terms of the Statement of Objections issued on 24 April 2008 (the 'Statement'), that First Quench and other parties set out in paragraph 4 of the Statement infringed the Chapter I prohibition of the Competition Act 1998 through:

- agreements and/or concerted practices that restricted the Retailer’s ability to determine its retail prices for the Manufacturer’s products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003 as set out in the Statement;

You have indicated First Quench’s willingness to admit its involvement in relation to all of the infringements that are applicable to it (see the appendix). You have also indicated First Quench’s

INVESTOR IN PEOPLE
willingness to co-operate in the OFT’s desire to expedite the process of concluding its investigation. Further to discussions between the OFT and First Quench, this letter (the ‘Agreement’) sets out the terms upon which the OFT would be prepared to resolve its investigation of the infringements, were First Quench to accept these terms.

1. First Quench will, by signing the Agreement, admit its involvement in the infringements on an object basis.

2. First Quench will maintain continuous and complete co-operation throughout the investigation and until the conclusion of any action by the OFT arising as a result of the investigation; and reference to such action includes any action taken by the OFT in any proceedings before the Competition Appeal Tribunal (the ‘CAT’) arising from a decision of the OFT in connection with the infringements.

3. In relation to the infringements, save as otherwise agreed by the OFT, such co-operation may include but may not be limited to, if requested by the OFT:

   a. First Quench using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to voluntarily provide the OFT with specific and valuable information (directly or indirectly) by 11 November 2008, which supports First Quench’s admission and, if applicable, supports the OFT’s findings in respect of the infringing conduct of the other parties to which the Statement addressed;

   b. First Quench using reasonable endeavours to ensure that such information is closely referenced to any available contemporaneous evidence, states the identities of the individuals involved in the infringements (their names, job description, the name of their employer), clearly outlines the infringing conduct (i.e. outlining what was said and agreed) and specifies dates and venues relevant to the infringements;

   c. First Quench using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to attend interviews in order to provide the OFT with specific and valuable information relevant to the infringements;

   d. First Quench facilitating the ability of current and former directors, officers, employees and agents to appear for such interviews as the OFT may reasonably require at the times and places reasonably designated by the OFT;

   e. First Quench using reasonable endeavours to ensure that current and former directors, officers, employees and agents who provide information to the OFT respond completely and truthfully to all questions asked in interviews;

   f. In relation to any CAT proceedings, First Quench using reasonable endeavours to facilitate and secure the complete and truthful co-operation of its current and former directors, officers, employees and agents, even if First Quench is not a party to those CAT proceedings in:

      i. assisting the OFT or its counsel in the preparation for those CAT proceedings;
ii. if requested by the OFT or its counsel, attending those CAT proceedings; and

iii. speaking to any relevant witness statements and being cross-examined on such witness statements in those CAT proceedings.

4. The OFT will accept from First Quench a concise memorandum indicating any material factual inaccuracies in the Statement[Statement], which should be received by the OFT by 23 July 2008. Should the memorandum, in the opinion of the OFT, go so far as to contest First Quench’s liability for all or any part of the infringements or represent that the penalty should be other than as set out in the Agreement, or otherwise exceed the scope identified in the previous sentence, the OFT will notify First Quench of its concerns. Should First Quench not agree promptly to amend its representations in a manner which satisfies the OFT, the OFT may treat any agreement on the terms set out in the Agreement as ceasing to have effect and shall notify First Quench accordingly.

5. In relation to the infringements, First Quench will refrain from seeking access to documents on the OFT’s file, other than those documents directly relied on and referred to in the Statement[Statement].

6. The OFT will adopt a decision in respect of the infringements which will:

   a. as to substance,

   i. set out the OFT’s findings of the facts which had taken place in materially the same form as set out in the Statement[Statement], subject to any amendments deemed necessary and appropriate by the OFT as a result of the representations referred to in paragraph 4 or equivalent representations from other recipients of the Statement[Statement];

   ii. note First Quench’s admission as to involvement in the infringements and conclude that such infringements had been committed;

   iii. have a copy of the Agreement annexed to it.

   b. as to remedy,

   i. set out the OFT’s approach to calculating the penalty in accordance with its published guidance and note that for the purpose of applying its guidance on penalties in Competition Act 1998 cases the OFT would have adopted, in the absence of resolution on the terms of the Agreement, a ‘starting point’ of per cent of relevant turnover in relation to the infringements described in the appendix to this Agreement;

   ii. set out clearly the factors considered in determining this ‘starting point’;

   iii. impose a penalty on First Quench of £ before any discount for co-operation;

   iv. note that we anticipate that the penalty figure for First Quench also includes a reduction in recognition of the procedural co-operation as set out in the Agreement, which will enable the OFT to complete its investigation into the
infringements more speedily and effectively. A reduction of up to 20 per cent is available for procedural co-operation with the OFT's investigation. If First Quench co-operates fully as set out in the Agreement the OFT will therefore impose a penalty on First Quench of £

7. In relation to the infringements, if First Quench brings appeal proceedings before the CAT in respect of the OFT's decision, the OFT reserves the right to make an application to the CAT:

   a. to increase the penalty imposed on First Quench in relation to the infringements; and

   b. to require First Quench to pay the OFT's full costs of the appeal regardless of the outcome of the appeal.

8. The OFT reserves the right, without further notice, to adjust the figures in applying steps 1 to 5 of its guidance on penalties in Competition Act 1998 cases, provided the final penalty remains as set out in paragraph 6.b.iv above. In addition, the OFT reserves the right to make further adjustments that reduce the final penalty as set out in paragraph 6.b.iv above without further notice.

9. The OFT agrees that any press announcement by it concerning the Agreement shall not be made until a resolution agreement has either been signed by the last of the parties in resolution discussions or in any event no later than 31 July 2008.

10. In relation to the infringements, in the event that First Quench wishes to withdraw its admission, seek access to documents on the file other than those relied on in the Statement envisaged by paragraph 4 above, First Quench will notify the OFT that it is terminating the Agreement. All terms of the Agreement, including but not limited to the agreed final penalty and procedural co-operation reduction referred to at paragraph 6 above, will then cease to have effect and the OFT will pursue its investigation in accordance with the normal procedures.

