THE MONOPOLIES COMMISSION

Report on the Supply of Cigarettes and Tobacco and of Cigarette and Tobacco Machinery

Presented to Parliament in pursuance of Section 9 of the Monopolies and Restrictive Practices (Inquiry and Control) Act, 1948

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218

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CONTENTS

APPENDICES

PRINCIPAL ABBREVIATIONS USED IN THE REPORT

Amfoco	American Machine & Foundry Company (British subsidiary: AMF Ltd.)
Ardath	Ardath Tobacco Company Ltd.
Ardath (U.K.)	Ardath (U.K.) Ltd.
B.A.T.	British-American Tobacco Company, Limited
Bewlay	Bewlay (Tobacconists) Limited (Formerly Salmon & Gluckstein Limited)
Carreras	Carreras Limited
C.W.S.	Co-operative Wholesale Society Limited
Federation, The	The Federation of Home & Export Tobacco Manufacturers
Finlay	Finlay & Company Limited
Gallaher	Gallaher Limited
Godfrey Phillips	Godfrey Phillips Limited
Hauni London	Hauni London Limited
Imperial	The Imperial Tobacco Company (of Great Britain and Ireland), Limited
Molins	Molins Machine Company Limited
N.U.R.T.	The National Union of Retail Tobacconists
Robert Legg	Robert Legg, Ltd.
Robert Sinclair	The Robert Sinclair Tobacco Company, Limited
Rothmans	Rothmans Ltd.
S.C.W.S.	Scottish Co-operative Wholesale Society, Ltd.
T.A.C.	The Tobacco Manufacturers' Advisory Committee
Thrissell	The Thrissell Engineering Company Limited (Formerly Brecknell, Munro & Rogers Limited)
T.T.A.	The Tobacco Trade Association
J. Wix	J. Wix & Sons Limited
W.T.T.A.	The Wholesale Tobacco Trade Association of Great Britain (and Northern Ireland)

REPORT ON THE SUPPLY OF CIGARETTES AND TOBACCO AND OF CIGARETTE AND TOBACCO MACHINERY

Introduction

(i) The following report on the supply in the United Kingdom of (1) cigarettes and manufactured cigarette and pipe tobacco and (2) machinery for the manufacture or packaging of cigarettes or of cigarette or pipe tobacco is submitted in compliance with Section 2(1) of the Monopolies and Restrictive Practices (Inquiry and Control) Act, 1948 (as amended). The two references (reproduced in Appendix 1) were received from the Board of Trade on 29th November, 1956. As the two subjects are closely connected we have dealt with both references in one report.

(ii) We have received evidence from The Imperial Tobacco Company (of Great Britain and Ireland) Limited (Imperial), the principal supplier of cigarettes and tobacco and the principal purchaser of machinery, and from Molins Machine Company Limited (Molins), the principal supplier of machinery.

(iii) We have also received evidence from other cigarette and tobacco manufacturers and their trade association, from other machinery manufacturers, from wholesale and retail distributors of tobacco goods and their trade associations, from leaf merchants and from the Government Departments concerned and the former Tobacco Controller. From some of these witnesses we took oral evidence after we had considered their written submissions. A list of our principal sources of evidence is given in Appendix 2. Members of the Commission and staff visited certain cigarette and tobacco factories and one of Molins' factories.

(iv) In June 1959 representatives of Imperial attended a meeting to clarify outstanding matters of fact, and in July 1959 representatives of Molins attended a similar meeting.

(v) In September 1959 we informed Molins of our provisional conclusion that the conditions of the 1948 Act, as amended by the 1956 Act, prevailed in respect of machinery. In October 1959 we informed Imperial both of this provisional conclusion and of our similar provisional conclusion in respect of cigarettes and tobacco. Both Imperial and Molins made certain representations to us in writing. In December 1959 and March 1960 respectively representatives of Molins and of Imperial attended separate hearings for the purpose of discussing with us whether the " conditions " or any of the " things done " operated or might be expected to operate against the public interest. At these two hearings the parties concerned were represented by Counsel. A further short hearing was held with Imperial in October 1960 to deal with certain developments which occurred at a late stage in the inquiry.

(vi) We wish to record our appreciation of the assistance given to us by Imperial, Molins and all the others who have provided us with the information required in our investigation. Some of the information relates to confidential business affairs and we have been careful not to disclose it in our report unless it is essential for a proper understanding of the issues.

PART I. CIGARETTES AND TOBACCO

CHAPTER 1. GENERAL BACKGROUND

(1) Description of the Goods

1. The goods to which the terms of the first of our references apply are cigarettes and manufactured cigarette and pipe tobacco. The total sales of these goods in the home market at manufacturers' selling prices in each of the years 1954 to 1959* are shown in the table below:—

	Cigarettes	Tobacco	Total
	£ million	£ million	£ million
1954	680·9	95·6	776·5
1955	712·3	94·5	806·8
1956	748·7	93·7	842·4
1957	793·1	97·6	890·7
1958	813·6	100·6	914·2
1959	833·4	99·7	933·1

These figures do not include imports, but the quantity, by weight, of imports of cigarettes and tobacco was not more than 0·2 per cent. of the volume of total† home market sales in any of these years.

2. With negligible exceptions all cigarettes and tobaccos supplied on the home market are sold under manufacturers' brand names. Cigarettes represented on average 88·7 per cent. of sales, by value, in these six years. The greater part of the cigarette trade (about 89 per cent. in 1959) is in plain, as distinct from filter tipped,‡ brands. Plain cigarettes can be divided into three main classes principally on the basis of price and size. The first consists of brands most of which sell at 1s. 7d. for 10 cigarettes, each with a length of about 66 mm. and a circumference of about 23 mm. The second consists of brands most of which sell at 2s. 0½d. for 10 cigarettes, each with a length of between 70 and 74 mm. and a circumference of from 25 to 25·5 mm. Most of the cigarettes sold are and have been for many years in these two classes. The third class consists of brands sold at higher prices, the cigarettes often being of larger dimensions. For convenience in our report we refer to the three classes as small, medium and large cigarettes. Filter tipped cigarettes, of which many

* Not all manufacturers work to calendar years. The table is based on figures for the nearest calendar year in each case.

† Value figures for imports given in the Annual Statement of the Trade of the United Kingdom exclude duty and so do not afford a fair comparison with the figures for sales of home-produced tobacco goods, which include duty.

‡ We use the term " filter tipped " throughout our report as being that most readily understood and to avoid confusion with brands having (external) cork tips. The term is not universally used by manufacturers in this country and our use of it does not imply any judgment on the filtering properties of the tips concerned.

brands have been introduced in recent years, range in price and size from brands which sell at 1s. 4d. for 10 and which have the same overall dimensions (including filter tip) as the small untipped brands, to king size brands which sell at 2s. 0½d. for 10; king size cigarettes have a tobacco content equivalent to that in a medium untipped cigarette, but the overall length is greater owing to the addition of the filter. Almost all brands of cigarettes at present on sale on the home market contain "Virginia" type, flue-cured leaf (see paragraph 6 below). There is a small demand for cigarettes containing other types of leaf (Greek or Turkish for example). With very few exceptions all cigarettes are machine made.

3. Cigarette and pipe tobaccos are of eight main types:—

Type	Characteristics and Use
Shag (Light and Dark)* ..	A finely cut tobacco (about 80–90 cuts per inch) suitable either for hand-rolling into cigarettes or for pipe smoking. Generally without additional flavouring.
Honeydew and Fancy Scented ..	Less finely cut than a shag (40–50 cuts per inch). Generally flavoured. Suitable for hand-rolling or for pipe smoking.
Mixture	A mixture of dark and light tobaccos with a broad cut (about 25 cuts to the inch). Suitable for pipe smoking.
Flake and Cut Plug	A sliced tobacco, cut from pressed cakes or bars. Some brands are flavoured. Sold either in flake form or ready rubbed. Suitable for pipe smoking.
Navy Cut	Similar to flakes and cut plugs, but less heavily pressed and lighter in colour. Suitable for pipe smoking.
Plug and Bar	Heavily pressed tobacco for pipe smoking or chewing. Sold in oblong blocks.
Roll and Pigtail (also known as Twist)	Pressed spun tobacco, for pipe smoking or chewing. This type varies in thickness from about one-sixth of an inch (pigtail) to 1¼ inches (thick roll).
Fancy Tobacco	These tobaccos undergo some distinctive process and do not fit in readily with any of the other types. They may, for example, be spun and then sliced; they may be sweetened tobaccos. Suitable for pipe smoking.

We describe the various manufacturing processes in paragraphs 15 to 23 below. Plug, bar, roll and pigtail are also referred to as hard tobaccos; they are old-fashioned and cheaper than most other types. The market for them, and indeed for all pipe tobaccos, is a dwindling one.

(2) The Manufacturers

4. The table overleaf shows the level of sales of the nine largest manufacturers in recent years, with the number of factories operated by each in 1959. In addition to those named, there are a number of smaller manufacturers (sixteen in 1959).

* The terms "light" and "dark" relate to the colour of the leaf, see paragraph 6.

Manufacturer	Sales of Cigarettes and Tobacco (*a*)						No. of Factories 1959
	1954	1955	1956	1957	1958	1959	
	£'000	£'000	£'000	£'000	£'000	£'000	
The Imperial Tobacco Co. (of Great Britain and Ireland) Limited (Imperial)	585,377	636,013	641,226	635,700	617,723	591,856	15
Gallaher Limited (Gallaher)	87,321	122,749	156,325	200,279	238,992	273,580	6 (*b*)
J. Wix & Sons Limited (J. Wix)	17,313	1,919	2,975	12,725	15,461	23,799	1
Carreras Limited (Carreras)	59,395	26,199	22,036	21,813	20,106	20,339	3
Rothmans Limited (Rothmans).. ..	56	195	694	1,924	4,767	8,562	1
Godfrey Phillips Limited (Godfrey Phillips) ..	7,005	7,537	8,829	8,458	7,977	6,855	2
Scottish Co-operative Wholesale Society Limited (S.C.W.S.)	3,898	3,231	3,380	3,371	3,285	2,910	1
Co-operative Wholesale Society Limited (C.W.S.)	3,418	2,157	2,111	2,174	2,082	1,923	1
Ardath Tobacco Company Limited (Ardath)	8,118	2,585	1,492	1,696	1,632	1,525	1
Others	4,628	4,226	3,303	2,600 (*c*)	2,200 (*c*)	1,800 (*c*)	
Total	776,529	806,811	842,371	890,740	914,225	933,149	

(*a*) Not all manufacturers' sales figures are for calendar years (e.g. Imperial's figures are for years ended 31st October). In such cases the figures have been allocated to the nearest calendar year.

(*b*) Including one very small factory making limited quantities of special cigarettes.

(*c*) Estimated figures.

Of the nine larger manufacturers mentioned, Imperial alone makes a full range of all types of cigarettes and tobacco; of the others, five (Carreras, Gallaher, Godfrey Phillips, C.W.S. and S.C.W.S.) make limited ranges of both cigarettes and tobacco and two (Rothmans and J. Wix) make only cigarettes. The ninth (Ardath) until 1960 was making cigarettes and also marketing its own brands of tobacco which were made for it by another manufacturer.* Of the small manufacturers, none makes a full range; five make both cigarettes and tobacco, five make cigarettes only and six tobacco only. It is estimated that the sixteen smaller undertakings supplied only about 0·2 per cent. by value of the total trade in 1959. The British-American Tobacco Co. Ltd. (B.A.T.), which does not supply on the home market, operates two factories in the United Kingdom. B.A.T. manufactures, or has manufactured for it, in the United Kingdom for export approximately 20 million lb. of cigarettes and 1½ million lb. of tobacco a year, which is equivalent to approximately 8 per cent. of the total home market sales in 1959. There are certain special relationships, financial or otherwise, between some of the manufacturers mentioned above. Imperial's financial

* But see paragraph 183. The Ardath business was reorganised in 1960 and Ardath (U.K.) Ltd., the newly formed company which now markets the Ardath brands in the United Kingdom, does not make its own cigarettes or tobacco.

interests in B.A.T., Gallaher and Ardath are referred to in Chapters 3 and 4; the financial relationship between Carreras and Rothmans and the marketing agreement made in 1960 between Godfrey Phillips and the newly formed Ardath (U.K.) Ltd. are referred to in Chapter 4.

5. All the larger manufacturers except Imperial, and most of the smaller manufacturers, are members of the Federation of Home & Export Tobacco Manufacturers (the Federation), a trade association established " to provide a forum for the discussion of matters affecting the industry of manufacturing, in Great Britain and Northern Ireland, tobacco products for home consumption or for export " and " to promote measures for the protection and advancement of the said industry and those interested therein ". B.A.T. is a member of this body. All the larger manufacturers except the Co-operative Wholesale Societies are also members of the Tobacco Manufacturers' Standing Committee formed to further research into the relationship between smoking and health (see paragraph 42). Four of the largest manufacturers supplying the home market, and B.A.T., are represented on the Tobacco Manufacturers' Advisory Committee (T.A.C.) (see paragraphs 70 and 99). The tobacco manufacturers are also represented jointly with the Trade Unions concerned on The Tobacco Manufacturing Consultative Committee, and on The National Joint Negotiating Committee for the Tobacco Industry.

(3) MATERIALS

(a) *Tobacco Leaf*

6. The principal material used in the manufacture of both cigarettes and tobacco is, of course, tobacco leaf. Leaf used for smoking in the United Kingdom is of the species *nicotiana tabacum,* of which there are many varieties, each with different characteristics in, for example, flavour, body or yield: different varieties are cured by different methods. The table below gives particulars of the normal classifications, methods of curing, producing countries and uses of leaf smoked in the United Kingdom:—

Type	Method of Curing	Principal Producing Countries	Use
Flue-cured ..	The leaves are hung in wholly enclosed barns. The curing process is carried out by conveying heat through sheet-iron flues running across the floor. No smoke comes into contact with the leaves. The process takes about four days and turns the leaves to colours varying from bright lemon to orange. The doors of the barn are then opened and the cured leaf is allowed to soften by absorbing moisture from the atmosphere.	U.S.A. Canada Rhodesia Nyasaland India	Cigarettes Tobacco (cigarette and pipe)
Fire-cured ..	The leaves are hung in open barns over trenches in which wood fires are kept burning for from one to six weeks, according to the degree of firing required. The smoke turns the leaves dark brown.	U.S.A. Nyasaland	Tobacco (pipe)
Air-cured ..	The leaves are hung in open barns for about two months. They gradually turn a light reddish-brown.	U.S.A. India	Tobacco (cigarette and pipe)

Type	Method of Curing	Principal Producing Countries	Use
Sun-cured ..	The leaves are exposed to the sun on the ground or on racks before being transferred to open barns. They turn a dark reddish-brown.	Nyasaland India	Tobacco (cigarette and pipe)
Burley ..	A type of air-cured tobacco grown originally in the U.S.A. After the complete plant has been cut and split down the stalk, it is suspended in open barns having free circulation of air.	U.S.A. Canada Rhodesia India Nyasaland	Tobacco (cigarette and pipe)
Oriental ..	These aromatic leaves are cured in the sun and subsequently bulked in sheds awaiting handling and baling.	Greece Turkey	Cigarettes
Perique ..	The plants are cut whole and hung in barns to cure. The leaves are then stripped from the main stem, made into twists and packed into boxes to which very heavy pressure is applied. This process is repeated over several months, during which time the leaf acquires its characteristic aroma.	Louisiana, U.S.A.	Tobacco (pipe)
Latakia ..	The leaves are small and are usually cured on the stalk in smoke houses, the plants being hung over fire pits and fumigated by the smoke from burning pine or oak brushwood. The process normally takes about three months.	Syria Cyprus	Tobacco (pipe)

7. After curing the leaf is graded by the growers according to colour, ripeness, length and other qualities. There is a considerable range of grades of each type of leaf and a considerable range of prices from the top to the bottom grades. In the United States, Canada, Rhodesia and Nyasaland leaf is bought at auction;* in other cases it may be bought direct from the grower. Some United Kingdom manufacturers (Imperial, Carreras, Gallaher, Godfrey Phillips) have their own leaf buying organisations; they may also buy leaf from certain producing countries through agents or merchants in the country of origin or in the United Kingdom. The smaller manufacturers normally buy from merchants or brokers. Virtually all tobacco leaf used in commercial manufacture is imported. Efforts to grow tobacco in the United Kingdom have been made from time to time; a very small amount is produced in this country, but this is for the most part for the grower's personal use. Figures for imports of unmanufactured tobacco in each of the years 1900 to 1958, according to country of origin, are given in Appendix 7, Table 1. Of all imports of leaf in 1958, 51·9 per cent. by weight was from the United States, 23·6 per cent. from Rhodesia and Nyasaland, 14·1 per cent. from India and 7·4 per cent. from Canada. Some 90 per cent. of all imported leaf is flue-cured.

8. Nearly all leaf is imported into the United Kingdom in wooden casks containing between 700 lb. and 1,000 lb.: Oriental leaf from Turkey, of which only small quantities are used, is imported in bales. Generally the whole leaf is imported, but some leaf from Rhodesia and India is imported in strips, that is, after the midrib or main stem has been removed in the country of origin. On arrival in the United Kingdom the leaf is placed in a bonded warehouse where it now normally remains for eighteen months, during which time it matures.†

* In some countries, particularly the United States, Government graders classify the leaf before auction according to an official grading code.

† Before the war it was normal for leaf to remain in bond for two years.

(b) *Other Material used in the Manufacture and Packing of Cigarettes and Tobacco*

9. The main material apart from leaf used in the manufacture of cigarettes is cigarette paper, a light-weight tissue made from pure cellulose originating from jute, hemp or flax, with a loading of chalk containing 99·5 per cent. calcium carbonate and with no other chemicals. The main criteria in judging the quality of cigarette paper are (i) tensile strength and stretch, which affect running properties in the cigarette machine, (ii) porosity, which affects, *inter alia*, the rate of burning, (iii) opacity, which affects the appearance and particularly the whiteness of the paper. Other materials required are starch and dextrine for sticking the lap of cigarette paper and, in the appropriate cases, cork tipping (a tinted paper sprayed with very fine granulated cork or natural cork laminated to tissue) and filter tips (or plugs) of various types.*

10. Most cigarettes are packed in cartons containing 10 or 20.† There are two types of carton: hull and slide, which works on a principle broadly similar to that of a matchbox, the carton consisting of two component parts (this is the earlier and more general type); and hinged lid, where the carton is in one piece, the top being hinged and opening backwards to disclose the tops of the cigarettes. Other types of packing include paper cups (i.e. open-ended packets) mostly containing 5 cigarettes, cardboard boxes of capacities varying from 10 to 100 but usually containing 50 or 100, and tins usually containing 50.

11. Cartons and boxes generally have foil and tissue " liners ". The medium-priced and more expensive brands have cellulose wrappers. Foil and tissue reduce the effects of shaking on the contents, and these and cellulose wrapping help to maintain an even moisture content.

12. The only materials other than leaf and water used in the manufacture of cigarette and pipe tobacco are the flavouring essences required for certain types, olive oil and nut arachis oil for roll tobacco, acetic acid (which is used to prevent mould in tobaccos with a relatively high moisture content) and sweetening materials used in the manufacture of certain brands.‡

13. Tobaccos are sold in soft packings, generally in ½-oz., 1-oz. and 2-oz. sizes, using various combinations of waxed and unwaxed paper liners, paper-backed foil, cardboard cartons, printed labels and wrappers, and cellulose film. They may also be packed in 1-oz., 2-oz., 4-oz. and 1-lb. tins, mostly airtight.

(c) *Materials used in Parcelling and Packaging Cigarettes and Tobacco*

14. The cartons, tins or packets of cigarettes or tobacco described above are subsequently assembled in parcels each containing a number of the basic units of quantity or weight. These parcels take the form of paper or cellulose film wrappers, paper bags and collapsible cardboard boxes. The goods are finally despatched in solid or corrugated fibreboard packing cases. Parcelling materials include a number of miscellaneous items such as cord, wire, glue, tape and brown paper.

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* There are many types of plug and these can be made from crepe paper, tissue, cellulose wadding and cotton wool or combinations of these materials or cellulose acetate filaments.

† In this report " packing " means assembling the product in the container in which it is normally sold retail (e.g. 5, 10 or 20 cigarettes in a carton or 1 oz. or 2 oz. of tobacco in a packet or tin); " parcelling " means assembling these units in parcels containing up to 500 cigarettes or 1 lb. of tobacco; " packaging " means assembling such parcels in still larger units (see paragraphs 14 and 23).

‡ Sweetened brands must be manufactured in bonded factories (see paragraph 34 below).

(4) Manufacturing Processes

15. The manufacturing processes described below are common to most manufacturers; there are variations in method or sequence as between manufacturers, however, particularly in the preliminary stage. The principal types of machines used are described more fully in Chapter 8.

(a) *Preliminary Leaf Processing*

16. The initial preparation of the tobacco leaf is generally similar whether it is intended to manufacture cigarettes, cigarette tobacco or pipe tobacco. The leaf, in casks or bales each containing one type and grade, is cleared from bonded warehouse on payment of duty and taken into the factory where the outer packaging is removed. The leaf is tightly packed and is in relatively dry condition, with a moisture content normally of between 10 and 13 per cent. The necessary quantities of each type and grade of leaf to make the required quantities of a given brand according to the formula or recipe for that brand undergo conditioning so as to increase the moisture content of the leaf until it becomes soft and pliable and can be handled without breaking. Blending of the various types and grades may take place either before or after conditioning.

17. Except when leaf has been imported in strips (see paragraph 8) the next process is stemming. The stem which runs through the middle of the leaf is removed either by hand or, more commonly, by machine. There are two alternative machine processes: in the first the leaf passes through a stemming machine which cuts out the stem; in the second it passes through a threshing machine which threshes the leaf, the heavy particles (the stem) being separated from the light particles (the lamina) by air suction. Turkish leaf is too small to need stemming. After stemming the lamina and that part of the stem which is to be used in manufacture go through different processes. The stem not required in manufacture is deposited with H.M. Customs and Excise for duty drawback.

(b) *Manufacture of Cigarettes*

18. The lamina now undergoes a bulking process during which moisture lost through evaporation during stemming is replaced, and the leaf is allowed to stand for one or two days so that the moisture may spread evenly. The stems are moistened to soften them, after which they are flattened in a crushing machine.

19. The next process is cutting. The lamina is fed to machines which cut it into long, fine shreds. The stem is cut separately into fine shreds. After being dried and cooled, the cut stem is added to the cut lamina according to the formula for the particular brand. The resulting cut cigarette tobacco, or " rag ", is passed through a rotary drier where it is shaken out and loses excess moisture, a process which also brings out the aroma of the tobacco. From the drier the rag passes through a rotary cooler where its temperature is reduced by air flow, during which process fine particles of tobacco, sand and dust are removed. The rag is then conveyed to store rooms where the temperature and humidity are controlled, to await manufacture into cigarettes.

20. The cigarette paper is purchased rolled on bobbins, the rolls being about eighteen inches in diameter and of a width slightly more than the circumference of the cigarette. As the paper is unrolled and fed into the machine a printing mechanism, which is part of the machine, automatically prints the brand name

and other particulars on the paper. The paper entering the machine is met by the tobacco fed from hoppers. The paper is rolled lengthways round the tobacco and stuck down at the edge, thus forming a continuous cigarette or rod. The rod is then cut into cigarettes of even length, usually by revolving knives. The operation may be modified by the addition of cork tips or the insertion of filter tips. The weight of cigarettes is automatically controlled. All cigarettes undergo a careful examination after leaving the cigarette making machines and any imperfect ones, as well as those made from the first and last few feet of the reel of cigarette paper, are rejected and pass through a special slitting machine which separates the tobacco from the paper so that the tobacco can be used again.

(c) *Manufacture of Cigarette Tobaccos*

21. The manufacture of cigarette tobaccos follows the same processes as those for cigarettes up to and including cutting, but the moisture content is higher and the tobacco is more finely cut. After drying and cooling to the required moisture content the manufactured tobacco is stored before being weighed out and packed.

(d) *Manufacture of Pipe Tobaccos*

22. Manufacture follows the same processes up to and including stemming, except that during the conditioning process most tobaccos with relatively high moisture content are sprayed with acetic acid as a deterrent to mould. After stemming the method of manufacture varies according to the type of product:—

(i) *Mixtures.* When the blended leaf has been cut, the various manufactured tobaccos required for the particular brand are mixed and then cooled and dried to the required moisture content.

(ii) *Flakes (including Navy Cuts and Plugs).* Flavouring is added. The leaf is pressed into cakes of varying shapes and sizes, and in some instances heat pressed. The cakes are then cut into bars which are covered with wrapper leaf and pressed again. This wrapping produces on the pressed bars a smooth face which is not disturbed in the cutting process. The cakes or bars are then cut into thin slices.

(iii) *Spun Tobaccos (including Roll and Pigtail).* Spun tobaccos may be either black or brown. Two types of leaf are required for spinning; namely the filler, which is the inner portion of the spun tobacco, and a good quality wrapper leaf which is wound round the filler. The leaf thus prepared is fed into a spinning machine which twists it and forms it into a cord of uniform thickness (varying from about one-sixth of an inch to one and a quarter inches according to the type). Olive oil is added during the spinning of black roll. The spun tobacco is wound into compact coils varying from about 1 lb. to 20 lb. in weight which are wrapped in canvas and bound with cord to prevent bursting under pressure. The coils are placed in a press, heat being applied in the case of black roll but not for brown roll. The pressed roll is cut into lengths of the required weight.

(e) *Packing, Parcelling and Packaging*

23. When the manufacturing processes are completed, cigarettes and tobacco are packed in cartons, boxes, tins or soft packets of appropriate type and unit contents. The unit packets are then made up into parcels of 100, 200 (the most common), 250 or 500 cigarettes and 1 lb. (the most common) or ½ lb. of

tobacco. Parcels are placed in stock rooms in which temperature and humidity are closely controlled, where they remain for between five and fifteen days. For despatch, both cigarettes and tobaccos are usually packaged in fibreboard cases. Cigarettes are packed, parcelled and packaged by machine. Most cigarette tobacco and pipe tobacco is packed by machine, but parcelled and packaged by hand.

(5) Distribution

24. Cigarettes and tobacco pass from manufacturer to wholesaler, or direct to retailer. Individual manufacturers fix the prices for virtually all their goods at all stages of distribution; prices to distributors are related to quantity irrespective of whether the purchaser is a wholesaler or a retailer. In practice, as will be seen, there is no clear distinction in this industry between wholesaler and retailer; many traders who are primarily wholesalers have also retail interests, while others who are primarily retailers do some wholesale business, although this is often on a very small scale. It has been estimated that there are about 14,000 traders who have some wholesale tobacco business.

25. There are two main distributors' associations, the Wholesale Tobacco Trade Association of Great Britain (and Northern Ireland) (W.T.T.A.), the members of which are responsible for the vast majority of the wholesale trade of the country, and the National Union of Retail Tobacconists (N.U.R.T.), a federation of local branches representing the interests of a very high proportion of those retail traders for whose business the sale of tobacco goods is of real importance. Some multiple tobacconists are members of the Multiple Shops Federation.

(6) The Consumers

26. In 1959 the amount spent on tobacco goods by consumers was £1,061 million, or some 7 per cent. of all expenditure on consumer goods and services in this country. According to Imperial, whose information is based on market surveys, in 1957 there were about 22¾ million smokers in this country, of whom about 13¾ million were men. Nearly 80 per cent. of the smokers (including nearly all the women) smoked proprietary brand cigarettes only and another 4 per cent. hand-rolled cigarettes only; about 7 per cent. only smoked pipes.

27. The type of tobacco goods smoked varies between age groups. It is estimated that in 1956 87 per cent. of pipe tobacco was smoked by men aged 35 or over and 40 per cent. by men over 60. For cigarettes the proportion smoked by men and women aged 35 and over was 66 per cent. and only 11 per cent. was smoked by those of 60 and over. Since 1949 there have been annual increases in the volume of sales of tobacco goods ranging from 1 per cent. to 3 per cent.; to an appreciable extent this upward tendency appears to have been attributable to increased smoking by women. Among cigarette smokers the main demand is for " Virginia " type cigarettes. A large part of this demand is concentrated at present on six brands—Player's Medium, Senior Service and Capstan in the medium cigarette class and Woodbine, Player's Weights and Park Drive in the small cigarette class. Senior Service and Park Drive are made by Gallaher and the rest by Imperial. The demand for filter tipped cigarettes has increased in the past few years and is now estimated to represent about 11 per cent. by value of total home market sales of cigarettes. Pipe smokers have more varied tastes: generally speaking, the South of England

prefers the milder types of tobacco, but in the North there is a market for the stronger plugs, twist, pigtail and cake, some of which are suitable for chewing. It is estimated that in 1956 about 40 per cent. of the manufactured tobacco sold as such in the United Kingdom was used in hand-rolled cigarettes, the trade in cigarette tobaccos being chiefly in the South of England.

(7) Legislation Concerning Tobacco Leaf and Tobacco Goods

28. The law as it relates to tobacco and tobacco goods is contained principally in the Customs and Excise Act, 1952, and especially in Part V of that Act,* and in Regulation (1911) No. 49† issued under the Finance Acts of 1908 and 1910. It concerns the importation of tobacco goods, the receipt of unmanufactured tobacco by manufacturers, restrictions on the use of non-tobacco substances, the payment of drawback of duty on tobacco goods including manufacturers' waste, and the distribution and sale of manufactured tobacco. The control exercised by these provisions is designed, *inter alia*, to prevent evasion of duty by smuggling or by the adulteration of tobacco by other non-dutiable substances.‡ The Finance Act, 1960, imposes the current customs and excise duties on tobacco leaf and manufactured tobacco.

(a) *Tobacco Leaf*

29. Tobacco leaf, when imported unstripped and with a moisture content of not less than 10 per cent., incurs customs duty at the full standard rate of 64s. 6d. per lb. or, in the case of leaf from Commonwealth countries, at the preferential standard rate of 62s. 11½d.: there are small additions to both rates where leaf is imported stripped or where the moisture content is less than 10 per cent. In the year ended 31st March, 1959 50·5 per cent. of the tobacco retained for consumption in the United Kingdom was subject to the full rate of duty. The rate of duty (which was 2s. 8d. per lb. in 1900) has risen steeply, especially during the past twenty years. The preferential duty rate was introduced in 1919, and was then 16⅔ per cent. less than the full standard rate; it is now about 2½ per cent. less than the full standard rate. A table of basic duty rates applicable since 1900 is given in Appendix 7, Table 3; particulars of current customs and excise duties for all types of tobacco leaf and manufactured tobacco goods are given in Appendix 7, Table 4. In the year ended 31st March, 1959 net receipts from customs and excise duties on tobacco were over £736 million and represented about one-third of the total net receipts from all customs and excise duties§ and about 13½ per cent. of the total ordinary revenue of the Exchequer.

30. Imported tobacco leaf may be unloaded only at specified ports, it must be in packages of not less than a specified weight, and any ships carrying it

* The following Statutory Instruments have been issued under the Customs and Excise Act, 1952, Part V:

The Manufacture of Tobacco Regulations 1952—Statutory Instrument 1952 No. 2226.
The Manufacture in Warehouse of Cavendish or Negrohead Tobacco Regulations 1952—Statutory Instrument 1952 No. 2227.

† Regulation (1911) No. 49 relates to home grown tobacco.

‡ Oak leaves and cabbage leaves were, for example, at one time used.

§ After tobacco the next highest receipts were from purchase tax (£498 million), hydrocarbon oils (£346 million) and beer (£253 million). A table showing the quantities of tobacco retained for consumption (i.e. the quantities upon which duty is levied) since 1900 and the net receipts from tobacco duty since 1900 is given in Appendix 7, Table 5.

must be of not less than a specified tonnage. It must be removed direct from the port of importation to a bonded warehouse where, on arrival, the net weight and moisture classification (over or under 10 per cent.) is determined. It must remain in bonded warehouse until required for removal to the manufacturer's premises (which in some cases are contiguous with the warehouse). Customs duty is payable when the leaf is removed from warehouse, unless it is being removed to a bonded factory (see paragraph 34).

31. Home grown tobacco leaf intended for commercial manufacture is grown under licence and is liable to excise duty at rates similar to the customs duty rates for imported leaf. The legal requirement of a grower's licence is dispensed with and the payment of excise duty is waived for leaf grown by private persons for their own consumption. The quantities involved are in any case negligible.

(b) *Manufacture*

32. Every manufacturer of tobacco goods is required to take out a licence for every factory he operates; it is a condition of the licence that Excise officials shall have the right of entry to his premises. Premises are kept under official survey and samples may be drawn to check that no substances other than those permitted are used in manufacture and that any prescribed limits for permitted substances are not exceeded. The manufacturer may receive tobacco leaf only from a bonded warehouse or in the case of home grown tobacco from the grower's or curer's premises. All movements of leaf are officially controlled. The cost of a manufacturer's licence ranges from £5 5s. 0d. to £31 10s. 0d. a year, depending on the quantity of leaf or other unmanufactured tobacco (tobacco stalks or tobacco refuse, for example) brought into the premises during the preceding year.* In the year ended 31st March, 1959 94 manufacturers' licences were issued.† Particulars of the number of licences issued in each of the years 1900 to 1959 are given in Appendix 7, Table 6.

33. In the manufacture of cigarettes and tobacco nothing may be added to the tobacco leaf without the permission of the Commissioners of H.M. Customs and Excise except water, subject to a limit of 32 per cent. moisture in the finished goods. Olive oil may, however, be used in the manufacture of spun and rolled tobacco, and essential oil for flavouring may also be used in these types and, in certain circumstances, in other types; no tobacco may contain more than 4 per cent. of oil. The Commissioners have allowed the use of acetic acid as a preservative.

34. Tobacco and cigarettes made in accordance with these regulations represent by far the greater part of all such goods supplied on the home market: they are manufactured out of bond, in accordance with the procedure described above.

* Details of the scale are as follows:—

Weight of Tobacco received	*Cost of Licence* £	s.	d.
Not exceeding 20,000 lb.	5	5	0
Exceeding 20,000 lb. but not exceeding 40,000 lb.	10	10	0
Exceeding 40,000 lb. but not exceeding 60,000 lb.	15	15	0
Exceeding 60,000 lb. but not exceeding 80,000 lb.	21	0	0
Exceeding 80,000 lb. but not exceeding 100,000 lb.	26	5	0
Exceeding 100,000 lb.	31	10	0

† This figure does not, however, give a clear indication of the number of manufacturers or factories, since some distributors also take out manufacturers' licences to facilitate claims for duty drawback on tobacco goods they export.

There are in addition certain types of tobacco, known as cavendish or negrohead, in the manufacture of which any sweetening or flavouring material except the leaves of trees and plants (other than tobacco) may also be used. Cavendish tobacco, which forms only a very small part of the total output, must be manufactured in bond. When intended for the home market it must be specially labelled and duty paid on its finished weight.*

(c) *Import of Manufactured Cigarettes and Tobacco*

35. Imported manufactured tobacco goods are subject to restrictions as to port, weight of package and tonnage of ship similar to those applying to tobacco leaf. They are subject to customs duty at rates shown in Appendix 7, Table 4. Manufactured tobacco (other than cavendish and negrohead) which contains any ingredient not permitted to be used in manufacture in this country may not be imported; sweetened cigarettes may be imported only by permission of the Commissioners of H.M. Customs and Excise.

36. Figures showing the volume of imports of manufactured goods in each of the years 1900 to 1959 are given in Appendix 7, Table 2. In 1958 imports amounted to 415,000 lb. (or 0·2 per cent. of total home market supplies), and re-exports to 37,000 lb.

37. Imported manufactured goods and tobacco leaf intended for re-export are stored in a bonded warehouse and do not attract duty.

(d) *Duty Drawback*

38. Broadly, drawback (or refund of duty) may be claimed where duty has been paid but where the tobacco has not been supplied for consumption on the home market. Thus it may be claimed on those parts of the leaf (waste or stem) which are not used in manufacture and which are deposited in a Queen's warehouse and abandoned to the Commissioners of H.M. Customs and Excise, and it may be claimed on cigarettes and tobacco manufactured out of bond in the United Kingdom and subsequently exported.

(e) *Distribution*

39. Tobacco dealers are required to be licensed by H.M. Customs and Excise and each branch or outlet requires a separate licence. The hawking of tobacco goods is prohibited and with certain exceptions (for example, on trains) licences are issued only in respect of premises. Dealers' premises are subject to official inspection and their stocks to sampling in the same way as manufacturers' premises; dealers' stocks are also examined to see that no sweetened tobacco is sold without being appropriately labelled. The cost of a dealer's licence is £1 for a period varying with the date of issue, but not exceeding four years. In the year ended 31st March 1959, 422,464 dealers' licences were issued. The number of licences issued in each of the years 1900 to 1959 is shown in Appendix 7, Table 7.

(f) *War-time Controls*

40. During the war the importation and supply of tobacco leaf and the manufacture (including packing, etc.) of tobacco goods were subject to a series

* The terms " cavendish " and " negrohead " when used by the tobacco industry do not necessarily conform to H.M. Customs definitions for purposes of legislation. Not all tobacco described by the industry as cavendish or negrohead is in fact sweetened and not all therefore has been manufactured in bond. Unsweetened tobacco sold under these descriptions does not of course bear the bonded factory label.

of Government regulations. Between 1940 and 1945 the various Statutory Rules and Orders concerned were administered by the Tobacco Control of the Board of Trade. Apart from the import licensing of tobacco leaf from the Eastern Area and of cigars from dollar countries, these controls have all since been withdrawn. From 1939* until 1955 individual import licences were required for United States, Canadian, Rhodesian and Indian leaf. Imports from Rhodesia and India were placed on Open General Licence in 1955, but individual licences continued to be required until February 1960 for imports from the United States and Canada. Further details of controls during and after the war are given in Chapter 2.

(8) Research and Development

41. Imperial has a large and comprehensive research organisation and undertakes both basic and applied research designed to improve the quality of its products and to improve its methods of manufacture and distribution. Basic and applied research on similar lines has been undertaken by five other manufacturers in the United Kingdom (Ardath, B.A.T., Carreras, Gallaher and Godfrey Phillips). Three other manufacturers (Philip Morris and Co. Ltd., Rothmans and J. Wix) have made use of the resources of their overseas parent companies. The remaining manufacturers do little research apart from work on quality control and on manufacturing and packing techniques.

42. The publication in 1950 of the results of statistical surveys in the United Kingdom and the United States of America led to suggestions that there might be some connection between smoking and the incidence of lung cancer. In 1954 the principal United Kingdom manufacturers undertook to make available to the Medical Research Council over the next seven years the sum of £250,000 to promote research into the true cause or causes of lung cancer. In 1956 the Tobacco Manufacturers' Standing Committee was set up to promote research into the various aspects of the relationship between smoking and health: it consists of nine representatives—five nominated by the Federation, two by B.A.T. and two by Imperial. The Committee has provided further funds to promote and assist research by various outside bodies. A considerable amount of work has also been carried out in the research laboratories of member companies into aspects of the problem more immediately connected with tobacco smoke. The Committee also keeps itself informed of the progress of fundamental research into the causes of cancer.

CHAPTER 2. HISTORY OF THE TOBACCO INDUSTRY

43. In this chapter we describe briefly the origin of many existing arrangements and the nature of certain other arrangements which, although no longer operative, are relevant to a study of the present position. Many of the matters referred to in this chapter are dealt with in greater detail in Chapters 3 to 6.

(1) Early History

44. Tobacco, first brought to Europe from Central and South America by the Spaniards, was introduced into England in the reign of Elizabeth I. Most of

* The Board of Trade has explained that although tobacco leaf did not become subject to import licensing until 1st January, 1940, Exchange Control " was used for similar purposes in 1939 ".

the tobacco imported into England at the end of the 16th century came from the Spanish American colonies where *nicotiana tabacum* was indigenous. In Virginia, where the native species of tobacco plant was of poor smoking quality, tobacco growing did not assume economic importance until after the introduction there, about 1610, of *nicotiana tabacum*. In this country tobacco was originally used for smoking in clay pipes, but after the Restoration snuff-taking became popular; the practice of chewing tobacco, never as common here as in the United States, appears to have developed later.

45. The high rates of duty imposed on tobacco, which has been a dutiable commodity since it was first introduced, encouraged smuggling and adulteration. The prevalence of these practices led to a succession of legal measures aimed at their suppression. There has in consequence been comparatively little smuggling since the beginning of the 19th century. Action against adulteration culminated in the Pure Tobacco Act of 1842; following further Statutes which fixed maximum moisture and oil contents for manufactured tobacco, legislation concerning the manufacture of tobacco was consolidated in the Customs and Excise Act, 1952 (see paragraph 28).

(2) The Foundations of the Modern Industry

46. At the beginning of the present century there were about 500 tobacco manufacturers in the United Kingdom. Of some 60 of those whose names are known to us the greater number were old-established businesses; many of them, including W. D. & H. O. Wills Ltd. (Wills) of Bristol, which was by far the largest, had been founded in the 18th century. Some manufacturers also had wholesale or retail businesses. Most of those about whose activities at this time we have some information made cigarettes as well as tobacco.

47. Cigarettes had begun to be smoked in this country in the early 1850's, when British officers serving in the Crimean War are reputed to have been introduced to them by the French and the Turks. The first British cigarette factory was opened in Walworth in 1856. The cigarettes smoked in this country were all of the " Turkish " variety until about 1870 when some firms began to produce cigarettes made from flue-cured Virginia leaf which had recently become available. British smokers liked the mild flavour of these Virginia cigarettes, and from this time onwards cigarette smoking became increasingly popular. Wills, which began making cigarettes in 1871, was one of the first leading British manufacturers to enter the cigarette market. In the 1880's the manufacture of cigarettes, which until then had been made by hand, was revolutionised by an American invention, the Bonsack cigarette machine. The Bonsack machine was first used in this country by Wills in 1883. During the same period progress was made in applying mechanisation to the packing of pipe tobacco. Developments in the use of machinery are described more fully in Chapter 9. By 1900 a large proportion of the cigarettes manufactured in the United Kingdom were machine made and in the early 1900's considerable progress was made in the mechanisation of cigarette packing. The cigarette brands then on the market included Wills' Gold Flake, Capstan, and Woodbine (already the best selling brand), and Player's Weights and Medium, the latter being introduced in 1900. In those days Woodbine cost 1d. for 5 and Player's Medium 2½d. for 10, while a typical cheap brand of tobacco could be bought

for 3d. an oz. Cigarette cards had first appeared about twenty years earlier when some manufacturers began to print pictures on the pieces of pasteboard that were inserted in the paper cigarette packets to stiffen them.

48. At the beginning of the century the consumption of tobacco greatly exceeded that of cigarettes, sales of which in 1901 are estimated to have accounted for only 12 per cent., by weight, of the combined trade.*

49. Well over 90 per cent. of the leaf used in the United Kingdom at this period came from the United States; of the remainder, Oriental leaf represented only some 2 per cent. Little or no tobacco was imported at this time from sources within the British Empire. The manufacturers purchased their leaf through leaf merchants and brokers.

50. By 1900 there were between 300,000 and 350,000 retail outlets for tobacco goods. Some of these were controlled by large multiple concerns, the oldest of which, Salmon & Gluckstein Ltd., had been established in the mid-eighties. As a result of complaints by distributors about price cutting, conditions of sale were imposed by the principal manufacturers. The retail trade was more specialised in character than it is today; much of the tobacco was sold loose and many retailers made up their own blends. General tobacco wholesaling was still a comparatively new development. Tobacco wholesalers had originally been the agents of particular manufacturers, and it was only towards the end of the 19th century that they had found it more profitable to give up their agencies and handle several manufacturers' products.

51. In 1901 the American Tobacco Company (American Tobacco), which controlled a large proportion of the tobacco trade in the United States and had already set up depots in the United Kingdom for the distribution of its brands, purchased Ogden's Ltd. with the avowed purpose of "capturing the English and European trade". American Tobacco and Ogden's embarked at once on a campaign of aggressive selling (see paragraph 102). In the face of this American competition thirteen United Kingdom manufacturers, among which were Wills and other old-established family businesses, decided to amalgamate. Thus in December 1901, Imperial came into being. Imperial did not reduce its prices to meet the competition from American Tobacco, but early in 1902 it introduced a bonus scheme which gave a share in profits to trade customers who undertook to promote the sale of its goods. This scheme, which with some modifications from time to time has remained in being ever since, is described in Chapter 6. The company also acquired a controlling interest in Salmon & Gluckstein and so obtained a footing in the retail trade. The inducements offered to the distributors by Imperial and American Tobacco did not find favour with the wholesalers who, on Imperial's formation at the end of 1901, had immediately formed the Wholesale Tobacco Protection Association (which later became the Wholesale Tobacco Trade Association) to protect their interests.

52. During 1902 Imperial explored the possibility of entering the United States market but towards the end of that year it came to terms with American Tobacco. Each agreed, broadly, to abstain from trading in the other's home market and not to engage in export trade to other markets except through the

* Unless otherwise stated, figures given in this report relating to the trade in years before 1954 are based on information obtained from Imperial.

British-American Tobacco Co. Ltd., a newly formed company whose ordinary shares they owned between them (as to two-thirds by American Tobacco and as to one-third by Imperial). Further details of this arrangement are given in Chapter 3. As part of the settlement Ogden's home market business was purchased by Imperial which, having been joined by three more manufacturers since its formation, now represented an amalgamation of seventeen tobacco manufacturing concerns. The bulk of the purchase price for Ogden's was paid in Imperial shares, with the result that American Tobacco, with a holding of just under 14 per cent., became the largest individual owner of Imperial's deferred ordinary shares except for the members of the Wills family.

(3) Developments up to the End of the 1914–18 War

53. In 1903 Imperial controlled about 47 per cent. of the trade in the home market. The total home trade at that time was a little over one-third of the present trade, measured by weight.* Among the larger manufacturers who did not amalgamate with Imperial were Gallaher Ltd. (founded in 1857), which at that time was trading mainly in the north of Ireland in hard tobaccos, and Godfrey Phillips Ltd. (founded as a cigar business in 1844), a company making both cigarettes and tobacco, which had expanded rapidly in the last few years of the 19th century. Another, Carreras Ltd., formed in 1903, was the successor of undertakings which had been in the tobacco trade since 1754. The Co-operative Wholesale Society Ltd. and the Scottish Co-operative Wholesale Society Ltd. already had interests in the tobacco trade. The C.W.S. began manufacturing cigarettes some time between 1898 and 1900; the S.C.W.S. did not begin to do so until 1914. J. Wix & Sons Ltd., a company which was to develop a national cigarette brand (Kensitas), was founded about 1901. Many of the other manufacturers known to have been trading in the early 1900's subsequently ceased business or were absorbed by the larger concerns. Since 1901, with the possible exception of a short period during and immediately after the 1914–18 war, the number of tobacco manufacturers in the United Kingdom has steadily declined.

54. In 1911 the arrangements between Imperial, American Tobacco and B.A.T. were modified as the result of anti-trust proceedings in the United States. American Tobacco was then split into a number of separate companies (one of the largest of which retained the original name). It was obliged to dispose of its interests in B.A.T. and Imperial and the undertakings not to export ceased to be operative.

55. By 1910 Imperial's share of the home market trade had increased to 57½ per cent., with a larger proportion for cigarettes than for tobacco; in 1915 it controlled 62½ per cent. of the total trade in cigarettes and tobacco and 71 per cent. of the trade in cigarettes alone. Imperial was in a stronger position than its competitors with regard to supplies of both leaf and packing materials. Within a few years of its formation it had set up leaf buying organisations in the United States and Africa. As early as 1902 it had acquired a printing firm, and later extended its subsidiary interests to the paper and board industries (see paragraphs 130–139).

56. During the pre-war period there was a rapid growth in sales of tobacco goods, although the rising trend in consumption was temporarily checked in

* In terms of retail selling value inclusive of duty the total home trade in 1903 amounted, however, only to some 3 per cent. of the present trade.

1909 when the duty on tobacco was raised to 3s. 8d. a lb. A decline in pipe tobacco sales during these years was more than offset by an increase in cigarette sales, which in 1914 accounted for about 45 per cent. of the home market sales of all tobacco goods. In spite of four duty changes, the net effect of which was to raise the rate from 3s. 8d. a lb. in 1909 to 8s. 2d. in 1918, the war brought a further expansion of sales, especially of cigarettes. There were no war-time controls in the tobacco industry until 1917, when a Tobacco Control Board was set up to fix maximum prices for tobacco goods and restrict withdrawals of leaf from bond; the Control operated until the beginning of 1919.

57. During the war the manufacturers formed the Council of Tobacco Manufacturers of Great Britain & Ireland, a loosely-knit association. In 1917 the National Union of Retail Tobacconists was founded to promote and protect the interests of retail tobacconists.

58. From 1907 onwards the United Kingdom imported a certain quantity of Empire leaf, first from Nyasaland and later from India and Rhodesia.* The quantities involved were very small, however, and the use of Empire leaf had no appreciable effect on the pattern of leaf supplies until after the 1914–18 war.

(4) The Years between the Wars

59. In 1919 a sub-committee of the Standing Committee on Trusts reported favourably on the manner in which Imperial exercised the power derived from its dominant position in the trade.† In 1920 Imperial controlled 91 per cent. of the cigarette trade, which by then accounted for more than 50 per cent. of total consumption, and 73½ per cent. of the combined trade in cigarettes and tobacco, which, on a weight basis, had increased by more than 50 per cent. since 1902. In the course of the 1920's Imperial and B.A.T. jointly purchased Ardath Tobacco Co. Ltd. (see Chapter 4) and Imperial acquired a controlling interest in Finlay & Co. Ltd., a large multiple retailer‡ (see paragraph 150); in the same period Imperial together with B.A.T. acquired a large financial stake in Molins Machine Co. Ltd. (Molins), which was to become the largest supplier of tobacco machinery in the United Kingdom (see Chapter 10).

60. Early in 1920 prices of tobacco goods rose in common with most other goods, but in the course of that year a general economic depression set in as an aftermath of the war and from 1920 to 1923 the consumption of tobacco goods fell sharply. It resumed its upward trend in 1924, but meanwhile severe price-cutting by retailers had developed and, although the number of outlets was increasing, many retail tobacconists were forced out of business. The individual enforcement of resale price maintenance having proved ineffective a group of

* Negligible quantities of leaf had been imported from Canada and India before 1907.

† Findings and Decisions of the Tobacco Sub-Committee appointed by the Standing Committee on Trusts (Cmd. 558).

The sub-committee, whose Chairman was Mr. Sidney Webb (later Lord Passfield), found that there existed in the tobacco industry " a large and important trade combination formed originally in 1901 as a defensive organisation against an American invasion of the British market ". After commenting upon the quality of Imperial's goods, the operation of its bonus system and its price policy the sub-committee concluded that " down to this date the existence of the Imperial Tobacco Company, with its present policy, has not resulted in raising the price of tobacco or cigarettes to the consumer; but, on the contrary, has tended in the opposite direction. Nor have we discovered that the Imperial Tobacco Company has so far exercised any injurious influence on the trade ".

‡ Imperial held a controlling interest in Finlay until 1946 when it disposed of part of its holding.

manufacturers, which did not include Imperial, joined in 1926 with some of the leading wholesalers and retailers to form the Tobacco Trade Advisory Committee. The Committee issued a Stop List, but despite its efforts price cutting became more widespread; in 1930 over 2,000 known " cutters " were operating in the trade. In 1931 Imperial co-operated in forming the Tobacco Trade Association (T.T.A.), which replaced the Committee.

61. The T.T.A. was governed by a Council comprising representatives of Imperial, the Council of Tobacco Manufacturers (later to be replaced by the Federation of Home & Export Tobacco Manufacturers, see paragraph 85), the W.T.T.A. and the N.U.R.T. Apart from the two distributors' organisations, membership of the Association was confined in practice to manufacturers. The primary function of the T.T.A. was to assist its manufacturer members in maintaining their prices and conditions of sale. Finding that the operation of a Stop List did not in itself provide the desired check to price cutting, the T.T.A. decided to introduce more stringent measures. Under its registration scheme, which came into operation on 1st January, 1934, all manufacturer members of the Association and all dealers who wished to obtain supplies of goods direct from such manufacturers (who were together responsible for most of the tobacco trade in the United Kingdom) were required to enter into agreements with the Association. There were four types of agreement, namely the manufacturers' agreement, the " A " agreement for completion by retailers buying direct from manufacturers, the " B " agreement for completion by wholesalers and the " C " agreement for completion by the trade customers of wholesalers; in addition, permits were granted for supplies to such outlets as clubs and canteens. The manufacturer members bound themselves to enforce the Stop List, to maintain their list prices and to supply non-signatory distributors only if they undertook in writing to abide by manufacturers' reselling prices and conditions of sale, and then only on terms less favourable than those applying to signatories; dealers who signed the appropriate T.T.A. agreements bound themselves not to sell price-maintained goods at less than the prescribed reselling price. When a price cutter who had been listed desired to conform to the conditions laid down in the T.T.A. agreement, he was asked by the Association to sign what was known as a " damages agreement " with each of the manufacturers from whom he wished to purchase price-maintained goods; this bound him for a period of seven years to pay damages to the manufacturer on committing any breach of his conditions of sale. Between 1932 and 1939 some 800 traders entered into damages agreements with Imperial. By 1939 retail price cutting had been reduced to negligible proportions.

62. Shortly after the end of the 1914–18 war Godfrey Phillips and Carreras had introduced bonus schemes in order to obtain better displays for their goods. Godfrey Phillips proceeded to broaden its interests by acquiring a number of subsidiary concerns which included a printing company and a Scottish tobacco manufacturer with wholesale and retail interests. It also achieved a considerable measure of success with Army Club cigarettes, a brand launched in 1924. Carreras, whose business had expanded greatly during the war, introduced what was to be its leading cigarette brand (Craven " A ") in 1921. In 1930, with the purchase of John Sinclair Ltd., a manufacturing business with its own wholesale and retail branches, Carreras acquired an interest in the distributive trade. The continued expansion of the company after the war was, however, largely

due to its introduction early in the 1920's of coupon gift schemes, which were used particularly in connection with Black Cat cigarettes. In 1926 J. Wix introduced a coupon-bearing cigarette brand, and other manufacturers soon followed suit. Among the first to do so were Ardath (by then controlled by Imperial and B.A.T.) and Godfrey Phillips. In 1927, a year after J. Wix had launched its coupon scheme, the American Tobacco Company acquired J. Wix and so re-entered the United Kingdom market.

63. In 1930 the full force of coupon trading began to be felt; new coupon brands appeared on the market in quick succession and sales of coupon cigarettes accounted for some 16 per cent. of total cigarette sales. The proportion continued to rise, reaching 33 per cent. in 1933, by which time the estimated cost of the goods supplied in exchange for coupons was over £4 million a year. Although Imperial had made an early entry into the coupon trade through Ardath as a form of insurance against coupon trading by other manufacturers, the company was opposed to coupons and did not at first participate in coupon trading directly. Imperial's share of the cigarette trade, which had been 80 per cent. in 1928, had fallen to 75 per cent. in the following year. After trying out various competition schemes, Imperial introduced in 1932 a coupon brand (Wills' Four Aces) which, the company tells us, immediately secured large sales. In the same year a Private Member's Bill sought to prohibit coupon trading in all branches of industry. The Bill was not passed, but in 1933 the Board of Trade set up a Committee on Gift Coupons and Trading Stamps to which Imperial submitted evidence setting out the company's case against coupon trading. It expressed the view that coupon cigarettes were generally of inferior quality, and argued that coupon schemes must by their nature be harmful to manufacturing and distributive interests in other trades.* When the Committee failed to recommend the suppression of coupons, Imperial took the initiative in proposing a scheme to put an end to coupon trading by tobacco manufacturers. By this time intense competition had so increased the cost of the gifts that profit margins on goods covered by gift schemes were being progressively reduced. In October 1933 Imperial and the six next largest manufacturers (Ardath, Carreras, Gallaher, International Tobacco Co. Ltd., Godfrey Phillips and J. Wix) entered into an agreement to bring their own coupon trading arrangements to an end. The " Martin Agreement ", as it was called, set up a pool into which manufacturers whose trade benefited from the agreement made payments and from which those whose shares of the total cigarette market fell received compensation. When, a few months later, the T.T.A. introduced its registration scheme (see paragraph 61), each type of agreement contained a clause binding signatories as appropriate not to manufacture, offer for sale or otherwise handle coupon-bearing goods and not to trade with anyone who did so. This measure appears to have had the support of all sections of the trade. Five manufacturers who had introduced coupon brands before 1933 were not parties to the Martin Agreement. One of them, Rothmans Ltd., which had not joined the T.T.A. and was an important tobacco customer of one of Godfrey Phillips' subsidiaries, agreed to discontinue coupon trading in response to an offer of compensation from Godfrey Phillips. The Godfrey Phillips subsidiary was thus enabled to continue supplying goods to Rothmans and thereby avoided a loss of trade.

* This should not be taken as necessarily representing Imperial's opinion of the quality of " coupon cigarettes " at the present time.

64. Coupon trading ended on 31st December, 1933. The effect of this on the respective sales of the parties to the Martin Agreement was immediately apparent. Imperial's share of the cigarette trade, which had fallen from nearly 80 per cent. in 1928 to just over 65 per cent. in 1933, rose to more than 79 per cent. in 1934. The shares of most other manufacturers fell, in some cases heavily. One of those who fared worst was Imperial's then largest competititor, Carreras, whose share of the trade was reduced from a peak of over 13½ per cent. in 1933 to less than half that proportion in 1934. During the life of the Martin Agreement, which was terminated in 1945, some £14 million passed through the pool. Of this Imperial contributed over £13½ million; with the exception of Gallaher, which eventually paid more into the pool than it received, the other members all received payments throughout the period, over £3½ million going to Imperial's associate, Ardath. Cigarette sales of the Gallaher group rose in each of the years 1935 to 1938, and in 1939 Gallaher's share of an expanding market was slightly higher than in 1933.

65. The Martin Agreement provided for the setting up of a Manufacturers' Committee; this Committee considered various questions of general interest to the trade and reached agreement on such matters as terms to the distributive trade and supplies to price cutters.

66. In 1932 Imperial acquired a controlling interest in Gallaher,* which had become a public company four years earlier. The circumstances of this acquisition are explained in paragraph 172. Gallaher, which in 1928 had been responsible for less than 1 per cent. of the cigarette trade, was by 1932 the fourth largest cigarette manufacturer in the United Kingdom, but it was not until 1937 that the company acquired E. Robinson & Sons, Ltd. together with its associate J. A. Pattreiouex Ltd., makers of Senior Service cigarettes (see paragraph 167). This brand, then almost unknown outside the Manchester area, Gallaher proceeded to develop and market throughout the country.

67. With the introduction of a preferential duty on Empire leaf in 1919, manufacturers had been given a strong incentive to use more Empire tobacco. The preferential rate of duty was five-sixths of the standard rate until 1925, when it was reduced to three-quarters. When the standard rate was increased from 8s. 2d. to 8s. 10d. a lb. in 1927 the preference remained at the same amount (2s. 0½d. a lb.); this difference was preserved, despite successive increases in the standard rate, until 1943. The relative advantage of the preference was thus progressively reduced. In 1920 Empire leaf accounted for only some 3 per cent. of the United Kingdom's total consumption of leaf. The proportion rose fairly steadily to about 10 per cent. in 1925, most of the additional Empire leaf being used in pipe tobaccos. During the period of coupon trading more Empire leaf was used in the manufacture of cigarettes, and in 1933 the Empire proportion of total leaf consumption reached 23 per cent. The proportion fell slightly when coupon trading ended, but soon began to rise again; it was 24 per cent. in 1939. Most of the light, flue-cured Empire leaf suitable for cigarettes was now grown in Rhodesia, Canada and India, while Nyasaland produced mainly dark, fire-cured types for use in pipe tobaccos.

68. In 1935 the Walters Tobacco Co. Ltd. (Walters), a small concern which was a newcomer to the trade, took advantage of the preferential duty rates and the low cost of Empire leaf to put on the market a cigarette made entirely of

* Imperial retained a controlling interest in Gallaher until 1946 when it disposed of part of its holding.

Empire tobacco (Walters Medium Navy Cut), which was intermediate in size between the small and medium cigarette classes, but with the same retail selling price as the small class. The Walters brand immediately achieved considerable sales; its success is said to have been partly due to a persistent rumour, reinforced by a similarity between the Walters packing and that of Player's Medium, that Walters was connected with Imperial's Player branch. The new competition offered by Walters was unwelcome to the manufacturers principally concerned in the small cigarette trade, namely, Imperial, Carreras, Gallaher and Godfrey Phillips. In 1936 these four manufacturers consulted together and agreed that Imperial should introduce an Empire brand (Tenner Medium) through its Churchman branch to compete with Walters Medium. This brand in its turn attained substantial sales. It was then arranged between the interested parties that Imperial should try to acquire the Walters business and, if successful, would bring both Walters Medium and Tenner Medium on to " a reasonably profitable basis " and would not seek to increase their sales. It was agreed further that Imperial would not introduce any other similar brand, and that the three other manufacturers would not bring out a similar brand for six months and would do so thereafter only on giving three months' notice. Imperial acquired Walters as from 1st January, 1938. According to figures obtained by our accountants Walters' profits as percentages on capital in the years 1935, 1936, 1937 and 1938 were 38 per cent., 75 per cent., 43 per cent. and 26 per cent. respectively. These figures must, however, be treated with some reserve since, in the absence of complete accounting data, it was not possible to make an accurate computation of the capital employed. Walters, before acquisition by Imperial, appears to have had difficulty in finding sufficient capital to finance its operations. Although the rate of profit on capital employed appears to have fallen in 1938 after Imperial took the company over, the rate of profit on sales was higher in that year than in any of the three preceding years. Imperial has told us that after the acquisition of Walters the net profit margins for both Walters Medium and Tenner Medium were improved by slightly reducing the weights to put both brands on the same gross profit basis as Imperial's brands in the small cigarette class. In January 1937, sales of Walters Medium and Tenner Medium amounted to 4·6 per cent. of total sales of small cigarettes, in October 1937 to 14·1 per cent. and in April 1938 to 13·2 per cent. In 1938 and 1939 sales of Tenner Medium increased substantially, although sales of Walters Medium declined steeply in 1938.* The combined sales of the two brands continued to rise until 1941 when they began to fall away. Meanwhile, at least one other small manufacturer had entered this market. The action of Imperial did not escape criticism, for one of the larger companies, which had looked to Imperial to suppress what it regarded as an undesirable line, appears to have considered that Imperial was unduly slow in reducing its sales and thereby gained an unfair trading advantage. Eventually, the higher cost of Empire leaf, the reduced margin of preference and the weight adjustments called for by successive duty increases made a cheap intermediate-sized cigarette no longer practicable. Production of Tenner Medium ceased in 1949 and of Walters Medium in 1953.

69. As we have mentioned in paragraph 60, consumption of tobacco goods fell in the early 1920's. From about 1924 onwards, however, it rose almost

* Walters' net sales were £0·2 million in 1935, £1·2 million in 1936, £1·8 million in 1937 and £1·1 million in 1938. Imperial says, however, that sales of Walters Medium had already fallen in the latter part of 1937, before it acquired the company.

without interruption, and in 1938 the total quantity consumed was slightly more than 200 million lb., an increase of one-third on the figure for 1930. While consumption of pipe and hand-rolling tobaccos fell by more than one-third in this period, the figure for cigarettes was almost doubled and by 1938 cigarettes formed rather more than three-quarters of the total quantity of tobacco goods consumed. The standard rate of duty had risen from 8s. 2d. per lb. to 9s. 6d. by 1931; it remained at that figure until April 1939 when it was increased to 11s. 6d.

(5) The Period of War-time and Post-war Controls

70. In the early months of the war tobacco goods became subject to a Tobacco Control operated by the Board of Trade. Two committees, the Tobacco Manufacturers' Advisory Committee (T.A.C.) and the Tobacco Distributors' Advisory Committee, were appointed to assist and advise the Tobacco Controller (who was a leaf merchant) on manufacturing and distribution problems. These committees continued to serve the Board of Trade in an advisory capacity after the Control itself had been wound up in 1945 and when the Controller had become Tobacco Adviser to the Board of Trade. The T.A.C., the members of which, although appointed as individuals, were mainly drawn from the larger companies, was consulted on virtually all matters affecting the industry, including schemes for the control of leaf supplies. Senior executives of Imperial played a leading part on this Committee and the company itself was to some extent regarded as the industry's spokesman in negotiations with the Board of Trade.

71. Tobacco leaf from all sources became subject to control in 1939. The average pre-war cigarette contained some 85 per cent. United States leaf, and in 1939 about 75 per cent. of the leaf used in the United Kingdom was imported from the United States; the other main sources of supply were Rhodesia and Nyasaland (11 per cent.), India (7 per cent.) and Canada (5 per cent.). Government controls affecting the purchase of leaf were therefore concerned principally with United States leaf, but import licensing controls remained in operation on leaf from all sources during and for some years after the war. Rhodesian and Indian leaf were placed on Open General Licence in 1955, but individual import licences continued to be required for United States and Canadian leaf until February 1960; no individual licences are now required for leaf from any of these sources.

72. From the beginning of the war until 1946 all leaf from the United States was imported by the Government. The leaf was purchased through the Commodity Credit Corporation, for which the leaf buying organisations of the larger United Kingdom manufacturers acted as agents. After importation into the United Kingdom the leaf was assigned by the Board of Trade to these larger manufacturers, but under a pooling arrangement approved by the Board, these manufacturers reserved a proportion of the leaf in a variety of grades for two leaf pools (one for light, the other for dark leaf) from which the other manufacturers obtained their requirements. From 1946 to 1954 the total amounts of United States dollars available were allocated to all manufacturers concerned in order that they might procure their own supplies. The amount allocated to each was related to his previous clearances from bond. Purchases of Canadian leaf had been suspended in 1939, but in 1941 licences were granted for limited imports, and from 1942 dollars were allocated for this purpose.

73. Before the war most of the larger manufacturers had set up their own leaf buying organisations in the United States and leaf merchants had imported relatively little United States leaf in the late 1930's. Merchants received no allocations of United States leaf and no share in the allocations of United States or Canadian dollars except when additional dollars were released for stockpiling or for the purchase of Commodity Aid tobacco. They did, however, purchase and import both United States and Canadian leaf on behalf of certain of the smaller manufacturers who had an allocation of dollars but no overseas buying organisation of their own. Apart from the merchants, who considered that more should have been done to help them, there was little criticism of these allocation arrangements until about 1950, when several small manufacturers who had used little United States leaf before the war became dissatisfied with the small share of the available dollars to which they were in consequence entitled. To ensure that the interests of such manufacturers were fully represented, a member of one of the smaller companies was subsequently appointed to the T.A.C.*

74. For Indian tobacco import licences were freely granted except during the years 1944 to 1945 when, owing to a temporary shortage, arrangements were made for the allocation of available supplies between manufacturers. The importation of Rhodesian leaf was subject to some restriction between 1943 and 1945 and an allocation scheme for Rhodesian leaf was in operation from 1947 to 1952; after 1952 there was in practice no limitation on the quantities imported.

75. The continuing scarcity of dollars after the war made it important for the industry to encourage greater production of suitable leaf in the Sterling Area, particularly in Southern Rhodesia. At the end of 1947 the T.A.C., on behalf of United Kingdom manufacturers, concluded with the Southern Rhodesian Tobacco Marketing Board what was known as the " London Agreement ". Under this agreement, which with slight modification was renewed each year until 1954, the Marketing Board undertook to increase the production of leaf of suitable quality for the British market, while each year the T.A.C. undertook that United Kingdom manufacturers would seek to purchase about two-thirds of the Southern Rhodesian flue-cured crop in each of the ensuing five years. The last of the five-year commitments under this form of agreement did not come to an end until 1958, but meanwhile in 1954 the T.A.C. had negotiated a new form of agreement. The effect of this is that the T.A.C. now undertakes to provide each year a firm estimate of United Kingdom manufacturers' requirements for the following year, with provisional estimates for the two next subsequent years.

76. Meanwhile, in 1950 the Board of Trade had evolved with the T.A.C. a five-year plan, known as the " substitution plan ", for the progressive substitution of Commonwealth for United States leaf in tobacco goods manufactured in the United Kingdom. To achieve this the manufacturers represented on the Committee agreed to reduce the United States leaf content in cigarettes for the home market by stages from some 70 per cent. to 50 per cent. This final stage was reached in the middle of 1954, but not without complaint from

* The interests of the smaller manufacturers had previously been looked after by the Chairman of the Federation, himself a member of one of the larger companies.

the T.A.C. that manufacturers had had to pay excessive prices and buy a great deal of inferior leaf, with a consequent deterioration in the quality of their brands.

77. The supply of Oriental leaf was subject to special arrangements. In 1940 the United Kingdom Government agreed with the Governments of Greece and Turkey to purchase certain quantities of Oriental tobaccos from those countries annually, and in the following year the larger manufacturers entered into an agreement among themselves to use a proportion of Oriental leaf in all their manufactures except dark tobacco. The arrangement lapsed at the end of the war, but in 1947, under pressure from the Board of Trade, the manufacturers agreed among themselves to include a proportion of Oriental tobacco in their home trade cigarettes. The proportion varied between 2 per cent. and 5 per cent. until 1957, when the arrangement was abandoned. Manufacturers continued to use Oriental leaf until 1959, by which time stocks of Oriental leaf had been virtually exhausted.

78. In addition to the control of leaf supplies described above, various controls affecting directly the production of tobacco goods were introduced. Between 1940 and 1950 the volume of production was regulated by controlling the amount of tobacco which each manufacturer could clear from bond. With the introduction of the substitution plan in 1950 clearances from bond ceased to be controlled and manufacturers became free to produce as much as they could within the limits set by their dollar allocations and other restrictions on imports described above. In 1942, as a further measure to achieve maximum economy in leaf, the amount of " offal " (i.e. stem and tobacco refuse) which manufacturers might deposit with H.M. Customs for the purpose of claiming duty drawback (see paragraph 38) was restricted to 6 per cent., as compared with a pre-war average of about 12 per cent. This restriction was modified in 1949 for dark tobaccos and was removed in 1954 on an assurance being given by the larger manufacturers that they would not exceed the 6 per cent. level; the assurance itself lapsed in February 1960 when individual import licensing ceased for American leaf (see paragraph 71). At no time during or after the war did the Government impose consumer rationing of the manufactured article, or price control. Tobacco had been designated an essential commodity early in the war and the Government's policy was to allow sufficient tobacco goods generally to be produced to meet total demand.

79. Although there was no official rationing of tobacco goods, towards the end of 1940 manufacturers, with the approval of the Tobacco Control, instituted their own arrangements for regulating supplies to the trade. Regulation of some of the leading brands continued until early in 1955 (see paragraph 88) but most other brands were supplied freely from about 1950 onwards. With minor exceptions no new accounts with customers other than works canteens were opened by manufacturers between 1940 and 1955. From 1942 to the end of the war the principal manufacturers made their own arrangements for the zoning of manufacture and distribution. These arrangements involved some interchange of manufacture between different manufacturers with different production methods.

80. During and immediately after the war there was a shortage of certain packing materials. This led to the introduction of paper packets, while the use of cellulose film and foil and tissue wrappings for cigarettes and of cigarette cards was discontinued.

81. At the outbreak of war the standard rate of duty, then 11s. 6d. a lb., was immediately raised to 13s. 6d. Further increases followed and in April 1943, when the standard rate reached 35s. 6d. a lb., the margin of preference on Empire leaf was reduced by 6d. to 1s. 6½d. a lb. Thereafter the standard rate remained unchanged until the 1947 Budget raised it to 54s. 10d.; as a result the price of cigarettes increased by 9d. for 20 in the small class and by 1s. for 20 in the medium class and tobacco prices were also considerably increased. In the following year the duty rate was raised to 58s. 2d. a lb. and retail prices were again increased.

82. There was a marked rise in consumption of tobacco goods during and immediately after the war. This was entirely due to the growing demand for cigarettes, consumption of which reached 222 million lb. in 1946. Tobacco sales continuing their pre-war trend lost ground fairly steadily, the decline being most noticeable in the case of loose, roll and dark tobaccos. Many of the cigarette brands available at this period were merely substitutes for the leading brands, supplies of which were restricted by the manufacturers in order to maintain their quality. Combined sales of cigarettes and tobacco, which had risen to 264 million lb. in 1946, fell by some 33 million lb. in 1947, the year of the heavy increase in duty. There were further small reductions in the two following years but from 1950 onwards consumption increased, reaching 239 million lb. in 1954. The publicity given from 1950 onwards to allegations that smoking is harmful to health had, on the whole, very little effect on demand.

83. Imperial's share of the total trade, which had increased during the war, rose to the level of 78½ per cent. in 1947 when, in a contracted market, the company's sales accounted for 81½ per cent. of the cigarette trade; from 1948, however, until the relaxation of controls in 1954, the proportion was appreciably lower. Of the other manufacturers, only Gallaher and Carreras obtained a larger share of the growing cigarette trade during the period of controls; by July 1954 Gallaher's cigarette sales, accounting for almost 9 per cent. of the trade, for the first time slightly exceeded those of Carreras. Both these companies sought actively to improve their positions after the war. In 1952 Carreras, having acquired the exclusive right to sell cigarettes in the home market under the trade marks of Alfred Dunhill Ltd., introduced Dunhill cigarettes in the medium class; in the following year the company acquired R. & J. Hill Ltd. and Murray Sons & Co. Ltd. of Belfast, two old-established manufacturing businesses whose trade, like that of many other small firms, had suffered serious losses after the war. Between 1944 and 1953 Gallaher acquired control of various companies, including a manufacturer of machinery (see paragraph 292); in the latter year the company took over Cope Bros. & Co. Ltd., the makers of a promising brand of hand-rolling tobacco (Old Holborn) for which it was later to achieve substantial sales.

84. In 1949, with the twofold object of conserving leaf and offering an appreciable saving to the smoker, who had been paying higher prices since the 1947 and 1948 duty increases, the principal manufacturers introduced brands of filter tipped cigarettes. The manufacturers concerned had agreed not to put these brands on the market until each of them had had the opportunity of acquiring sufficient specialised machinery to manufacture 5 per cent. of his total cigarette output with tips. To implement this understanding, Imperial

made certain filter tip machinery available to the other manufacturers and jointly with them acquired rights in other filter tip machinery. These arrangements are described more fully in Chapter 11.

85. At the beginning of 1947 the Council of Tobacco Manufacturers (see paragraph 57) was replaced by the Federation of Home & Export Tobacco Manufacturers, which was registered as a limited company. The purpose of forming this new body, which took over the functions of the Council, was to establish a legal entity which could enter into binding agreements with the Trade Unions on behalf of its members. Imperial did not join the Federation. Membership of the Federation was originally restricted to manufacturers who were members of certain other trade bodies. One of these, the Northern Tobacco Manufacturers Association, to which Gallaher and subsidiaries of Imperial, Carreras and Godfrey Phillips belonged, had been formed to further the interests of smaller manufacturers in the tobacco trade. For many years this Association maintained minimum prices for certain of the cheaper types of tobacco which are sold mainly in Scotland and the North of England; its schedule of prices was discontinued in 1953 and the Association itself was dissolved in 1956.

(6) The Return to a Free Market

86. In 1954, when the dollar position had improved and the use of United States leaf had been substantially reduced by the substitution of other growths, it became possible to abandon the arrangements for allocating scarce tobaccos. The Board of Trade consulted the T.A.C. on methods of relaxing the dollar leaf controls and, having enlisted the help of Imperial in estimating the likely dollar commitment, introduced what was known as the " freedom scheme ". Under this scheme, which operated from the middle of 1954, manufacturers were allowed to import all the United States and Canadian tobacco they thought they would require to meet the full demand for their brands on giving an undertaking that the dollar proportion of the light and Oriental tobacco used in manufacture for the home trade would not exceed 61 per cent. (in effect, a limitation of the " dollar content " of cigarettes) and that they would use all dollar tobaccos as economically as possible.* It will be noted that these undertakings covered Canadian as well as United States leaf. When the substitution plan had been introduced in 1950 (see paragraph 76) it had taken no account of Canadian tobacco, for which there was then little demand; but later, as the availability of Canadian leaf improved and more dollars were expended on it, it was considered necessary to bring Canadian leaf under control. In 1954, except for Imperial and Gallaher who agreed to accept a cut in the dollars they had applied for, licences were given in full for each manufacturer's own estimate of his requirements. In subsequent years individual allocations of dollar tobaccos were settled in consultation between manufacturers and the Board of Trade. The intention was to enable each manufacturer to meet all his available trade and maintain reasonable stocks.