11. The OFT may, subject to the provisions of paragraph 12 below, terminate the Agreement and impose a penalty in accordance with section 36 of the Competition Act 1998 in relation to the infringements if, at any time before the conclusion of the case including any proceedings before the CAT (whether by adopting a decision or otherwise), it determines that the conditions in paragraphs 1 to 6 above have not been complied with.

12. Before terminating the Agreement, the OFT shall serve written notice to First Quench of the nature of the alleged non-compliance and that the OFT is considering terminating the Agreement with First Quench. First Quench will then be given a reasonable opportunity to respond to the notice and to remedy any breach within a reasonable period of time from the service of the notice.

13. All information, documents and other evidence provided by First Quench to the OFT under the Agreement shall, notwithstanding the termination of the Agreement (whether by revocation, the conclusion of the case, including any proceedings before the CAT, in relation to the infringements or otherwise), remain the property of the OFT and may be used by the OFT to facilitate the performance of its functions by or under any enactment.
14. Nothing in the Agreement affects any of the OFT's separate ongoing or future investigations into possible infringements of the Competition Act 1998 and/or Articles 81 and 82 of the EC Treaty or of the Enterprise Act 2002 outside the scope of the Statement.

If First Quench accepts the terms set out in the Agreement, a duly authorised representative of First Quench should sign the Agreement as indicated below and return a faxed copy to the OFT. The copy bearing the original signature of the duly authorised representative should then be returned to the OFT as soon as reasonably practicable thereafter. The OFT will send to First Quench a counter-part of the Agreement bearing the original signature of the duly authorised representative of the OFT and will also send a faxed copy to First Quench. The Agreement will become effective when First Quench and the OFT have signed their respective counter-part of the Agreement.

Yours faithfully

[Signature]

Sonya Branch
Senior Director, Markets and Projects, Goods

cc Jonathan Moakes, Halliwells LLP

SIGNED FOR AND ON BEHALF OF FIRST QUENCH RETAILING LIMITED, THRESHER WINES ACQUISITIONS LIMITED AND THRESHER WINES HOLDINGS LIMITED

Signature: [Signature]
Name: [Name]
Position: Director
Date: 11/7/08

SIGNED FOR AND ON BEHALF OF THE OFFICE OF FAIR TRADING

Signature: [Signature]
Name: Sonya Branch
Position: Senior Director, Ms P Goods
Date: 11/7/08
APPENDIX: The infringements

First Quench has infringed the Chapter I prohibition of the Competition Act 1998 as set out in the Statement of Objections issued on 24 April 2008 by its involvement in an agreement and/or concerted practice with each of ITL and Gallaher that restricted First Quench’s ability to determine its retail prices for the Manufacturer's products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003.
BY SPECIAL DELIVERY

Gallaher Group Limited
Members Hill
Brooklands Road
Weybridge
Surrey
KT13 0QU

FAO Andrew Bingham
Regional General Counsel, UK and
Ireland

Your ref
Our ref CE/2596-03
Date 23 June 2008

Direct line (020) 7211 8707
Fax (020) 7211 8575
Email Sonya.Branch@oft.gsi.gov.uk

Dear Sirs

Gallaher Limited and Gallaher Group Limited ('Gallaher')
Case CE/2596-03: Tobacco
Competition Act 1998

As you are aware, the Office of Fair Trading (the 'OFT') proposes to make a decision in terms of the Statement of Objections issued on 24 April 2008 (the 'Statement'), that Gallaher and other parties set out in paragraph 4 of the Statement infringed the Chapter I prohibition of the Competition Act 1998 through:

- agreements and/or concerted practices that restricted the Retailer's ability to determine its retail prices for the Manufacturer's products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003 as set out in the Statement;

You have indicated Gallaher's willingness to admit its involvement in relation to all of the infringements that are applicable to it (see the appendix). You have also indicated Gallaher's willingness to co-operate in the OFT's desire to expedite the process of concluding its investigation. Further to discussions between the OFT and Gallaher, this letter (the 'Agreement') sets out the terms upon which the OFT would be prepared to resolve its investigation of the infringements, were Gallaher to accept these terms.
1. Gallaher will, by signing the Agreement, admit its involvement in the infringements on an object basis.

2. Gallaher will maintain continuous and complete co-operation throughout the investigation and until the conclusion of any action by the OFT arising as a result of the investigation; and reference to such action includes any action taken by the OFT in any proceedings before the Competition Appeal Tribunal (the ‘CAT’) arising from a decision of the OFT in connection with the infringements.

3. In relation to the infringements, save as otherwise agreed by the OFT, such co-operation may include but may not be limited to, if requested by the OFT:
   
   a. Gallaher using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to voluntarily provide the OFT with specific and valuable information (directly or indirectly) by 24 October 2008, which supports Gallaher’s admission and, if applicable, supports the OFT’s findings in respect of the infringing conduct of the other parties to which the Statement addressed;

   b. Gallaher using reasonable endeavours to ensure that such information is closely referenced to any available contemporaneous evidence, states the identities of the individuals involved in the infringements (their names, job description, the name of their employer), clearly outlines the infringing conduct (i.e. outlining what was said and agreed) and specifies dates and venues relevant to the infringements;

   c. Gallaher using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to attend interviews in order to provide the OFT with specific and valuable information relevant to the infringements;

   d. Gallaher facilitating the ability of current and former directors, officers, employees and agents to appear for such interviews as the OFT may reasonably require at the times and places reasonably designated by the OFT;

   e. Gallaher using reasonable endeavours to ensure that current and former directors, officers, employees and agents who provide information to the OFT respond completely and truthfully to all questions asked in interviews;

   f. In relation to any CAT proceedings, Gallaher using reasonable endeavours to facilitate and secure the complete and truthful co-operation of its current and former directors, officers, employees and agents, even if Gallaher is not a party to those CAT proceedings in:

      i. assisting the OFT or its counsel in the preparation for those CAT proceedings;

      ii. if requested by the OFT or its counsel, attending those CAT proceedings; and

      iii. speaking to any relevant witness statements and being cross-examined on such witness statements in those CAT proceedings.
4. The OFT will accept from Gallaher a concise memorandum indicating any material factual inaccuracies in the Statement[ ], which should be received by the OFT by 23 July 2008. Should the memorandum, in the opinion of the OFT, go so far as to contest Gallaher's liability for all or any part of the infringements or represent that the penalty should be other than as set out in the Agreement, or otherwise exceed the scope identified in the previous sentence, the OFT will notify Gallaher of its concerns. Should Gallaher not agree promptly to amend its representations in a manner which satisfies the OFT, the OFT may treat any agreement on the terms set out in the Agreement as ceasing to have effect and shall notify Gallaher accordingly.