87. During the last few years before freedom, as leaf supplies had become easier, there was a growing tendency among smokers who had previously accepted whatever brands they could get to be more discriminating and to insist on smoking the brands of their choice. The extent to which many brands of

* A few manufacturers were temporarily exempted from this undertaking.

cigarettes had been accepted as substitutes during the time of shortage became even more apparent when, with the easing of dollar restrictions, demand concentrated on Imperial's and Gallaher's main brands, which had long been sold " under the counter " and now began to appear on the tobacconists' shelves. To ensure that there should be no runaway expenditure of dollars when the freedom scheme was introduced, Imperial had given an undertaking to the Board of Trade that during the first twelve months of freedom it would not expand production by more than 5 per cent. and would not run down its stocks of dollar tobacco below eleven months' requirements. The company was thus unable to satisfy in full the increased demand for its four leading cigarette brands (Player's Medium, Capstan, Woodbine and Weights). Gallaher, on the other hand, which had not been asked to give a similar undertaking, embarked on a vigorous and successful selling campaign for Senior Service and Park Drive. In view of these developments Imperial, which had for some time regarded Gallaher as its most formidable competitor, asked to be released from the undertaking which had been given to the Board of Trade; the release was granted when the undertaking had been effective for only three months. Gallaher's sales expanded so rapidly that it ran down its stocks of dollar leaf to an extremely low level, but even so demand exceeded manufacturing capacity and the company was obliged to put its brands on quota. In 1955, however, Gallaher received an additional allocation of Commodity Aid tobacco which enabled it to bring its stock durations back to a level at which, subject to increasing its manufacturing capacity, it could plan to increase its sales during the following year.

88. Except for Gallaher's temporary return to quota control mentioned in paragraph 87, Imperial was the only company which continued to restrict the distribution of its main cigarette brands during 1954. These restrictions were removed in January 1955 and shortly afterwards the company again began to open new accounts with trade customers. The rapidity with which Imperial and Gallaher extended their direct trade with retailers created difficulties both for the wholesalers, who thereby lost some of their most profitable customers, and for the specialist tobacconists, who complained that much of their trade was being diverted into non-specialist channels. To alleviate the position of those two sections of the distributive trade, the manufacturers introduced certain modifications of the price structure, which are described in Chapter 5.

89. Imperial had rightly foreseen that the freeing of its main cigarette brands would bring little comfort to most of its competitors. Sales of these brands rose to such an extent that in some cases production did not keep pace with demand; towards the end of 1955 it became necessary temporarily to re-impose rationing on the distribution of Player's Medium and Weights. By contrast, many well-known brands such as Carreras' Craven " A " and Dunhill and J. Wix's Kensitas failed to maintain their sales, while numerous minor brands that had enjoyed a ready sale as substitutes disappeared altogether. Only Gallaher with Senior Service and Park Drive now offered any severe competition to Imperial's four leading brands in the two popular classes of cigarettes. As a result of this re-alignment of demand, Imperial's share by value of an expanding market rose from 76 per cent. in 1954 to 81 per cent. in 1955 for cigarettes alone and from 75 per cent. to 79 per cent. for cigarettes and tobacco combined. Gallaher's share by value of the cigarette trade, which had already risen from 6 per cent. in 1953 to 10 per cent. in 1954, increased to over 14 per cent. in 1955,

while its share of the combined trade for the latter year amounted to about 15 per cent. By contrast Carreras' share of the cigarette trade was reduced from 8½ per cent. in 1953 to about 3 per cent. in 1955, and thereafter its sales continued to decline. Godfrey Phillips, whose cigarette sales had declined considerably in both 1953 and 1954, was able more or less to maintain its position from 1955 until 1957 when its sales again began to fall. The sales of most other companies fell in 1954 and 1955, in a few cases heavily. The most notable fall was in the case of J. Wix, whose sales were reduced in 1955 to about one-eighth of their value in the previous year. Ardath's sales in the year ended June 1956 were less than one-fifth by value of its sales in the year ended June 1954. Rothmans, whose small sales showed a marked improvement in both 1955 and 1956, was one of the few exceptions to the general trend; this company had become a subsidiary of Rembrandt Tobacco Corporation (S.A.) Ltd. of South Africa in 1954. In Imperial's case the marked improvement achieved in 1955 was not maintained; not only did the company's share of the total trade decline in each of the years 1956 to 1959, but there was an actual loss of sales in quantity. Gallaher, on the other hand, improved both its sales and its share of the market very substantially in these years; a considerable part of the increase, which applied to tobacco as well as to cigarettes, was due to the popularity of Senior Service and Park Drive cigarettes, and of Old Holborn, which became established as a leading brand of hand-rolling tobacco. The sales of other manufacturers continued in general to decline up to and including 1959 with the exception of J. Wix and Rothmans (see paragraph 4).

90. During the period of controls the small companies had on the whole been sheltered from the effects of competition, and in one or two cases their trade had expanded quite considerably. The heavy duty increases in 1947 and 1948 had, however, imposed a severe financial strain on them, and some of them found it increasingly difficult to meet the cost of duty during manufacture. In 1952 a number of manufacturers had suggested that the T.A.C. might explore the possibility of introducing a " credit on duty " arrangement similar to that operated in the brewing industry, but the proposal had received no support from the larger manufacturers. By 1954 the heavy incidence of duty and the declining market for the cheaper types of tobacco had caused a number of small manufacturers to stop producing or to be absorbed by one or other of the larger concerns. Of those that survived, a further number were eliminated in the more competitive conditions that developed when the controls were relaxed. One effect of this has been to reduce very considerably the amount of business available to leaf merchants who, since the larger companies have their own leaf buying arrangements, had come to rely to a very great extent on the custom of the smaller manufacturers.*

91. As indicated in paragraph 89 it was not only Imperial's smaller competitors that suffered a severe loss of trade from 1954 onwards. Imperial's records show that in 1955, in order to assist one of the larger manufacturers, it exchanged certain grades of leaf with the company concerned at that company's valuation, the difference between that valuation and the valuation of Imperial's own Leaf Department being some £9,000 in the other company's favour. In the same year Imperial also bought from the same company part of a consignment of leaf at a price in excess of Imperial's own valuation. In April 1956 Imperial entered

* The evidence submitted to us on this point by leaf merchants is summarised in Chapter 14.

into an agreement with the same company which gave Imperial the right to call upon it to manufacture cigarettes on Imperial's behalf. Under this agreement the other company was required to obtain Imperial's consent before agreeing to manufacture for a third party. In consideration of this company maintaining its existing cigarette manufacturing capacity (including in effect its surplus capacity), it was to receive from Imperial a quarterly sum of £60,000 during the three-year term of the agreement (March 1956 to March 1959), a total of £720,000. Imperial has told us that the agreement resulted from a discussion with the Board of Trade, when it was concluded that it was not in the interests of the trade as a whole that an old-established manufacturer should be forced out of business because of the abnormal conditions following the end of the cigarette shortage without having an opportunity of re-establishing his trade on a profitable basis. Imperial did not in fact call upon the company to manufacture for it and the provision in the agreement for further payments in that event of cost plus 9d. per thousand cigarettes was not implemented. When another manufacturer approached the company in question concerning the possibility of the latter manufacturing one of the former's brands, Imperial gave its consent. In fact the arrangement did not mature during the currency of the agreement.

92. Although the removal of the war-time restrictions on packing materials left manufacturers free to re-introduce cigarette cards if they wished they were deterred from doing so by the high costs involved, including the cost of purchase tax. In 1955, however, Imperial felt that if any other leading manufacturer were to re-introduce cards before the company was in a position to do so, it might be at a disadvantage competitively. Imperial therefore decided as a measure of insurance to build up a stock of cigarette cards at a cost of over £1 million. The company explained the position to the other leading manufacturers and undertook that, unless forestalled, it would give them six months' notice before introducing cards. Later, when Gallaher also thought it prudent to prepare for the possible re-introduction of cigarette cards and wished to place an order for cards with Imperial's subsidiary Mardon, Son & Hall Ltd. (Mardon), it gave Imperial a reciprocal undertaking with regard to notice. The order was not, in fact, placed. Gallaher's undertaking was withdrawn in February 1957 and Imperial's in April 1957. The use of cigarette cards since the war has been negligible.

93. The ending of controls also raised again the question of coupon trading. Notwithstanding the firmness with which the T.T.A. had continued to enforce the coupon ban, in July 1955 a small company, Amalgamated Tobacco Corporation Ltd. (Amalgamated), launched a coupon scheme for one of its cigarette brands. The T.T.A. was at first reluctant to take action, but later a number of Amalgamated's customers were induced not to handle the coupon brand.* Similar action was taken against B. Morris & Sons Ltd., another small manufacturer who introduced a coupon gift scheme in 1956. Towards the end of 1955 the N.U.R.T., supported by some of the manufacturer members of the T.T.A., proposed that the coupon clause should be deleted from the T.T.A. agreements; against this, Imperial successfully argued that in view of the recent

* Imperial's records show that the branch representatives reported to Head Office all traders who were found to be handling the coupon cigarettes, and that the company held up supplies pending a satisfactory report on each case from the T.T.A. Imperial has told us that " this was a requirement of the T.T.A. regulations and [Imperial's] action in these cases was the same as was required of other manufacturer members of the T.T.A.".

publication of the Commission's Report on Collective Discrimination* the coupon clause should be retained pending a decision on collective resale price maintenance, which might necessitate the abrogation of the agreements.

94. It had become clear by the middle of 1956 that, with the passing of the Restrictive Trade Practices Act, the T.T.A. would be obliged to abandon its arrangements for collective price maintenance. It was therefore decided, not without some opposition from the distributors' organisations, to wind up the T.T.A.; notice was accordingly served on traders by the Association terminating their agreements on 1st September, 1956. At the same time Imperial indicated its intention to continue to maintain its reselling prices. There has been no marked increase in price cutting since collective resale price maintenance was abandoned.

95. With the disbanding of the T.T.A. the coupon ban which had been in force for over twenty years automatically came to an end, but this did not lead to the extensive revival of coupon trading which some had expected. Only three gift coupon schemes of any significance have in fact been launched since the threat of collective sanctions was removed. The first of these schemes was introduced in November 1956 by the American-owned J. Wix for Kensitas Extra Size; the scheme was later extended to J. Wix's filter tipped cigarettes. J. Wix was followed by Carreras, which in May 1957 re-introduced coupons with Black Cat and launched a minor gift scheme for Turf which was discontinued in the following year. Carreras appears to have returned to coupon trading with some reluctance, and before this step was taken the Chairman of the company, in 1956, discussed with Imperial the possibility of devising some arrangement that would protect the trade from gifts and coupons as the Martin Agreement had done. Imperial, which believed that "the right sort of competition for the trade was competition in the tobacco goods themselves and not in 'gifts'", was strengthened in its opposition to coupons by apprehension that aggressive coupon trading might create an adverse impression at a time when allegations had been made as to the health hazards of smoking. Imperial considered whether it would be practicable to evolve a scheme under which manufacturers, such as Carreras and J. Wix, who had lost trade following the return to "freedom", would, provided they refrained from coupon trading, be compensated by manufacturers whose sales were expanding. Eventually Imperial decided that no agreements with other manufacturers could be contemplated: in coming to this decision the company was influenced by the fact that any such arrangement would have been registrable under the Restrictive Trade Practices Act. Some two months after Carreras had launched its Black Cat coupon scheme, Imperial, which controlled the home trade of Ardath (see Chapter 4) decided that that company could re-introduce coupons with two of its brands (Ardath Plain and Ardath Tipped). In the case of at least some coupon brands the weight of the cigarettes was slightly reduced to reduce the manufacturing cost.

96. It is estimated that in 1959, more than two years after the coupon ban had been lifted, sales of coupon brands accounted for about 3 per cent. of the home cigarette trade. Neither of the two small manufacturers who brought out coupon schemes before the winding up of the T.T.A. was able

* Collective Discrimination: A Report on Exclusive Dealing, Collective Boycotts, Aggregated Rebates and other Discriminatory Trade Practices—Cmd. 9504, 1955.

to establish any permanent demand for his coupon brands; the cigarette brands of both these companies were eventually acquired by another small manufacturer. Amalgamated attributed the failure of its coupon brand to the loss of trade resulting from the action taken by the T.T.A. and Imperial to induce distributors not to stock the brands.* Of the three larger manufacturers who reverted to coupon trading, only J. Wix has achieved any substantial success. On the introduction of coupons in 1956 this company's sales rose by about 50 per cent; in 1959 the quantity of cigarettes sold was over seven times higher than in 1956 and accounted for nearly 3 per cent. by value of the total cigarette trade. J. Wix's comparative success may well be attributable to the fact that it was first in the coupon field after the winding up of the T.T.A. and, by issuing coupons with a brand (Kensitas) that already had an established reputation, was able to capture a large part of the limited coupon market before any serious competition developed. The sales of Ardath's coupon brands have remained very small, despite expenditure on special advertising, while Carreras found that the introduction of coupon and gift schemes had a negligible effect on its sales. At the end of 1958, the Rembrandt Tobacco Co. Ltd. acquired a majority of the ordinary voting shares in Carreras, which thus came under the control of the Rembrandt group which already controlled Rothmans (see paragraph 163). Since joining the Rembrandt group Carreras has withdrawn its coupon brand from the market.

97. Consumption of tobacco products has increased year by year since 1954. In 1959 the figure was more than 260 million lb., so that the whole of the fall occasioned by the duty increases of 1947 and 1948 had by then been recovered. An increase in the standard rate of duty from 58s. 2d. to 61s. 2d. per lb. in 1956 appears to have had little effect in checking the rise in demand. The duty was further increased to 64s. 6d. in 1960. We have given in paragraph 26 the latest available information on retail expenditure on tobacco goods. The rise in consumption is entirely accounted for by increased demand for cigarettes, which in 1959 were responsible for 90 per cent. by weight of the tobacco products sold. We have referred in paragraph 27 to the increasing proportion of filter tipped cigarettes sold. The trade in tobaccos as a whole has continued to contract, although the demand for hand-rolling tobaccos, which was stimulated by the effect of the 1947 duty increase on the price of cigarettes, appears to have grown; sales of hand-rolling tobaccos were estimated in 1956 to have accounted for nearly 40 per cent. of total tobacco sales.

98. Since the completion of the five-year substitution plan (see paragraph 76) United Kingdom manufacturers have continued to use a high proportion of leaf from Commonwealth countries. In the years 1954 to 1956 non-dollar Commonwealth leaf accounted on average for more than 36 per cent. of total leaf requirements, United States leaf for more than 47 per cent. and Canadian leaf for just under 10 per cent. In 1957 United Kingdom imports of Rhodesian leaf were more than twice as large as they had been ten years earlier when the T.A.C. negotiated the London Agreement with the Southern Rhodesian growers.

99. When in 1956 the Board of Trade asked the T.A.C. manufacturers to consider the possibility of setting up a trade committee to deal with matters outside the scope of the T.A.C., Imperial was strongly pressed by another manufacturer to join the Federation so that the Federation's Executive Committee might

* See footnote on page 30.

serve this purpose. Imperial rejected the proposal on the ground that it would not be in the interests of the trade for the company to join the Federation, a view with which both Gallaher and Godfrey Phillips concurred. In the same year the Tobacco Distributors' Advisory Committee, which had not met since 1949, was formally wound up. The T.A.C. continued in being until the post of Tobacco Adviser to the Board of Trade was abolished in May 1958; it then ceased to exist as an officially appointed body, but a committee of the same name has been maintained by the leading manufacturers with the former Tobacco Adviser as its independent Chairman.

CHAPTER 3. THE IMPERIAL TOBACCO COMPANY (OF GREAT BRITAIN AND IRELAND) LIMITED

(1) FORMATION

100. Imperial was incorporated as a public company in December 1901 " to acquire and take over as going concerns certain of the principal tobacco manufacturing concerns in the United Kingdom . . . ". The new company had an authorised capital of £15 million divided equally into preference, preferred ordinary and deferred ordinary shares of £1 each. It was formed to acquire thirteen tobacco manufacturers, namely:—

W. D. & H.O. Wills Ltd.	Bristol
Franklyn, Davey & Co.	Bristol
Edwards, Ringer & Bigg Ltd.	Bristol
Lambert & Butler Ltd.	London
Hignett's Tobacco Co. Ltd.	London
Adkin & Sons	London
Hignett Bros. & Co. Ltd.	Liverpool
William Clarke & Son Ltd.	Liverpool
The Richmond Cavendish Co. Ltd.	Liverpool
Stephen Mitchell & Son	Glasgow
F. & J. Smith	Glasgow
D. & J. Macdonald	Glasgow
John Player & Sons Ltd.	Nottingham

The purchase price of the thirteen concerns amounted to £11,957,000, including goodwill, land, buildings and stocks. Of this sum, W. D. & H. O. Wills Ltd. accounted for £6,992,000, Lambert & Butler Ltd. for £754,000, Stephen Mitchell & Son for £701,000 and John Player & Sons Ltd. for £601,000. Early in 1902 three more manufacturers (W. A. & A. C. Churchman of Ipswich, W. T. Davies & Sons and W. Williams & Co. of Chester,* and W. & F. Faulkner Ltd. of London) were acquired. In all cases the greater part of the purchase price was met by the allotment of shares in Imperial. Most of the sixteen concerns were old-established family businesses, so that the share capital of Imperial was originally held almost entirely by members of those families. Preference shares carried only limited voting rights and before 1918 no ordinary shares could be

* W. T. Davies & Sons and W. Williams & Co. had already amalgamated in 1895.

allotted except in part payment of purchase money to vendors. In 1901, when the company was incorporated, members of the Wills family held nearly 68 per cent. of the issued ordinary share capital.*

101. On purchase by Imperial the sixteen concerns, and subsequently Ogden's Ltd. (see paragraphs 102 and 103 below), became branches of the company; they remained separate producing and selling units but had no legal entity of their own. With one exception (The Richmond Cavendish Co. Ltd., which was concerned with tobacco only) all were at the time producing both cigarettes and tobacco. The board of directors of Imperial was elected from the directors and partners of the constituent businesses: in many cases the directors became branch managers.

102. Imperial has told us that the formation of the company " was directly connected with the purchase by the American Tobacco Company of the business of Ogden's of Liverpool in September 1901 " and that American Tobacco had approached other concerns, including Player. Imperial has quoted statements by the Chairman of Ogden's made at a meeting of stockholders called to discuss American Tobacco's offer to purchase the company, in which he referred to the American company's intention of making available a sum of £6 million to capture the English and European tobacco trade and said that it would not be a matter of great concern to the new shareholders whether the Ogden business paid a dividend for the next three to five years. Imperial adds that the aggressive selling methods foreshadowed by the Chairman of Ogden's were quickly put into effect: the prices of some Ogden and American Tobacco brands were substantially reduced, heavy advertising expenditure was incurred, and gift coupon schemes were introduced for certain Ogden brands. As a result of these policies, in the period 1st December, 1901 to 30th September, 1902, Ogden's incurred a net loss of £376,000 on sales amounting to £1,850,000. Meanwhile, Imperial itself began to explore the possibility of entering the United States market and in May 1902 representatives of the company visited the United States to investigate whether a suitable interest could be acquired there. It was against this background that Imperial and American Tobacco began negotiations with one another and reached agreement.

103. On 27th September, 1902, Imperial entered into two agreements with American Tobacco and other companies associated with it. The first of these agreements provided that Imperial should purchase (subject to certain conditions and with minor reservations) the business of American Tobacco's United Kingdom subsidiary, Ogden's.† The second agreement provided for the transfer of the export and overseas trade of both Imperial and American Tobacco to a new company to be formed in the United Kingdom, the British-American Tobacco Co. Ltd. As a result of these arrangements:

(i) American Tobacco withdrew from the United Kingdom market‡ and undertook not to re-enter it and Imperial agreed not to enter the United States market.

(ii) Each of the two companies acquired the trading rights in the other's brands in its own home market, including the right to use the respective trade marks.

* In 1911 the Wills family still held 55 per cent. of the issued ordinary share capital, but the family had ceased to hold a majority interest by 1918.

† The purchase price was met partly by the allotment of shares (including 1,500,000 ordinary shares) and debenture stock in Imperial, and partly in cash.

‡ Including what is now the Irish Republic.

(iii) Except as provided for in (ii) the two companies agreed not to engage in exports except through B.A.T. and B.A.T. became entitled to purchase at a price not exceeding cost any export business afterwards acquired by either Imperial or American Tobacco, any shares in foreign companies* which might be acquired by either, and the export business and the assets employed in such business of any company the direct or indirect control of which might be acquired by either Imperial or American Tobacco.

(iv) Imperial was allotted one-third and American Tobacco two-thirds of B.A.T.'s equity capital. Both appointed directors to the board.

(v) B.A.T. was bound not to trade in the United Kingdom or United States markets.

(vi) American Tobacco acquired (through the sale of Ogden's) a substantial minority interest in Imperial and the right to nominate three directors to the board.

104. In 1911 under a decree of the United States Supreme Court (see paragraph 54) American Tobacco's interests in Imperial and in B.A.T. were sold or distributed to its stockholders and the successor companies of American Tobacco became free to export to the United Kingdom. A list was compiled of Imperial brands which American Tobacco had regularly sold in the United States between 1902 and 1911 and the new American Tobacco Company acquired the trading rights in the listed brands in the United States: Imperial was left free to sell in the United States any of its brands not on the list. The arrangement between Imperial and B.A.T. remained unchanged. In 1960 Imperial held £13,557,389 ordinary stock in B.A.T. out of a total issued ordinary capital of £47,515,522. The President and Chairman of Imperial are directors of B.A.T. Arising from the 1902 arrangements, B.A.T. owns the rights to Imperial brands outside the United Kingdom, the Irish Republic and the United States of America. The two companies have had certain other interests in common. Up to the present they have jointly controlled the Ardath Tobacco Co. Ltd. (see Chapter 4) and they have, or have had, common interests in certain companies making packaging materials (see paragraphs 135 and 139) and machinery (see Chapters 9 and 10).

105. Since 1901 Imperial has, as indicated in Chapter 2, expanded its interests in tobacco and cigarette manufacture, in the manufacture and supply of materials and in distribution. We describe these interests more fully later in this chapter and in Chapter 4 ; we describe the company's interests in machinery manufacture in Chapter 10.†

(2) Capital Structure

106. Imperial's present share capital is made up as follows:—

Class of Stock	*Authorised*	*Issued*
	£	£
"A" 5½ % Cumulative Preference	6,000,000	4,959,249
"B" 6 % Non-Cumulative Preference	6,000,000	5,260,469
"C" 10 % Non-Cumulative Preference	3,000,000	2,638,218
Ordinary	70,000,000	60,100,880

* That is, companies incorporated in countries foreign to both the United Kingdom and the United States.

† In addition Imperial has interests in tobacco warehousing, nicotine manufacture and the production of cigar tobacco.

In 1957 there were 185,000 ordinary stockholders and the largest single holding represented under 2 per cent. of all stock in the class. The company has a loan capital of £55 million, as follows:—

	£
3¾ % Notes, 1965	15,000,000
4 % Unsecured Loan Stock 1960/70	20,000,000
4 % Unsecured Loan Stock 1975/80	20,000,000

Particulars of changes in the company's capital structure since 1901 are given in Appendix 3.

(3) Board of Directors and Executive Committee

107. The present board consists of thirty directors, seventeen of whom are engaged full-time in the business, in most cases either as members of the Executive Committee (see paragraph 108), or in the management of the company's branches or subsidiaries, or as chiefs of the various Head Office Departments; eleven of the others were formerly so engaged. By special resolution passed each year the board delegates authority for the central administration of the company to the Executive Committee. The board itself meets six or seven times a year to consider matters of major policy and to receive reports from the Executive Committee.

108. The Executive Committee normally consists of the Chairman and Deputy Chairman of the company and three other directors. It is authorised to exercise all powers of the board except for the sale of the company's undertaking or any part thereof. It holds regular weekly meetings of all members, which generally occupy two days. When the full Committee is not in session individual members are available at all times to consider matters arising in the course of the day-to-day business of the company. Membership of the Executive Committee is a full-time appointment and members have no other current responsibilities. Although individuals may be asked to take a particular interest in certain subjects, no member is assigned specific departmental or branch responsibilities and decisions on all important questions are taken collectively.

109. A number of technical and other special committees have been formed from time to time to consider certain aspects of the company's business.*

(4) Head Office Departments

110. Imperial's Head Offiee is organised in fifteen departments. Of these, the Secretary's Department, with its six sections, is the central administrative department of the company. It is responsible for providing economic and statistical intelligence relevant to the company's business, for prices and related matters, and for submitting to the Executive Committee matters raised by branches, subsidiaries and Head Office departments and later transmitting the Committee's decisions to those concerned. Among the other Head Office departments are those of the Chief Accountant, the Solicitor, and the Chief Engineer (whose responsibilities include the centralised purchase of machinery); the Advertising Department which receives branch proposals for advertising expenditure and submits them to the Executive Committee and which administers

* For example, committees concerned with research, with the technical aspects of such matters as packing materials, cigarette paper and office methods, with relations with Trade Unions, with costing methods.

window dressing (see Chapter 5) and sign maintenance services throughout the country; the Bonus Department which administers the Company's bonus scheme (see Chapter 6); the Leaf Department which is responsible under the direction of the Executive Committee for co-ordinating and placing orders for tobacco leaf to meet the requirements of the branches; the Supply Department which is responsible for the central ordering of cigarette paper and packing and despatching materials; and the Research Department which has wide terms of reference in the field of research and development and which is the largest of the Head Office departments.

111. Imperial undertakes both basic and applied research designed to improve the quality of its products and its methods of manufacture and distribution. Basic research is primarily a function of Head Office through the Research Department, although some activities of other departments including the Chief Engineer's Department are concerned with aspects of research. Applied research is primarily a function of the branches. Imperial carries out tests on samples of leaf withdrawn from bonded warehouse to check the moisture content in relation to Customs regulations and the assessment of duty payable; it also tests samples of its own and other manufacturers' cigarettes and tobaccos and it has developed special testing equipment for these purposes. The company has designed certain machines for use in the tobacco industry, such as automatic weighing scales for tobacco and an attachment to the cigarette making machine for producing filter tipped cigarettes and has co-operated with machinery manufacturers in developing them. The Statistical Section conducts market research and the company's analytical laboratory has undertaken investigations into such matters as the determination of pesticide and fungicide residues in tobacco following the increased use of agricultural chemicals in the cultivation of tobacco leaf. More particularly within the past few years Imperial has undertaken a series of long-term fundamental studies of the chemical and physical properties of tobacco at all stages of growth and manufacture and of tobacco smoke. Imperial's records show that the company has done a great deal to assist the development of the tobacco growing industry in Rhodesia and Nyasaland, and that it has been active in promoting research to improve the quality of African leaf and has been ready to experiment with various types to see if they might be used in the company's products. (See also Imperial's comments in paragraph 431.) Imperial says that its research work as a whole has been of great value in helping it to meet a number of post-war problems, including the technical difficulties resulting from the partial change-over from American to Rhodesian and other leaf from the sterling area (see paragraphs 71–76) and the need to achieve maximum economy in the use of labour and other resources. In the latter connection it says that annual production per operative in manufacturing departments had risen by 42 per cent. between 1947 and 1956, despite a fall of about one hour in the standard working week.

112. Matters coming within the sphere of responsibility of the various Head Office departments, whether originating with them or with the branches or subsidiaries, are submitted to the Executive Committee in periodical departmental reports; these may be submitted at varying intervals, for instance weekly by the Prices Section, fortnightly by the Advertising Department, monthly by the Research Department, quarterly by the Registration Department, and at irregular intervals by the Bonus Department.

(5) THE BRANCHES

113. By the end of 1902 the seventeen tobacco manufacturers acquired by Imperial on or shortly after incorporation were organised in fifteen branches.* Imperial formed a further branch in 1911;† any manufacturing interests acquired in the United Kingdom after this date became not branches but subsidiaries of the company (see paragraph 127).‡ From 1902 onwards there have been numerous mergers between branches, usually because a decline in trade made it impracticable for a branch to continue as a separate unit. The following table shows the numbers of branches operating over the years and indicates the rate and frequency of mergers:—§

Year	No. of Branches	Year	No. of Branches
1901	13	1932	11
1902	15	1946	10
1911	16	1954	9
1918	15	1957	7
1923	13	1959	6
1930	12	1961(*a*)	4

(*a*) Projected, see below.

Note: Fuller details are given in Appendix 4.

Of the six branches existing at the end of 1960, five (W. D. & H. O. Wills, John Player & Sons, Edwards, Ringer & Bigg (Ringer), Ogden and W. A. & A. C. Churchman) both manufactured and supplied their own brands of cigarettes and tobacco made to their own formulae, particulars of which are not normally disclosed to other branches. The sixth (Lambert & Butler) manufactured its own brands of cigarettes and tobacco until 1958, since when the cigarette brands have been made on the branch's behalf by the Churchman branch and the tobacco brands by the Ringer branch. Imperial has announced that as from February 1961 the Churchman, Ringer and Lambert & Butler branches are to be amalgamated.

114. The following table shows branch sales over the years expressed as percentages of Imperial's total sales:—

* The company had, in fact, at that time another branch, now Mardon, Son & Hall Ltd., which did not make tobacco products—see paragraph 133.

† Namely the Allan Ramsay branch, formed to take over the trade of Murad Ltd., a subsidiary which had itself been set up the previous year to specialise in Oriental cigarettes.

‡ Three branches were, however, established in the Irish Free State in 1923.

§ In addition to the manufacturing branches the following subsidiaries of Imperial were manufacturing tobacco products at the dates shown:—

	Acquired by Imperial	*Ceased manufacturing*
The Robert Sinclair Tobacco Co. Ltd. (see paragraph 128) ..	1930	1953
Walters Tobacco Co. Ltd. (see paragraphs 68 and 128) ..	1938	1953
E. & W. Anstie Ltd. (see paragraph 128)	1944	1958

	Percentage of Imperial's total cigarette and tobacco sales by weight				
	Year ended 31st October				
	1905	1920	1938	1956	1959
	%	%	%	%	%
CIGARETTES					
W. D. & H. O. Wills	24·5	43·1	40·4	40·5	39·7
Stephen Mitchell & Son	1·1	1·3	0·2	neg	—
F. & J. Smith	0·4	0·3	—	—	—
D. & J. MacDonald	0·1	—	—	—	—
John Player & Sons	4·6	17·3	36·6	47·8	47·0
Ogden	2·0	1·6	0·5	neg	neg
Hignett	0·3	0·4	—	—	—
Wm. Clarke & Son	0·1	0·1	—	—	—
W. & F. Faulkner	0·1	0·1	neg	neg	—
Adkin	neg	neg	neg	—	—
W. T. Davies & Sons	neg	neg	neg	—	—
Lambert & Butler	0·5	1·1	0·3	0·2	0·2
W. A. & A. C. Churchman	neg	0·2	6·2	1·1	1·2
Edwards, Ringer & Bigg	neg	0·2	neg	neg	neg
Franklyn, Davey & Co.	neg	0·1	neg	neg	—
Total Cigarettes	33·7	65·8	84·2	89·6	88·1
TOBACCOS					
W. D. & H. O. Wills	8·1	4·3	1·8	2·1	3·5
Stephen Mitchell & Son	5·8	2·7	1·1	0·6	—
F. & J. Smith	3·9	1·5	—	—	—
D. & J. MacDonald	1·1	—	—	—	—
John Player & Sons	3·2	2·9	4·3	1·9	2·4
Ogden	15·3	9·4	4·1	3·0	3·8
Hignett	3·0	0·8	—	—	—
Wm. Clarke & Son	7·6	2·6	—	—	—
W. & F. Faulkner	2·7	1·9	1·5	0·8	—
Adkin	1·7	1·5	0·6	—	—
W. T. Davies & Sons	2·1	0·9	0·2	—	—
Lambert & Butler	4·2	2·4	0·5	0·1	0·1
W. A. & A. C. Churchman	1·4	0·6	0·3	0·1	0·1
Edwards, Ringer & Bigg	3·4	1·3	0·7	1·8	2·0
Franklyn, Davey & Co.	2·8	1·4	0·7	...	—
Total Tobaccos	66·3	34·2	15·8	10·4	11·9
TOTAL IMPERIAL CIGARETTES AND TOBACCOS	100·0	100·0	100·0	100·0	100·0
TOTAL IMPERIAL TRADE IN UNITED KINGDOM IN CIGARETTES AND TOBACCOS—MILLION LB.	47·8	109·8	149·0	189·5	168·3

neg = negligible.
... = not specified.

It will be seen that the branches vary greatly in size, over 90 per cent. of Imperial's trade being in the hands of the two large branches (Player and Wills). The Player branch has increased its proportion of the company's trade from about 8 per cent. in 1905 to about 49 per cent. in 1959. In 1959 the two large branches together employed 17,413 out of the total labour force of 20,356 of the cigarette and tobacco manufacturing branches and subsidiaries.* Wills operate six† factories, of which four make cigarettes only and two make cigarettes and tobacco; Player operates four factories, of which three make cigarettes only and one makes cigarettes and tobacco; Ringer operates two factories and the other two branches which still manufacture each operate one factory.

115. Imperial has told us that " the circumstances under which . . . [the company] was formed have had a profound effect on its organisation. . . The constituent businesses . . . were anxious to retain as much as possible of their individuality " and " there was great emphasis on the highest degree of autonomy consistent with the interests of . . . [the company] as a whole ": each branch is " a separate trading entity which maintains its own sales force and customers' accounts; and it has virtually complete autonomy in the day-to-day administration of its manufacturing and selling activities ". According to the company the branches operate within a framework of general policy administered by the Executive Committee, which is responsible for the efficient and profitable deployment of the company's resources as a whole; " while this general policy inevitably imposes a considerable degree of control in certain fields, . . . it is . . . firmly based on the cardinal principle that a strongly competitive spirit between the constituent Branches is essential to the Company's well-being ". In the paragraphs which follow we describe the branch organisation and the relations existing between individual branches, and between the branches and Head Office, with a view to illustrating the practical extent both of branch autonomy and of inter-branch competition.

116. The position may be summarised by saying that each branch has its own management and is responsible for manufacturing and marketing its own brands,‡ but is required to refer to the Executive Committee (in some cases direct and in others through the appropriate Head Office department) proposals for such matters as major capital expenditure, new brands or alterations in price or specification of existing brands, and advertising grants. Machinery and the main materials for use in manufacture are purchased centrally.

117. The respective responsibilities of branches and Head Office departments on all matters in which the branches are not autonomous are defined in Imperial's Handbook, where the procedure to be followed by branches is laid

* Imperial's total labour force in the United Kingdom comprised:—

Head Office	1,448
Tobacco branches and subsidiaries—excluding factory labour employed directly in the manufacture of cigars and snuff	20,356
Subsidiary companies engaged in the manufacture of paper and board and in printing	6,939
Subsidiary companies engaged in the distribution of tobacco products	1,025
	29,768

† A seventh Wills factory makes cigars only.

‡ From 1958, however, Lambert & Butler ceased making its own brands—see paragraph 113.

down, often in considerable detail; circulars relating to procedure are also issued by Head Office departments from time to time. Instructions issued by the Chief Accountant's Department, for example, cover such matters as cost accounting, the preparation of accounts, banking arrangements, income tax procedure and insurance of all kinds. Those from the Secretary's Department deal with a number of general administrative matters including staff salary scales (which are fixed by the Executive Committee), press enquiries (requests for permission to publish descriptions of the company's works, for information concerning the company's business or for expressions of opinion on trade questions must be referred to the Secretary) and circulars to customers (which must be forwarded by the branch for approval by the Executive Committee). The Solicitor's Office gives instructions concerning matters such as the grant of credit, guarantees of customers' accounts, the collection of debts, notification of factory accidents, cases of fraud or theft in factories. The Chief Engineer's Department covers expenditure on buildings, land and machinery (expenditure exceeding £500 requires Executive Committee approval), patents and inventions, the security of all drawings and designs. The effects of instructions concerning conditions of sale, window dressing and bonus are considered in Chapters 5 and 6. Instructions concerning advertising and prices are described in greater detail below; in some cases we have given examples based on our examination of Imperial's records for the years 1952 to 1956 to illustrate the way in which the instructions worked out in practice in that period.*

118. The branches work out their own advertising schemes in collaboration with their advertising agents and in most cases place their own contracts; Executive Committee approval is required for all advertising expenditure and payment for most types of advertisement is made by the company's Advertising Manager. The relevant sections of the Handbook give detailed and comprehensive guidance on procedure to be followed. Each branch is required to submit annually to the Executive Committee through the Advertising Manager on the appropriate advertising requisition form an application for a grant to cover all advertising for the following financial year. The particulars to be supplied on this form in respect of each brand include the total amount which it is proposed to spend, broken down to show Head Office departmental expenditure (on press, billposting, television, miscellaneous advertisements, window dressing charges and sign maintenance charges) and branch expenditure (on distribution of advertising material, etc.), the advertising cost per lb. of tobacco or per 1,000 cigarettes (based on estimated sales for the current year), the estimated sales of the brand for the current year and the estimated percentage increase or decrease in sales in the current and following years. If, owing to exceptional circumstances, an existing grant is later found to be insufficient the branch concerned must immediately submit a supplementary requisition.

119. Advertising copy and material must be submitted by branches to the Advertising Manager, who refers it to the Executive Committee in such cases as he considers necessary. From time to time the Executive Committee may give guidance on matters of general advertising policy: it may, for example, discourage a particular type of approach (such as testimonial advertising), or

* The records for these years do not, of course, reflect subsequent changes in the tobacco industry generally or in the company's own organisation. The examples quoted are not necessarily typical of other periods.

object to advertising which links a branch's products with those of a manufacturer of goods such as cigarette paper, or urge a branch to develop a consistent theme for a particular brand. In some cases the company has laid down general rulings which the branches must observe. For example, restrictions were placed on the advertising of tobacco for hand-rolled cigarettes in view of the competition which this type of cigarette offered to the company's more important manufactured cigarette trade. In this connection it was decided in 1950 that branches other than the three main cigarette branches (Wills, Player, Churchman) might use such phrases as " For Pipe and Cigarette " in descriptions on the packet and in van and shop advertising, but not in press advertisements; there were to be no pictorial representations of hand-rolling and no reference to economy. In 1954, when competition had intensified and the advertisements of other manufacturers were beginning to feature hand-rolling, the ruling was relaxed to allow the smaller branches to describe their brands in all types of advertisements as suitable for hand-rolling; the ban on the mention of economy remained. A proposal by Wills and Player in 1956 that, in view of Gallaher's competition, they should be allowed to describe their cigarette tobaccos as suitable for hand-rolling was rejected on the grounds that this would be more likely to have an adverse effect on the sales of Ringer's A.1. Light* than on those of Gallaher's Old Holborn,* and that it was not in the company's interests to encourage the smoking of hand-rolled rather than manufactured cigarettes.

120. Another general ruling prohibits the use of the term " filter tipped " in advertising. It was explained in 1954 that the word " filter " inevitably suggested protection, which was not justified, and that " consumption could be affected " if the company did anything to " give the impression that there is in tobacco smoke something which should not be taken into the system ". When introducing its Bristol brand in 1954 Wills was not allowed to mention the price advantage offered by a filter tipped brand, but in 1956 Lambert & Butler was told that there would be " no objection whatever " to emphasising the economy aspect in advertising. Until 1959 it was also a company rule that a tobacco or cigarette packing must not bear the word " Virginia " unless the brand in question was manufactured exclusively from tobacco grown in Virginia, North or South Carolina, Georgia or Florida.† The company was reluctant to relax this rule even when Gallaher was reported to be making freer use of the word. A ban on the use of superlatives in the company's advertisements was lifted in 1956 when Wills represented that some relaxation was necessary in view of " the present intense competition " in the market for small cigarettes and submitted examples of the use of superlatives in the slogans of other manufacturers.