5. In relation to the infringements, Gallaher will refrain from seeking access to documents on the OFT's file, other than those documents directly relied on and referred to in the Statement[ ].

6. The OFT will adopt a decision in respect of the infringements which will:
   a. as to substance,
      i. set out the OFT's findings of the facts which had taken place in materially the same form as set out in the Statement[ ], subject to any amendments deemed necessary and appropriate by the OFT as a result of the representations referred to in paragraph 4 or equivalent representations from other recipients of the Statement[ ];
      ii. note Gallaher's admission as to involvement in the infringements and conclude that such infringements had been committed;
      iii. have a copy of the Agreement annexed to it.
   b. as to remedy,
      i. set out the OFT's approach to calculating the penalty in accordance with its published guidance and note that for the purpose of applying its guidance on penalties in Competition Act 1998 cases the OFT would have adopted, in the absence of resolution on the terms of the Agreement, a 'starting point' of per cent of relevant turnover (in relation to the infringements described in paragraph 1 of the appendix to this Agreement) ;
      ii. set out clearly the factors considered in determining this 'starting point';
      iii. impose a penalty on Gallaher of £ before any discount for cooperation;
      iv. note that we anticipate that the penalty figure for Gallaher also includes a reduction in recognition of the procedural co-operation as set out in the Agreement, which will enable the OFT to complete its investigation into the infringements more speedily and effectively. A reduction of up to 20 per cent is available for procedural co-operation with the OFT's investigation. If
Gallaher co-operates fully as set out in the Agreement the OFT will therefore impose a penalty on Gallaher of £[ ].

7. In relation to the infringements, if Gallaher brings appeal proceedings before the CAT in respect of the OFT’s decision, the OFT reserves the right to make an application to the CAT:
   a. to increase the penalty imposed on Gallaher in relation to the infringements; and
   b. to require Gallaher to pay the OFT’s full costs of the appeal regardless of the outcome of the appeal.

8. The OFT reserves the right, without further notice, to adjust the figures in applying steps 1 to 5 of its guidance on penalties in Competition Act 1998 cases, provided the final penalty remains as set out in paragraph 6.b.iv above. In addition, the OFT reserves the right to make further adjustments that reduce the final penalty as set out in paragraph 6.b.iv above without further notice.

9. The OFT agrees that any press announcement by it concerning the Agreement shall not be made until a resolution agreement has either been signed by the last of the parties in resolution discussions or in any event no later than 31 July 2008.

10. In relation to the infringements, in the event that Gallaher wishes to withdraw its admission, seek access to documents on the file other than those relied on in the Statement [ ], or submit representations that exceed the scope envisaged by paragraph 4 above, Gallaher will notify the OFT that it is terminating the Agreement. All terms of the Agreement, including but not limited to the agreed final penalty and procedural co-operation reduction referred to at paragraph 6 above, will then cease to have effect and the OFT will pursue its investigation in accordance with the normal procedures.

11. The OFT may, subject to the provisions of paragraph 12 below, terminate the Agreement and impose a penalty in accordance with section 36 of the Competition Act 1998 in relation to the infringements if, at any time before the conclusion of the case including any proceedings before the CAT (whether by adopting a decision or otherwise), it determines that the conditions in paragraphs 1 to 8 above have not been complied with.

12. Before terminating the Agreement, the OFT shall serve written notice to Gallaher of the nature of the alleged non-compliance and that the OFT is considering terminating the Agreement with Gallaher. Gallaher will then be given a reasonable opportunity to respond to the notice and to remedy any breach within a reasonable period of time from the service of the notice.

13. All information, documents and other evidence provided by Gallaher to the OFT under the Agreement shall, notwithstanding the termination of the Agreement (whether by revocation, the conclusion of the case, including any proceedings before the CAT, in relation to the infringements or otherwise), remain the property of the OFT and may be used by the OFT to facilitate the performance of its functions by or under any enactment.

14. Nothing in the Agreement affects any of the OFT’s separate ongoing or future investigations into possible infringements of the Competition Act 1998 and/or Articles 81 and 82 of the
EC Treaty or of the Enterprise Act 2002 outside the scope of the Statement.

If Gallaher accepts the terms set out in the Agreement, a duly authorised representative of Gallaher should sign the Agreement as indicated below and return a faxed copy to the OFT. The copy bearing the original signature of the duly authorised representative should then be returned to the OFT as soon as reasonably practicable thereafter. The OFT will send to Gallaher a counter-part of the Agreement bearing the original signature of the duly authorised representative of the OFT and will also send a faxed copy to Gallaher. The Agreement will become effective when Gallaher and the OFT have signed their respective counter-part of the Agreement.