121. Regulations laid down by the Executive Committee apply to virtually all forms of indoor and outdoor advertising and the numerous branch requests for exemption from the various regulations are referred to the Executive Committee. Thus, for example, neon signs may not be erected on tobacco traders' premises; this rule has been strictly enforced even where the branch concerned

* Both brands are primarily intended for hand-rolling.

† In November 1959 the Tobacco Advisory Committee (see paragraph 99) issued a statement giving its opinion that any flue-cured tobacco derived from Virginia-type seed, wherever grown, could properly be described as " Virginia ". The statement explained that the production of flue-cured tobacco had been developed during the present century in many countries of the world and that the description " Virginia " was now commonly used throughout the world to apply to flue-cured leaf. Imperial revised its own rulings to conform with the view expressed by the T.A.C.

felt that it gave Gallaher an advantage. Illuminated signs issued for traders' premises should be " of a stock nature ". In approving a proposal by Player to supply eighteen special illuminated box signs the Executive Committee pointed out that this was " making a rather large exception " as the Player sign cost about twice as much as a stock sign. On another occasion Player was not to be allowed to adapt some of its illuminated signs in order to advertise one of its brands of tobacco because " smaller Branches would not be able to afford similar advertising ". A request for permission to supply a glass window pelmet for display inside a trader's premises was refused because the Executive Committee was not prepared to waive a rule prohibiting the supply of expensive permanent advertisements; permission was also refused for Ringer to order counter stands in the form of " illuminated giant packets of 'A.1' Light Tobacco complete with flashing light ", as this would be a bad precedent and might encourage other manufacturers to retaliate with " bigger and better signs ". A company rule prohibits the payment of rent for advertisements fixed on the customers' premises (see paragraph 235).

122. Head Office control is equally close in other matters affecting the prices and costs of the company's products. Each branch issues its own price list, but all grant the same terms to distributors except that the smaller branches grant quantity allowances and free carriage on smaller quantities than do the two large branches (see paragraphs 199 and 200). The branches are required to keep operation books covering all articles manufactured by them. These books contain standard forms on which the branches show (normally on the basis of an " operation "* of 100 lb. weight of leaf) the leaf formulae, and details of production, packing materials used, labour, despatching expenses, direct costs and margins towards charges. The Handbook lays down instructions for calculating on a uniform basis the various particulars to be entered; operation books are to be completely re-written each year (and following any change in duty) and are audited periodically by the Prices Section. Branches are enjoined to keep a constant watch on their monthly gross profits and operation book margins, which should be calculated on a comparable basis. Proposals for changes in the formula of a brand must be submitted to the Prices Section. No changes in the weights or dimensions of cigarettes may be made without reference to the Executive Committee, and proposals for such changes, with details (including the effect on the margin), must be sent to the Prices Section. Branches must supply the Prices Section each half year with a list of the average weights of " rag "† per thousand cigarettes (calculated by a prescribed method) for certain specified cigarette brands and must comment on any substantial variations from the standard weight, indicating whether the excess or deficiency is likely to continue.

123. New brands are normally introduced on the initiative of individual branches, but proposals from the branches for new brands, for re-introducing former brands or for alterations to existing brands must be approved by the Executive Committee. In each case of a new introduction or a re-introduction particulars must be given as to the direct cost, the gross margin, the distributors'

* An " operation " is the name given to a quantity of tobacco, normally consisting of several grades, weighed out in the factory leaf room for the manufacture of a given article. An operation retains its identity up to the time when it goes to the store or cigarette room, although during the process it may have had stem, etc. taken out or added to it and offal extracted from it (see paragraphs 15–22).

† See paragraph 19.

terms and retail price, the design of the label, the advertising grant required, estimated sales, and (where appropriate) the dimensions of cigarette packings, together with a sample of the proposed article and an indication of machinery requirements.

124. In 1960 Imperial was making over 50 brands of cigarettes and nearly 200 brands of proprietary tobaccos as well as many loose tobaccos. Since 1905 the company's five leading brands have always accounted for at least 80 per cent. of its cigarette trade. All five are made by the two large branches, namely Woodbine (Wills) and Weights (Player) in the small cigarette class and Player's Medium, Capstan (Wills) and Gold Flake (Wills) in the medium class. Sales of Gold Flake have fallen away, but in 1956 the other four brands accounted for 95 per cent. of Imperial's cigarette trade, or about 84 per cent. of the company's total trade in cigarettes and tobacco. None of the small branches has succeeded in establishing a leading cigarette brand in either of the popular classes. All the branches make a number of brands many of which, particularly in the case of tobacco brands, have only small sales and some only regional sales. The Wills and Player branches, and in more recent years the Churchman branch, have been increasingly concerned with cigarettes, though continuing to produce many brands of tobacco. The Ogden and Ringer branches have been primarily concerned with tobacco, as were many of the branches whose interests have now been merged with those of existing branches; these branches have necessarily been adversely affected by the change in public taste from pipe to cigarette smoking (see paragraphs 56, 69, 82 and 97).

125. We have shown that in many matters the branches are subject to Head Office control and to a uniform procedure. Our examination of Imperial's records shows that in administering these matters the Executive Committee is concerned with a great number of issues, some of them involving very considerable attention to detail. It is equally clear, however, that in those fields in which they exercise autonomy, the branches regard themselves as being in competition with one another. We have already shown that in most cases the branches have not maintained their original position within Imperial (see paragraph 114). The pattern follows that of the industry as a whole in that branches relying mainly on tobacco manufacture have declined, but this does not account for the success of the Player branch over the years and Imperial has pointed to Player as an illustration of the reality and effectiveness of competition between branches. There are differences between Imperial branches in size, operating conditions, manufacturing technique and efficiency and therefore in manufacturing costs.

126. As examples of these differences we note from the company's records that in a table compiled in May 1956 for the Executive Committee showing total man-hours per million hypothetical standardised Class " X " cigarettes for each of the company's factories, the lowest figure (178·0) was for a Wills factory and the highest (345·1) for Lambert & Butler; two Player factories (185·1) had the next best result to Wills. Player's output per man-hour improved steadily between 1952 and 1955 and Wills' improvement in the same period was almost as consistent; the figures for the other branches showed more fluctuation over the period and in several cases the output per man-hour was reduced by a drop in production following a falling off in demand for the branch's products. In 1951 Lambert & Butler told the Executive Committee that the branch's output per man-hour remained " well below the Company standard " mainly on account of the " unsuitability " of its factory building; in 1952 a member of

the Executive Committee described the Ringer factory as " very inconvenient " and " with the present volume of trade, over crowded "; in 1955 E. & W. Anstie Ltd. (Anstie) (a subsidiary, not a branch, see paragraph 127), whose cigarette trade had declined sharply, said the company realised that it could not undertake manufacture on behalf of any of the branches in view of its " somewhat primitive methods ". Player, which claimed in 1953 to have " improved the consistency of the blend in the finished product " by " improvements in mechanical mixing ", was reluctant to allow small branches to undertake manufacture for it " on grounds of the lack of technique and special plant, e.g., for blending, peculiar to Players "; in 1955 the branch was prepared to consider allowing Wills to help it out in the manufacture of Player's Medium, but only " provided the layout and control was in Player's hands ". Wills is reported to have " reacted unfavourably " to a suggestion that Churchman should manufacture some Woodbine for it in 1955. Of the three small branches which undertook manufacture of Weights, Churchman, which had to reorganise production to achieve uniformity with Player, particularly on the preliminary processing side, found that " considerably more labour is required to manufacture ' Weights ' than any Churchman cigarette operation ", while Ogden reported that the manufacture had entailed special arrangements in the factory, including " modifications to the Rotary Mixing Roller to enable Player's method of blending, liquoring and casing to be adopted ".* Commenting on some of the examples given above the company acknowledges that two or three of its older factories have not lent themselves to modernisation, but in general claims that the great majority have a very high degree of manufacturing efficiency. We deal further with differences in manufacturing costs as between branches and factories in paragraphs 364 to 373.

(6) SUBSIDIARIES OF IMPERIAL FORMERLY MANUFACTURING TOBACCO GOODS

127. In addition to the tobacco manufacturing interests acquired in 1901 and 1902, which became branches of the company, Imperial has acquired over the years three subsidiary companies engaged wholly or in part in tobacco manufacture,† namely the Robert Sinclair Tobacco Co. Ltd. (Robert Sinclair), the Walters Tobacco Co. Ltd. and E. & W. Anstie Ltd. None of the three now manufactures.

128. Imperial acquired a controlling interest in Robert Sinclair in 1930; Robert Sinclair is now a wholly owned subsidiary primarily engaged in the wholesale distribution of tobacco goods, confectionery and fancy goods in the North of England and in Scotland. The company ceased manufacture in 1953 (see paragraphs 153–157 below). The circumstances leading to the acquisition of Walters are described in paragraph 68. The company ceased manufacture in 1953. The third company, Anstie, was acquired in 1944 when its directors offered to sell the business to Imperial. Imperial has said that the principal reasons for the offer were the advanced age and failing health of members of the Anstie family, who were the largest shareholders, and their desire to provide for the future of their workpeople. Imperial purchased the greater part of the

* The years immediately following relaxation of control of tobacco leaf (see Chapter 2) created abnormal conditions; it is not usual for one branch to manufacture on behalf of another except where it takes over the entire manufacture of that branch's products.

† A fourth concern, Joseph and Henry Wilson Ltd., acquired in 1953, was and is wholly concerned with snuff manufacture.

shares and has since acquired virtually all of them. Until it ceased manufacturing Anstie was managed by the Ringer branch. Imperial's records show that in 1956 the Executive Committee agreed that Ringer should for the time being maintain production at the Anstie factory: the branch wished to do this " on sentimental grounds " although it realised that the factory would almost certainly incur a financial loss. Anstie ceased manufacture in October 1958; the company's brands and goodwill were then transferred to the Ringer branch which became directly responsible for manufacture at Anstie's factory at Devizes and for the sale of Anstie brands.

(7) Overseas Leaf Buying Organisations

129. Imperial has its own leaf buying and handling organisations in the United States, Canada, Southern Rhodesia and Nyasaland which are responsible, under the direction of the Leaf Department (see paragraph 110), for the purchase of the company's leaf requirements in those countries and for the packing and shipment of such purchases. The organisation in the United States (with headquarters in Richmond, Virginia) was set up in 1902, very soon after the formation of Imperial; the constituent manufacturers had previously, with the exception of one of the smaller concerns, bought from leaf merchants in the United Kingdom. Imperial has now twelve leaf handling factories in the United States in the main districts where leaf is sold at auction, besides docks and transit sheds at Norfolk, Virginia. The Canadian leaf buying organisation was set up in 1926 and comes under the control of the United States organisation. The African leaf buying organisation originated in 1906 when Imperial sent an expert to investigate leaf buying prospects in Nyasaland. In 1927, as a result of the introduction of Imperial Preference duty rates and of the increase in cigarette smoking, a leaf buying organisation and handling factory was set up in Southern Rhodesia. The African organisation has expanded considerably in recent years, particularly in Southern Rhodesia, and Imperial has acquired and developed forestry estates, primarily to produce timber for casks for shipping tobacco. Imperial does not itself undertake or finance the growing of tobacco required for its trade in cigarettes and tobacco.

(8) Subsidiaries and Associates of Imperial Making Materials and Components used in Manufacture and Packaging of Cigarettes and Tobacco

130. The main materials other than leaf used in the tobacco industry are described in paragraphs 9–14. The most important of these items are cigarette paper, hulls and slides for cigarette cartons and fibreboard packing cases, which together accounted in 1953, for example, for some 90 per cent. of the expenditure of Imperial's Head Office Supply Department. The Supply Department purchases branch requirements of cigarette paper, filter tipping material and packing, parcelling and packaging materials;* branches then deal direct with suppliers on delivery and technical matters. Specifications are settled between the branches and the department. Branches purchase their own requirements of cork tipping material and of starch and dextrine and the Research Department purchases branch requirements of flavouring essences, olive oil, nut arachis oil and acetic acid. By far the greater part of

* For a definition of the terms "packing", "parcelling" and "packaging" see footnote † on page 7.

the more important materials used by the branches is supplied by subsidiary companies of Imperial, namely Mardon, Son & Hall Ltd. (Mardon), St. Anne's Board Mill Co. Ltd. (St. Anne's), Ashton Containers Ltd. (Ashton) and Robert Fletcher & Son Ltd. (Robert Fletcher). It is the company's policy to place at least 90 per cent. of its orders for such materials with its subsidiaries, provided that they can supply the quantities and qualities required. Some materials are not, however, made by subsidiaries and even where they are it is Imperial's practice to place orders for up to 10 per cent. of its requirements with outside concerns, partly because " the prices quoted by outside firms afford a yardstick to the competitiveness of Subsidiary Companies ", partly because it gives Imperial access to alternative sources of supply and partly because it helps the branches and the Supply Department to keep in touch with new developments.

131. The subsidiary companies themselves supply other customers besides Imperial, including other tobacco manufacturers. As each customer has his own specifications, prices cannot be readily compared. We are told by Imperial, however, that " as a general rule . . . the profit margins earned by the Subsidiaries, expressed as a percentage on selling prices, are not substantially different as between sales within the . . . [Imperial] group and sales outside it ". We have received no criticism from other tobacco manufacturers concerning either the availability of supplies from Imperial's subsidiaries or the prices charged. Alternative sources of supply are in all cases available.

132. The Chief Engineer of Imperial is a director of Mardon; the Manager of the Supply Department is a member of the boards of Ashton and Robert Fletcher, and both he and the Manager of the Research Department are on the board of St. Anne's. The companies are responsible for their own manufacturing and marketing arrangements and for their internal administration. The board of each is responsible to the Executive Committee for the maintenance of the business on an efficient and profitable basis and is required to submit accounts and an annual report on trade to the Committee; each company is also required to obtain approval for major items of capital expenditure and for any proposals which would have repercussions on the Imperial group as a whole.

133. The business of Mardon, colour printers and specialists in the production of packing and parcelling materials, was acquired by Imperial in 1902 and Mardon then became a branch of the company; in 1938 it was made a wholly owned subsidiary to bring its status into line with that of other subsidiaries manufacturing packing materials. In 1953 Mardon acquired a substantial interest in a Canadian printing firm; it also acquired Celloglas Ltd., a British company engaged principally in making printed material laminated with cellulose acetate film. In 1955 Mardon acquired a subsidiary in Southern Rhodesia which specialises in lithographic printing. Mardon continues to supply the bulk of the printed packing materials used by branches; it supplies, *inter alia,* over 90 per cent. of Imperial's requirements for hulls and slides.

134. Imperial's records show that during the years 1952 to 1956 (the only period examined) Mardon was sometimes underquoted by outside suppliers. Imperial has exercised pressure on the company to make its prices more competitive but has told us that " it should be borne in mind that there were a number of reasons, including the destruction by enemy action . . . of a large part of Mardon's production capacity, " why the company's prices were uncompetitive at that time. Since, according to Imperial, some 35 per cent. of Mardon's

trade in 1959 was with customers other than Imperial* it may be presumed that, in general, these other customers have been satisfied with the prices paid.

135. St. Anne's was formed in 1913 by Imperial and B.A.T. Before that date almost all supplies of carton board used for cigarette and tobacco packets came from abroad; in forming St. Anne's the two companies wished to lessen their dependence on imports. In 1921 St. Anne's became a wholly owned subsidiary of Imperial. St. Anne's supplies a large proportion of the board used in the Imperial group; it has also a substantial outside trade which accounts for about two-fifths of its total sales. Before 1921 arrangements for the supply of board to Imperial and B.A.T. by St. Anne's were covered by agreements made in 1913 and 1915. Since then there has been no joint policy between Imperial and B.A.T. on the production or supply of board.† Board ultimately required by Imperial is supplied mainly through Mardon (which stamps out the hulls and slides and other containers and prints them) or other printers, although small quantities of board are also supplied direct by St. Anne's to the Player branch which makes some types of boxes itself. In view of the size of its orders, and consequent economies in manufacturing and selling costs, Mardon gets certain price allowances from St. Anne's.‡ Where Imperial places orders with printers other than Mardon, St. Anne's supplies the printers at the normal price charged to other customers and subsequently pays the branches of Imperial a rebate equal to the sum of the allowances that would have been made if the board had been supplied to Mardon. St. Anne's customers also include B.A.T. which receives an allowance on one type of board.§ These allowances have been granted for at least thirty years. The only other price allowance made by St. Anne's is the rebate|| recently granted to Gallaher in view of a considerable increase in the size of that company's orders.

136. Ashton was originally formed by Imperial in 1919 as Ashton Saw Mills Ltd. to supply timber for Imperial's packing case factory. The name was changed in 1937. Ashton, which is a wholly owned subsidiary, now manufactures fibreboard containers and packing cases. In 1921 Imperial's packing case factory was transferred to Ashton. In 1959 41 per cent. of Ashton's trade was with Imperial, 17 per cent. with other tobacco manufacturers, and 42 per cent. with customers in other trades. The company supplies 90 per cent. of Imperial's requirements of fibreboard cases.

137. Robert Fletcher, a wholly owned subsidiary of Imperial, manufactures cigarette paper and other fine tissues and waxed paper. Before 1914 the greater part of Imperial's requirements of cigarette paper came from France. During the 1914–18 war the French mills had difficulty in getting the necessary raw materials and Imperial made an arrangement with Robert Fletcher to manufacture part of the company's requirements. In 1918 Imperial purchased a majority shareholding in Robert Fletcher and in 1935 it acquired the remaining shares. In 1959 paper of types used in the tobacco trade accounted for more

* i.e. about 16 per cent. with other tobacco manufacturers and 19 per cent. with customers outside the tobacco industry.

† There is, however, a regular interchange of packings of principal brands manufactured by the two companies in the United Kingdom so as to achieve similarity as far as this is practicable.

‡ For example, in 1958, on coated board (basic price £92 10s. 0d. per ton) Mardon received an allowance of £10 10s. 0d. per ton, and on Woodbine lined (uncoated) board (basic price £72 15s. 0d. per ton) £2 per ton; certain extra charges for special services, commodities or small quantities are waived in the case of Mardon. The Player branch buys on the same terms as Mardon.

§ i.e. £3 per ton on coated board. The same allowance was given to Ardath.

|| i.e. £1 per ton on coated board.

than 70 per cent. of the company's turnover, three-quarters of this business being with Imperial. Fletcher supplies 90 per cent. of Imperial's requirements of cigarette paper.*

138. Imperial had formerly two other subsidiaries engaged in the manufacture of materials, neither of which is now trading. Of these, Tuebrook Packing Case Co. Ltd. was registered in 1920 to take over the work of the Ogden branch's box making factory. In 1938 the Tuebrook factory was sold and its machinery transferred to Ogden, which again undertook its own box manufacture until Ashton was able to supply all its requirements (see paragraph 136 above). The Tuebrook company was wound up in 1950.

139. The other company, Bristol Tin Case Co. (1920) Ltd., was formed as the Bristol Tin Case Co. Ltd. in 1912 by Imperial, B.A.T. and G. H. Williamson & Son Ltd. to manufacture airtight and other tins. In 1920 Imperial bought the interests of the other two parties and the company was reconstituted. From then until 1931 the greater part of its trade consisted in the manufacture of tins for Imperial's branches. In 1931 Imperial entered into an agreement with the Metal Box Co. Ltd. for the supply of airtight and non-airtight cylindrical tins in lieu of tins previously made and supplied by the Bristol Tin Case Co. (1920) Ltd. This agreement expired in 1936. In 1937 and 1938 Imperial entered into further agreements with Metal Box which gave Imperial exclusive rights in the use for packing tobacco goods of patented tins developed jointly by Imperial and Metal Box; the 1937 agreement also covered the supply of tins of types which had been the subject of the earlier (1931) agreement, but gave Imperial no exclusive rights so far as these types were concerned. Both the later agreements expired in 1952 and were not renewed. Thereafter until 1956 Metal Box continued to supply rectangular tins exclusively to Imperial as far as the tobacco trade was concerned; in 1956 Metal Box modified the design of the tin and, with the agreement of Imperial, thereafter supplied it freely to all purchasers. Meanwhile the Bristol Tin Case Co. (1920) Ltd. had been wound up in 1950.

140. In one other case Imperial has entered into preferential arrangements with an outside manufacturer for the supply of materials. In 1947, anticipating the end of Government restrictions on the use of certain packaging materials, Imperial entered into an agreement with British Rayophane Ltd., makers of cellulose film, under which Imperial purchased £100,000 cumulative preference shares in the company and undertook to purchase from it not less than 25 per cent. of its requirements of viscose transparent wrapping material. British Rayophane was required to supply at a contract price (provided the price so obtained did not exceed that of other manufacturers) and, after making allowance for Board of Trade allocations, to give Imperial preference for the execution of its orders up to a specified volume. The agreement remains in force so long as Imperial retains its financial interest, provided that British Rayophane continues to be able to supply film of a type suitable for Imperial's requirements. British Rayophane has told us that the proportion of its output committed to supplies to Imperial is a decreasing one, and that in its view the agreement has provided an incentive to the company to increase its productivity.

* Fletcher is one of the two sources of supply of cigarette paper in the United Kingdom, the other being Cromptons (Stubbins) Ltd., a wholly owned subsidiary of B.A.T. (Another United Kingdom manufacturer stopped production in 1950.) Tobacco manufacturers in this country also buy cigarette paper from France and Imperial obtains the balance of its requirements from this source. Imported cigarette paper is liable to a duty of 16⅔ per cent.

(9) Subsidiaries and Associates of Imperial engaged in the Distribution of Tobacco Goods

141. Since its formation Imperial has acquired interests in both the wholesale and the retail distribution of tobacco goods through its ownership of Robert Sinclair and Bewlay (Tobacconists) Ltd. (formerly Salmon & Gluckstein Ltd.) and its substantial shareholding in Finlay & Co. Ltd.

142. Imperial acquired a controlling interest in Salmon & Gluckstein Ltd., retail tobacconists, in 1902. The company was then operating 140 shops in London and the provinces and was manufacturing in a small way. Under the terms of the acquisition Salmon & Gluckstein increased its authorised capital from £500,000 (£450,000 of which had been issued) to £600,000 by the creation of 100,000 deferred shares of £1 each and adopted new Articles of Association. These provided that the original 500,000 shares should become preference shares entitled to a fixed cumulative preferential dividend of 10 per cent. per annum without voting powers and that the deferred shares should carry voting rights and the right to any surplus profits. Imperial agreed to subscribe at par for the whole of the deferred shares and at the same time to guarantee that the profits of Salmon & Gluckstein should be sufficient for the payment of the 10 per cent. preference dividend.

143. In the same year Imperial acquired A. I. Jones & Co. Ltd., owner of a chain of retail tobacconists' shops; the company had an authorised capital of £120,000, of which 60,000 ordinary shares and 25,046 preference shares had been issued. Under the terms of the acquisition A. I. Jones increased its authorised capital to £150,000 by the creation of 30,000 deferred shares of £1 each and adopted new Articles of Association which provided that the original capital should be merged into one class of preference shares entitled to a fixed cumulative preferential dividend of 5 per cent. per annum without voting powers and that the deferred shares should carry voting rights and the right to any surplus profit. Imperial agreed to subscribe at par for the whole of the deferred shares and guaranteed that profits should be sufficient for the payment of the preference dividend. Also in 1902 Imperial purchased for the sum of £10,500 the business of James Quinton Ltd., retail tobacconists, a former subsidiary of Lambert & Butler Ltd., with a capital of £10,000. Both companies were transferred to Salmon & Gluckstein.

144. Imperial says that its files do not record the reasons why it decided to acquire a controlling interest in Salmon & Gluckstein, but that it was probably to prevent the company from falling into the hands of American Tobacco; it probably acquired A. I. Jones for the same reason. According to a report made to the Executive Committee in 1955 Imperial's "primary objective [in acquiring Salmon & Gluckstein] was to stop competitive manufacturing allied with cut-price retailing"; the report adds that to achieve this Imperial "had to pay considerably more than the business as such was worth to them". With reference to this report, Imperial has explained that towards the end of the 19th century Salmon & Gluckstein engaged in cut-price trading through its retail shops. These activities were curtailed "around the turn of the century" when the principal manufacturers introduced conditions of sale (see paragraph 50), and in 1901 Salmon & Gluckstein built a factory for making its own brands. It also approached an association of retailers with a proposal that it should supply the members with all their requirements of tobacco and fancy goods;

at the time, the Salmon & Gluckstein factory would appear to have been operating at only about 25 per cent. of capacity. The response of the retail trade was unfavourable, perhaps because Salmon & Gluckstein brands were less popular with the public than those of other manufacturers, with the result that retailers feared to jeopardise their own business by tying themselves to Salmon & Gluckstein. Imperial submits that, this being so, it had apparently " little to fear from Salmon & Gluckstein's manufacturing and cut price retailing of . . . [its] own brands, and would have been unlikely to purchase the business on that account alone ". It was known, however, that American Tobacco had approached Salmon & Gluckstein and " it was clearly considered that the Salmon & Gluckstein business in their hands would have been a potent competitive weapon ".

145. When Imperial acquired its interest in the Salmon & Gluckstein group in 1902 it agreed upon certain " self-imposed " limitations,* namely, that:—

(a) the total number of outlets operated by the group should not exceed the then existing number of 184;

(b) if Salmon & Gluckstein wished to go into any new areas, or to increase the number of outlets in an area (other than the 20-mile radius of London) in which it was already trading, it should only acquire existing tobacconists' businesses;

(c) it should not have an undue share of the retail trade in any one town;

(d) it should not engage in any wholesale trade (apart from servicing the shops of J. Lyons & Co. Ltd.).†

Imperial says that " the limitations on expansion . . . were attributable to the fact that . . . [Imperial] wished to maintain the goodwill of its trading Branches with the distributive trade and therefore had no intention of expanding the scope of the Salmon & Gluckstein business at the expense of other distributors ".

146. In 1937 Salmon & Gluckstein acquired Bewlay & Co. Ltd., owner of thirteen high-class retail tobacconists' shops in the London area, with the intention of using Bewlay shops to replace less remunerative shops operated by the group in that area.

147. Restricted in its operations by the limitations referred to in paragraph 145 and hampered by outdated methods the company's trading was unsuccessful and was subsidised by Imperial through the guarantee of the preference dividend. Its main value, in the view of Imperial, lay in advertising and publicity. From 1955 onwards considerable reorganisation was undertaken with a view to modernising the business and putting it upon a profitable footing.

148. In evidence submitted to us in 1959 Imperial has confirmed that for a long time it has recognised that the business of Bewlay has been uneconomic. The company does not, however, regard Bewlay as " a typical retail business ". Whilst secondary shops as a whole are at present run at a profit and the unprofitable ones are being closed, many other Bewlay shops are uneconomic largely because they occupy very expensive sites. Imperial has thought it " a good thing to have in most of the big cities in this country at least one specialist tobacconist where the smoker can be sure of finding a really wide range of

* The report of a special committee appointed by the Executive Committee of Imperial in 1954 also mentions that Salmon & Gluckstein group shops were not to sell confectionery or newsagents' goods or to open on Sundays.

† See paragraph 209.

tobacco and cigarette brands "; Bewlay stocks the brands of all manufacturers but it stocks little else except smokers' requisites. These factors have meant " that the business has been an unprofitable one " and Imperial has regarded the losses as in part an advertising charge.

149. Meanwhile in 1954 Bewlay & Co. Ltd. had been wound up and Salmon & Gluckstein Ltd. had changed its name to Bewlay (Tobacconists) Ltd. The company now operates 153 shops in London and the provinces. Imperial now owns £466,587 of the £500,000 issued 10 per cent. cumulative preference shares and all the £100,000 issued deferred shares.

150. In 1927 Imperial acquired a controlling interest in Finlay, owner of a chain of retail tobacconists' shops and kiosks. Imperial has told us that at the time it was concerned at the possibility that American Tobacco contemplated entering the United Kingdom market and has pointed out that in fact that company acquired the business of J. Wix & Sons Ltd. in October of the same year (see paragraph 62). When the Managing Director of Finlay informed Imperial that he was negotiating for the business of A. Baker & Co. Ltd. but would require substantial financial help, Imperial agreed to subscribe the money and at the same time acquired a controlling interest in the Finlay/Baker group. Control was maintained until 1946, when Imperial disposed of part of its holding. Imperial has explained that it " had never regarded the Finlay Company as a subsidiary and considered that consolidation of Finlay's figures in [Imperial's] accounts (which would have been required as a result of the recommendations of the Cohen Committee on Company Law Amendment) would be misleading ". It therefore sold 18,500 of its holding of Finlay ordinary shares on the open market and 1,000 of its holding of preference shares to Imperial's staff pension fund.

151. Imperial now holds £27,326 of the £50,000 issued cumulative preference shares of Finlay, and £258,397 of the £525,000 issued ordinary shares. The shares are held in the name of a nominee and Imperial has not publicly acknowledged its holding. Imperial says that it " exercises no control " over Finlay, but that by virtue of its " large shareholding and the important position of the Finlay Company in the retail tobacco trade the Executive Committee discuss matters of mutual interest from time to time with the Chairman of the Finlay Company ", who consults Imperial on matters of major policy, such as the possible acquisition of other businesses. Imperial is not represented on the board, but its views would be taken into consideration and would carry considerable weight; it would, however, be an " overstatement " to say that Imperial still exercises considerable influence in Finlay's affairs. The day-to-day management is entirely in the hands of the Finlay board and the company " is run very much at arm's length " from Imperial. Imperial's records show that Finlay does not submit an annual report on trade to the Executive Committee, as Imperial's subsidiaries are required to do, but that the Executive Committee considers the Directors' Report and Statement of Accounts of the company each year. It is the practice of the Managing Director of Finlay to attend for this item; he informs the Executive Committee about the trend of the company's trade and gives his views on trade matters generally. It is recorded that in 1954 the Managing Director discussed his company's annual accounts with the Secretary of Imperial in advance of publication. We are told by Finlay that this action was exceptional and that discussions between the two companies are rare.

152. Imperial has said that, unlike Bewlay, Finlay is in a particularly favourable position in that its costs are exceptionally low. It has a great many kiosks on railway stations and other sites the rentals of which have been negotiated with the British Transport Commission over a period of years, labour costs are low and there is " a tremendous turnover ". In recent years Finlay has started selling many types of goods other than tobacco, cigarettes and smokers' requisites, but a very large part of its profits is still derived from the turnover in cigarettes and tobacco; it is one of the few specialist retailers trading under particularly favourable conditions who " can make quite a good living on present retail margins ".* Finlay receives special payments from Imperial in connection with window dressing (see paragraph 234), as does Bewlay.

153. In 1930 Imperial acquired a controlling interest in Robert Sinclair, a company primarily engaged in the wholesale distribution of tobacco goods in the North of England and Scotland (see paragraph 128). Both Robert Sinclair and another company called John Sinclair Ltd. had interests in manufacture as well as in distribution. We are told by Imperial that the two Sinclair companies were the leading wholesale tobacco distributors in the Newcastle-upon-Tyne area. In 1930 Carreras Ltd. acquired control of John Sinclair and Imperial learned that a financial group representing Gallaher had approached Robert Sinclair with a view to purchase. Imperial " felt that if both these substantial wholesale businesses fell into the hands of competing manufacturers the sales of . . . [Imperial] brands in the . . . area might be prejudiced ". Following negotiations, Robert Sinclair was converted into a public company and Imperial acquired a controlling interest. Robert Sinclair's results for the years 1932–3 and 1933–4 were poor and in 1934 it was decided not to pay a dividend on the ordinary shares. As this would have had an adverse effect on the company's relations with its trade customers (who held a large number of its ordinary shares) it was also decided that outside shareholders should be given the full facts concerning the company's position and that Imperial should offer to buy their shares at par. Most of the outside shareholders accepted this offer and the rest have since done so.

154. Robert Sinclair continued to manufacture its own brands of cigarettes and tobacco until 1953. Between 1930 and 1960 it has enlarged the scale of its wholesale trading operations by acquiring the businesses of fourteen other wholesale tobacconists including John Sinclair.†

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* That is, retail margins in June 1959 before the improvement in margins for cigarette and pipe tobaccos resulting from the price increases of August 1959 (see paragraph 226).

† Namely:—

1930 Telfer & Sons Ltd., Newcastle-upon-Tyne.
1932 G. M. Frame, Glasgow.
1936 Wilde & Co., Harrogate and Ripon.
1936 F. J. Routledge, Glasgow.
1936 James Yule & Son Ltd., Aberdeen.
1946 Gregg Bros., Darlington.
1952 J. Duncan & Co. Ltd., Glasgow.
1952 Kinnear & Scott Ltd., Perth.
1953 Forster Tobacco Co. Ltd., Newcastle-upon-Tyne.
1956 W. Williams, Sunderland.
1956 A. Proctor, Leeds.
1956 John Auld Ltd., Aberdeen.
1958 John Sinclair Ltd., Newcastle-upon-Tyne.
1960 Thomson & Porteous Ltd., Edinburgh.

Thomson & Porteous was acquired from Godfrey Phillips Ltd. Imperial negotiated this purchase on behalf of Robert Sinclair at approximately the same time as it was negotiating a marketing agreement with Godfrey Phillips on behalf of another of its subsidiaries, Ardath (U.K.) Ltd.—see paragraph 185.

155. We found in Imperial's records a Head Office memorandum of 1952 which commented on the fact that the accounts of Robert Sinclair showed a loss, for which a decrease in turnover and profit from sales of the company's own goods had been partly responsible, and suggested that the difference between expected and actual results had been largely due to accounting errors resulting from " lack of delegation of duties and lack of full realisation of the importance of control figures to management ". In a report dealing with the company's future submitted to the Executive Committee of Imperial early in 1953, the Managing Director of Robert Sinclair referred to many difficulties including " rates of pay and conditions which follow manufacturers' practice rather than wholesalers' " and an out-of-date factory. He said the company's margins were " insufficient to support a structure which in the main pertains to a manufacturing house conforming to the highest standards of employment ", with the result that the expenses of the business were " quite out of balance with its earning capacity ". To effect economies it was proposed that the company should concentrate on wholesaling in its own area, eliminate unprofitable lines of its own manufacture and transfer manufacture of the remaining lines to the Ogden branch, whose quotations were for the most part lower than Robert Sinclair's manufacturing costs. The proposal to transfer manufacture was approved and Robert Sinclair was told that the Executive Committee expected the company to make a net profit before taxation of £75,000, less say £25,000 to allow for conforming with Imperial's practices in such matters as rates of pay and conditions. The company ceased to manufacture its own brands in the same year.

156. Robert Sinclair's overall net profit rose from 4 per cent. on capital employed in 1954 to 10 per cent. in 1957. Imperial has said, however, that a profit of 10 per cent. is not adequate and that in the years concerned Robert Sinclair's business must be considered to have been uneconomic. The burden of overhead costs was heavy because of the large number of scattered depots operated and the present management was engaged in " streamlining . . . the organisation in order to reduce overheads ". Imperial has told us that when the business was acquired it had overstretched itself and was not in very good order; Imperial was trying to improve it in various ways before the war and in recent years the management of Robert Sinclair has been endeavouring to improve the profitability of the business as a whole. The improvement in profitability since 1954 is taken to indicate that this policy has achieved some success, and in this connection we are told that in 1959 Robert Sinclair's net profits were some two-thirds greater than in 1957. Imperial does not consider the business of Robert Sinclair " entirely typical " of that of all wholesalers; some wholesalers may be run more economically, although others in particular areas " possibly are not doing very well".

157. The board of Robert Sinclair consists of three members of the company's management and a member from the Chief Accountant's Department of Imperial, all nominated by Imperial. Imperial says that the board has complete autonomy in the day-to-day running of the business but is required to obtain approval from the Executive Committee for proposals to acquire new businesses and for major capital expenditure.

158. Bewlay, Finlay and Sinclair stock the brands of all manufacturers. In 1954 75 per cent. of Bewlay's turnover in tobacco goods consisted of Imperial's products, but by 1959 the proportion had fallen to 57 per cent. In the case of

Robert Sinclair from 1954 to 1959 the proportion varied between 83 per cent. and 67½ per cent. In the case of Finlay the proportion was 70 per cent. in 1954 and 57½ per cent. in 1959. The three companies provide Imperial with sales information as required and are consulted when Imperial is seeking information on matters relating to the distributive side of the trade.* In 1952, for example, when Imperial was considering the possible implications of a free market, the company thought it might be helpful to ascertain the views of the three companies, although the distributors generally were not to be informed of Imperial's plans until these were about to be put into effect. Again in 1955 Imperial had discussions with Bewlay and Finlay, as well as with the branches, before deciding to re-issue automatic vending machines. Also in 1955, when multiple retailers were dissatisfied with their position and were pressing the manufacturers for better terms, the Managing Director of Finlay kept Imperial in touch with the views of multiple tobacconists who were members of the Multiple Shops Federation (see footnote * on page 75).†

CHAPTER 4. OTHER MANUFACTURERS

(1) General

159. There were at the beginning of the present century some 500 manufacturers of tobacco and cigarettes (see paragraph 46); there are now 24 from all of whom we have received evidence.‡ We have also received evidence from a number of former manufacturers, most of whom went out of business between 1951 and 1957. The reasons they have given for ceasing manufacture include: (i) a falling off in demand for the products concerned; (ii) the difficulty of recruiting labour; (iii) the burden of financing the high rates of duty and difficulties raised by Customs and Excise legislation generally; and (iv) the difficulty of competing with the large companies with their greater financial resources. We give further information on these matters in Chapter 14. Seventeen other manufacturers, among them several old-established and well-known makers of pipe tobaccos, are known to have been taken over by others since 1945.§

160. Many of the manufacturers at present operating have connections with the industry dating back to the 19th or 18th centuries; there have been very few new entrants in the past 60 years. In paragraph 4 we give the names of the eight largest manufacturers of recent years after Imperial, with the value of their sales and other particulars. The sixteen smaller companies include a few old-established family businesses whose trade is based mainly on the cheaper hard pipe tobaccos (and also on snuff), which they sell locally. According to Imperial

* Imperial also receives information concerning sales from other distributors in which it has no financial interest—see paragraph 236.

† Finlay points out that its Chairman was at that time also Chairman of the multiple tobacconists' group.

‡ One of the 25 referred to in paragraph 4 stopped manufacturing during 1960 (see paragraph 182). In addition to the present 24 there are a few undertakings producing their own blends of pipe tobaccos in very small quantities or making hand-made cigarettes from tobacco processed and cut by other concerns.

§ For example: Murray, Sons & Co. Ltd., taken over by Carreras Ltd. in 1953; Cope Brothers & Co. Ltd., taken over by Gallaher Ltd. in 1953. George Dobie & Son Ltd. went out of business in 1956 and the company's goodwill and trade marks, together with one of its subsidiaries, were taken over by Godfrey Phillips Ltd.

(see paragraphs 445 and 447) there were in 1959 about 217 brands of cigarettes and some 430 brands of tobacco on the home market, of which 160 brands of cigarettes and some 250 brands of tobacco belonged to manufacturers other than Imperial.

161. Of the larger manufacturers, the two Co-operative Wholesale Societies have not played a conspicuous part in the industry as producers. The manufacture of tobacco goods is only a very small part of their activities; it is only in recent years that their output has been comparable in size with that of some of the other manufacturers named, and this is due not to any expansion of their own production but to a very sharp fall in the output of those other manufacturers. The success of Gallaher Ltd. since the war has been accompanied by a decline in the share of sales of Imperial's other competitors as well as of Imperial itself. We have no precise figures for years earlier than 1954, though it is clear that Gallaher's share of the market in that year was appreciably higher than it had been at the end of the war. The table below shows how the position has changed since 1954 and it will be seen that, although the aggregate share of manufacturers other than Imperial and Gallaher has increased slightly in the last two or three years,* it was still substantially lower in 1959 than in 1954.

Shares of Total Sales (by value) of Cigarettes and Tobacco in the United Kingdom

	1954	1955	1956	1957	1958	1959
	%	%	%	%	%	%
Imperial	75·4	78·8	76·1	71·4	67·6	63·4
Gallaher	11·2	15·2	18·6	22·5	26·1	29·3
Ardath, Carreras, Godfrey Phillips, Rothmans and J. Wix	11·9	4·6	4·3	5·1	5·5	6·6
Others	1·5	1·4	1·0	1·0	0·8	0·7

162. Apart from Imperial and the two Co-operative Societies, the issued capital of the larger companies ranges from just over £1 million to nearly £26½ million; with one exception all are public companies. Three of them (Carreras Ltd., Gallaher Ltd. and Godfrey Phillips Ltd.) have each a number of subsidiaries engaged in tobacco and cigarette manufacture, two (Carreras and Gallaher) have subsidiaries concerned with the manufacture of tobacco machinery (see paragraphs 282 and 292) and another (Godfrey Phillips) has subsidiaries concerned with the supply of materials, printing and other activities. Nearly all the sixteen smaller manufacturers are private companies. Their organisation is generally simple; few have any subsidiary interests; none now operates more than one factory. Four of those making only tobacco have also wholesaling interests and in at least one case this interest is now the predominant part of the business.

163. Four companies are owned or controlled by interests outside the United Kingdom. In 1927 members of the Wix family sold J. Wix & Sons Ltd. to the American Tobacco Company of New York (see paragraph 62). In 1954 Rothmans Ltd. became a subsidiary of the Rembrandt Tobacco Corporation (S.A.) Ltd. of South Africa and in 1958 Rembrandt's British subsidiary acquired

* Due to increased sales by J. Wix & Sons Ltd. and Rothmans Ltd.—see paragraph 4.

a controlling interest in Carreras. Philip Morris & Co. Ltd., one of the smaller companies, which is engaged only in cigarette manufacture, is effectively owned by Philip Morris Incorporated of the United States.

164. With the exception of the Co-operative Societies and Rothmans,* all the larger manufacturers were parties to the Martin Agreement (see paragraph 63) and to an understanding covering the introduction of filter tipped cigarettes (see paragraph 84); Carreras, Gallaher and Godfrey Phillips were also parties to an understanding with Imperial concerning Walters Tobacco Co. Ltd. (see paragraph 68).

165. We give below further information concerning Imperial's principal competitors (Gallaher, Ardath, Carreras, Rothmans, Godfrey Phillips and J. Wix), including particulars of Imperial's financial interests in Gallaher and Ardath. Imperial also holds, or has held, a token number of shares in fifteen other manufacturers. In nearly all cases the holdings are of preference shares; all are registered in the name of nominees. Imperial has told us that it has been the company's practice to acquire small holdings in other tobacco manufacturing concerns so that it may see their accounts and keep its intelligence concerning the activities of its competitors as complete as possible. We have noted from Imperial's records that in 1956 Imperial was represented at two general meetings of one of these companies, when the question of that company's entry into the coupon cigarette market was discussed: Imperial has said that it was considerably interested in this matter at the time and therefore wished to know what was said. Imperial has told us that on one occasion in 1952 and on three occasions in 1956 it was also represented at meetings of a second company. These are the only occasions when Imperial has been represented at the meetings of any of the fifteen companies; its representatives took no part in the proceedings.

(2) GALLAHER LTD.

166. The business was founded by Thomas Gallaher in Londonderry in 1857; in 1863 it moved to Belfast. In early years it was concerned principally in manufacturing hard tobaccos, although when its founder died in 1927 it was also making some cigarettes, including Park Drive. Gallaher Ltd. was formed in 1896 and in 1928 became a public company. In 1932 Imperial acquired a majority interest in the equity of Gallaher, which it retained until 1946, since when Imperial's interest has been less than 50 per cent. (see paragraph 172 below).

167. Since 1932 Gallaher has acquired a number of subsidiary interests engaged in cigarette and tobacco manufacture. In 1934 the company acquired Peter Jackson (Tobacco Manufacturer) Ltd., now Peter Jackson Ltd., makers of du Maurier cigarettes which Gallaher has described as " the first filter tip cigarettes to become popular "; two related companies (International Tobacco Co. Ltd. and The National Tobacco Co. Ltd.) were acquired at the same time. All three companies had been owned by members of the Wix family (see paragraph 192), who in two cases (Peter Jackson and International) retained the export trade, forming new companies for the purpose; the third company (National) was not trading. By acquiring the home trade of Peter Jackson and International, Gallaher was enabled under the terms of the Martin Agreement to claim compensation although its own proportion of total sales had not fallen,

* But see paragraph 63 as regards Rothmans.

since the businesses acquired were in deficit. Probably as a result of these acquisitions Gallaher's receipts from the Martin Agreement pool exceeded its payments by £298,793 up to the end of 1939: from 1940 to 1945, however, it paid into the pool a total amount of £461,435. Meanwhile, in 1937 the company had acquired E. Robinson & Sons Ltd., parent company of J. A. Pattreiouex Ltd., makers of Senior Service cigarettes; this brand, which had been introduced in 1925, was then enjoying considerable success in the Manchester area but was virtually unknown elsewhere and the owners lacked the financial resources to extend their trade to a national market. Gallaher has told us that at that time it did not itself possess " a cigarette brand of the standard type which appeared to have a favourable chance of being sold on a national scale to compete with the leading brands in the ' Senior Service ' price category ".

168. In 1947 Gallaher extended its interests into another new field by acquiring a group of companies (Associated Tobacco Manufacturers Ltd.) which included an old-established undertaking making cigars. In 1953, it acquired all the issued share capital of Cope Brothers & Co. Ltd., also trading under the name of Richard Lloyd & Sons, tobacco manufacturers, with five subsidiaries.* Gallaher has told us that for some years before 1953 the board and management of the company had " felt frustrated . . . because the basis of allocating Dollars for the purchase of American tobacco precluded them from meeting the demand for the Group's cigarette brands ". By acquiring Cope Brothers' dollar quota Gallaher was able to increase supply of its own brands; in addition Cope Brothers " had a considerable tobacco business with a promising brand in ' Old Holborn ' " and a range of products broadly complementary to the Gallaher range. In 1955 Gallaher acquired all the issued share capital of Benson & Hedges Ltd., principally, we are told, for its name " which is widely known and is associated with high quality products ". Meanwhile, Gallaher had also acquired interests in a group of engineering companies, one of which subsequently manufactured tobacco machinery (see paragraph 292), and in leaf buying and processing subsidiaries (see paragraph 170).

169. Gallaher operates seven factories, at Manchester (where there are three, all of which make only cigarettes), at Lisnafillan, Northern Ireland (cigarettes, tobacco and cigars), Belfast (cigarettes, tobacco and snuff), London (tobacco only) and Cardiff (cigars only). Under its own name or under the names of its subsidiaries it markets 23 brands of cigarettes and 33 brands of tobacco.† We describe Gallaher's distribution arrangements in paragraph 211. Since 1947 it has operated a bonus scheme (see paragraph 254).

170. Except for the company's engineering interests, executive and administrative control over the activities of all subsidiaries is exercised from Gallaher's Head Office in London. All decisions regarding capital expenditure and policy matters generally are made by the board and implemented by Head Office staff either direct or through local management at the factories. Most materials are purchased centrally. The company maintains a small staff in America to

* Cope Brothers was registered in 1885. In 1902 the company purchased the business of Richard Lloyd, founded in 1785. Gallaher has told us that the two businesses were similar in character; " the alliance was a mutually protective measure in view of the formation at that time " of Imperial. In 1924 Cope Brothers had acquired the goodwill and other assets of H. C. Lloyd & Son Ltd. of Exeter, an undertaking founded by one of the two sons of the founder of Richard Lloyd.

† These figures include 15 Benson & Hedges brands of cigarettes and 3 Benson & Hedges brands of tobacco.

supervise and co-ordinate the company's purchases of leaf through dealers both in the United States and in Canada; it has its own leaf buying organisation in Africa, which includes a packing factory in Salisbury, Southern Rhodesia.*

171. In the years since 1929 Gallaher, as we have already shown (see paragraphs 64, 66, 83, 89 and 161), has consistently expanded its share of a growing market and it has been the only one of Imperial's competitors to do so. At the same time an increasing proportion of the company's production has been in cigarettes; in 1930 these represented only about 25 per cent. of the company's production but by 1959 the proportion was about 90 per cent. Figures for Gallaher's sales in the years since 1954 are given in paragraph 4. The steady increase in the company's sales is largely attributable to its two leading brands of cigarettes and more particularly to Senior Service. Up to 1959 filter tipped cigarettes formed a lower proportion of the cigarette output of Gallaher than of the other large manufacturers, but the company has since introduced the Nelson brand which, we are told, has been very successful. Imperial's records bear testimony to the intensity of competition from Gallaher in recent years, to the success of that company's leading brands (Senior Service, Park Drive, Condor Sliced and Old Holborn), and to the high quality of its products.

172. Imperial has told us that it acquired its interest in Gallaher in 1932 after it had received information that American Tobacco, which had acquired J. Wix in 1927, was contemplating obtaining control and that Wix had opened negotiations with Gallaher to this end.† On receiving this news Imperial approached Gallaher. Following discussion, the Chairman of Imperial wrote to the Chairman of Gallaher telling him that the Executive Committee of Imperial was prepared to recommend to the board " that this Company should acquire an investment interest in Gallahers by taking say 51 per cent. of the Gallaher ordinary shares and leaving the management of the business to go on undisturbed and unhampered, we using that interest in no way other than that appropriate to any large shareholder with such an interest ". Imperial subsequently purchased 51 per cent. of the ordinary shares. Imperial still had this majority interest when the Report of the Cohen Committee on Company Law Amendment, published in 1945, recommended that holding companies should be required to produce consolidated accounts incorporating the results of all companies in which the holding company held a majority interest.‡ Imperial has told us that it considered that consolidation of Gallaher's financial results with its own would have been misleading since it exercised no control over that company. When, therefore, in June 1946 Gallaher made an issue of shares to shareholders, Imperial did not retain its full entitlement. Since July 1946 Imperial has held less than 50 per cent. of the equity in Gallaher and since 1956 its interest has amounted to 42½ per cent. of Gallaher's ordinary shares. The company remains the largest single holder of Gallaher's ordinary share capital. In 1955 it also acquired a small number of preference shares which it disposed of in 1959. Imperial's shares have throughout been registered in the names of nominees

* Oriental and Indian leaf is bought through the British-American Tobacco Co. Ltd. and British merchants. Small quantities of American leaf are also bought through British merchants.

† According to Gallaher its Chairman was asked by the Chairman of Imperial in November 1932 whether American Tobacco was negotiating to purchase the Gallaher business and replied that no negotiations had taken place but that a representative of J. Wix had seen over Gallaher's factory in Northern Ireland.

‡ The recommendation was subsequently implemented in the 1948 Companies Act.

and the existence of the interest has been treated by the company as a confidential matter. Imperial is not represented on the board of Gallaher and has never interfered with its policy except in so far as appears in the following paragraph.

173. Indirectly Imperial's interest in Gallaher has had an effect on that company's export trading arrangements. The 1902 agreement between Imperial, B.A.T. and others whereby Imperial transferred its export and overseas interests to B.A.T. (see paragraph 103) provided, *inter alia*, that B.A.T. should be entitled to purchase the export business of any company the control of which should in the future be acquired by Imperial. In 1932, therefore, when Imperial acquired a controlling interest in Gallaher, which at that time had virtually no export trade, Gallaher entered into an agreement with B.A.T. Under the agreement now current Gallaher undertakes not to engage in export business except through its Export Branch, which is managed by B.A.T. Similar arrangements applied to the export business of subsidiaries subsequently acquired by Gallaher. As a corollary to the agreement between Imperial and B.A.T., Imperial pays to B.A.T. that proportion of Gallaher's profit from the export trade appropriate to Imperial's holding in Gallaher.

(3) Ardath Tobacco Co. Ltd.

174. The Ardath business was founded in 1895 and from about 1901 onwards traded as Ardath Tobacco Company; in 1912 the Ardath Tobacco Co. Ltd. was incorporated. In 1925 some 84 per cent. of production was exported.

175. B.A.T. has told us that in 1925 it had the opportunity of acquiring the whole of the capital of the Ardath company. Imperial has told us that the initiative for purchasing Ardath in 1926 came from B.A.T., which wished to acquire the company's export trade; as the result of the market-sharing arrangements of 1902 between the two companies (see paragraph 103), B.A.T. approached Imperial but Imperial cannot now trace from its files any other reasons which led it to acquire its share in Ardath. The two companies decided to purchase the Ardath company and formed a new holding company, Universal Tobacco Co. Ltd. (Universal), for that purpose. Since 1932 the whole of the ordinary capital of Universal has been registered in the name of B.A.T. which held, and holds, 50 per cent. of the shares on behalf of, and as nominee for Imperial.* Meanwhile, in 1926 the old Ardath company was wound up and a new company of the same name was incorporated. The new company had a nominal capital of £6 million divided into £3 million ordinary and £3 million preference shares each of £1, all the ordinary shares being issued and held by Universal. The £1,400,000 issued preference shares were held on the open market and in 1959 the largest single holder (643,000 shares) was Imperial's Pension Trust.

176. Under the 1925 arrangements Imperial and B.A.T. had equal interests in Ardath and Imperial received half the profits, including profits attributable to Ardath's export trade which formed the greater part of its business. Imperial controlled Ardath's home market trade without reference to B.A.T., and B.A.T. similarly controlled Ardath's export trade, except that the two companies exercised joint control over Ardath's trade in the United States. Ardath's general policy was determined by an Advisory Committee consisting of two

* Before 1932 Imperial's nominee was the then Chairman of Ardath.

representatives of Imperial, two of B.A.T. and one of Ardath. In 1947 Imperial and B.A.T. entered into an agreement which amended the original arrangements by providing that the two companies should share the Ardath ordinary dividend in proportions which reflected the contributions of the home and export trades to Ardath's total profits. The 1947 agreement further provided that Imperial should make a payment to Ardath if Ardath's profits from home trade fell below a specified figure and that similarly B.A.T. should make a payment if profits from export trade fell below a specified figure.

177. For practical purposes as far as Ardath's home trade is concerned the company was from 1925 to June 1960 in a position comparable with that of a branch of Imperial, although supervision was less close. The company had its own management and its own sales force and customers' accounts, but in many respects was bound to follow the same procedure as that laid down in Imperial's Handbook (see paragraph 117). As in the case of the branches Ardath had, for example, to submit for approval by Imperial's Executive Committee proposals for new brands or for changes in existing brands; changes in prices were agreed by Imperial and Ardath was normally expected to show the same gross margin of profit as that required of the branches for comparable brands. Ardath financed its own advertising but the level of advertising expenditure was agreed by Imperial. Ardath had its own price list: its terms to distributors, which were not identical with those offered by Imperial's branches, were agreed by the Executive Committee. On the other hand Ardath did not participate in Imperial's centralised arrangements for the purchase of leaf and other materials. Although Imperial's window dressers (see paragraph 233) included Ardath material in windows dressed by them, this material did not form part of the Imperial display but was treated on a par with that supplied by other manufacturers outside the Imperial group. From 1926 onwards Ardath operated its own bonus scheme the details of which were approved by the Executive Committee of Imperial (see paragraph 256).

178. In 1927 Ardath entered the coupon market. There were then four coupon-bearing cigarette brands on sale in the home market made by four manufacturers and sales of coupon brands accounted for about 4 per cent. of all cigarette sales. In the six years which followed before the signature of the Martin Agreement and the arrangements of the Tobacco Trade Association put an end to coupon trading, eighteen further coupon brands appeared and the estimated proportion of total sales represented by such brands rose to 22 per cent. in 1932 and 33 per cent. in 1933. Although the cost of Ardath's scheme was increased in 1930, the company's share of the coupon trade declined after that year, particularly after Imperial itself entered the field in November 1932. Ardath's share of the total home cigarette trade in these years was as follows:—

Year	Per cent.	Year	Per cent.
1928	1·4	1932	4·9
1929	3·2	1933	4·3
1930	6·2	1934	1·8
1931	5·6		

Ardath was a party to the Martin Agreement and in the years 1934 to 1945 received compensation amounting to £3,611,752.

179. In 1952 and 1953 Ardath acquired the whole of the share capital of three United Kingdom tobacco manufacturers (John Wood & Son (Tobacco) Ltd., Charlesworth & Austin Ltd. and The Express Tobacco Co. Ltd.). The manufacturing and marketing of the products of one of the three was discontinued, but the cigarette brands of the other two continued to be made in Ardath factories. The pipe tobaccos of these two companies were marketed by Ardath, but made for the company by one of the Imperial branches. In 1959 Ardath had one factory and supplied on the home market fourteen brands of cigarettes and four brands of tobaccos, the greater part of the company's cigarette trade being in the class then selling at 20 for 4s. or more, or in filter tipped brands (see paragraph 2). In 1954 Ardath supplied about 1 per cent. of the total home trade in cigarettes and tobacco. After the relaxation of Government controls in that year the company's home trade declined steadily; the following table gives figures of sales by weight and value in each of the years 1954 to 1959:—

Year	Quantity (lb.'000)			Value (£'000)		
	Cigarettes	Tobacco	Total	Cigarettes	Tobacco	Total
1954	2,324	31	2,355	8,023	95	8,118
1955	711	25	736	2,514	71	2,585
1956	383	20	403	1,432	60	1,492
1957	415	9	424	1,668	28	1,696
1958	402	7	409	1,607	25	1,632
1959	386	6	392	1,504	21	1,525

Figures produced in 1955 by Imperial's Chief Accountant for the Executive Committee showed that Ardath had made very little profit on its home trade in the years immediately before the war. In June 1953 it had been reported to the Ardath Advisory Committee that the addition of a third factory in the United Kingdom, concurrently with a reduction in output, had " resulted in an alarming increase in overheads ". In 1955 and subsequently (see paragraphs 379 and 381) Ardath incurred losses on its home trade which Imperial was required to make good under the terms of the 1947 agreement (see paragraph 176).

180. Imperial's records show that in 1954 and 1955 the Executive Committee considered Ardath's position and discussed the level of Ardath's expenditure on advertising, the size of the company's sales force and the relation between goodwill on the home market and exports. In 1955 the opinion was expressed that it might be desirable to "retain Ardath in its present form for a year or two in case one or more " of Imperial's competitors took some action which Imperial " might have to counter in a manner which would be undesirable " for one of the branches to adopt; it was doubtful, however, whether Imperial would wish to retain " this form of insurance for long ". A memorandum submitted to the Executive Committee in March 1955 by the Chief Accountant and the Solicitor, outlining two possible courses if the investment in Ardath continued to show a negative return, envisaged the possibility that the arrangement as then existing might continue in order to " arrange for the Ardath Company to fight back with coupon trading if such a form of competition should develop ". In January 1956 the Executive Committee decided that Ardath should operate on a reduced selling and advertising budget and should " continue for the time being on the reduced basis ".

181. Imperial's records also show that from the end of 1952 onwards Imperial had recognised that when Government controls were relaxed there might be some resumption of coupon trading and discussions on the subject had taken place within the T.T.A. In July 1955, one of the small manufacturers introduced a coupon brand of cigarettes and another did so during 1956 (see paragraph 93). In May 1956 Imperial set up an internal committee to consider " matters regarding coupon trading, competitions etc.". The committee took the view that Imperial would probably not want to take immediate action to counter coupon trading unless Gallaher introduced a coupon scheme, but the committee considered that if Imperial had to meet this type of competition it should first introduce competitions* in connection with the company's brands, which could if necessary be followed up by the introduction of coupons by Ardath. Representatives of the Wills and Player branches were opposed to the introduction of coupons in connection with any of their main brands. In September 1956 the T.T.A. was wound up (see paragraph 94). In October Ardath was given permission to make enquiries among manufacturers of gifts with a view to preparing a coupon scheme, but Imperial still inclined to the view that it should rely on competitions rather than on coupon schemes and the Chairman said he was " by no means yet convinced " that Imperial " would want the Ardath Company to ' bell the cat ' "; by the end of the year plans for competitions were being prepared. In November 1956 one of the larger manufacturers (J. Wix) introduced a coupon scheme; another small company did so in December and Carreras followed suit in May 1957. In July 1957 Ardath also introduced coupons with two of its brands, but with little success.†

182. In 1960 the business of Ardath was again reorganised and manufacture at the company's remaining factory ceased at the end of June that year. In the same month, with the sanction of the High Court, all the issued preference shares were repaid at 21s. per £1 share. A new company, Ardath (U.K.) Ltd., a wholly owned subsidiary of Imperial, has been incorporated, is at present acting as manager of Ardath's home trade and will become concessionnaire for the Ardath brands in the United Kingdom. Imperial and B.A.T. have agreed that on or about 31st December, 1960, they will terminate the agreements of 1925 and 1947 concerning the management of Ardath, and B.A.T. has agreed to buy Imperial's interest in Universal, with the practical effect that the Ardath Tobacco Co. Ltd. will become a wholly owned subsidiary of B.A.T.

183. The Ardath brands are now being manufactured by Imperial for the home market and by B.A.T. for overseas markets. Imperial has told us that all are at present on sale in the home market. Whether they will all continue to be sold in the future will be a matter for consideration by Ardath (U.K.) in the light of the profitability and sales of the individual brands. We describe arrangements recently made between Ardath (U.K.) and Godfrey Phillips in paragraph 185.

(4) Godfrey Phillips Ltd.

184. Godfrey Phillips, an old-established family business, was incorporated as a public company in 1908. Over the years, particularly in the 1920's, it has acquired a number of tobacco and cigarette manufacturing subsidiaries,

* Imperial had run similar competitions between 1930 and 1933 (see paragraph 63).

† For the results of other companies' coupon schemes see paragraph 96.

besides interests in materials, printing, box-making, publishing and distribution.* The company manufactures cigars as well as cigarettes and virtually all types of pipe tobacco. The company has emphasised that although by weight of tobacco used and by value of sales its cigarette trade appears to have been the more important part of its business, its position *vis-à-vis* the rest of the trade has been much stronger in pipe tobaccos and it has had a much higher proportion of the country's pipe tobacco trade than of its cigarette trade. In 1928 Godfrey Phillips had the largest share of the United Kingdom cigarette market after Imperial and Carreras. It suffered a set-back in 1930, perhaps due to more successful coupon trading by other manufacturers, since when, with temporary rallies, its share appears to have declined progressively. It was a party to the Martin Agreement and received compensation under that agreement totalling £1,530,703. The company's trade has been decreasing since 1952 and from 1953 to 1956 it incurred losses on its home trade in each year.†

185. In September 1960, Godfrey Phillips entered into an agreement‡ with Ardath (U.K.), a wholly owned subsidiary of Imperial (see paragraph 182), whereby it appointed Ardath (U.K.) sole concessionnaire to manage and control the manufacture, sale and distribution for the home market of most of its brands of cigarettes and tobacco on a royalty basis. The agreement, which comes into force with effect from 1st February, 1961, is for 50 years.§ It covers the existing brands of Godfrey Phillips and five subsidiaries, but does not include the brands of two other subsidiaries (Abdulla & Co. Ltd. and Pritchard & Burton Ltd.);|| the brands covered by the agreement have accounted for about five-sixths of the total home trade of the Godfrey Phillips group in recent years. Ardath (U.K.) is to make " such arrangements as it thinks fit for the manufacture and marketing " of the brands concerned and is to have the use of trade names, the benefit of trade marks, and control of advertising. In view of Ardath (U.K.)'s interest in brands other than those covered by the present arrangement, the company is " to be under no obligation as a result of the Agreement to take any action which it regards as inimical to its interests or to refrain from taking any action which may be to its advantage ": in particular Ardath (U.K.) is to be entitled to withdraw from the home market any Godfrey Phillips group brands covered by the agreement. If it does so, Godfrey Phillips is to be entitled to arrange for " such manufacture and distribution as shall be required to maintain the validity of the Trade Marks concerned but not further or otherwise ". Godfrey Phillips is to supply " all requisite recipes and specifications " and there is provision for whatever manufacturer is to make the brands for Ardath (U.K.) to take over such stocks of materials as may be required.

186. Godfrey Phillips has told us that by the early part of 1960 it had come to the conclusion that it must either close down its main factory altogether or

* As from 1st November, 1960, the company has disposed of Thomson & Porteous Ltd., its principal interest in the distributive trade (see footnote † on page 53).

† See paragraph 379. We have not examined the company's results for years subsequent to 1956.

‡ Heads of Agreement were signed on 2nd September, 1960.

§ But terminable by either party after 20 years, on six months' notice, if the royalty, calculated in accordance with given rates, does not amount to a specified minimum total.

|| The trade of a branch of one of the five subsidiaries (Muratti) is, however, excluded from the arrangements. The agreement also covers the home market rights to any brands which members of the Godfrey Phillips group (other than Abdulla and Pritchard & Burton) may subsequently introduce in export markets, and any new brands which Ardath (U.K.) may introduce in the name of one of the companies in the group.

divest itself of its interest in the home market. Sales of the company's main brand of cigarettes, De Reszke Filter, had been falling and its share of the growing filter tipped trade in the United Kingdom had decreased from nearly 10 per cent. in 1955 to about 3 per cent. in 1960. Godfrey Phillips' larger competitors were concentrating their advertising efforts on this section of the market. The company was anxious to retain its export trade, but there seemed little hope of building up a successful brand in the home market without advertising it uneconomically for several years and expending " a far greater sum than could economically be justified ". After exploratory negotiations with two of its other competitors, Godfrey Phillips decided to approach Imperial. Godfrey Phillips suggested a royalty agreement with specified nominal minimum annual payments because it was anxious that Imperial (through Ardath (U.K.)) should press the sales of its brands and realised that if the profit margin on these brands were to compare unfavourably with that on Ardath (U.K.)'s own brands the incentive to do so would be lacking.

187. Imperial has told us that after " very careful consideration " it came to the conclusion that the proposition put forward by Godfrey Phillips " could well be of real and substantial benefit " to Ardath (U.K.). In the first place Ardath (U.K.) could handle the additional volume of trade (amounting to some 30 million cigarettes and 50,000 lb. of tobacco a month) without appreciably increasing its overhead costs. Secondly, Ardath (U.K.) would have access to Godfrey Phillips' direct account customers; after making due allowance for duplication, this should increase the number of its direct contacts to the company's advantage. The higher quantity allowances which would result from combining the trade of Ardath (U.K.) with that of Godfrey Phillips should prove attractive to distributors, many of whom at present buy only small quantities from both companies. Finally, Imperial considered that its branches could undertake the manufacture of the Godfrey Phillips brands with a comparatively small increase in overhead costs, thus effecting a saving as compared with the manufacturing costs incurred by Godfrey Phillips.

188. Imperial estimates that the arrangements entered into in September 1960 will represent to the group (i.e. Imperial and Ardath (U.K.)) a net advantage of " something like £100,000 a year ". Provisionally most, if not all, of Godfrey Phillips' cigarette brands will be made by the Churchman branch and most of its tobaccos by the Ogden branch: the existing manufacturing capacity of both is sufficient for the purpose.

(5) Carreras Ltd. and Rothmans Ltd.

189. As tobacco and cigar merchants the antecedents of Carreras go back to 1754. The present company was formed in 1903, when it became associated with members of the Baron family. The first member of this family concerned (Bernhard Baron) had come to England from America in 1895 and was the proprietor of patents for one of the earliest cigarette making machines; these he proceeded to build in this country. An associated company of Carreras started manufacturing cigarettes in 1904 and on reorganisation Carreras itself took over this interest in 1912. Over the years Carreras has expanded its interests, particularly overseas. In 1919 the Baron Machinery Co. Ltd. was incorporated as a subsidiary to market Baron cigarette making machines (see also paragraph 282). Although primarily a cigarette manufacturer, Carreras

had from the beginning a small interest in tobacco manufacture. This it expanded in 1930 when it acquired John Sinclair & Co. Ltd. (see paragraphs 62 and 153) and again in 1953 when it acquired interests in two old-established and well-known tobacco manufacturing businesses, both of which had found it impossible to continue trading under the market conditions then prevailing.*

190. In early years Carreras' cigarette trade appears to have prospered. As mentioned in paragraph 62 it was one of the first to introduce coupon trading in the early 1920's, and its Craven "A" brand achieved considerable success between the wars. Figures prepared by Imperial show that in 1933 Carreras supplied over 13½ per cent. of the total cigarette market in the United Kingdom and after Imperial (with over 65 per cent.) was the largest supplier. When the Martin Agreement came into operation the following year, however, Carreras' sales fell sharply. During the life of the agreement the company received compensation to a total of £3,954,318, and although for many years it remained the second largest manufacturer of tobacco goods its share of the cigarette market has not since exceeded 9 per cent. and has usually been less. With the relaxation of Government controls in 1954 the company's trade dropped heavily. In 1957 it re-introduced coupon schemes with two of its brands; the schemes met with little success and have since been withdrawn.

191. In November 1958 control of Carreras passed to the Rembrandt Tobacco Corporation (S.A.) Ltd., an organisation with considerable resources operating in a number of Commonwealth countries. Carreras now markets 6 brands of cigarettes and 23 brands of tobacco.† Rembrandt's other United Kingdom subsidiary, Rothmans Ltd., was acquired in 1954 and although it was then a small manufacturer supplying only a negligible proportion of the total home market, it has recently achieved considerable success with its king size filter tipped brands (see paragraph 2). In 1959 Carreras and Rothmans formed a joint marketing organisation, the Carreras Rothmans Marketing Division Ltd. It has recently been agreed in principle that Carreras should acquire Rothmans' interests in the home market and in certain export markets.‡ Before passing under the control of Rembrandt, Carreras had begun to enlarge and adapt a modern factory which it had bought at Basildon. This has now been equipped with modern machinery. Although Carreras' and Rothmans' combined share of the home trade was still in 1959 little more than 3 per cent. this group, backed as it is by Rembrandt's resources, may prove a more serious competitor in future.

(6) J. Wix & Sons Ltd.

192. The business was founded in 1901 by Mr. Julius Wix. In 1922 it was incorporated as a limited company and in 1927 the whole of the share capital was sold to the American Tobacco Company of New York, the present owner. Mr. Julius Wix retired and in 1928 his two sons also left the company.§

* Carreras acquired certain of the assets of R. & J. Hill Ltd. of London and the entire share capital of Murray, Sons & Co. Ltd. of Belfast.

† The number of brands was greater before Rembrandt acquired control.

‡ For this purpose it is proposed to form a new Rothmans company the whole issued capital of which would be acquired by Carreras on a share exchange basis.

§ The sons were at an early date interested in the possibilities of filter tipped cigarettes. After leaving J. Wix they set up their own business and incorporated several companies, including the Peter Jackson group of companies; at one time they also owned Benson & Hedges. One of the brothers, Mr. Michael Wix, was a director of Carreras from 1955 to 1958.

193. In early years J. Wix developed Kensitas cigarettes, and this has been a well-known brand for many years. In 1926 J. Wix introduced a coupon trading scheme and in 1930 it extended coupon trading to the Kensitas brand, apparently with successful results; Imperial has estimated that J. Wix's share of the United Kingdom cigarette market rose from 2·3 per cent. by quantity in 1930 to 6·3 per cent. in 1931. In 1934, after the conclusion of the Martin Agreement, the company's share fell and remained at a general level of 1½ to 2½ per cent. of the total cigarette market until 1954. During the life of the Martin Agreement J. Wix received a total of £4,563,905 in compensation. J. Wix was at this time the fifth largest supplier of cigarettes. The company's trade suffered a severe set-back when Government controls were relaxed. Towards the end of 1956 it successfully re-introduced a coupon trading scheme in connection with Kensitas. This appears to be the only post-war coupon scheme for cigarettes which has been successful; the company has more than recovered the share of the market which it had in 1954 (see paragraph 4). It has told us that it regards its gift coupon scheme as merely a method of advertising, the great advantage of which is that the cost varies directly with the turnover. The company says that in present conditions it can by this method attract some of the demand in spite of the advertising power of the larger manufacturers, while offering consumers " the utmost value for the money that they spend on our products ". The company now markets two brands of cigarettes; it does not manufacture or sell tobacco. The fact that the company is controlled by American Tobacco does not appear to have affected materially the strength of the competition which J. Wix has offered over the years.

CHAPTER 5. DISTRIBUTION

(1) The Distributors

194. As we have explained in paragraph 24, in the tobacco industry there is no clear distinction between the wholesale and retail sections of the distributive trade. The number of dealers' licences issued in 1958–59 was about 422,000. The Wholesale Tobacco Trade Association has estimated that there are about 14,000 tobacco traders who undertake some wholesaling but that only about 1,500 of these are exclusively or mainly wholesalers, the rest being retailers with small wholesale interests. Thus the total number of retail outlets is over 400,000, though the number of retail traders concerned is no doubt somewhat less, since a dealer's licence is required for each point of sale.

195. Tobacco goods still form the bulk of the trade of many of the larger wholesalers, though most of them tend increasingly to deal in other goods as well, such as fancy goods, confectionery, smokers' requisites and stationery. Among the other wholesalers are concerns such as breweries which buy for resale to their own retail outlets. As regards retailers, the type of specialist tobacconist who formerly stocked only tobacco goods also now generally sells a range of other products as well. These specialist retailers include a number of chain tobacconists, some of them confined to a particular town or district, others covering a large part of the British Isles. There are many other types of retail

outlets for tobacco goods including newsagents, confectioners, grocers, Co-operative Societies, garages, canteens, public houses, hotels, restaurants, department stores, cinemas and fish and chip shops. Cigarettes are also sold from automatic slot machines installed outside tobacconists' premises or in stations and hotels, etc. Imperial has given the following rough estimate of retail outlets divided into five broad categories and of the proportion of the company's total trade which passes through each:—

	Percentage of Total Outlets	*Percentage of Imperial's Total Sales*
Specialist tobacconists	2	7½
Combining tobacco goods with confectionery and/or newsagency and/or hairdressing	15	30/35
Grocers (including Co-operative Societies)	23	20/25
Licensed premises	28	10
Miscellaneous (restaurants, teashops, garages, cinemas, canteens, general shops, etc.)	32	25/30

(2) Imperial's Distribution Arrangements

(a) *System of Distribution*

196. Each branch of Imperial is responsible for its own distribution. Goods are despatched to traders direct from factory or depot. Most deliveries are made by rail, but in certain areas road transport is used. The Wills branch distributes from its factories in Newcastle and Glasgow and its depots in London and Belfast, each of which serves a specified area, and from its factories in Bristol, which are grouped together to serve all other areas. The Player branch distributes from its group of factories in Nottingham, except that stock cases* are distributed from its London depot to the surrounding area and from its Glasgow depot to the whole of Scotland. The other branches have only one point of distribution each.† The Wills and Player branches distribute nationally, as does the Ogden branch for tobaccos; the other branches have a nation-wide distribution only for one or two of their brands.

197. Each branch has its own sales representatives, who both take orders and collect payment. In 1959 there were altogether 491 representatives, of whom 180 represented the Wills branch and 174 the Player branch. Thus the four smaller branches together accounted for more than one-quarter of the sales force, though it is expected that this proportion will be reduced following the amalgamation of three of the branches in February 1961. Sales representatives are in regular contact with direct account customers and occasionally also canvass retailers who buy through wholesalers. A representative generally calls on his direct customers every five weeks and normally collects payment for orders placed with him on his previous call and for any supplementary orders sent in during the ensuing five weeks. Some customers, however, including a number of large traders, prefer their accounts to be on a calendar monthly basis

* Certain of the Wills and Player branch factories which manufacture the main brands of cigarettes pack directly from the machines into stock cases of 5,000 or 10,000 cigarettes, each case being filled with one size of packing of one brand only.

† We are told that when the amalgamation of the Churchman, Edwards, Ringer & Bigg and Lambert & Butler branches comes into effect on 1st February, 1961, the newly formed branch will have only one selling organisation, though manufacture will continue at the existing factories.

and these deal with the branches direct; monthly accounts are due for settlement by the fourteenth day of the month following the calendar month in which delivery was made. Direct account customers thus receive a maximum of from five to six weeks' credit. Wholesalers appear to give their retail customers about three weeks' credit.

(b) *Terms and Conditions of Sale*

198. For most of its products Imperial fixes selling prices at all stages of supply.* Each branch has its own price list, but conditions of sale and, with the exceptions mentioned later (see paragraphs 199–200), terms are the same for all branches.

199. The company supplies both wholesale and retail customers at either best terms (for parcels of not less than 5,000 cigarettes or 14 lb. of tobacco)† or small parcel terms (for smaller quantities). All goods are invoiced at net prices, i.e. after deduction of a cash discount (of 2s. 6d. per 1,000 for cigarettes and 1s. per lb. for tobacco) which can be added back if payment is not made by the settlement date. The best terms prices for cigarettes, but not tobaccos, are subject to quantity allowances which vary according to the retail price of the cigarettes and the size of the order. Wills and Player allow these quantity discounts on orders of 10,000 cigarettes and over with a higher rate of discount for orders of 50,000 and over, but for the other branches the qualifying quantity is smaller, namely 5,000 with a higher rate of discount at 10,000. These allowances are normally given on a branch's own brands of cigarettes when taken in one delivery at one address.

200. In addition to the discounts described above, Imperial's customers can in certain circumstances earn deferred bonus (see Chapter 6). Carriage is paid on parcels of £20 value and upwards by Wills and Player and on parcels of £6 value and upwards by all other branches.