Yours faithfully

[Signature]

Sonya Branch  
Senior Director, Markets and Projects, Goods

cc Bertrand Louveaux / Isabel Taylor, Slaughter and May

SIGNED FOR AND ON BEHALF OF GALLAHER LIMITED AND GALLAHER GROUP LIMITED

Signature: [Signature]  
Name: Andrew Bingham  
Position: Company Secretary of Gallaher Limited and Gallaher Group Limited  
Date: 2 July 2008

SIGNED FOR AND ON BEHALF OF THE OFFICE OF FAIR TRADING

Signature: [Signature]  
Name: Sonya Branch  
Position: Senior Director, M&Y Goods  
Date: 11/7/08
APPENDIX: The infringements

Gallaher has infringed the Chapter I prohibition of the Competition Act 1998 as set out in the Statement of Objections issued on 24 April 2008 by its involvement in:

1. an agreement and/or concerted practice with each of Asda, the Co-operative Group, First Quench, Morrisons, Safeway, Sainsbury, Shell, Somerfield, T&S Stores and TM Retail that restricted the Retailer’s ability to determine its retail prices for the Manufacturer’s products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003;
BY SPECIAL DELIVERY

One Stop Stores Limited and Tesco plc
Tesco House
Delamare Road
Cheshunt
Hertfordshire EN8 9SL

FAO: Lucy Neville-Rolfe,
Executive Director, Corporate and Legal Affairs

Your ref
Our ref CE/2596-03
Date 10 July 2008

Direct line (020) 7211 8707
Fax (020) 7211 8575
Email Sonya.Branch@oft.gsi.gov.uk

Dear Sirs

One Stop Stores Limited1 ('T&S Stores') and Tesco plc ('Tesco')
Case CE/2596-03: Tobacco
Competition Act 1998

As you are aware, the Office of Fair Trading (the 'OFT') proposes to make a decision in terms of
the Statement of Objections issued on 24 April 2008 (the 'Statement'), that T&S
Stores and other parties set out in paragraph 4 of the Statement infringed the Chapter I prohibition
of the Competition Act 1998 through:

- agreements and/or concerted practices that restricted the Retailer’s ability to determine its
  retail prices for the Manufacturer’s products and thereby had the objective of
  preventing, restricting or distorting competition in the supply of tobacco products in the
  United Kingdom in the period 2000 to 2003 as set out in

You have indicated T&S Stores’s willingness to admit its involvement in relation to all of the
infringements that are applicable to it (see the appendix). You have also indicated T&S Stores’s
willingness to co-operate in the OFT’s desire to expedite the process of concluding its
investigation. Further to discussions between the OFT and T&S Stores, this letter (the
'Agreement') sets out the terms upon which the OFT would be prepared to resolve its investigation

1 Formerly named T&S Stores Limited.
of the infringements, were T&S Stores and Tesco plc (in respect of T&S Stores) to accept these terms.

1. T&S Stores will, by signing the Agreement, admit its involvement in the infringements on an [object] basis.

2. T&S Stores will maintain continuous and complete co-operation throughout the investigation and until the conclusion of any action by the OFT arising as a result of the investigation; and reference to such action includes any action taken by the OFT in any proceedings before the Competition Appeal Tribunal (the 'CAT') arising from a decision of the OFT in connection with the infringements.

3. In relation to the infringements, save as otherwise agreed by the OFT, such co-operation may include but may not be limited to, if requested by the OFT:
   a. T&S Stores using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to voluntarily provide the OFT with specific and valuable information (directly or indirectly) by 11 November 2008, which supports T&S Stores's admission and, if applicable, supports the OFT's findings in respect of the infringing conduct of the other parties to which the Statement [object] addressed;
   b. T&S Stores using reasonable endeavours to ensure that such information is closely referenced to any available contemporaneous evidence, states the identities of the individuals involved in the infringements (their names, job description, the name of their employer), clearly outlines the infringing conduct (i.e. outlining what was said and agreed) and specifies dates and venues relevant to the infringements;
   c. T&S Stores using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to attend interviews in order to provide the OFT with specific and valuable information relevant to the infringements;
   d. T&S Stores facilitating the ability of current and former directors, officers, employees and agents to appear for such interviews as the OFT may reasonably require at the times and places reasonably designated by the OFT;
   e. T&S Stores using reasonable endeavours to ensure that current and former directors, officers, employees and agents who provide information to the OFT respond completely and truthfully to all questions asked in interviews;
   f. In relation to any CAT proceedings, T&S Stores using reasonable endeavours to facilitate and secure the complete and truthful co-operation of its current and former directors, officers, employees and agents, even if T&S Stores is not a party to those CAT proceedings in:
      i. assisting the OFT or its counsel in the preparation for those CAT proceedings;
      ii. if requested by the OFT or its counsel, attending those CAT proceedings; and
iii. speaking to any relevant witness statements and being cross-examined on such witness statements in those CAT proceedings.

4. The OFT will accept from T&S Stores a concise memorandum indicating any material factual inaccuracies in the Statement[ ], which should be received by the OFT by 23 July 2008. Should the memorandum, in the opinion of the OFT, go so far as to contest T&S Stores’s liability for all or any part of the infringements or represent that the penalty should be other than as set out in the Agreement, or otherwise exceed the scope identified in the previous sentence, the OFT will notify T&S Stores of its concerns. Should T&S Stores not agree promptly to amend its representations in a manner which satisfies the OFT, the OFT may treat any agreement on the terms set out in the Agreement as ceasing to have effect and shall notify T&S Stores accordingly.

5. In relation to the infringements, T&S Stores will refrain from seeking access to documents on the OFT’s file, other than those documents directly relied on and referred to in the Statement[ ].

6. The OFT will adopt a decision in respect of the infringements which will:

a. as to substance,

i. set out the OFT’s findings of the facts which had taken place in materially the same form as set out in the Statement[ ] subject to any amendments deemed necessary and appropriate by the OFT as a result of the representations referred to in paragraph 4 or equivalent representations from other recipients of the Statement[ ].

ii. note T&S Stores’s admission as to involvement in the infringements and conclude that such infringements had been committed;

iii. have a copy of the Agreement annexed to it.

b. as to remedy,

i. set out the OFT’s approach to calculating the penalty in accordance with its published guidance and note that for the purpose of applying its guidance on penalties in Competition Act 1998 cases the OFT would have adopted, in the absence of resolution on the terms of the Agreement, a ‘starting point’ of per cent of relevant turnover in relation to the infringements described in the appendix to this Agreement;

ii. set out clearly the factors considered in determining this ‘starting point’;

iii. impose a penalty on T&S Stores and Tesco plc (in respect of T&S Stores) of £[ ] before any discount for co-operation;

iv. note that we anticipate that the penalty figure for T&S Stores and Tesco plc (in respect of T&S Stores) will, after any discounts for leniency under the OFT’s leniency programme, also include a reduction in recognition of the procedural co-operation as set out in the Agreement, which will enable the OFT to complete its investigation into the infringements more speedily and
effectively. A reduction of up to 20 per cent is available for procedural co-operation with the OFT’s investigation. If T&S Stores co-operates fully as set out in the Agreement the OFT will therefore impose a penalty on T&S Stores and Tesco plc (in respect of T&S Stores) of £