201. The minimum prices at which wholesalers may resell to retailers are laid down in the price lists. There are two minimum wholesale reselling prices for cigarettes: small box terms for parcels of less than 7,500, and large box terms for " mixed " parcels of 7,500 and over, which may be made up of the brands of more than one manufacturer. The small box terms, and the minimum wholesale reselling prices for tobaccos, are the same as the small parcel terms; the large box terms are between the small parcel terms and best terms prices. Since the wholesaler buys on the same terms as the retailer who buys direct from Imperial, his reselling prices are higher than Imperial's direct account terms, so that a retailer who is able to buy from Imperial does so more cheaply than if he buys from a wholesaler. In general the terms do not vary with the type and size of packing except where, as is the case with some brands of tobacco, there are different retail prices, quantity for quantity, for different forms of packing.

202. The following table shows how the prices and terms described in paragraphs 199 to 201 operate in the case of some of the company's leading brands:—

* For some proprietary brands of hard tobacco retail prices are " suggested " and for non-proprietary brands of hard tobacco and loose tobaccos no retail prices are listed.

† The 14 lb. qualification for best terms on orders for tobacco does not apply in Scotland and Northern Ireland, where all orders for tobacco are executed at best terms.

Cigarettes—per 1,000

	Player's Medium	Wills' Woodbine
	s. d.	s. d.
(*a*) Retailer's price to consumer	204 2	158 4
(*b*) Imperial's price to wholesaler or retailer:		
Best terms*(5,000 and over)	184 7	143 3
Quantity allowance (10,000 to 50,000)	10	9
	183 9	142 6
Quantity allowance (50,000 and over)	10	8
	182 11	141 10
(*c*) Wholesaler's price to retailer:		
(i) Small box terms (up to 7,500)	188 4	146 3
(ii) Large box terms (7,500 and over)	186 3	144 7

Tobaccos—per lb.

	Wills' Golden Virginia	Ringer's A.1 Light
	s. d.	s. d.
(*a*) Retailer's price to consumer	72 0	69 4
(*b*) Imperial's price to wholesaler or retailer: Best terms*(14 lb. and over)..	64 8	62 3
(*c*) Wholesaler's price to retailer	66 6	64 1

* Imperial's small parcel terms are:—

For less than 5,000 cigarettes—	*Player's Medium*	*Wills' Woodbine*
	188s. 4d.	146s. 3d.
For less than 14 lb. of tobacco—	*Wills' Golden Virginia*	*Ringer's A.1 Light*
	66s. 6d.	64s. 1d.

It should be noted that where the terms are shown as depending on the quantities purchased the qualifying figures relate to the total quantities of cigarettes (or tobaccos) of all brands of the branch concerned taken in one delivery (except that the cigarette brands of any manufacturer may be included to make up the qualifying figure of 7,500 for the wholesaler's large box terms). The effect of the deferred bonus is not shown in the table.

203. A retailer purchasing direct from Imperial now earns a gross margin of from $9\frac{1}{2}$ to $11\frac{1}{2}$ per cent. on his selling price for cigarettes and just over 10 per cent. on tobaccos; a wholesaler buying direct at best possible terms earns from $1\frac{3}{4}$ to $3\frac{1}{4}$ per cent. on his selling price for cigarettes and nearly 3 per cent. on tobaccos; for a retailer buying from a wholesaler, the margin is from $7\frac{1}{2}$ to $9\frac{1}{2}$ per cent. on cigarettes and about $7\frac{1}{2}$ per cent. on tobaccos. These margins are before allowing for deferred rebate which may add about another $\frac{1}{2}$ per cent. (of selling price) to the margin of a wholesaler or retailer buying direct (see paragraph 240). Changes in the margins since 1954 are illustrated in paragraph 226.

204. In July 1956 Imperial introduced a "pre-payment scheme" with the object of encouraging customers to pay their accounts before the prescribed date. The scheme, which is confined to the Wills and Player branches, was initially an experiment available to customers with trade in excess of £30,000 in an account period, but is now available to any of their customers who makes a first pre-payment of £500 or more in an account period. The pre-payment allowance fluctuates with the bank rate; it was 3½d. per £100 per day in June 1960. 350 customers of Wills and 325 customers of Player participate in the scheme.

205. Practically the whole of the company's output of cigarettes and 96 per cent. of its output of tobaccos are in branded goods sold subject to the conditions of sale. These apply whether the goods are bought direct from Imperial or from another source. They provide that the buyer will not, "whether directly or indirectly, by reduction of price, discount, the giving of presents, or in any other way whatever", resell or deal in the goods at less than the current minimum retail price specified in the company's price lists, except for sales to other retailers or wholesalers, when the prices charged are to be not less than the current minimum wholesale prices specified in the price lists. When selling otherwise than by retail the buyer must give notice to his customer that the goods may not be resold by that customer or any subsequent purchaser except upon these conditions; and the buyer must not knowingly sell to a customer who fails to observe them. The conditions contain a provision, however, which permits certain kinds of deferred payments such as Co-operative Societies' dividends.

(c) *Direct Accounts with Retailers*

206. We have referred in paragraph 88 to the increase in direct trading between manufacturers and retailers since 1954. Imperial now has accounts with more than 100,000 traders, most of whom are retailers, covering about 140,000 outlets. In 1960 the Wills and Player branches each had accounts with about 92,000 of these traders, but none of the other branches had more than 20,000 accounts. Some of the largest retailers have accounts with each branch.* The normal qualification for the opening of a direct account is that the customer should be able to take regularly 5,000 cigarettes or 14 lb. of tobacco in each account period from the branch concerned.† The value of purchases by traders with direct accounts ranges from about £500 to £5,000,000 per annum.

207. Imperial considers that direct trading is an advantage to the company because the contact between the branch and the trader ensures that the trader is encouraged to sell Imperial goods, maintains adequate stocks in good condition, receives display material for the branch's goods, and can be given answers to any queries about the branch's products which he may raise.

(d) *Preferential Arrangements with Distributors*

Savoy Group of Hotels

208. Under an agreement made in July 1925, The Savoy Hotel Ltd. received from Imperial an annual payment of £2,000 in return for an undertaking not

* Imperial estimated in 1957 that about 3 per cent. (i.e. some 3,000) of its customers had accounts with all the branches.

† In September 1959 Imperial gave an undertaking to the W.T.T.A. that the Wills and Player branches would not open new direct accounts unless the customer could take regularly at least 10,000 cigarettes (see paragraph 471).

to sell any Virginia cigarettes other than Imperial's brands and one other brand: there was no restriction on the sale of other types. This agreement was terminated in 1948, when it was superseded by a non-exclusive arrangement whereby, in return for a publicity fee of £900 per annum, Imperial brands of Virginia cigarettes are listed in the wine lists of the Savoy group on a separate page before those of other manufacturers.

J. Lyons & Co. Ltd.

209. An agreement made in 1928 provided that all Lyons' establishments should stock Imperial's products and specifically limited the stocking and offering for sale of other manufacturers' products. In return Imperial undertook to pay Lyons £6,500 per annum and an additional sum equivalent to 5 per cent. of the amount by which Lyons' annual purchases of Imperial's goods should exceed the total of such purchases in 1926. In 1951 this agreement was terminated and an agreement was entered into between Lyons and Salmon & Gluckstein Ltd. (now Bewlay (Tobacconists) Ltd.) under which Lyons appointed Salmon & Gluckstein its sole buying and distributing agents for tobacco goods (other than cigars not made by Imperial).

British Automatic Co. Ltd.

210. British Automatic had an agreement with the Great Western Railway to erect and maintain automatic machines on its stations. Under an agreement of 1930 Imperial lent British Automatic 50 automatic vending machines free of charge and British Automatic undertook to stock these exclusively with Imperial brands of cigarettes and not to install machines for brands of other manufacturers' cigarettes on G.W.R. Stations. The agreement expired in 1944. British Automatic has told us that it is now " operating many thousands of cigarette vending machines on British Railway stations and is completely free to sell any brands of cigarettes ".

(3) Distribution Arrangements of the Other Manufacturers

211. The largest of the other manufacturers have national distribution systems, but some of the smaller companies which operate in more isolated parts of the country and are concerned chiefly with the cheaper types of tobacco have only regional markets. The distribution systems of the other manufacturers are broadly similar to those of Imperial, though there are variations in the numbers and types of distribution points. Gallaher Ltd. differs most from Imperial in this respect. A certain proportion of the company's products is despatched direct from the company's factories to large wholesalers and retailers, but the greater part is sent in bulk from the factories to the company's seven distribution centres in Belfast, Glasgow, Newcastle, Manchester, Sheffield, Bristol and London, each of which serves a particular sales area. In these distribution centres the products of the individual factories are combined into composite orders for despatch to the customer. Before March 1958 Carreras Ltd. distributed from Newcastle, Belfast and London, but the company's distribution point in Newcastle was closed in February 1958 when the goodwill and certain assets of its former subsidiary, John Sinclair Ltd., were acquired by the Robert Sinclair Tobacco Co. Ltd. (see paragraph 154). Since the formation of the Carreras Rothmans Marketing Division Ltd. (see paragraph 191) cigarettes (including Rothmans' brands) are distributed from London and tobaccos from

London and Belfast. Godfrey Phillips Ltd. has four distribution points, its London factory, and its subsidiary companies in Glasgow, Edinburgh and Dundee which receive bulk supplies weekly from London. After 1st February, 1961, as the result of the agreement between Godfrey Phillips and Ardath (U.K.) Ltd. most Godfrey Phillips brands for the home market will be marketed by Ardath (U.K.) (see paragraph 185).* All the other tobacco manufacturers distribute direct from their factories to their customers.

212. The terms of trade of other manufacturers approximate closely to those of Imperial: Gallaher's terms are similar to those of the Wills and Player branches, and the terms of all other manufacturers correspond with those of the smaller Imperial branches. So far as cigarettes are concerned the qualifying quantities for best terms and quantity discounts are not always identical as between the manufacturers. Thus for Gallaher, Carreras/Rothmans and J. Wix & Sons Ltd. the qualifying quantity for best terms is 5,000 as for Imperial, but Godfrey Phillips has been giving best terms on 3,000 and Ardath Tobacco Co. Ltd. on 2,500. All give broadly the same quantity allowances, although at times there have been some differences. Many of the smallest manufacturers make only tobacco and they tend to have only one trade price, subject in most cases to a rebate of 1d. or 2d. a lb. for large orders (in some cases 7 lb. and over). Of the larger manufacturers Gallaher, like Imperial, gives best terms on 14 lb. of tobacco, but Carreras/Rothmans on 7 lb., which has also been the qualifying figure for Godfrey Phillips and Ardath; the latter, moreover, has permitted orders for tobacco and cigarettes to be aggregated to qualify for best terms. Of the larger manufacturers, only Godfrey Phillips has given any quantity allowance for tobacco. All the large manufacturers prescribe wholesalers' reselling prices, which are similar to Imperial's. Gallaher alone of the other manufacturers operates a pre-payment scheme like that of Imperial, but Rothmans allows a further discount of 1s. per 1,000 cigarettes to certain large distributors if payment is made within seven days instead of the normal thirty days.

213. Until the Tobacco Trade Association was dissolved in 1956 all its manufacturer members had the same conditions of sale. Subsequently the conditions of sale of most manufacturers have been broadly similar to Imperial's.

214. The Co-operative Wholesale Society Ltd. and the Scottish Co-operative Wholesale Society Ltd. distribute their own products only to other Co-operative Societies. The C.W.S. has told us that in fixing its prices it must have regard to the normal retail margins on cigarettes and tobacco and to the retail prices charged by other manufacturers with which it has to compete. The S.C.W.S. quotes net prices. Both Societies show retail selling prices in their price lists, but both say such prices are only recommended.

215. All the larger manufacturers and some of the smaller ones have direct accounts with retailers. Gallaher has 75,000 accounts, Carreras about 30,000, Godfrey Phillips 15,000 and Rothmans 7,500. One of the smaller manufacturers has about 3,000 accounts. Gallaher, Carreras and Godfrey Phillips have told us that the advantage to them of direct trading is the regular contact which it enables them to maintain with retail distributors. Gallaher has, as well as

* Unless otherwise stated, all references to Godfrey Phillips' distribution arrangements in this chapter are to the company's current arrangements as distinct from those which will operate after 1st February, 1961.

its regular travellers who call on distributors with direct accounts, a force of pioneer salesmen for the promotion of point-of-sale advertising, not only with traders who have direct accounts but also with those who obtain their supplies through wholesalers.

(4) DISCUSSIONS BETWEEN MANUFACTURERS AND BETWEEN MANUFACTURERS AND DISTRIBUTIORS ON PRICES AND TERMS

216. Before the war the Manufacturers' Committee set up in 1933 under the Martin Agreement (see paragraph 65) discussed and agreed upon reselling prices to be charged by wholesalers for cigarettes selling at particular list prices. The list prices themselves were fixed by manufacturers independently and price maintenance at the retail selling stage was assured under the arrangements of the T.T.A.

217. Although the prices charged by manufacturers for a given class and type of cigarette have been similar and often identical (see paragraph 2), there has been no agreement on prices between manufacturers. Imperial, the acknowledged price leader in the industry, has sometimes indicated the prices it intended to charge. In 1949, when the leading manufacturers discussed the general introduction of filter tipped cigarettes (see paragraph 84), questions affecting retail prices and distributors' margins were considered and Imperial told the other manufacturers what prices and margins it had in mind for its own brands. Distributors' margins have frequently been discussed between manufacturers, particularly when a change seemed imminent in the general level of prices of cigarettes or tobacco or both. Such changes are usually made either as the immediate result of a change in the rate of duty payable on tobacco leaf or as the cumulative result of other changes in costs; for many years the effect of all such changes has been to increase prices. Since January 1939 Imperial has made sixteen general price increases, ten of them due to increases in the duty rate, as shown below:—*

Date	*Goods affected*	
April 1939	Cigarettes and tobacco.	(Duty change)
September 1939	Cigarettes and tobacco.	(Duty change)
April 1940	Cigarettes and tobacco.	(Duty change)
July 1940	Cigarettes and tobacco.	(Duty change)
April 1942	Cigarettes and tobacco.	(Duty change)
April 1943	Cigarettes and tobacco.	(Duty change)
April 1947	Cigarettes and tobacco.	(Duty change)
April 1948	Cigarettes and tobacco.	(Duty change)
August 1951	Cigarettes.	
January 1953	Tobacco.	
June 1955	Tobacco.	
October 1955	Cigarettes.	
April 1956	Cigarettes and tobacco.	(Duty change)
September 1957	Cigarettes and tobacco.	
August 1959	Tobacco.	
April 1960	Cigarettes and tobacco.	(Duty change)

In most cases the other manufacturers made similar changes at about the same time.

* In addition to general increases, the prices of limited ranges of tobacco were increased in November 1945, January 1947, November 1950 and January 1952.

218. Between 1945 and 1956 there were 54 meetings between manufacturers. Imperial met representatives of the distributors' organisations* on 39 occasions and other manufacturers also participated at 21 of these meetings. The manufacturers discussed distributors' margins amongst themselves before the price changes of August 1951, January 1953, June 1955 and October 1955 (which were not attributable to duty changes). The meetings were generally called by Imperial and a representative of the company took the chair. The other manufacturers represented were normally Gallaher, Carreras and Godfrey Phillips, and sometimes J. Wix and Ardath.† There was no set procedure; Imperial tabled its proposals for changes in distributors' margins and the discussions led to virtual agreement on the changes to be made by all the manufacturers concerned. Imperial has told us that apart from the price increase for cigarettes in August 1951, to which we refer again below, " retail prices were not the subject of discussion or understanding, although of course it was clear to all concerned that increases would be necessary ". Other manufacturers could certainly make " intelligent guesses " at what was in Imperial's mind for its principal cigarette brands; it would have been " much more difficult and frequently impossible for them to do so in the case of tobaccos ".

219. Since 1952 the manufacturers, particularly Imperial, have been under constant pressure from the distributors to increase margins. The question of distributors' margins is closely bound up with the question of turnover and with the manufacturers' system of direct trading with retailers. From the outbreak of war in 1939 until Government controls were relaxed in 1954 the supply of tobacco goods was restricted and manufacturers opened few new accounts (see paragraph 79). With the return to normal trading conditions in 1954 to 1955, pressure from distributors on the manufacturers increased. The description of the main course of the negotiations given below is based mainly on information given to us by Imperial and on our examination of the company's records.

220. The Board of Trade has told us that whenever the duty was increased during the years of Government controls the price increases necessary to cover the increased cost of finance could be precisely forecast. As regards other general price increases, the leading manufacturers gave prior notice of their intentions to the Board. In general the Board has not pressed manufacturers to vary their proposals except on the occasion, in 1951, of the first increase in cigarette prices since the beginning of the war which did not arise from an increase in duty. As we explain in paragraph 355 Imperial was then induced to modify the price increases it had at first proposed. The Board intimated that it would not object to comparable price increases being made by other manufacturers, but that the prices of any manufacturer who attempted to make greater increases would be frozen at their existing level. After discussion with other manufacturers, Imperial informed the Board of the distributors' margins which had been agreed upon.

* Namely the Wholesale Tobacco Trade Association and the National Union of Retail Tobacconists. An informal group formed by multiple tobacconists who were members of the Multiple Shops Federation also sometimes participated, but the Federation itself was not concerned.

† Imperial has told us that the representative of Carreras (later of Godfrey Phillips) would also, in his capacity as Chairman of the Federation of Home & Export Tobacco Manufacturers, have borne in mind the position of the smaller companies which were not directly represented.

221. During 1952 the distributors' organisations made two unsuccessful demands to the manufacturers for a further improvement in trade terms to meet increased overheads. When tobacco prices were increased in 1953 the manufacturers agreed on the broad lines of the increases to be made in margins to the distributive trade; as a result of these changes the relative position of the wholesale distributor was improved. According to Imperial's records, the wholesalers in particular were very satisfied with the new terms, but later in the year, supported by the retailers, the W.T.T.A. represented to the manufacturers that trade had fallen to a level which necessitated a general review of trade margins.* The manufacturers did not accept the distributors' figures, however, and refused to take any action. In 1954, on learning that supplies of tobacco goods were to be increased following the relaxation of control of tobacco leaf from dollar countries (see paragraph 86) the distributors urged the manufacturers to improve the margins on pipe tobacco, which they claimed to be selling at a loss. The manufacturers recognised that the margins on tobacco were low in relation to those on cigarettes, but as any revision of margins would entail increasing the selling price they decided at Imperial's suggestion to leave the matter in abeyance until after the 1955 Budget for fear of prejudicing the case for a duty reduction.

222. In June 1955 tobacco prices were again increased following agreement by the manufacturers to increase the combined wholesale and retail distributors' margins by a minimum of 8d. per lb. On this occasion Imperial let the other manufacturers have advance copies of the company's new price list before the joint meeting with the distributors at which the new margins were announced. The distributors regarded the increase as inadequate.

223. In July 1955 the W.T.T.A. informed Imperial that wholesalers' trade since January was down by 10 to 12½ per cent. compared with the corresponding period in 1954.† Meanwhile the multiple tobacconists' group had represented to the manufacturers that unless something was done for multiple retailers in recognition of the special services which they rendered they would soon cease to be "professional tobacconists". During the summer Imperial told Carreras that the company thought there should be an increase in cigarette prices before the next Budget. In October 1955 cigarette prices were in fact increased, following agreement in principle between the manufacturers to the introduction of quantity allowances designed to help wholesalers and multiple traders, and of wholesalers' large box terms which enabled the wholesaler to sell parcels of 7,500 cigarettes at terms nearer manufacturers' best terms‡ than before (see paragraphs 201 and 202); there was no agreement between manufacturers on the details of the allowances to be given or on the amounts by which distributors' margins should be increased. The W.T.T.A. was appreciative of the concessions made, but both the multiple tobacconists' group and the N.U.R.T. remained dissatisfied. The N.U.R.T. considered the margin on Churchman's No. 1

* According to the W.T.T.A. trade had fallen by more than 25 per cent. below the level prevailing before the 1947 Budget (see paragraph 81) and manufacturers had previously agreed that margins should be reviewed in such an event.

† Because of the increase in direct trading between manufacturers and retailers the proportion of trade passing through wholesalers was falling at this time; Imperial has told us that it probably fell from about 50 per cent. to about 35 per cent. between 1954 and 1959 (see paragraph 472).

‡ At this time best terms were in most cases applicable to purchases of 5,000 cigarettes (see paragraphs 199 and 212).

particularly unsatisfactory and recommended its members to boycott all Churchman's brands for two months in protest.* Imperial's records show that when the new terms had been in operation for some months Bewlay, whose sales had apparently been reduced by " intensive competition from many outlets ", told Imperial that they did not enable the tobacconist to " produce an economic result ".

224. Early in 1956 Imperial and the other manufacturers agreed to grant a further concession to multiple traders by modifying the rule whereby the quantity qualifying for the maximum allowance had to be taken in one delivery at one address. The traders concerned are reported to have considered this help insufficient. Shortly afterwards the W.T.T.A. complained to the manufacturers that its members' profits were being reduced and that many of them were losing turnover; the Association pressed for terms which would enable wholesalers to sell to retailers at the same prices as manufacturers. When the prices of cigarettes and tobacco were increased in April after the 1956 Budget, quantity allowances were also increased, but the manufacturers had previously decided not to concede the wholesalers' request for a 15,000 large box price accompanied by a reduction in the wholesalers' buying price. Some months later the N.U.R.T. told the manufacturers that a decrease of 3 to 4 per cent. in members' turnover since the Budget had offset the better margins; at the same time the Association proposed that higher margins should be given on filter tipped brands, sales of which were increasing at the expense of higher-priced cigarettes. The manufacturers pointed out that turnover would have to fall by 7½ per cent. before the position became the same as it had been before the Budget. When cigarette prices were increased in September 1957, however, the margins on filter tipped cigarettes were improved.† The N.U.R.T. was dissatisfied, but was more content when, on the occasion of the price increase of August 1959, tobacco margins were brought to a level more nearly comparable with those on cigarettes.

225. Since the passing of the Restrictive Trade Practices Act, 1956, Imperial has made two general price increases not the direct result of duty changes; one in September 1957 for all its cigarettes and tobaccos, the other in August 1959 for all its tobaccos. In each case the company had previously told other manufacturers of its ideas concerning changes in distributors' margins on the understanding that this should lead to no agreement, and it also informed them immediately before the event of the changes which it intended to make in its selling and resale prices. Since 1956 there have been no joint meetings between manufacturers and distributors and no meetings of manufacturers to consider distributors' problems.

* Before the October 1955 price increase both Churchman's No. 1 and Carreras' Piccadilly No. 1 sold at the same price, namely 1s. 10½d. for 10, and yielded the same margin to the retailer buying at best terms (namely 19s. per 1,000 or 10·13 per cent. on selling price). After October, the retail price of Churchman's No. 1 became 1s. 11½d. and the margin 20s. or 10·21 per cent.; the retail price of Piccadilly No. 1 became 1s. 11d. and the margin 20s. or 10·43 per cent. N.U.R.T.'s complaint was that: (a) although the retail price of Churchman's No. 1 was increased to a greater extent than that of Piccadilly No. 1 the cash margin remained the same for both brands; (b) the margin on Churchman's No. 1 after October was lower than that on brands which had sold at 1s. 11½d. before October—on which the cash margin had been 21s. 3d. per 1,000 or 10·85 per cent. on selling price. The N.U.R.T. recommended a similar boycott of Wills' Bristol Tipped for some months during 1957.

† The relative improvement in the margins on filter tipped cigarettes as compared with untipped is illustrated in paragraph 226.

226. The table which follows shows the maximum margins (excluding bonus) as percentages of selling price earned by distributors on some leading brands of cigarettes and tobaccos and the effects of the various changes made between 1954 and 1960. In practice, the average margins, exclusive of bonus, earned by many retailers and practically all wholesalers on their sales of these brands will have been somewhat lower than the figures shown.

Cigarettes

	Wills' Woodbine, Player's Weights, Gallaher's Park Drive	Player's Bachelor Tipped	Player's Medium, Wills' Capstan, Gallaher's Senior Service
Retail price per 20:	s. d.	s. d.	s. d.
1954	2 8	3 0	3 7
1960 April	3 2	3 6	4 1
Retailer's Margin	%	%	%
buying direct at lowest possible price			
1954	9·38	9·33	9·35
1955 October	9·82	9·84	9·82
1956 April	10·06	10·10	10·13
1957 September	10·50	11·40	10·47
1960 April	10·42	11·43	10·41
Wholesaler's Margin			
buying at lowest possible and selling at highest possible price			
1954	2·03	1·98	1·94
1955 October	2·59	2·60	2·51
1956 April	2·84	2·88	2·73
1957 September	2·95	3·17	2·82
1960 April	3·02	3·25	2·88

Tobaccos

	Gallaher's Condor Sliced	Ringer's A.1 Light	Wills' Golden Virginia	Gallaher's Old Holborn	Ogden's St. Bruno Flake (*a*)
Retail price per oz.:	s. d.	s. d.	s. d.	s. d.	s. d.
1954	3 7	3 8	3 10½	3 10	4 1
1960 April	4 3½	4 4	4 6	4 6	4 10½
Retailer's Margin	%	%	%	%	%
buying direct at best terms					
1954	6·69	6·82	6·85	6·93	7·14
1955 June/July	7·76	7·92	7·85	7·98	8·13
1956 April	8·42	8·55	8·46	8·59	8·73
1957 September	9·04	9·11	9·16	9·16	9·26
1959 August	10·20	10·23	10·19	10·19	10·27
1960 April	10·19	10·22	10·19	10·19	10·26
Wholesaler's Margin					
buying at best terms					
1954	1·83	1·80	1·84	1·86	1·89
1955 June/July	2·13	2·21	2·12	2·26	2·26
1956 April	2·32	2·39	2·29	2·29	2·40
1957 September	2·43	2·51	2·52	2·52	2·49
1959 August	2·76	2·87	2·76	2·76	2·78
1960 April	2·76	2·86	2·76	2·76	2·78

(*a*) Margins are those earned on soft packings, not airtight tins.

(5) PRICE MAINTENANCE

227. All the leading manufacturers other than the two Co-operative Wholesale Societies maintain prices for virtually all their branded goods at all stages of supply (see paragraphs 205, 213 and 214). Imperial's branches are required to report to the Conditions of Sale Department all cases of underselling that come to their notice. Gifts of any kind and " dividend " schemes other than those specifically exempted (see paragraph 205), as well as simple reductions in wholesale or retail prices, are regarded as infringements of the company's conditions of sale. Until September 1956, when collective resale price maintenance through the T.T.A. was brought to an end, Imperial sometimes consulted the T.T.A. in cases of price cutting and might refer such cases to the Association for action. In some instances the company asked wholesalers to discontinue supplies to an offending retailer, and on one occasion at least it employed enquiry agents to find out more about the activities of a trader who was known or suspected to be underselling.

228. When the T.T.A.'s arrangements for collective resale price maintenance came to an end, the distributors appear to have welcomed Imperial's announcement that the company intended to maintain its prices and to have expressed their confidence in its ability to do so. In the last four months of 1956, following the termination of the T.T.A. agreements, Imperial's Conditions of Sale Department dealt with 35 cases of price cutting as compared with only 8 during the first eight months of the year. Imperial says that in recent years supplies have been withheld from a trader in one case, where there had been a persistent breach of the company's conditions of sale. In 1960 Imperial is reported to have obtained an injunction against a retailer who had been selling its products in breach of the price condition. Gallaher has told us that there have been comparatively few cases in which traders have failed to adhere to the company's terms and conditions of sale. Since the dissolution of the T.T.A. the company has handled such cases itself; it has found it necessary to obtain an injunction against one trader.

229. While the N.U.R.T. and various other spokesmen for the distributors regard the winding up of the T.T.A. as regrettable, the opposite view has been expressed on behalf of the Co-operative Societies, on the ground that the T.T.A. was " responsible for the rigid collective enforcement of restrictive practices ". Many wholesalers and retailers regard some form of price maintenance by the manufacturers as essential, both because distributors' gross profits are low and because cigarettes can so readily be used as loss leaders by traders who are not primarily concerned with the sale of tobacco goods.

230. It has not been customary in the tobacco industry to regard the payment of a deferred dividend by Co-operative Societies as an infringement of manufacturers' conditions of sale. The rest of the distributive trade objects to this and many distributors have from time to time complained to Imperial that the payment of such dividends causes loss of trade to other outlets. Imperial thinks it reasonable to draw a distinction between price cutting at the time of purchase and the Co-operative system of paying a deferred dividend, which was an established practice long before the company or its predecessors introduced conditions of sale. When in 1956 the W.T.T.A. asked how Co-operative Societies would be treated when resale prices were enforced individually, it was told that there would be no change in the position so far as Imperial was concerned. Later some traders commented unfavourably on the clause in Imperial's

new conditions of sale (see paragraph 205) which provided that the payment of deferred dividends in circumstances such as apply to Co-operative Societies was not an infringement of the conditions.

(6) The Supply of Automatic Vending Machines

231. A number of the automatic machines installed on tobacco traders' premises are supplied by manufacturers. At the beginning of the war Imperial called in all its machines. As the company did not wish the machines to be used for selling other manufacturers' cigarettes, it kept them in store for some years after the war while supplies of its own goods were restricted. After the freeing of supplies in 1955 Imperial reviewed the position in the light of increasing competition from Gallaher; towards the end of 1956, having fitted a number of the machines with change-giving mechanism, it decided to re-issue them without delay. The company appears to have felt some doubt about the expediency of charging rent since it would be open to Gallaher to issue comparable machines rent free; it also appears to have felt that in the new atmosphere created by monopolies legislation it might be difficult to insist on the pre-war provision that the company's machines should be used solely for the company's brands.* It was decided to issue the machines rent free but to give traders the option of using one slot in a 4-column machine for another manufacturer's brand on payment of rent to Imperial. The option, which did not apply to 2-column machines, was withdrawn in June 1958, and thereafter all Imperial's machines were reserved for the company's brands exclusively. Provided that machines are available, Imperial lends them on request to any tobacco trader whose premises are considered suitable. At present the company has about 27,000 outdoor and indoor automatic machines in use.

232. Gallaher also issues machines on loan to suitable customers, on condition that they are used exclusively for the sale of the company's cigarettes. More than 12,000 of Gallaher's machines are at present being operated by over 8,000 customers. Carreras, Rothmans and Ardath (U.K.) also issue machines, though on a smaller scale, in each case for the exclusive sale of the company's own brands.

(7) Window Dressing and Display Rentals

233. We deal in Chapter 6 with bonus schemes, some of which, and particularly Imperial's, involve an obligation on the part of distributors to allot certain display facilities to the manufacturer concerned. Independently of such arrangements Imperial has a Window Dressing Department which provides a free service for the periodic dressing of certain traders' windows throughout the country. This service is available to any trader whose windows are considered of sufficient value from the advertising standpoint. The windows are dressed on an average every eight weeks with advertising material provided by the branches together with material supplied to the trader by other manufacturers. Imperial estimates that 15 to 20 per cent. of its total trade passes through outlets whose windows are dressed by the company; about 20 per cent. of some 26,000 windows at present covered by the service are those of traders who have not

* This was a provision in the agreements signed by traders on whose premises Imperial installed its machines and should be distinguished from the undertaking given by traders who sign the Bonus Agreement to reserve for Imperial 50 per cent. of the slots in all machines on their premises, whoever owns the machines (see paragraph 239).

signed the company's Bonus Agreement (see Chapter 6). The branches submit proposals to the Executive Committee on such matters as the balance to be observed between secondary and centre displays and certain types of display may not be included in company dressed windows without the Committee's approval. Since 1934, when certain manufacturers complained that they were getting insufficient representation in windows dressed by Imperial, the company has permitted 25 per cent. of the space devoted to the display of tobacco goods to be allocated to other manufacturers' material if the customer wishes. Centre displays are reserved for Imperial, but other manufacturers' made-up displays not exceeding certain specified dimensions may be included if they are balanced by equivalent displays of Imperial's material. Imperial does not allow other manufacturers' advertisements printed in a particularly bright kind of colour known as " Dayglo " to be included in windows which it dresses. Some of the other rules which Imperial applies affect the bonus scheme as well as the window dressing scheme (see paragraph 243). A number of retailers have expressed appreciation of Imperial's window dressing service, which enables them to have their windows efficiently dressed free of charge.

234. Imperial does not dress the windows of Bewlay and Finlay & Co. Ltd., but these two companies receive instead an annual window dressing grant to cover the cost of dressing the windows themselves. They normally devote some 75 per cent. of the display space allotted to tobacco goods to Imperial's brands. This arrangement has applied to Bewlay since 1908 and to Finlay since 1932. Imperial's branches provide and pay for the material used in the displays, and also bear the cost of the window dressing grants as an advertising charge. Originally the grants were related to the display space received, but in 1949 they were put on a basis related to what it would cost the Window Dressing Department to dress the windows. When the payments came under review in 1953, the branches took exception to the payment of window dressing grants and considered that, so far as Bewlay was concerned, they were not getting value for money. In 1955 a new formula was adopted which related the payments more closely to the actual costs incurred, having regard to the respective styles of Bewlay's and Finlay's displays. For Bewlay the basis of payment was further amended in November 1959 and is now £50 per window per annum;* for Finlay it remains two-thirds of the labour costs per window if a similar dressing were effected every six weeks.†

235. Imperial's Handbook lays down that the branches may not pay rent for advertisements placed on the premises of any customers other than Bewlay or Finlay. In practice rental is paid only in respect of a few neon signs on Bewlay shops which have been in position for a long time. In 1955 when Gallaher was considering a scheme for renting advertising sites on tobacconists'

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* Before November 1959 the basis of payment for Bewlay was half the labour costs per window that would have been incurred if a standard dressing were effected by the Window Dressing Department every fifteen days.

† The payments made from 1956 to 1960 were as follows:—

Year ended 31st October	*Bewlay* £	*Finlay* £
1956	9,516	20,773
1957	9,682	20,773
1958	9,529	20,561
1959	8,806	19,155
1960	13,700	20,122

premises, Imperial pointed out to the company that to do so would encourage traders to demand rent for other tobacco advertisements which were at present accepted without charge as being of mutual benefit; Gallaher acknowledged the force of this argument and decided not to pursue the matter. In the case of one large multiple concern which is a bonus customer of Imperial, substantial display rentals are paid by certain other manufacturers to obtain a larger share of the display space available than they could reasonably expect as the result of normal trading.

(8) Arrangements for obtaining Market Information

236. For many years Bewlay has provided Imperial with details of its monthly turnover in the principal cigarette and tobacco brands of Imperial and its competitors. Similar statistics have been provided by Finlay since 1928 and by the Robert Sinclair Tobacco Co. Ltd. since the business was acquired by Imperial in 1930. Finlay has received payment for this service since 1938 and Robert Sinclair since 1950; the current payments to Finlay and Robert Sinclair are £5,500 and £3,000 per annum respectively. In Bewlay's case Imperial since 1937 has met the actual cost of preparing the statistics, which in recent years has varied between £2,000 and £2,600 per annum. For a number of years Imperial has also paid smaller annual fees to two large independent wholesalers who make similar monthly returns; these returns, being based on an analysis of purchases instead of sales, entail less work in preparation than the returns provided by the three other companies. Imperial uses the statistics obtained in this way in conjunction with information from other sources to estimate trends in other manufacturers' sales, both regionally and on a national basis, with a view to meeting competition more effectively.

237. While it is not uncommon practice in the trade for distributors to volunteer information about their sales to manufacturers' representatives, or even to disclose more detailed figures on request, Carreras is the only manufacturer other than Imperial which has had arrangements for obtaining regular sales information from distributors. Since 1954, and in one case since 1929, various traders have periodically supplied the company with figures, either of all brands or of brands in specific categories. Up to the present time Carreras, whose purpose in obtaining the information is much the same as Imperial's, has made no payment for it.

CHAPTER 6. BONUS

(1) Imperial's Bonus Scheme

238. Imperial introduced its bonus scheme in 1902 (see paragraph 51). The company has told us that the scheme was intended to give traders willing to promote sales of the company's goods a share in its profits and to counter the aggressive sales methods of the American Tobacco Company's subsidiary, Ogden's Ltd., which in addition to reducing prices to uneconomic levels was already operating a bonus scheme of its own. With some modifications the scheme has been maintained ever since.

239. To qualify for bonus a distributor must be accepted as a direct customer of Imperial (see paragraph 206) and enter into a written agreement with the company. The text of this agreement is reproduced in Appendix 5. Under

it the distributor undertakes to stock Imperial's " bonus-bearing goods and display them prominently and effectively " in his windows and elsewhere on his premises, to reserve for them at least 50 per cent. of the slots in automatic machines installed on his premises, to display the company's showcards and advertising matter so far as the nature of his business permits, to make " all proper and reasonable efforts " to extend the sale of Imperial's goods and promote Imperial's interests, to conform to the company's prices, terms and conditions of sale and not knowingly to sell Imperial's goods to anyone who does not so conform. Except for the provision relating to automatic machines, which was added in 1927, these requirements have not been altered since 1902.* Before 1957 the relatively small sales of Imperial's unbranded goods were excluded from the scheme; since then " bonus-bearing goods " has meant all kinds of tobacco goods made by the company.

240. In consideration of the undertakings given by the distributor, Imperial agrees to pay him a cash bonus at a flat rate per cent. on the value of his purchases of the company's goods during the year. By the terms of the agreement the total amount to be distributed as bonus in any particular year is the equivalent of two-fifths (or before November 1956 one-fifth) of that part of the amount required for Imperial's dividend† which has arisen from net profits on the company's sales in the United Kingdom in that year. The rate of bonus is arrived at by expressing the amount so computed as a percentage of the company's total net sales of bonus-bearing goods in the year. The actual rate of bonus, therefore, varies from year to year. In the years 1954 to 1959 the rates of bonus and the total payments made were as follows:—

Year ended 31st October	Rate as percentage of sales	Total amount paid
	%	£
1954	0·35	2,049,000
1955	0·32	2,051,000
1956	0·32	2,045,000
1957	0·58	3,678,000
1958	0·64	3,950,000
1959	0·68	4,067,000

Since the rate of bonus was increased in November 1956 the deferred bonus payment has represented on average about 5 per cent. of retailers' margins and about 20 per cent. of wholesalers' margins on the main classes of cigarettes; at least until August 1959, when distributors' margins for tobaccos were improved, it represented a rather higher percentage in the case of tobaccos. Imperial has told us that in 1959, out of a total of nearly 101,000 bonus customers, 20/25,000 received a bonus payment of less than £5 each and another 60,000 received between £5 and £25 a year; at the other end of the scale some 450 customers received payments in excess of £1,000.