7. In relation to the infringements, if T&S Stores or Tesco plc (in respect of T&S Stores) brings appeal proceedings before the CAT in respect of the OFT’s decision, the OFT reserves the right to make an application to the CAT:

a. to increase the penalty imposed on T&S Stores and Tesco plc (in respect of T&S Stores) in relation to the infringements; and

b. to require T&S Stores and Tesco plc (in respect of T&S Stores) to pay the OFT’s full costs of the appeal regardless of the outcome of the appeal.

8. The OFT reserves the right, without further notice, to adjust the figures in applying steps 1 to 5 of its guidance on penalties in Competition Act 1998 cases, provided the final penalty remains as set out in paragraph 6.b.iv above. In addition, the OFT reserves the right to make further adjustments that reduce the final penalty as set out in paragraph 6.b.iv above without further notice.

9. The OFT agrees that any press announcement by it concerning the Agreement shall not be made until a resolution agreement has either been signed by the last of the parties in resolution discussions or in any event no later than 31 July 2008.

10. In relation to the infringements, if the event that T&S Stores or Tesco plc (in respect of T&S Stores) wishes to withdraw T&S Stores’s admission, seek access to documents on the file other than those relied on in the Statement[^], or submit representations that exceed the scope envisaged by paragraph 4 above, T&S Stores and/or Tesco plc (in respect of T&S Stores) as applicable will notify the OFT that it is terminating the Agreement. All terms of the Agreement, including but not limited to the agreed final penalty and procedural co-operation reduction referred to at paragraph 6 above, will then cease to have effect and the OFT will pursue its investigation in accordance with the normal procedures.

11. The OFT may, subject to the provisions of paragraph 12 below, terminate the Agreement and impose a penalty in accordance with section 36 of the Competition Act 1998 in relation to the infringements if, at any time before the conclusion of the case including any proceedings before the CAT (whether by adopting a decision or otherwise), it determines that the conditions in paragraphs 1 to 8 above have not been complied with.

12. Before terminating the Agreement, the OFT shall serve written notice to T&S Stores and Tesco plc (in respect of T&S Stores) of the nature of the alleged non-compliance and that the OFT is considering terminating the Agreement with T&S Stores and Tesco plc (in respect of T&S Stores). T&S Stores and Tesco plc (in respect of T&S Stores) will then be given a reasonable opportunity to respond to the notice and to remedy any breach within a reasonable period of time from the service of the notice.

13. All information, documents and other evidence provided by T&S Stores, or if it chooses to do so, by Tesco plc (in respect of T&S Stores), to the OFT under the Agreement shall,
notwithstanding the termination of the Agreement (whether by revocation, the conclusion of the case, including any proceedings before the CAT, in relation to the infringements or otherwise), remain the property of the OFT and may be used by the OFT to facilitate the performance of its functions by or under any enactment.

14. Nothing in the Agreement affects any of the OFT's separate ongoing or future investigations into possible infringements of the Competition Act 1998 and/or Articles 81 and 82 of the EC Treaty or of the Enterprise Act 2002 outside the scope of the Statement.

If T&S Stores and Tesco plc (in respect of T&S Stores) accept the terms set out in the Agreement, a duly authorised representative of T&S Stores and Tesco plc (in respect of T&S Stores) should sign the Agreement as indicated below and return a faxed copy to the OFT. The copy bearing the original signature of the duly authorised representative should then be returned to the OFT as soon as reasonably practicable thereafter. The OFT will send to T&S Stores and Tesco plc (in respect of T&S Stores) a counter-part of the Agreement bearing the original signature of the duly authorised representative of the OFT and will also send a faxed copy to T&S Stores and Tesco plc (in respect of T&S Stores). The Agreement will become effective when T&S Stores, Tesco plc (in respect of T&S Stores) and the OFT have signed their respective counter-part of the Agreement.

Yours faithfully

Sonya Branch
Senior Director, Markets and Projects, Goods

cc Andrea Gomes da Silva, Freshfields

SIGNED FOR AND ON BEHALF OF ONE STOP STORES LIMITED AND TESCO PLC
Signature: Lucy Neville-Rolfe
Name: Lucy Neville-Rolfe
Position: Director
Date: 15 July 2008

SIGNED FOR AND ON BEHALF OF THE OFFICE OF FAIR TRADING
Signature: 
Name: Sonya Gomes da Silva
Position: Senior Director, Markets and Projects
Date: 11/7/08
T&S Stores has infringed the Chapter I prohibition of the Competition Act 1998 as set out in the Statement of Objections issued on 24 April 2008 by its involvement in an agreement and/or concerted practice with each of ITL and Gallaher that restricted the Retailer’s ability to determine its retail prices for the Manufacturer’s products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003.
Dear Sirs

Somercroy Stores Limited and Somercroy Limited (together 'Somercroy')
Case CE/2596-03: Tobacco
Competition Act 1998

As you are aware, the Office of Fair Trading (the 'OFT') proposes to make a decision in terms of the Statement of Objections issued on 24 April 2008 (the 'Statement'), that Somercroy and other parties set out in paragraph 4 of the Statement infringed the Chapter I prohibition of the Competition Act 1998 through:

- agreements and/or concerted practices that restricted the Retailer’s ability to determine its retail prices for the Manufacturer’s products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003 as set out in the Statement;

You have indicated Somercroy’s willingness to admit its involvement in relation to all of the infringements that are applicable to it (see the appendix). You have also indicated Somercroy’s willingness to co-operate in the OFT’s desire to expedite the process of concluding its investigation. Further to discussions between the OFT and Somercroy, this letter (the 'Agreement') sets out the terms upon which the OFT would be prepared to resolve its investigation of the infringements, were Somercroy to accept these terms.