241. Nearly all distributors who trade direct with Imperial enter into Bonus Agreements with the company, and between 1954 and 1959 the number of signatories increased from 74,100 to 112,193. In 1959 about 99½ per cent. by value of

* The original form of the Bonus Agreement also contained a clause precluding the trader from stocking the goods of American Tobacco or its associates but this provision (which Imperial says was never implemented) was dropped when Imperial came to terms with American Tobacco later in 1902 (see paragraph 52).

† i.e. the dividend on the company's " Ordinary Stock (whether preferred or deferred) ", which includes the " B " and " C " non-cumulative preference stock—see paragraph 106.

the company's trade passed through distributors who were signatories. The scheme is administered from Imperial's Head Office by the Bonus Department (see paragraph 110) which employs a staff of nearly 70, together with about 20 bonus representatives (called bonus inspectors until 1956). Imperial's Handbook lays down that the Department in conjunction with the representatives will decide whether a signatory is carrying out the terms of his agreement. Bonus is distributed twice a year, by an interim payment for the first half-year which is made before the end of the second half, and by a final payment which is normally made some eight months after the end of the year. Payment may be withheld and set against the sum owing if a customer's account is overdue at the time.

242. The Bonus Agreement does not precisely define the obligations of signatories as to display, and in practice Imperial applies its own interpretation. The Handbook says that the display by a signatory of other manufacturers' goods and advertisements will not be objected to provided that Imperial is given " a proper share of the customer's display in both quantity and prominence ". A further definition of the company's requirements is contained in general instructions to bonus representatives; these instructions, first issued in 1934, were revised in 1954. In addition representatives are instructed from time to time by letters dealing with specific points.

243. As we have explained in paragraph 233 Imperial's Window Dressing Department undertakes the dressing of some 26,000 distributors' windows free of charge, and in those cases reserves for itself 75 per cent. of the total display available for tobacco goods, including all centre displays. This requirement is not related to the bonus scheme and about one-fifth of the distributors who have their windows dressed in this way are not Bonus Agreement signatories. Some of Imperial's requirements, however, have applied to both schemes. Thus, the 1934 instructions laid down that, whether windows were dressed by Imperial or not, (a) if another manufacturer's illuminated advertisement was exhibited in any window it should be balanced by a similar Imperial advertisement; (b) where a customer with only one window had a pelmet advertising another manufacturer's brand " its advertising value should be compensated for either by greater displays of Imperial brands or by outside advertisements of the Imperial Company ", and where a customer had two or more windows at least 50 per cent. of the pelmets were to be for Imperial brands; the maximum depth of the pelmet was not to exceed one-fifth of the depth of the window; (c) other manufacturers' block displays must not exceed specified maximum dimensions and must not " collectively occupy the centre of the window, or collectively occupy " more than 25 or 50 per cent. (as appropriate) " of the value of the space ".*

244. For bonus signatories' windows not dressed by the company the 1934 instructions laid down that 50 per cent. of the space and of the display value should be used for Imperial brands, including any centre display; in interpreting this requirement each window or showcase was to be considered separately; 50 per cent. of any window bills were to be Imperial's and it was desirable that not more than two such bills should be shown.

245. The revised instructions issued in 1954, which are still in force, contain two important modifications. They permit in windows not dressed by the

* In windows dressed by Imperial there must not be more than one block display for any one brand of another manufacturer and not more than three displays for any one manufacturer or group of manufacturers.

company: (a) centre displays for other manufacturers in certain circumstances;* (b) other manufacturers' illuminated advertisements which cannot be balanced by a similar Imperial advertisement to be balanced in other ways, as with pelmets. Imperial's records show that the 1954 concessions were made following representations by Carreras Ltd. that it was "becoming increasingly difficult for any other Company to obtain for their brands even a small representation" in traders' displays. Imperial tells us that it is now customary for bonus representatives to explain to all new bonus signatories that the company asks for "not less than 50 per cent. of each type of display or advertisement in quantity and quality" both inside and outside the premises.

246. From what has been said it will be seen that Imperial assesses the obligations of Bonus Agreement signatories in terms not only of the physical space available but also of the advertising value of the display. This necessarily involves balancing the merits of competing displays in terms of quality and the decision must, it would seem, ultimately rest on the personal judgment of bonus representatives, subject to guidance from the Bonus Department. With the exceptions already noted, where the advertising material of other manufacturers cannot in Imperial's opinion be adequately balanced the company asks for it to be removed.

247. Imperial's records show that in 1955 it told Gallaher Ltd. that there could be no question of resolving any difficulty arising from the installation of projector lighted signs by Gallaher by agreeing to balance a display in one shop with a competing display in another shop. Fixed neon signs are a form of advertisement which in Imperial's view cannot be effectively balanced.† In accordance with a ruling made in 1936 the company, with rare exceptions, does not permit its own branches to erect neon signs on tobacco traders' premises. It therefore regards the display of such signs advertising competitors' brands as inconsistent with the obligations of a Bonus Agreement signatory. In 1936 Imperial reached an understanding with Ardath, Carreras, Gallaher and Godfrey Phillips that none of them would install neon signs on customers' premises. The arrangement was in abeyance during and immediately after the war when advertising was restricted. When the matter was raised again in 1949 Carreras did not wish to renew the understanding, which was therefore considered to have lapsed. Imperial says that the manufacturers concerned in the arrangement recognised that competition in the erection of neon signs on tobacconists' premises was likely to prove very expensive; the company also thinks that such competition would have been undesirable because any attempt to confine signs to premises where they would be an economic proposition might have resulted in loss of goodwill from traders who would not have been eligible and because of the danger that proliferation of signs would have made many of them ineffective. Since 1949 Carreras, Gallaher and Godfrey Phillips have all been involved in difficulties over neon signs arising from action taken by Imperial's

* Where there is more than one window one may include another manufacturer's centre display not exceeding certain specified dimensions provided the trader balances it with a comparable display of Imperial's material elsewhere and uses 50 per cent. of the space in the window for Imperial brands; where there is only one window but there are facilities for two main displays one of the main positions may be taken by another manufacturer provided the other is used for an Imperial brand.

† Ostensibly, one fixed neon sign can be "balanced" by the erection of another one, but Imperial would hold that this would make both signs ineffective.

bonus representatives. Gallaher has told us of cases in recent years where the company, after installing a neon sign on a tobacco trader's premises, has had to pay him rental for the site to compensate for the loss of Imperial's bonus.

248. Imperial has told us that it considers the obligations imposed by the bonus scheme to apply to all forms of advertising activity and not only to the display of advertising material on customers' premises. The company has not issued any general notification to the trade about activities such as press advertising associated with another manufacturer's brands or the sponsoring of gift coupon schemes, but it regards such activities as incompatible with the signatory's undertaking to promote Imperial's interests. According to Imperial such cases are rare; when they do occur a bonus representative visits the customer concerned to explain the company's views. Imperial has told us that it does not encourage traders to advertise its own goods by comparable methods.

249. Imperial says that distributors who also manufacture have never been automatically disqualified from the bonus scheme: a number were in fact admitted to the scheme in the early days and there are signatories with manufacturing interests at the present time. The company's attitude changed, however, when coupon trading began to become important and a number of Bonus Agreements were terminated in the early 1930's. Among them was the agreement with John Sinclair Ltd., which was cancelled in 1930 a few months after the business had been acquired by Carreras (see paragraph 62). No reason for this cancellation was given to the signatory but Imperial has told us that the main reason was that the distributive side of John Sinclair's business was being used to promote the sale of Carreras' brands in a way that was inconsistent with John Sinclair's bonus obligations, though the introduction of a coupon brand of cigarette by John Sinclair itself was also a relevant factor. When coupon trading ended in 1933 Imperial reconsidered its policy and some of the distributors whose agreements had been terminated were re-admitted to the bonus scheme. John Sinclair was re-admitted in 1934 on giving an assurance that it would " avoid excessive competition " with the Robert Sinclair Tobacco Co., which was by that time controlled by Imperial (see paragraph 153). Imperial can recall only one other case where it was considered necessary to obtain special assurances before re-admitting a trader to the bonus scheme: the distributor concerned was E. Robinson & Sons Ltd. (see paragraph 167), which was re-admitted in 1935 on giving an assurance that it would not increase the amount spent on advertising its own brands and would not extend its advertising activities to new areas.

250. There are indications that, at least since 1934 and more particularly since 1954, Imperial has progressively interpreted its requirements less stringently and enforced them less severely. The instructions to bonus representatives illustrate this tendency (see paragraph 245). Imperial's records show that on several occasions in 1956 the company was reluctant to take action which other manufacturers might regard as unreasonable or obstructive. It is also on record that in the same year, when the rate of bonus was increased, the Bonus Department took the view that to tighten up the bonus requirements, as some of the branches had suggested, would be " a bad thing " unless there was excessive advertising of coupon brands. Imperial says that there has recently been some further relaxation in its requirements with regard to automatic machines: in spite of the specific provision in the Bonus Agreement (see paragraph 239), if another manufacturer supplies machines to the distributor

Imperial no longer asks for any slots in them, and if there is room for only one machine the company does not ask for a competitor's machine to be removed.

251. Imperial's Handbook lays down that the Bonus Department will advise the Executive Committee to terminate an Agreement only after every effort has been made to persuade the customer to conform to its terms. On termination of his agreement the distributor loses his bonus but is not debarred from obtaining supplies of the company's goods. Figures provided by Imperial show that the number of Bonus Agreements terminated annually was much higher before the war than it has been since. In the mid-1920's about 160 agreements a year were terminated; the number increased sharply in the early 1930's, reaching a peak of over 1,000 in 1931, when most of the terminations were due to breaches of conditions of sale or to the display of coupon gifts in windows. After the signature of the Martin Agreement and the establishment of the Tobacco Trade Association the number fell rapidly, and in the three years 1937 to 1939 476 agreements were terminated (334 for breaches of conditions of sale and 142 for breaches of display provisions). The total number of terminations for the years 1945 to 1958 was 92; in only two of these cases was termination imposed for breaches of conditions of sale, and in both these cases the accounts were closed, as had been the usual practice where such breaches were involved. In 85 out of the 90 remaining cases where agreements were terminated the traders concerned continued to trade with Imperial, and 35 of these were subsequently re-admitted to the bonus scheme. Imperial is unable to say how many signatories were approached over alleged breaches of the Bonus Agreement before the war, but in 1957 3,500 customers (about 3 per cent. of all bonus customers) were interviewed about bonus matters. We are told that in most of these cases the points raised by the bonus representatives called for relatively minor adjustments in the traders' displays. In the years 1937 to 1939 and 1945 to 1958 the total number of signatories was never less than 73,000.

(2) Other Manufacturers' Bonus Schemes

252. Bonus schemes have been operated by Gallaher, Carreras, Rothmans, Godfrey Phillips, J. Wix, Ardath and two smaller companies; at least one other small manufacturer also operated a bonus scheme until recently, when he ceased manufacture. In their present form all the current schemes differ from that of Imperial in that the bonus payment is expressed as a fixed sum per 1,000 cigarettes or per lb. of tobacco deductible from the invoice price. In effect, therefore, these bonus payments are additional discounts rather than deferred rebates. The sums payable were in all cases increased in 1957. Particulars of the schemes of Carreras, Gallaher, Godfrey Phillips and Ardath are given below.

253. Carreras introduced its scheme in 1920 with the object of competing with Imperial's bonus scheme. When first introduced the company's bonus was calculated as a percentage on the value of the customer's order. From 1947 to 1955 Carreras followed Imperial's practice of paying a deferred bonus at a rate related to the company's dividend, but in 1955 the basis was again changed and became a flat rate of 6d. per 1,000 cigarettes and 2d. per lb. of tobacco. These rates were doubled in 1957. In that year the company had some 33,000 bonus customers.

254. Gallaher had no general bonus scheme before 1947, although after acquiring Senior Service in 1937 it continued the former proprietor's practice of

selling this brand at a trade price per 1,000 6d. below Gallaher's and other manufacturers' trade prices for comparable brands; the differential of 6d. was regarded as " an additional rebate competitive with the bonus allowed by the Imperial Tobacco Company ". In 1947 this differential of 6d. per 1,000 was extended to all Gallaher's cigarette brands by deduction from invoice. Gallaher had also earlier introduced a discount off the trade price of 2d. per lb. on quantities of 7 lb. and over on packet Empire tobaccos to encourage the sale of these goods. This allowance was extended to all branded tobaccos irrespective of quantity in 1954 and to unbranded tobaccos in 1956. In 1957 the rates of bonus were increased to 9d. per 1,000 for brands in the small cigarette class and 1s. per 1,000 for all other cigarettes and to 4d. per lb. for tobaccos. All Gallaher's direct account customers, numbering about 75,000 in 1960, are allowed this bonus.

255. Godfrey Phillips introduced a bonus scheme at about the same time as Carreras. Before 1957 the company paid bonus at the rate of ½d. or 1d. per £ on the value of its sales to the distributor concerned, but in that year it changed the basis to a rate of 1s. per 1,000 cigarettes and 4d. per lb. of tobacco in order, it has explained, " not to be disadvantageously placed " in comparison with similar schemes operated by its competitors. Since 1957 Godfrey Phillips has paid bonus on about 80 per cent. of all reference goods made by the company; about 80 per cent. of the company's direct account customers participate.

256. Ardath's scheme, which was introduced in 1926 to encourage trade customers to foster the sale of the company's goods and to ensure that the company's goods and advertising material were continuously displayed, originally provided for half-yearly payments at the rate of 1¼ per cent. on a trader's net purchases. It was discontinued in 1931 but re-introduced in 1934 when the rate was raised to 1½ per cent. Until 1937 the company entered into written bonus agreements. In October 1942, following a substantial increase in tobacco duty, the bonus was changed from a percentage basis to a flat rate of 1s. per 1,000 cigarettes irrespective of price and this rate has since been maintained. The rate of bonus allowed by Ardath was formerly higher than that allowed by other manufacturers, who did not bring their rates up to the same level until 1957. Ardath's scheme covers virtually all the company's sales of cigarettes, but not its tobaccos; bonus is paid to about 10,000 distributors. The scheme continues to be operated by Ardath (U.K.) Ltd.—see paragraph 182.

257. The following table shows the effect since 1954 of the schemes operated by the four companies:—

Year	Manufacturer	Rate of bonus as percentage of value of sales of bonus-bearing goods	Total amount paid	Total for all manufacturers
		%	£	£
1954	Carreras	0·34	202,040	561,088
	Gallaher	0·35	286,156	
	Godfrey Phillips ..	0·37	19,387	
	Ardath	0·67	53,505	
1955	Carreras	0·59	154,082	595,470
	Gallaher	0·33	403,584	
	Godfrey Phillips ..	0·39	22,215	
	Ardath	0·62	15,589	

Year	Manufacturer	Rate of bonus as percentage of value of sales of bonus-bearing goods	Total amount paid	Total for all manufacturers
		%	£	£
1956	Carreras	0·25	54,486	575,812
	Gallaher	0·31	488,440	
	Godfrey Phillips ..	0·38	24,971	
	Ardath	0·55	7,915	
1957	Carreras	0·42	92,383	1,289,658
	Gallaher	0·58	1,157,475	
	Godfrey Phillips ..	0·43	29,000	
	Ardath	0·65	10,800	
1958	Carreras	0·47	93,201	1,502,421
	Gallaher	0·57	1,366,133	
	Godfrey Phillips ..	0·53	34,000	
	Ardath	0·57	9,087	
1959	Carreras	0·51	104,069	1,704,210
	Gallaher	0·57	1,564,668	
	Godfrey Phillips ..	0·50	27,300	
	Ardath	0·54	8,173	

These figures may be compared with those given for Imperial in paragraph 240.

258. Of the other four companies operating bonus schemes, J. Wix, Rothmans and one of the small companies pay bonus at the rate of 1s. per 1,000 cigarettes; they do not manufacture tobacco. The fourth allows 1s. or 1s. 7d. per 1,000 cigarettes, according to price, and 2d. per lb. on tobaccos.

259. Carreras is now the only company apart from Imperial to require distributors to enter into a written bonus agreement. This agreement provides that the distributor concerned shall stock and promote the sale of the company's tobaccos and cigarettes and display its goods and advertising material prominently on his premises " to the satisfaction of the company ". Godfrey Phillips and Ardath ask for an informal assurance that the distributor will co-operate in stocking and promoting sales of their goods and in displaying their advertising material prominently and Gallaher pays bonus " in consideration of " his complying with similar display requirements. Gallaher has told us that until 1956 it did not feel in a sufficiently strong position to link its bonus allowances specifically to display. J. Wix and one of the small companies make the payment of bonus conditional on the receipt of certain display services, but Rothmans and the other small company attach no conditions; one of the small companies has explained that as other manufacturers make a display allowance it has felt it necessary to do likewise. Godfrey Phillips has told us that it has enforced the display conditions and, on occasion, withheld the bonus when the conditions have not been observed, and it considers that it has received some additional display service in consideration of the bonus. Gallaher, on the other hand, regards the bonus as little more than an additional discount; although the company uses it as " a mild lever " if a retailer does not display its goods it has never withheld a customer's bonus on the ground that he was providing an inadequate display. Carreras also considers that its bonus has in practice become an additional discount, and says that bonus has in no instance been withheld because of a trader's failure to comply with the conditions regarding display. It finds that the amount of display received by the company in return for its bonus is limited by the customer's obligations under his agreement with Imperial. Wix and one of the small companies say that they are unable to enforce display conditions and have to rely on the distributor's goodwill.

CHAPTER 7. CONCLUSIONS AS TO THE CONDITIONS DEFINED IN THE ACT

260. We are required to report whether the conditions to which the Act of 1948 (as amended) applies prevail as respects the supply of cigarettes and manufactured cigarette and pipe tobacco. The conditions to which the Act applies in relation to the supply of goods of any description prevail if at least one-third of those goods supplied in the United Kingdom are supplied by or to one person or two or more inter-connected bodies corporate, or two or more persons who (other than by an agreement which is required to be registered with the Registrar of Restrictive Trading Agreements) so conduct their respective affairs as in any way to prevent or restrict competition in connection with the production or supply of any of the goods.

261. The figures relevant to the position of the two largest individual suppliers of cigarettes and tobacco are the following:—

	Total United Kingdom Supplies	Supplied by Imperial	Supplied by Gallaher
	£'000	£'000	£'000
1954	776,529	585,377 (75·4%)	87,321 (11·2%)
1955	806,811	636,013 (78·8%)	122,749 (15·2%)
1956	842,371	641,226 (76·1%)	156,325 (18·6%)
1957	890,740	635,700 (71·4%)	200,279 (22·5%)
1958	914,225	617,723 (67·6%)	238,992 (26·1%)
1959	933,149	591,856 (63·4%)	273,580 (29·3%)

Note: " Total supplies " have been determined by aggregating all manufacturers' sales of their own products in the United Kingdom. Sales of imported cigarettes and tobacco are not included, but this has a negligible effect on the figures (see paragraph 1). The figures for Imperial and Gallaher also represent sales of their own products.

262. Although Imperial's share of the trade has been declining, it supplied in 1959, and is no doubt supplying in 1960, a proportion not far short of two-thirds of the total market. The figures for Gallaher point to the possibility that that company will be responsible for one-third or more of the total supplies in the future, but it did not reach this proportion in or before 1959 and we have no reason to think that it has yet done so. We do not find that its share of the trade is a ground for concluding that the conditions to which the Act applies prevail as regards the supply of cigarettes and tobacco by Gallaher. We conclude that these conditions do prevail in the case of Imperial by reason of the proportion of total supplies for which that company is responsible.

263. As we have shown in paragraphs 205 and 227 to 230 individual manufacturers prescribe the minimum retail and intermediate selling prices of practically all the cigarettes and tobacco they sell, and the conditions of sale

of the leading manufacturers and many of the smaller ones—who are together responsible for about 99 per cent. of total supplies—provide for the maintenance of prices by all subsequent suppliers.* Distributors cannot buy from these manufacturers, directly or indirectly, except on these conditions and each distributor concerned accepts the conditions as a term of purchase and, with rare exceptions, observes them. While, therefore, there is no collective agreement between suppliers to maintain prices, each manufacturer and distributor concerned acts in such a way as to prevent price competition in the supply of any particular brand. Nearly all the cigarettes and tobacco supplied in the United Kingdom are supplied at all stages by persons who so conduct their respective affairs as to restrict competition in the supply of these goods and we conclude, therefore, that the conditions to which sub-section (2) of Section 3 of the Act applies prevail.

* The conditions of sale of all the suppliers named in paragraph 4, except the Co-operative Wholesale Society Ltd. and Scottish Co-operative Wholesale Society Ltd., have such a provision and some of the smaller manufacturers sell on similar conditions.

PART II. MACHINERY

CHAPTER 8. GENERAL BACKGROUND

(1) Description of the Machinery

264. Our second reference covers machinery for the manufacture or packaging of cigarettes or of cigarette or pipe tobacco. Cigarette and tobacco manufacturers use some types of machinery—such as conveying systems, weighing machines, dust and metal extraction plant, case packing equipment and various kinds of electric motors—which are in common use in other industries. We regard as within our terms of reference only those types of machinery that are specifically or primarily designed for use in the tobacco industry. Such machinery can be classified under four main sub-divisions, namely machinery (including spare parts) for (a) the preliminary processing of tobacco leaf, (b) the processing and manufacture of pipe and cigarette tobacco, (c) cigarette making, and (d) packing, parcelling and packaging cigarettes and cigarette and pipe tobacco. The term "machinery" as used hereinafter in our report means machinery within our terms of reference as so construed.

265. Sales of machinery in the United Kingdom in the eight years 1951 to 1958 averaged about £2·1 million per annum. Rather more than 80 per cent. of these sales were of complete machines, the rest being of spare parts or additional equipment for existing machines. We give further details of supplies during these years in paragraph 268.

266. The main machines in each of the four sub-divisions are listed below. The brief descriptions given of each should be read in conjunction with the description of manufacturing processes for tobacco goods given in paragraphs 15 to 23.

(a) *Machinery for the Preliminary Processing of Tobacco Leaf*

Conditioning plant which is designed to render the leaf soft and pliable by increasing its moisture content. This plant is of two main types: humidifying plant in which the leaf is either opened and sprayed with water and steam or is subjected to a stream of air at controlled temperature and humidity, and vacuumising plant where the whole cask of leaf is put in a vacuum chamber, the vacuum being broken with steam which penetrates the whole of the mass of leaf.

(b) *Machinery for the Manufacture and Processing of Pipe and Cigarette Tobacco*

Tipping machines and *butting machines* which cut the tips and butts from the leaf. Machines which carry out both processes are also made.

Stemming (or stripping) machines and *threshing machines* which provide alternative methods of removing the stem.

Stem crushers which are used to prepare that part of the separated stem which is to be used for manufacture.

Blending plant where the leaf is mixed either in revolving bins or on an oscillating belt. Blending plant which incorporates bulking silos for storing the processed leaf is also made.

Cutting machines which work on two main principles: one (the earlier) type uses a reciprocating knife of the chaff cutter type; the other uses a rotating cutter head.

Drying and cooling plant in which the cut tobacco rag is first subjected to a stream of warm or hot air and then cooled with the aid of ambient temperature air.

Spinning machines, making off machines, cording machines, plug rolling machines and hydraulically operated *presses* are used in the manufacture of roll, twist, pigtail and similar types of hard tobacco.

(c) *Cigarette Making Machinery*

Cigarette making machines, the most elaborate and important machines covered by our reference. Different makes of machine embody different devices; for example, the cut-off (which cuts the rod to form the individual cigarettes) may take the form of either a sickle or a rotating knife; there is more than one method of feeding tobacco on to the cigarette paper as it moves forward; different mechanisms have been devised for making filter tipped cigarettes. The most modern types of cigarette machines can produce 1,500 cigarettes or more a minute.

Cigarette splitting or *ripping machines* are used to recover the tobacco from cigarettes rejected as imperfect.

(d) *Packing, Parcelling and Packaging Machinery*

A wide range of these machines is produced including:—

Cigarette packing machines which pack in units of 5, 10 or 20 cigarettes and are of several types. Some form the packet and fill it, first wrapping the cigarettes in paper-backed metal foil or glascine paper. Others fold a paper packet round the cigarettes, with or without an inner foil wrapper. One type packs two foil bundles, each containing 10 cigarettes, side by side in the carton. The packets themselves are of several types (see paragraph 10) and require different machines; the hinged lid carton packer, for example, is designed to pack cigarettes in single or twin bundles in a stiff carton with a hinged lid. Modern machines are capable of packing up to 2,400 cigarettes a minute, or 5,000 on duplex models. Machines also pack 25, 50 or occasionally 100 cigarettes in ready-made boxes.

Parcelling machines and boxing attachments which parcel or box a number of packets (usually 10 or 20). Some types of parcellers can be equipped to print or label the parcel wrappers.

Wrapping machines which wrap the cigarette packets in moisture-proof film or other materials. Usually the film is of heat sealing type, like cellophane, but where heat sealing is not desired a solvent is applied.

Tobacco packing machines. Tobacco wrapping and labelling machines which received portions weighed by hand in ordinary scales (similar to those used in tobacconists' shops) and which operated in much the same way as cigarette packing machines were formerly in general use, but are being superseded by a recently developed weighing and packing machine in which the desired weight of tobacco is automatically discharged into the packing section of the machine.

267. Hybrid machines for many purposes are also made by combining various pieces of mechanism, or even several separate machines. Such special types of machine are usually made to meet the requirements of a particular cigarette

or tobacco manufacturer. All the machinery described above is specialised or semi-specialised for use in the tobacco industry; except for some of the packing, parcelling and packaging machinery it has few if any other uses.

(2) THE MANUFACTURERS

268. The table below shows the sales of the principal suppliers and the total sales of machinery in the home market in the eight years 1951 to 1958:—

Company	Machines and Spare Parts							
	1951	1952	1953	1954	1955	1956	1957	1958
	£	£	£	£	£	£	£	£
AMF Limited	95,723	55,395	104,321	134,638	167,904	145,262	257,124	255,459
J. & E. Arnfield Limited (Arnfield)	18,863	135,298	120,782	206,031	238,199	261,600	205,979	243,063
Ayers & Grimshaw Limited (Ayers & Grimshaw)	14,056	29,178	33,464	57,453	53,566	71,916	68,615	118,422
G. H. Bowen Limited (Bowen)	14,400	9,000	28,500	20,000	20,000	44,000	16,389	8,448
D. K. Hamblin & Company Limited (Hamblin)	9,051	14,466	13,219	24,221	21,378	39,812	45,600	75,800
Hauni London Limited (Hauni London) ..	—	3,057	4,069	39,822	63,197	51,800	228,516	424,971
Robert Legg Limited (Robert Legg) ..	114,000	125,000	98,000	124,000	175,000	185,000	264,177	298,172
Molins Machine Company Limited (Molins)	822,898	805,161	727,364	619,432	909,220	1,470,765	1,572,130	2,148,935
Rose Brothers (Gainsborough) Limited (Rose)	96,576	96,733	91,134	108,942	40,845	21,272	15,031	38,212
The Thrissell Engineering Company Limited (Thrissell)	12,070	41,927	4,520	4,305	1,694	—	11,806	17,444
Tingey & Company (Tingey)	19,068	16,904	9,537	12,410	13,790	17,333	33,999	37,240
Vokes-Cardwell Limited (Vokes-Cardwell) ..	(a)	(a)	(a)	(a)	16,610	35,680	46,796	100,594
Wix of London Limited	(a)	(a)	3,031	2,550	12,864	18,770	19,402	8,142
Others	227,912	132,036	83,035	115,389	70,360	107,650	89,488	61,734
Total	1,444,617	1,464,155	1,320,976	1,469,193	1,804,627	2,470,860	2,875,052	3,836,636

(a) The two companies concerned were not operating in the years indicated.

There is in addition a very small market for second-hand machines.

269. All the thirteen companies named above except Hauni London either manufacture in the United Kingdom the machinery they supply or procure its manufacture here. The largest supplier, Molins, has a special relationship with Imperial and the British-American Tobacco Co. Ltd.; we describe the part played by Molins in the industry more fully in subsequent chapters. Four suppliers (AMF Ltd., Hauni London, Robert Legg and Vokes-Cardwell) are subsidiaries or associates of foreign machinery manufacturers. AMF Ltd., a United Kingdom subsidiary of American Machine & Foundry Company (Amfoco) of New York, supplies machinery based on its parent company's

designs and manufactured for it in this country under contract;* it has a factory of its own, but this is engaged principally in development work and in the production of spare parts. In 1960 the American company acquired Robert Legg, one of the oldest British manufacturers of tobacco machinery. Hauni London does not itself manufacture, but imports machinery made by Hauni Werke Körber & Co., K. G. of Hamburg, for sale in the United Kingdom. Vokes-Cardwell is owned jointly by Vokes Ltd., a British company, and Cardwell Machine Company of Richmond, U.S.A.: incorporated in 1954, Vokes-Cardwell has rights of manufacture of Cardwell Machine Company types of plant. Of the other companies named, Thrissell is a wholly owned subsidiary of Molins (see paragraph 289), Arnfield is a wholly owned subsidiary of Gallaher (see paragraph 292), and Wix of London Ltd. is controlled by members of the Wix family (see paragraph 192). In addition to the companies named in the table there is a number of general contractors who make, or have made, a limited range of machinery, in most cases to the designs and specifications of individual tobacco manufacturers. These contractors are not regular suppliers to the tobacco industry and tobacco machinery represents a small proportion of their business. There is also some importation of machinery from sources other than Hauni. It is estimated that in the eight years referred to about 6 per cent. of the machinery sold was imported.

270. The following table gives a general indication of the types of machinery supplied by the thirteen companies which are regular suppliers of machinery:—

Company	Types of Machinery supplied			
	Preliminary leaf processing	Processing and manufacture of cigarette and pipe tobacco	Cigarette making	Packing, parcelling and packaging
AMF Ltd.	X	X	X	
J. & E. Arnfield Ltd.		X	X	
Ayers & Grimshaw Ltd.				X
G. H. Bowen Ltd.	X			
D. K. Hamblin & Co. Ltd. ..	X	X		
Hauni London Ltd.	X	X	X	X
Robert Legg Ltd.	X	X		
Molins Machine Co. Ltd.		X	X	X
Rose Brothers (Gainsborough) Ltd.				X
Thrissell Engineering Co. Ltd. ..		X		
Tingey & Co.		X	X	
Vokes-Cardwell Ltd.	X	X		
Wix of London Ltd.			X	X

Several suppliers of machinery, including Molins, offer services for planning and equipping complete cigarette and tobacco factories. These services, which are not normally used by United Kingdom cigarette and tobacco manufacturers, would include the installation of plant not made by the suppliers. Three companies make machinery in only one of the four main categories and not all those shown as supplying machinery in a particular category make a full or even a

* AMF Ltd. is also sole agent for the supply in the United Kingdom of Guardite leaf conditioning equipment designed by the Guardite Corporation of the United States. Manufacture of this equipment in the United Kingdom is undertaken by other companies for AMF Ltd.

wide range of machines within that category. Rose is a specialist in packing machinery for industry generally and manufacture for the tobacco industry represents only a very small part of the company's total business. Of the six companies shown as supplying cigarette making machinery, only four (AMF Ltd., Arnfield, Hauni London and Molins) supply the main cigarette making machine. Machinery for the tobacco industry represents a widely varying proportion of the business of the thirteen suppliers named; for some it is the principal or at least an important part of the business, for others only a secondary interest. Molins' business is practically confined to the manufacture and supply of machinery for the tobacco industries in the United Kingdom and overseas.

271. There is no trade association or other body representing the interests of manufacturers of this machinery as such.

(3) Materials and Manufacturing Processes

272. The basic materials and the manufacturing processes and techniques used by machinery manufacturers are those common to the engineering industry as a whole. Semi-finished and finished components are normally bought from outside producers or stockists. Exceptionally, Rose makes its castings in its own foundries.

(4) Legislation concerning Cigarette and Tobacco Machinery

(a) *Manufacture*

273. During and immediately after the war the production of machinery was subject to the provisions of the Machinery and Plant (Control) Order, 1940, the Machinery, Plant and Appliances (Control) Order, 1940, and subsequent amending orders. There has been no control of production since 1st December, 1948.

(b) *Importation*

274. Under an Order dated 25th October, 1939, tobacco and cigarette making machinery and plant and packing and labelling machinery could be imported only under specific licence. From October 1949 " cigarette making machinery and parts " and " tobacco processing machinery and parts " were allowed to be imported under Open General Licence except from hard currency areas and the Eastern Area; " packaging machinery " was brought within the scope of the Open General Licence in January 1950. This relaxation has since been extended and, so far as tobacco machinery is concerned, a specific licence is now required only for importation from the Eastern Area.

(c) *Import Duty*

275. The current rates of duty on imported foreign machinery are 15 per cent. or 17½ per cent. of the value, according to the type of machine.* If it can be

* Namely:—

(i) Machines for the manufacture of cigarettes or pipe tobacco	17½ per cent. *ad valorem*
(ii) Can casing machines and cappers, sealers (excluding carton sealing machines), closers; certain types of machines for filling containers, which automatically control the quantities to be inserted into each container	15 per cent. *ad valorem*
(iii) Packing and labelling machinery other than that specified under (ii)	17½ per cent. *ad valorem*

shown that machinery similar to the foreign machinery is not available in the United Kingdom, the Board of Trade will, subject to certain conditions, consider recommending H.M. Treasury to issue a duty free licence. Machinery manufactured in and consigned from Commonwealth countries is free of duty.

(5) Research and Development

276. Of the thirteen regular suppliers of machinery, two (AMF Ltd. and Molins) undertake fundamental research as well as development work. Molins has told us that cigarette making machines in particular offer scope for fundamental research; the accurate distribution of tobacco in the finished product, for example, has presented a constant problem. The necessity for a separate research and development department became apparent to the company during the 1920's; by 1957 the workshop devoted to development work employed over 140 mechanics. In addition there is today a technical staff which varies in size according to the nature of the work in hand: in 1960 it numbered some 70 persons. The department has recently been considerably enlarged.

277. AMF Ltd.'s own engineering facilities in the United Kingdom are used mainly for the manufacture of spare parts and for development and experimental work. This work includes the adaptation of units designed by the parent company primarily for the American market to make them suitable for the different requirements of the tobacco industry in Europe. The company also conducts fundamental research into ways of producing tobacco goods of higher quality at lower manufacturing cost, and in this it works closely with tobacco manufacturers.

278. The German company which is Hauni London's source of supply is, like Molins, one of the leading manufacturers of machinery for the tobacco industries of the world but we have no information about its research activities. Most of the other companies concerned carry out development work, sometimes in close collaboration with tobacco manufacturers who are their customers.

CHAPTER 9. HISTORY AND ORGANISATION OF THE MACHINERY INDUSTRY

279. As we have shown in Chapter 8, there are few companies which specialise in the production of cigarette and tobacco machinery, and the cigarette and tobacco manufacturers themselves have played an active part, directly and indirectly, in the development of the machinery they use. Sometimes they have designed or adapted machines to fit their own requirements and had them manufactured by general engineering contractors. In other cases their development work has been carried out in co-operation with particular machinery manufacturers, with whom special relationships have grown up. In view of the high proportion of the cigarette and tobacco trade for which Imperial is responsible, the paragraphs which follow are necessarily to a large extent an account of relations between Imperial and the machinery manufacturers and more especially between Imperial and Molins Machine Co. Ltd.

280. The first manufacturer in the United Kingdom of machinery for the tobacco industry was probably Robert Legg, who in 1853 invented a continuously fed tobacco cutting machine. In 1900 the business he had founded

was turned into a limited company. Another early manufacturer was William Rose, a retail tobacconist in Gainsborough, who about 1880 developed an appliance for wrapping ½-oz. packets of tobacco. His first machine was sold to W. D. & H. O. Wills Ltd., which allowed its name to be included in the original patent specification. Both Robert Legg Ltd. and Rose Bros. (Gainsborough) Ltd. have continued to make certain kinds of machinery for the tobacco industry; Robert Legg now specialises in machinery for preliminary leaf processing and the processing and manufacture of cigarette and pipe tobacco, while Rose makes packing and wrapping machinery for use in many industries. In 1960 Robert Legg became a subsidiary of American Machine & Foundry Company (see paragraph 286).

281. Meanwhile in the United States of America cigarette making machines based on the continuous rod principle (see paragraph 20) had been successfully developed. One of the earliest and most successful of these was the Bonsack machine designed and patented in the 1870's. In 1883 two Bonsack machines and the British patent rights were sold to W. D. & H. O. Wills, and the company's price list for December that year drew attention to considerable price reductions resulting from great savings in cost of manufacture following the introduction of " powerful machinery ". The machine had an output capacity of 200 cigarettes a minute as compared with a hand-roller's output of 1,250 a day. By 1888 eleven Bonsack machines were in use at Bristol, each producing 85,000 or more cigarettes a day.

282. In 1895 Bernhard Baron came to England from America, where he had been engaged in cigarette manufacture. He was the owner of patents for cigarette making machinery and on reaching England he started, with considerable success, to build these machines for sale in this country and in Europe.* He later (in 1903) became one of the founders of Carreras Ltd. His customers for machinery included John Player & Sons Ltd. and other United Kingdom tobacco manufacturers who had not been able to use the Bonsack machine to which W. D. & H. O. Wills had acquired the sole rights.

283. The Bonsack machine was used in preference to the Baron machine in the factories of Imperial branches after the formation of that company in 1901. The machine was continually improved and in 1904 was capable of producing 600 cigarettes a minute. Bonsack machines remained in use in Imperial's branches for a further 25 years. Other successful early competitors of the Bonsack machine were the United made by the United Cigarette Machine Company (United), and the Briggs, both American machines.

284. In the 1890's J. S. Molins, an experienced manufacturer of cigars and cigarettes, also came to England from America and started business. In addition to making cigarettes, he obtained in 1893 the agency for the Briggs machine, which was then capable of producing some 300 cigarettes a minute. After selling a number of these machines, he sold the business to United, part of the consideration being that he was allowed the free use of three Briggs

* Robert Legg made some of the machines for Baron. Baron himself used the machines to make cigarettes and also rented them to other manufacturers. Robert Legg has described them as " being at that time easily the best of the somewhat crude cigarette making machines which were available ". The Baron interests in machinery manufacture were vested in the Baron Machinery Co. Ltd. and later passed to Carreras Ltd. The present Baron Machinery Co. Ltd., a subsidiary of Carreras, is now largely inactive. It holds patents and supplies spare parts for Baron cigarette making machines.

machines. With these he made cigarettes for trade customers who supplied their own tobacco, in addition to making several brands of his own. J. S. Molins' two sons, W. E. and H. B. Molins, were also engaged in the business and began to turn their attention to the development of machinery. Their early inventions included machines for making paper packets, with variations for making cardboard hull and slide packets, and machines for closing the packets after they had been filled with cigarettes by hand.*

285. Molins has told us that the brothers at first concentrated on packet making machines because these were more suited to small-scale manufacture than cigarette making machines, which need good factory facilities and large machine tools. The brothers succeeded in selling their machines, but they had neither an adequate factory nor sufficient capital resources. For this reason they entered into negotiations with United and, as a result, the present Molins company was formed in 1912 to acquire the brothers' business. The company had an authorised capital of £20,000, the shares being divided equally between United on the one hand, and the Molins brothers jointly on the other. As, however, only £2 of the capital was subscribed in cash, sufficient capital to equip a factory in the United Kingdom was not provided, and as a temporary measure the Molins brothers and some of their leading employees worked in Dresden where a subsidiary of United had a large and well-equipped factory. During this period the first Molins automatic packing machine, used for packing Wills' Gold Flake in paper packets, was successfully developed. The Dresden arrangements ended with the 1914–18 war and in 1919 Molins moved to a small and derelict factory in Deptford.