1. Somercroy will, by signing the Agreement, admit its involvement in the infringements on an object basis.
2. Somerfield will maintain continuous and complete co-operation throughout the investigation and until the conclusion of any action by the OFT arising as a result of the investigation; and reference to such action includes any action taken by the OFT in any proceedings before the Competition Appeal Tribunal (the ‘CAT’) arising from a decision of the OFT in connection with the infringements.

3. In relation to the infringements, save as otherwise agreed by the OFT, such co-operation may include but may not be limited to, if requested by the OFT:

   a. Somerfield using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to voluntarily provide the OFT with specific and valuable information (directly or indirectly) by 11 November 2008, which supports Somerfield’s admission and, if applicable, supports the OFT’s findings in respect of the infringing conduct of the other parties to which the Statement addressed;

   b. Somerfield using reasonable endeavours to ensure that such information is closely referenced to any available contemporaneous evidence, states the identities of the individuals involved in the infringements (their names, job description, the name of their employer), clearly outlines the infringing conduct (i.e. outlining what was said and agreed) and specifies dates and venues relevant to the infringements;

   c. Somerfield using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to attend interviews in order to provide the OFT with specific and valuable information relevant to the infringements;

   d. Somerfield facilitating the ability of current and former directors, officers, employees and agents to appear for such interviews as the OFT may reasonably require at the times and places reasonably designated by the OFT;

   e. Somerfield using reasonable endeavours to ensure that current and former directors, officers, employees and agents who provide information to the OFT respond completely and truthfully to all questions asked in interviews;

   f. In relation to any CAT proceedings, Somerfield using reasonable endeavours to facilitate and secure the complete and truthful co-operation of its current and former directors, officers, employees and agents, even if Somerfield is not a party to those CAT proceedings in:

      i. assisting the OFT or its counsel in the preparation for those CAT proceedings;

      ii. if requested by the OFT or its counsel, attending those CAT proceedings; and

      iii. speaking to any relevant witness statements and being cross-examined on such witness statements in those CAT proceedings.

4. The OFT will accept from Somerfield a concise memorandum indicating any material factual inaccuracies in the Statement, which should be received by
the OFT by 23 July 2008. Should the memorandum, in the opinion of the OFT, go so far as to contest Somerfield's liability for all or any part of the infringements or represent that the penalty should be other than as set out in the Agreement, or otherwise exceed the scope identified in the previous sentence, the OFT will notify Somerfield of its concerns. Should Somerfield not agree promptly to amend its representations in a manner which satisfies the OFT, the OFT may treat any agreement on the terms set out in the Agreement as ceasing to have effect and shall notify Somerfield accordingly.

5. In relation to the infringements, Somerfield will refrain from seeking access to documents on the OFT's file, other than those documents directly relied on and referred to in the Statement.

6. The OFT will adopt a decision in respect of the infringements which will:

   a. as to substance,

      i. set out the OFT's findings of the facts which had taken place in materially the same form as set out in the Statement, subject to any amendments deemed necessary and appropriate by the OFT as a result of the representations referred to in paragraph 4 or equivalent representations from other recipients of the Statement;

      ii. note Somerfield's admission as to involvement in the infringements and conclude that such infringements had been committed;

      iii. have a copy of the Agreement annexed to it.

   b. as to remedy,

      i. set out the OFT's approach to calculating the penalty in accordance with its published guidance and note that for the purpose of applying its guidance on penalties in Competition Act 1998 cases the OFT would have adopted, in the absence of resolution on the terms of the Agreement, a 'starting point' of per cent of relevant turnover (in relation to the infringements described in paragraph 1 of the appendix to this Agreement);

      ii. set out clearly the factors considered in determining this 'starting point';

      iii. impose a penalty on Somerfield of £ before any discount for cooperation;

      iv. note that we anticipate that the penalty figure for Somerfield will, after any discounts for leniency under the OFT's leniency programme, also include a reduction in recognition of the procedural co-operation as set out in the Agreement, which will enable the OFT to complete its investigation into the infringements more speedily and effectively. A reduction of up to 20 per cent is available for procedural co-operation with the OFT's investigation. If
Somerfield co-operates fully as set out in the Agreement the OFT will therefore impose a penalty on Somerfield of £___________.

7. In relation to the infringements, if Somerfield brings appeal proceedings before the CAT in respect of the OFT's decision, the OFT reserves the right to make an application to the CAT:
   a. to increase the penalty imposed on Somerfield in relation to the infringements; and
   b. to require Somerfield to pay the OFT's full costs of the appeal regardless of the outcome of the appeal.

8. The OFT reserves the right, without further notice, to adjust the figures in applying steps 1 to 5 of its guidance on penalties in Competition Act 1998 cases, provided the final penalty remains as set out in paragraph 6.b.iv above. In addition, the OFT reserves the right to make further adjustments that reduce the final penalty as set out in paragraph 6.b.iv above without further notice.

9. The OFT agrees that any press announcement by it concerning the Agreement shall not be made until a resolution agreement has either been signed by the last of the parties in resolution discussions or in any event no later than 31 July 2008.

10. In relation to the infringements, in the event that Somerfield wishes to withdraw its admission, seek access to documents on the file other than those relied on in the Statement envisaged by paragraph 4 above, Somerfield will notify the OFT that it is terminating the Agreement. All terms of the Agreement, including but not limited to the agreed final penalty and procedural co-operation reduction referred to in paragraph 6 above, will then cease to have effect and the OFT will pursue its investigation in accordance with the normal procedures.

11. The OFT may, subject to the provisions of paragraph 12 below, terminate the Agreement and impose a penalty in accordance with section 36 of the Competition Act 1998 in relation to [the infringements] if, at any time before the conclusion of the case including any proceedings before the CAT (whether by adopting a decision or otherwise), it determines that the conditions in paragraphs 1 to 8 above have not been complied with.

12. Before terminating the Agreement, the OFT shall serve written notice to Somerfield of the nature of the alleged non-compliance and that the OFT is considering terminating the Agreement with Somerfield. Somerfield will then be given a reasonable opportunity to respond to the notice and to remedy any breach within a reasonable period of time from the service of the notice.

13. All information, documents and other evidence provided by Somerfield to the OFT under the Agreement shall, notwithstanding the termination of the Agreement (whether by revocation, the conclusion of the case, including any proceedings before the CAT, in relation to the infringements or otherwise), remain the property of the OFT and may be used by the OFT to facilitate the performance of its functions by or under any enactment.
14. Nothing in the Agreement affects any of the OFT's separate ongoing or future investigations into possible infringements of the Competition Act 1998 and/or Articles 81 and 82 of the EC Treaty or of the Enterprise Act 2002 outside the scope of the Statement.

If Somerfield accepts the terms set out in the Agreement, a duly authorised representative of Somerfield should sign the Agreement as indicated below and return a faxed copy to the OFT. The copy bearing the original signature of the duly authorised representative should then be returned to the OFT as soon as reasonably practicable thereafter. The OFT will send to Somerfield a counter-part of the Agreement bearing the original signature of the duly authorised representative of the OFT and will also send a faxed copy to Somerfield. The Agreement will become effective when Somerfield and the OFT have signed their respective counter-part of the Agreement.

Yours faithfully

Sonia Branch  
Senior Director, Markets and Projects, Goods

cc Bill Hull/Nicola Kingaby, TLT Solicitors

SIGNED FOR AND ON BEHALF OF SOMERFIELD STORES LIMITED AND SOMERFIELD LIMITED

Signature: 
Name: DAV. D. CHEYNE  
Position: GROUP FINANCE DIRECTOR  
Date: 9th July 2008

SIGNED FOR AND ON BEHALF OF THE OFFICE OF FAIR TRADING

Signature: 
Name: SONIA BRANCH  
Position: SENIOR DIRECTOR, MER P GSDS  
Date: 1/9/08
APPENDIX: The infringements

Somerfield has infringed the Chapter I prohibition of the Competition Act 1998 as set out in the Statement of Objections issued on 24 April 2008 by its involvement in:

1. an agreement and/or concerted practice with each of ITL and Gallaher that restricted the Retailer’s ability to determine its retail prices for the Manufacturer’s products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003.
BY SPECIAL DELIVERY

TM Retail Limited and Martin McColl
Retail Group Limited
Martin McColl House
Ashwells Road
Pilgrims Hatch
Brentwood
Essex, CM15 9ST

FAO Martlyn Aguss
Director, Martin McColl Retail Group Limited

Your ref CE/2596-03
Date 9 July 2008

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Dear Sirs

TM Retail Limited and Martin McColl Retail Group Limited (together "TM Retail")
Case CE/2596-03: Tobacco
Competition Act 1998

As you are aware, the Office of Fair Trading (the "OFT") proposes to make a decision in terms of
the Statement of Objections issued on 24 April 2008 (the "Statement") that TM Retail
and other parties set out in paragraph 4 of the Statement infringed the Chapter I prohibition of the
Competition Act 1998 through:

• agreements and/or concerted practices that restricted the Retailer's ability to determine its
  retail prices for the Manufacturer's products and thereby had the object of
  preventing, restricting or distorting competition in the supply of tobacco products in the
  United Kingdom in the period 2000 to 2003, as set out in

You have indicated TM Retail's willingness to admit its involvement in relation to all of the
infringements that are applicable to it (see the appendix). You have also indicated TM Retail's
willingness to co-operate in the OFT's desire to expedite the process of concluding its
Investigation. Further in discussions between the OFT and TM Retail, this letter (the "Agreement")
sets out the terms upon which the OFT would be prepared to resolve its investigation of the
infringements, were TM Retail to accept these terms.
1. TM Retail will, by signing the Agreement, admit its involvement in the infringements on an object basis.

2. TM Retail will maintain continuous and complete co-operation throughout the investigation and until the conclusion of any action by the OFT arising as a result of the investigation; and reference to such action includes any action taken by the OFT in any proceedings before the Competition Appeal Tribunal (the "CAT") arising from a decision of the OFT in connection with the infringements.

3. In relation to the infringements, save as otherwise agreed by the OFT, such co-operation may include but may not be limited to, if requested by the OFT:
   
a. TM Retail using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to voluntarily provide the OFT with specific and valuable information (directly or indirectly) by 11 November 2008, which supports TM Retail's admission and, if applicable, supports the OFT's findings in respect of the infringing conduct of the other parties to which the Statement addressed;

b. TM Retail using reasonable endeavours to ensure that such information is closely referenced to any available contemporaneous evidence, states the identities of the individuals involved in the infringements (their names, job description, the name of their employer), clearly outlines the infringing conduct (i.e. outlining what was said and agreed) and specifics dates and venues relevant to the infringements;

c. TM Retail using reasonable endeavours to secure the complete and truthful co-operation of its current and former directors, officers, employees and agents and encouraging such persons to attend interviews in order to provide the OFT with specific and valuable information relevant to the infringements;

d. TM Retail facilitating the ability of current and former directors, officers, employees and agents to appear for such interviews as the OFT may reasonably require at the times and places reasonably designated by the OFT;

e. TM Retail using reasonable endeavours to ensure that current and former directors, officers, employees and agents who provide information to the OFT respond completely and truthfully to all questions asked in interviews;

f. In relation to any CAT proceedings, TM Retail using reasonable endeavours to facilitate and secure the complete and truthful co-operation of its current and former directors, officers, employees and agents, even if TM Retail is not a party to those CAT proceedings in:
   
   i. assisting the OFT or its counsel in the preparation for those CAT proceedings;

   ii. if requested by the OFT or its counsel, attending those CAT proceedings; and

   iii. speaking to any relevant witness statements and being cross-examined on such witness statements in those CAT proceedings.
4. The OFT will accept from TM Retail a conciso memorandum indicating any material factual inaccuracies in the Statement[________], which should be received by the OFT by 23 July 2008. Should the memorandum, in the opinion of the OFT, go so far as to contest TM Retail’s liability for all or any part of the infringements or represent that the penalty should be other than as set out in the Agreement, or otherwise exceed the scope identified in the previous sentence, the OFT will notify TM Retail of its concerns. Should TM Retail not agree promptly to amend its representations in a manner which satisfies the OFT, the OFT may treat any agreement on the terms set out in the Agreement as ceasing to have effect and shall notify TM Retail accordingly.

5. In relation to the infringements, TM Retail will refrain from seeking access to documents on the OFT’s file, other than those documents directly relied on and referred to in the Statement[________].

6. The OFT will adopt a decision in respect of the infringements which will:

a. as to substance,

i. set out the OFT’s findings of the facts which had taken place in materially the same form as set out in the Statement[________], subject to any amendments deemed necessary and appropriate by the OFT as a result of the representations referred to in paragraph 4 or equivalent representations from other recipients of the Statement[________];

ii. note TM Retail’s admission as to involvement in the infringements and conclude that such infringements had been committed;

iii. have a copy of the Agreement annexed to it.

b. as to remedy,

i. set out the OFT’s approach to calculating the penalty in accordance with its published guidance and note that for the purpose of applying its guidance on penalties in Competition Act 1998 cases the OFT would have adopted, in the absence of resolution on the terms of the Agreement, a ‘starting point’ of [_____] per cent of relevant turnover in relation to the infringements described in the appendix to this Agreement;

ii. set out clearly the factors considered in determining this ‘starting point’;

iii. impose a penalty on TM Retail of £[_____] before any discount for cooperation;

iv. note that we anticipate that the penalty figure for TM Retail also includes a reduction in recognition of the procedural co-operation as set out in the Agreement, which will enable the OFT to complete its investigation into the infringements more speedily and effectively. A reduction of up to 20 per cent is available for procedural co-operation with the OFT’s investigation. If TM Retail co-operates fully as set out in the Agreement the OFT will therefore impose a penalty on TM Retail of £[_____].
7. In relation to the infringements, if TM Retail brings appeal proceedings before the CAT in respect of the OFT's decision, the OFT reserves the right to make an application to the CAT:
   a. to increase the penalty imposed on TM Retail in relation to the infringements; and
   b. to require TM Retail to pay the OFT's full costs of the appeal regardless of the outcome of the appeal.

8. The OFT reserves the right, without further notice, to adjust the figures in applying steps 1 to 5 of its guidance on penalties in Competition Act 1998 cases, provided the final penalty remains as set out in paragraph 6.b.iv above. In addition, the OFT reserves the right to make further adjustments that reduce the final penalty as set out in paragraph 6.b.iv above without further notice.

9. The OFT agrees that any press announcement by it concerning the Agreement shall not be made until a resolution agreement has either been signed by the last of the parties in resolution discussions or in any event no later than 31 July 2008.

10. In relation to the infringements, in the event that TM Retail wishes to withdraw its admission, seek access to documents on the file other than those relied on in the Statement or submit representations that exceed the scope envisaged by paragraph 4 above, TM Retail will notify the OFT that it is terminating the Agreement. All terms of the Agreement, including but not limited to the agreed final penalty and procedural co-operation reduction referred to at paragraph 6 above, will then cease to have effect and the OFT will pursue its investigation in accordance with the normal procedures.

11. The OFT may, subject to the provisions of paragraph 12 below, terminate the Agreement and impose a penalty in accordance with section 36 of the Competition Act 1998 in relation to the infringements if, at any time before the conclusion of the case including any proceedings before the CAT (whether by adopting a decision or otherwise), it determines that the conditions in paragraphs 1 to 8 above have not been complied with.

12. Before terminating the Agreement, the OFT shall serve written notice to TM Retail of the nature of the alleged non-compliance and that the OFT is considering terminating the Agreement with TM Retail. TM Retail will then be given a reasonable opportunity to respond to the notice and to remedy any breach within a reasonable period of time from the service of the notice.

13. All information, documents and other evidence provided by TM Retail to the OFT under the Agreement shall, notwithstanding the termination of the Agreement (whether by revocation, the conclusion of the case, including any proceedings before the CAT, in relation to the infringements or otherwise), remain the property of the OFT and may be used by the OFT to facilitate the performance of its functions by or under any enactment.

14. Nothing in the Agreement affects any of the OFT's separate ongoing or future investigations into possible infringements of the Competition Act 1998 and/or Articles 81 and 82 of the EC Treaty or of the Enterprise Act 2002 outside the scope of the Statement
If TM Retail accepts the terms set out in the Agreement, a duly authorised representative of TM Retail should sign the Agreement as indicated below and return a faxed copy to the OFT. The copy bearing the original signature of the duly authorised representative should then be returned to the OFT as soon as reasonably practicable thereafter. The OFT will send to TM Retail a counter-part of the Agreement bearing the original signature of the duly authorised representative of the OFT and will also send a faxed copy to TM Retail. The Agreement will become effective when TM Retail and the OFT have signed their respective counterparts of the Agreement.

Yours faithfully

Sonya Branch
Senior Director, Markets and Projects, Goods

cc Nigel Saay, Travers Smith

SIGNED FOR AND ON BEHALF OF TM RETAIL LIMITED

Signature: 
Name: J Lancaster
Position: CHAIRMAN
Date: 10/07/2008

SIGNED FOR AND ON BEHALF OF MARTIN MCCOLL RETAIL GROUP LIMITED

Signature: 
Name: J Lancaster
Position: CHAIRMAN
Date: 10/07/2008

SIGNED FOR AND ON BEHALF OF THE OFFICE OF FAIR TRADING

Signature: 
Name: Sonya Branch
Position: SENIOR DIRECTOR, MD & GMB
Date: 11/07/08
APPENDIX: The Infringements

TM Retail has infringed the Chapter I prohibition of the Competition Act 1998 as set out in the Statement of Objections issued on 24 April 2008 by its involvement in an agreement and/or concerted practice with each of ITL and Galliker that restricted the Retailer's ability to determine its retail prices for the Manufacturer's products and thereby had the object of preventing, restricting or distorting competition in the supply of tobacco products in the United Kingdom in the period 2000 to 2003.