286. In the same year (1919) another American company, American Machine & Foundry Company (Amfoco), set up a United Kingdom subsidiary.† Amfoco was the manufacturer of Standard cigarette making machines which began to be installed in increasing numbers in the factories of Imperial's branches, gradually superseding the earlier Bonsack machines. At first Standard machines were imported from America; later many of those used by Imperial were manufactured in the United Kingdom under licence by Brecknell, Munro & Rogers Ltd. (Brecknell). Imperial has told us that much of the earlier development of cigarette packing machinery, as well as improvements in the Standard machine, resulted from the joint work of Imperial and Brecknell. In 1920 Imperial and B.A.T. together acquired a majority of the shares in Brecknell, whose main business was the manufacture of machinery for the tobacco industry. By this time cigarette making machines were also being manufactured on a large scale in Germany, one of the best known being the Triumph which was made first by the American company United and later by " Universelle " Cigarettenmaschinen-Fabrik J. C. Müller & Co. (Müller) of Dresden (see also paragraph 290).

287. In 1924 Molins entered into agreements with Imperial under which Imperial purchased twenty machines for packing Woodbine cigarettes in paper packets containing 5 and obtained an option, on condition that it purchased not less than 52 of these machines, to acquire exclusive rights to buy and use

* The earliest type of cigarette packet in use in the United Kingdom was the paper cup type. This was followed by sealed paper packets and later by cardboard hull and slide containers. (See also paragraph 10.)

† Originally called American Machine & Foundry Co. Ltd., the subsidiary company changed its name in 1928 to Industrial Machinery Co. Ltd. and again recently to AMF Ltd.

them in the United Kingdom for fourteen years or the life of the relevant patents. The option, which was exercised, was dependent upon, *inter alia*, the advance of money by Imperial, and the company in fact advanced £10,000 on mortgage to Molins. In the same year Molins purchased another factory and from 1924 onwards was able for the first time to consider seriously the manufacture of cigarette making machines. The first Molins cigarette making machine appeared in 1926 and the company has since continually improved upon or redesigned its models: the latest, the Mark VIII, which was developed between 1957 and 1959 and produces 1,500 or more cigarettes a minute, is in some ways revolutionary and for most purposes virtually supersedes all earlier models of cigarette making machines. Over the years Molins' machines have superseded Standard machines in the factories of Imperial branches.

288. Meanwhile in 1923 the Molins brothers had commenced negotiations as a result of which they bought out United and assumed full control of the Molins company. In 1924 the company entered into an agreement with United which gave the latter exclusive licence under Molins' patents for certain machines in the Western Hemisphere (except Canada) and Eastern Europe (including Germany) with entire sales rights in these territories against payment of royalty. The machines concerned in the arrangements were machines for packing any article of merchandise (including cigarettes), for making packets for such articles and for stamping the packets or packages; most of the machines sold in United's territory were made in Dresden.

289. By 1927 Molins, Rose and Brecknell were Imperial's principal suppliers of machinery. In that year Molins entered into two agreements with Imperial and the British-American Tobacco Co. Ltd. (the "Associated Companies"). Under one of these agreements, which is still in force, the Associated Companies together agreed to purchase an interest in Molins' share capital, including 49 per cent. of the voting shares, the 49 per cent. to be increased to 50 per cent. on the death of the survivor of W. E. and H. B. Molins. The second agreement covered the supply of machinery by Molins to Imperial and B.A.T. and gave these companies certain preferential rights as to prices and the use of new Molins machines. The provisions and effects of these arrangements are described in greater detail in Chapters 10 and 11. It is sufficient to say here that Imperial exercised its right to exclusive use in the home market of several machines including the Molins cigarette making machine, but that B.A.T. did not exercise its corresponding option for overseas markets. A further effect of the arrangements was that Brecknell (see paragraph 286) became a wholly owned subsidiary of Molins and changed its name to the Thrissell Engineering Co. Ltd. The arrangements covering the supply of machinery to Imperial and B.A.T. continued in force until 1957; the original machinery agreement was then replaced by separate agreements between Molins and Imperial and between Molins and B.A.T. (see paragraphs 334–337); these agreements, which are still current, make no provision for any exclusive right by either customer to use machines.

290. A month after the 1927 agreement with Imperial and B.A.T. had been signed, the 1924 agreement between Molins and United (see paragraph 288) was cancelled and the two companies entered into a new agreement which increased the proportion of the world market reserved to Molins; the types of machinery concerned were the same as those covered by the earlier agreement and did not include the Molins cigarette making machine. Molins has

told us that United had been " slowly disintegrating " and in 1929 it transferred all its rights under the 1927 agreement with Molins to its Dresden subsidiary, United Cigarette Machine Co. A.G. (United A.G.). By 1930 Molins had become aware that United A.G. had been sold to Müller of Dresden* and that United A.G. was also associated with a Viennese manufacturer of cigarette packing machinery who was to make United's cigarette machines for it; it appeared that the Viennese manufacturer was also to make Molins packing machines for United. In 1930 Molins told Müller that it considered the agreement between Molins and United had lapsed. Litigation followed, ending in 1932 with a decision in Molins' favour. In 1934 Molins entered into an agreement with Müller which cancelled all existing contracts and provided, *inter alia*, that the parties should grant each other licences under patents covering specified machines (mainly of the types covered in the earlier United agreements); Müller undertook not to make " tobacco machines " in Great Britain and Ireland and Molins not to do so in Germany and Austria. These arrangements ended with the outbreak of war.

291. Of the remaining leading manufacturers of cigarette and tobacco machinery in the United Kingdom, the first to enter this field was Tingey & Co. Founded as general engineers in 1870, Tingey the proprietor of which is Oscar Legg Ltd., has since 1926 manufactured a range of tobacco machinery invented by Oscar Legg; in 1947 patents and drawings relating to cigarette ripping and paper cleaning machines were sold by the parent company to Imperial which then licensed Oscar Legg to manufacture; under the terms of the licence Imperial receives a royalty of 5 per cent. on all machines sold to other tobacco manufacturers. Ayers & Grimshaw Ltd., G. H. Bowen Ltd. and D. K. Hamblin & Co. Ltd. entered the tobacco machinery market more recently. Ayers & Grimshaw, a company founded in 1940, began manufacturing tobacco machinery in 1946 when, at the request of the Wills branch, it successfully developed a parcelling machine based on Wills' master patents; it has since supplied this machine to all Imperial's branches. In 1949 Imperial granted the company a licence to supply machines on the open market in any part of the world. Bowen, a family business which became a limited company in 1951, owes its existence as a tobacco machinery manufacturer to the " Patent Conditioning Machine for tobacco leaf ". Imperial had co-operated in the original development of the machine and Bowen licensed Imperial to manufacture it under the relevant patent; Imperial did not in fact work the patent, but placed orders with Bowen. Bowen has also an arrangement with Robert Legg whereby the latter pays Bowen a royalty on " Bowen " conditioning machines made and sold by Robert Legg. The machine is available on the open market. Hamblin, another family business, became a limited company in 1946; in addition to tobacco machinery, the company makes non-specialised equipment including vibrating and belt conveyors, as well as dust-collecting plant and cigarette trays and trolleys, for use in tobacco factories. The German company Hauni Maschinenfabrik Körber & Co. G.m.b.H. (now Hauni Werke Körber & Co. K.G.) of Hamburg was also founded after the war, by a former director of Müller (see paragraphs 286 and 290). It at first appointed agents in the United Kingdom; in 1956 the agents formed a subsidiary company, Hauni London Ltd., to deal with the sale of Hauni machines in this country. Hauni's latest cigarette making machine is the chief rival of the Molins Mark VIII machine.

* See also paragraph 286.

292. It remains to describe the circumstances in which Gallaher Ltd. acquired control of J. & E. Arnfield Ltd. Before the war the principal cigarette making machines available to United Kingdom manufacturers other than Imperial were Amfoco's Standard, designed in the United States and made under contract in this country, and Müller's Triumph, made in Germany.* A cigarette making machine consists of two main parts, the bed and the feed. Gallaher had developed its own type of machine consisting of an imported Müller bed and an Amfoco feed. Gallaher considered that this combination produced the best machine then available to it, and one which in the company's opinion made better cigarettes than those of any other manufacturer. During the war, however, Gallaher foresaw that it might be unwise to rely on the supply of machine beds from Dresden in future and difficult to obtain currency for the purchase of American machines; for technical reasons it did not in any case like the American machine which was available. At the same time Gallaher considered that there were reasonable grounds for expecting that its own business would expand after the war. The company therefore decided to develop its own machinery manufacturing capacity and in 1944 it acquired the whole of the share capital of a group of engineering companies including Arnfield. None of the companies in the group had at that time made cigarette and tobacco machinery, but Arnfield has since made for Gallaher cigarette making machines similar to those the latter was already using. Arnfield also reconditions machinery for Gallaher and acts as an engineering contractor. Machinery made under contract has included stemming machines for AMF Ltd. and Baron cigarette machines for Carreras. Arnfield has also made another type of cigarette making machine, the British Triumph, for which Robert Legg acts as agent.† This machine is sold on the open market, most sales being for export.

293. Gallaher has told us that it has recently placed a small order for Molins Mark VIII cigarette making machines and is testing the new Hauni machine. The company's future policy has not yet, however, been decided and Arnfield has continued up to the present to be one of its principal sources of machinery.

294. The speed and efficiency of the main types of machinery used in cigarette and tobacco manufacture have been progressively improved over the years. We refer in greater detail in Chapter 11 to certain machines developed by Molins.

CHAPTER 10. MOLINS MACHINE COMPANY LIMITED: FINANCIAL ARRANGEMENTS AND ORGANISATION

295. Molins Machine Co. Ltd., a private company, was formed in 1912 with an authorised and issued capital of £20,000; this remained unchanged until 1925, when the authorised capital was increased to £200,000. There was one class of shares and the two Molins brothers (see paragraphs 284, 285 and 289) between them held the whole of the £100,000 issued capital. The expansion of 1925 followed agreements between Molins and Imperial which gave Molins a

* French and Czechoslovakian machines were also available, as was the Baron machine.

† A director of Legg is also on the board of Arnfield.

limited guaranteed market for one of its machines and made certain financial resources available to it (see paragraph 287).

296. Under the first of two agreements concluded in 1927 (see paragraph 289) between the Molins company, the Molins brothers and the " Associated Companies " (Imperial and British-American Tobacco Co. Ltd.), the authorised capital of Molins was to be increased to £1 million and divided into three classes: namely, 900,000 7 per cent. cumulative participating preference shares, 66,000 " A " voting ordinary shares and 34,000 " B " non-voting ordinary shares, all of £1. In consideration of the payment by the Associated Companies to the Molins brothers of £450,000, shares were allotted or transferred to those companies, and as a result of this and of the implementation of other provisions of the agreement the position by 1928 was as follows:—

Shareholder	7% Cumulative Preference		"A" Voting Ordinary		" B " Non-Voting Ordinary		Total	
	£	%	£	%	£	%	£	%
H. B. Molins ..	207,000	50	4,725	51·2	—	—	212,225	49·5
W. E. Molins ..	242,500		5,775		—	—	248,275	
Bishopsgate Nominees Ltd. (for Imperial)	225,000	25	5,000	24·4	4,750	50	234,750	25·25
Branch Nominees Ltd. (for B.A.T.) ..	225,000	25	5,000	24·4	4,750	50	234,750	25·25
Total issued ..	900,000		20,500		9,500		930,000	

The Molins brothers and the Associated Companies each undertook that they would not sell or transfer any of their shares in Molins without first offering them on equally favourable terms to the other parties. The Molins brothers undertook that on the death of the survivor of the two brothers their representatives would exchange with the Associated Companies a specified number of " A " voting ordinary shares for a specified number of " B " non-voting ordinary shares, the numbers concerned being such that in effect the voting control of the company would then be held 50 per cent. by the representatives of the Molins family and 50 per cent. by the Associated Companies.* The brothers agreed to guarantee for three years a dividend of 6 per cent. on the preference shares held by the Associated Companies. They also agreed each to invest £25,000 in Imperial's ordinary shares and £25,000 in B.A.T.'s ordinary shares.

297. The agreement included provisions concerning Brecknell, Munro & Rogers Ltd. (see paragraph 286). The Associated Companies undertook to acquire all the shares in that company which they did not already hold (namely 79,791 ordinary shares of 10s. each and 2,058 preference shares of £5 each) and then to transfer the whole of the share capital (consisting of 174,829 ordinary shares and 2,058 preference shares) to Molins for the sum of £80,679 15s. 0d. This sum was provided by the allotment to the Molins brothers of 80,680

* The number specified was 250, 125 relating to Imperial and 125 to B.A.T. The numbers were adjusted to produce the same result when Molins' capital was reconstructed in 1954—see paragraph 298.

preference shares in Molins for cash at par. (These shares are included in the holdings shown in the table in the preceding paragraph.)

298. Between 1927 and 1954, although there were some changes in shareholdings occasioned principally by the death of W. E. Molins in 1935, the overall totals of the various classes of shares held by the Molins family and the Associated Companies remained unchanged and there was no increase in either the authorised or the issued capital. In 1954 the capital of the company was increased and reconstructed. Imperial has told us that " by mutual understanding but without any formal agreement between . . . [Imperial] and B.A.T. the arrangement of a joint interest, equally divided between them and falling short of voting control, has persisted through subsequent changes in Molins' capital structure ". Except for the transfer in 1957 of preference shares held by the Molins family to the Molins Pension Trust, there was no further change until the death of H. B. Molins in 1958, when the clause of the 1927 agreement relating to the readjustment of voting shares came into effect. Since 1959, when the necessary transfer of shares was completed, the position has been as follows:—

	6% Cumulative Preference		"A" Voting Ordinary		" B " Non-Voting Ordinary		Total	
	£	%	£	%	£	%	£	%
Authorised	900,000		17,160		762,840		1,680,000	
Issued								
Molins family ..	—	—	8,580	50	377,624	49·5	386,204 }	49·8
Molins Pension Trust	450,000	50	—	—	—	—	450,000 }	
Bishopsgate Nominees Ltd. (for Imperial)	225,000	25	4,290	25	192,608	25·25	421,898	25·1
Branch Nominees Ltd. (for B.A.T.) ..	225,000	25	4,290	25	192,608	25·25	421,898	25·1
Total issued ..	900,000		17,160		762,840		1,680,000	

299. In addition to the financial arrangements described above, the 1927 agreement contained provisions securing to the Molins company the full-time services of the Molins brothers and the assignment of patents and inventions which might be developed in the future by the brothers or by regular employees. It also provided that the Molins brothers would take steps to terminate or revise the 1924 agreement between Molins and the United Cigarette Machine Company. It was a term of the financial agreement that Molins should forthwith enter into another agreement relating to the supply of machinery to the Associated Companies, the terms of which were annexed to the financial agreement. We have referred in paragraph 290 to the action taken in the case of United; we describe the terms and effects of the machinery agreement in Chapter 11. In the following paragraphs we describe the relationship between Molins and Imperial and B.A.T. which has resulted more specifically from the financial interest held by the Associated Companies.

300. The financial agreement of 1927 provided that the board of Molins was to consist of not fewer than five or more than twelve directors. Of these, the Associated Companies were to have the right to nominate two when the

total number did not exceed eight, three when the total was more than eight but not more than eleven, and four when there were twelve directors.* In practice Imperial and B.A.T. have not at any time exercised their right to appoint directors, though a representative of each of them has been appointed as an alternate director for a member of the Molins board. The alternate directors receive copies of the monthly reports made to the board and attend board meetings, but since 1949 the board has not met more than once a year.

301. We are told by Molins that the Associated Companies have never pressed for a greater degree of representation and that the alternate directors representing them " have never . . . in any shape or form directed " any of Molins' business affairs. B.A.T. has told us that it would not exercise its right to appoint directors unless this were considered necessary for the purposes of safeguarding the company's investment in Molins. Imperial's records show that, at any rate in recent years, Molins has opposed any suggestion for a closer working arrangement between the company and the Associated Companies or for direct representation of the Associated Companies on the Molins board. There are indications that in 1955 Imperial considered disposing of its shareholding in Molins; there are also indications that at times both Imperial and B.A.T. may have felt that they should press for stronger representation on the Molins board. Imperial has told us that Molins has always been very sensitive to any " undue degree of interference " and is anxious " that it should not appear to any customer that in fact [the company is] . . . unduly influenced " by either B.A.T. or Imperial. At times Imperial has felt that it would have liked to exercise more influence on certain aspects of the Molins business, but the relationship between the two companies has settled down on the basis appropriate to that between a supplier and one of his largest customers. In Imperial's view, Molins has proved itself " to be certainly at least as good as any other cigarette and tobacco machinery supplier " and in some ways, particularly inventively, better. Imperial does not regret the association, which it thinks has served both Molins and itself well, and as far as it can foresee is not likely to wish to dispose of its interest.

302. Imperial's motive in acquiring a financial interest in Molins was threefold, namely (a) to secure an assured supply of the best machinery available, (b) to assist development, particularly in cigarette making and packing machinery, by bringing to bear Imperial's considerable practical experience, and (c) to ensure that development was not hindered by lack of finance. The first two points are considered at greater length in Chapter 11: it is sufficient to say here that, according to Imperial, Molins " showed great promise of inventive capacity " and that Imperial claims to have helped Molins technically in the development of a good deal of its machinery. With regard to the third point, Molins has told us that it " had from the very beginning, fought an uphill struggle against financial difficulties and it was obviously necessary for the Company to have considerable capital if it were to expand and attempt to promote the development of new machines to an adequate extent ". After the financial arrangements with Imperial and B.A.T. in 1927, Molins' business continued to expand with increasing momentum; by 1948 Molins' financial

* A supplemental agreement of December 1957 provided that the number of directors should not be less than five or more than eighteen and extended the Associated Companies' rights of nomination accordingly, the effect being as in the original agreement that their nominees should not in general exceed one-third of the total number of directors.

position had changed to such an extent that it was able to lend Imperial the sum of £1,200,000; it made a second loan of £1,000,000 to Imperial in 1955.*

303. Molins now has two factories, one at Deptford and the other at Saunderton, near High Wycombe. The original buildings in Molins' present Deptford factory were acquired in 1919 (see paragraph 285) but on at least seven occasions both before and since the war the factory has been extended.† In 1950 the Saunderton site was acquired to provide the increased manufacturing capacity then needed by Molins and the Thrissell Engineering Co. Ltd. The Deptford factory includes Molins' administrative offices; all the company's research and development is carried out at Deptford and machinery for the tobacco industry is manufactured and assembled there. The Saunderton factory is engaged 65 per cent. on the manufacture and assembly of machinery for the tobacco industry and 35 per cent. on the manufacture and distribution of spare parts. The production of standardised lines has increasingly been moved from Deptford to Saunderton and virtually all spare parts are now made there. We are told that Molins intends " that Deptford will remain as the main plant, the centre of the business, and the centre of all development work ". Molins employs a labour force of about 3,000, including management, office and drawing office staff and production engineers.

304. In addition to the parent company's factories, Molins' subsidiary, Thrissell (formerly Brecknell) has a factory at Bristol. In July 1960 some 48 per cent. of Thrissell's business was concerned with machinery for the food packing and box industries, 44 per cent. with manufacture for Molins, 7 per cent. with manufacture of its own tobacco machines and 1 per cent. with miscellaneous work.‡ Tobacco machinery made by Thrissell comprises stemming machines, stem crushing machines, tobacco cutting machines and presses, and slide cutting and hull making machines. With the exception of one director (Imperial's Chief Engineer) all members of the board of Thrissell are directors or employees of the parent company.

305. Molins has one other United Kingdom subsidiary concerned with machinery for the tobacco industry, namely Filter Tips Ltd.§ This company, all the shares in which were formerly owned by members of the Wix family, owns certain patents relating to machinery for making filter tipped cigarettes. We are told by Molins that in August 1953 Filter Tips was approached by Hauni Werke Körber & Co. K.G. for a licence under certain of these patents. At about the same time American Machine & Foundry Company also approached Filter Tips with a view to acquiring the company. Filter Tips

* Molins has since called in all funds on loan to Imperial, the last refund being made in February 1960. Imperial does not regard the loan from Molins as different in character from the arrangements it has for some time had with a number of companies for accepting money on deposit.

† In 1926, 1928, 1929, 1931, 1948, 1949 and 1953. During the war, when Molins was engaged almost entirely on engineering contracts for the Government, the company operated three other factories; two of these were given up in 1945 and the third in 1950.

‡ The division of work at the Thrissell factory varies considerably from time to time. The volume of orders fluctuates and the amount of work carried out for Molins depends on the capacity available in the different works at a given time.

§ In addition Molins has a United Kingdom subsidiary which is not directly concerned with machinery, namely Molins Housing Association Ltd., which was formed to enable employees at the Saunderton factory to buy houses on housing estates built by Molins; it operates on similar lines to a building society. Molins has also an overseas subsidiary, Molins Machine Co. Inc. of Richmond, Virginia. In the 1930's it had subsidiaries in Germany and France.

informed Molins, with which it had had connections for many years, of these facts, and as a result it was agreed that Molins should buy the shareholding of Filter Tips; Molins has told us that it took this course rather than allow the company to pass into the hands of a foreign competitor to whom Molins would have had to pay royalties under the terms of an existing patent licensing agreement to which Molins, Filter Tips and other companies controlled by the Wix family were parties (see paragraph 318).

CHAPTER 11. MOLINS MACHINE COMPANY LIMITED: THE SUPPLY OF MACHINERY

306. In 1927, as part of the financial arrangements described in Chapter 10, Molins Machine Co. Ltd. entered into an agreement with Imperial and the British-American Tobacco Co. Ltd. (the " Associated Companies ") relating to the terms of supply of machinery to them. The agreement, which remained in force until 1957, gave the Associated Companies the right to purchase at preferential prices and the option, subject to certain conditions, to establish exclusive rights to use, both in the home market and in certain export markets, any new types of machine which Molins might produce. For this purpose it distinguished between " marketed " machines (that is, those Molins machines of types already on sale) and " unmarketed " machines (including machines of types to be developed in the future) and between " Free Territory " and " Restricted Territory ". " Free Territory " comprised all countries of the world where the tobacco industry was a state monopoly (France, Italy and Spain for example). " Restricted Territory " comprised the rest of the world which was divided into eleven " exclusive areas ", Great Britain and Ireland being one of them.

307. Molins was free to sell any machine in the Free Territory and any marketed machine in the Restricted Territory. Molins undertook not to offer any unmarketed machine for use in the Restricted Territory to any purchaser other than the Associated Companies without first giving the Associated Companies the option to acquire exclusive rights to use the machine. When it had developed a new type of machine, Molins was to deliver and erect one for Imperial at Bristol and one for B.A.T. at Liverpool. The Associated Companies were then to have 60 days to decide, in the light of practical experience of the machine in operation, whether either or both of them wished to exercise the option; the 60-day period could be extended from month to month upon payment of compensation. The agreement contained a schedule listing ten machines classified as unmarketed and specifying the monthly rate of compensation payable in each case; the total involved amounted to £6,500 per month. As Molins had refrained from selling these machines elsewhere while the terms of the agreement were being negotiated, the Associated Companies paid Molins the sum of £19,500, representing three months' compensation on all the ten machines.

308. To obtain the exclusive right to use a machine in a particular area of the Restricted Territory the Associated Companies had to place an order for a specified number and notify Molins that the order applied to that area. The number required varied according to the cost of the machine, being smaller where the cost to the Associated Companies exceeded £2,250; the qualifying number for cigarette making and tobacco cutting machines, however, was to be

double that for other machines of comparable cost unless the Associated Companies could prove after twelve months' trial that the saving effected by the machines in nine months was not equal to the price paid.* Alternatively the Associated Companies might obtain exclusive rights by ordering a smaller number of machines and paying Molins compensation equal to 33⅓ per cent. of the price for each machine by which the order fell short of the full qualifying number. There was no specific provision enabling Molins, with the consent of the Associated Companies, to supply to other customers in the area concerned machines for which exclusive rights had been established (though in practice applications from other customers were considered and consent was sometimes given—see paragraphs 312 to 327).

309. For machines other than those for which the Associated Companies acquired exclusive rights in a particular area they were to pay the "established selling price" for the area for which the machines were bought, less a rebate of 15 per cent.† For machines for which the Associated Companies did acquire exclusive rights they were to pay "actual cost" (as defined in the agreement) plus 50 per cent. for the number of machines required to qualify for exclusive rights and actual cost plus 25 per cent. for any additional machines ordered;‡ except that if a machine constructed by Molins was "based on an idea emanating from one of the Associated Companies" the percentage addition to cost was to be agreed. Spare parts for all machines were to be supplied by Molins at not more than actual cost plus 25 per cent. When an order was placed Molins was to estimate the actual cost, and the estimate was to be adjusted at the end of the company's financial year.

310. In addition to the clauses described above the agreement provided that (a) the Associated Companies would not sell or transfer any machine purchased from Molins (except to one of their own subsidiary or allied companies) without first offering it to Molins,§ (b) if Molins sold an unmarketed machine in the Free Territory it would obtain an undertaking that the purchaser would not

* In the United Kingdom and Ireland the qualifying number for machines other than cigarette making and tobacco cutting machines was 50 machines where the cost was £2,250 or less, and 112,500 divided by "the number of pounds representing the cost to the Associated Companies" where this exceeded £2,250. We are told by Imperial that the provision that the qualifying number should be doubled in the case of cigarette making and tobacco cutting machines resulted from negotiations in which Molins asserted that these machines offered the user more scope for economy in his own production costs than other types of machine. In only one case did Imperial represent to Molins that the anticipated saving had not been effected. The case (in 1929) concerned Imperial's first order for a Molins cigarette making machine; after test it was agreed that Imperial had established exclusive right of use by taking 50 machines.

† If, however, the established selling price yielded Molins a profit of less than 30 per cent. of the price, the rebate was to be reduced to half the profit actually earned by Molins on the established price.

‡ In cases where the Associated Companies established exclusive rights to use a machine by paying compensation and taking a number less than the qualifying number (see paragraph 308), any additional orders placed by them during the following three years were to be charged at actual cost plus 25 per cent., and half the 33⅓ per cent. compensation already paid on each machine was to be credited against the price. The effect of this was to bring the total amount paid for these additional machines, including the original amount of compensation paid on them, up to the equivalent of cost plus 50 per cent.

§ Molins has told us that the provision relating to second-hand machines "was inserted for the protection of Molins' reputation. Molins were unwilling that their machinery should be put on the market second-hand unless they had themselves reconditioned it. The Associated Companies in fact never sold any machinery to Molins under this provision nor, so far as Molins are aware, have they ever scrapped any Molins machinery which had any useful life left in it".

sell either the machine or the products of the machine in the Restricted Territory, (c) Molins would not, without the Associated Companies' consent, sell any material used in the tobacco trade which it might manufacture (such as cartons, boxes or labels) at a price lower than 15 per cent. below current trade prices for similar articles, and (d) if the Associated Companies wished to secure from Molins a licence to make or sell a patented product on a royalty basis, the royalty payable to Molins was in no case to exceed two-thirds of the royalty payable by any of Molins' other customers. The agreement covered the supply of machinery by Molins to subsidiaries of the Associated Companies and Molins has told us that for this purpose it treated Ardath Tobacco Co. Ltd. as a subsidiary of B.A.T. Imperial has told us that the agreement was never regarded as covering supplies to Gallaher Ltd. (in which Imperial had no financial interest at the date of the agreement) and that any of its subsidiaries which manufactured tobacco goods required little machinery.

311. Since B.A.T. does not trade in the United Kingdom and at no time exercised the option to exclusive rights, the main result of the machinery agreement between Molins and the Associated Companies, apart from the price provisions, was to give Imperial the option of establishing exclusive rights to use unmarketed machines in the United Kingdom and Ireland. Between the years 1927 and 1957 Molins offered the Associated Companies 50 unmarketed machines.* Imperial exercised its option to secure exclusive rights for eleven machines, namely three cigarette making machines (Marks I–IV of the original model, treated as one machine, and two subsequent Marks, V and VI), an "auto-weigher attachment" for use with cigarette making machines, an "axial assembler" for making filter tipped cigarettes, and six machines for packing or wrapping cigarettes, including machines for making and packing novelties such as the wallet packet and the hinged lid carton. In six cases (including all Marks of the cigarette making machine) Imperial established its right by taking the specified qualifying number, in another case the company bought a lesser number and paid compensation, and in four cases the machines were the subject of special arrangements. On the products of three of the packet making and packing machines Imperial paid royalties. We consider seven of these machines in greater detail below.†

312. Molins has told us that "the characteristic of a Mark is that all the machines had the same organs so far as function was concerned and they would be fairly similar in structure"; the company says, however, that it has always

* Including the ten listed in the original schedule. In addition to Molins machines for which Imperial exercised its option, the Associated Companies retained exclusive rights to use certain machines made by Molins' subsidiary, the Thrissell Engineering Co. Ltd. (formerly Brecknell, Munro & Rogers Ltd.—see paragraph 297).

† The other four machines to which Imperial established exclusive rights were:—

Machine	*Exclusive rights* *Established*	*Exclusive rights* *Released*
Auto-weigher attachment to cigarette making machine	1927	1949
Round tab packet..	1928	1957
Glascine wrapper for waxed interior lining	1929	1957
Link-up gear between certain packing and wrapping machines	1932	1950

It is recorded that applications from Carreras Ltd. in 1939 to purchase the auto-weigher and from J. Wix & Sons Ltd. in 1935 to purchase the round tab packet were approved. There is no record of any application to purchase either of the two other machines. But see * on page 110 with regard to records of such applications.

followed a policy of continuous improvement so that all machines of a particular Mark would not necessarily be identical, although the differences (for example in the bearings or the materials used) would not be great. One Mark differs from another Mark by virtue of the inclusion of additional equipment or by having " different organs to perform equivalent functions ". The first Molins cigarette making machine (the Mark I) appeared in 1926; Marks II to IV appeared before 1933. Although for the purposes of the 1927 agreement they are usually referred to as the Molins cigarette making machine Marks I–IV and treated as a single model, in fact each differed from the others in various ways. Earlier Marks were regularly adapted to incorporate improvements introduced in later Marks. Imperial established exclusive rights to use the machine by placing orders for the full qualifying number. Imperial has told us that to " ensure that progress and development were not handicapped by want of funds and in order to remunerate Molins adequately for their efforts " it made voluntary payments additional to the price as calculated under the agreement in respect of all cigarette making machines ordered within three years of 1932, namely £300 on each machine converted from Mark I to Mark III and £600 on each new Mark III machine. It is recorded* that Gallaher made applications to purchase the Mark I machine in 1932, 1933 and 1934; all three applications were refused. An application in 1939 on behalf of a company controlled by members of the Wix family (see paragraph 167) to purchase a Mark IV machine was approved, but an application on behalf of the same interests in 1945 for two Mark IV machines was refused,† as was an application in 1936 from a subsidiary of Gallaher.

313. Meanwhile, in 1933 Molins had placed the Mark V cigarette making machine on the market. Imperial established exclusive rights to use it and made additional voluntary payments of £150, £300 or £750 per machine according to the date of order. It is recorded that an application from Gallaher in 1935 to purchase the Mark V was refused. As is shown in paragraph 312, the establishment of exclusive rights to use the later model did not automatically release earlier models.

314. The Mark VI machine differed from previous models in its method of feeding tobacco on to the cigarette paper, resulting in a greater measure of uniformity in the filling of the cigarette. Imperial established exclusive rights to the machine in 1936 and agreed to make voluntary additional payments of £1,050 per machine on new purchases, £450 per machine on conversion to Mark VI of machines bought as Mark V, and £150 per machine on conversion to Mark VI of earlier machines which had already been converted to Mark V. Voluntary payments on the Mark VI machine finished in 1947. Over the whole period and on all Marks of cigarette making machines voluntary payments made by Imperial to Molins in addition to the agreed prices amounted to £526,941.

* The number of recorded applications from other manufacturers to purchase machines to which Imperial had established exclusive rights is not necessarily comprehensive. Our account of such applications is based primarily on information received from Imperial and Molins. Molins' records for earlier years are incomplete and Imperial's records include only those applications which were referred to the company by Molins. The other tobacco manufacturers concerned have not in all cases been able to confirm the statements made.

† Imperial has told us that both applications were in respect of machines which the Wix interests wished to rent for the purpose of their export trade. In 1939 Imperial told Molins that it was prepared to approve the application provided B.A.T. had no objection. In 1945 Imperial was also prepared to agree, but B.A.T. asked that consent should be withheld as B.A.T. was itself short of cigarette making machines at the time.

315. In August 1948 Imperial agreed that Molins should be free to supply cigarette making machines Marks I–IV and Mark V to other customers in the United Kingdom and Ireland.* In December 1953 Mark VI machines were also released subject to Molins first consulting Imperial.† Imperial says that no application from another manufacturer to purchase the Mark VI machine was referred to it by Molins before 1952, when one from Carreras Ltd. was approved. Applications from Godfrey Phillips Ltd. and Rothmans Ltd. in 1953, from another manufacturer in 1954, from Rothmans and the Scottish Co-operative Wholesale Society Ltd. in 1955, and from another manufacturer in 1956 are also recorded; all were approved.

316. On release Molins agreed to pay Imperial £200 on each cigarette making machine of Marks I–IV and Mark V sold to other manufacturers, £250 on each Mark VI machine and a further £100 on each Mark V or Mark VI machine sold with automatic control. Imperial has told us that these payments " were in the nature of an acknowledgment of [Imperial's] . . . contributions to development ". The arrangements came to an end in December 1956 (see paragraph 324). The total amount received by Imperial on this account up to that date was £22,650.

317. Of later models of cigarette making machine introduced by Molins, the Mark VII was abortive, at least as far as the home market was concerned. The Mark VIII, the latest model, was introduced after the 1927 machinery agreement had been terminated and is therefore subject to the terms of the current agreements with Imperial and B.A.T. signed in 1957 (see paragraphs 334–337 below).

318. Imperial established its right to exclusive use of the axial assembler for making tipped cigarettes in 1935. The first machine-made filter tipped cigarette sold on the home market appears to have been du Maurier, introduced about 1929 by Peter Jackson (Tobacco Manufacturer) Ltd., a company then controlled by members of the Wix family. Early machinery for making filter tipped cigarettes worked on various principles, the most usual being either to make an ordinary cigarette, scoop out some of the tobacco and insert a plug or filter in the space so made, or to insert a plug in a tube of cigarette paper the length of a cigarette and then fill the remaining space with tobacco. In 1934 the home market business of the Peter Jackson company was acquired by Gallaher but the Wix brothers continued to work on the development of filter tip machinery through Filter Tips Ltd., a company formed by them for the purpose. Meanwhile Molins was independently working on similar lines on the development of the axial assembler. Both parties completed their developments at roughly the same time and both applied for patents, the two specifications being substantially the same. The conflict which followed was resolved in 1936 by a licensing agreement by which the two companies agreed not to dispute one another's patents.

* Under a supplementary agreement of November 1949 releasing Mark V machines for use with " auto control or any auto weigher ", Molins undertook to ensure that manufacture and delivery of any machinery ordered by Imperial (whether cigarette making machinery or otherwise) should, if so requested by Imperial, be given priority over Mark V machines or control devices ordered by other tobacco manufacturers. We are told that Imperial never invoked this provision.

† Mark VI machines for use with an attachment for making filter tipped cigarettes had, however, been available to United Kingdom cigarette manufacturers in 1949, see paragraph 322.

319. The method of manufacture which had been developed by the two companies involved the use of three separate machines: a special machine for making the plugs or filters; a cigarette making machine, on which cigarettes shorter than the normal length were produced; and an " assembler ", by which the two component parts were joined together to make filter tipped cigarettes. This superseded earlier practice and remained the only effective method of manufacture until about 1948. Meanwhile, under the terms of the 1927 machinery agreement Molins was bound to give the Associated Companies the option of establishing exclusive rights to use the axial assembler. Imperial was not itself making filter tipped cigarettes at this time and in February 1935, by a series of arrangements between Molins, Imperial and Gallaher, it was agreed that Molins should be free to supply the axial assembler to Gallaher and that if within nine months Imperial and Gallaher between them had ordered nine machines, Imperial should be deemed to have established exclusive rights in the United Kingdom and Ireland. The price for machines ordered by Gallaher was to be agreed between Gallaher and Molins; the price to Imperial was to be in accordance with the main machinery agreement,* except that Imperial had the option of paying a price equivalent to that paid by Gallaher (exclusive of royalty) less 15 per cent. If Imperial should later secure exclusive rights to use a plug making machine designed by Molins it would make this machine also available to Gallaher but not to any other party. Imperial and Gallaher also undertook to grant one another cross-licences under their respective existing patents relating to the making and assembling of filter tipped cigarettes.†

320. Following these arrangements Gallaher bought eight axial assemblers and Imperial bought one. The price to Gallaher was £1,500 per machine, plus royalty at the rate of 3d. per 1,000 cigarettes. The price to Imperial was £1,275 and there was no royalty. Gallaher ordered five more machines before the outbreak of war, three in 1936 at a price of £1,500 per machine (plus royalty) and two in 1939 at £1,650 each (plus royalty). The company ordered ten more machines in 1947. Imperial ordered five machines between November 1935 and the outbreak of war; these were supplied at cost plus 25 per cent., namely £855 for one machine and £892 for each of the other four. The Lambert & Butler branch introduced Varsity (Imperial's first filter tipped cigarette) in 1936 and Matinee in 1938. Both brands were made on Molins' machines; both were withdrawn from sale early in the war owing to lack of demand. Imperial retained exclusive rights to use the axial assembler until 1949 and Gallaher continued to pay royalty until January that year. It is recorded that an application from companies controlled by the Wix family to acquire a machine was approved in 1936; Imperial has told us it understands that the machine was rented by Molins to the companies concerned for their export trade.‡

* That is, cost plus 50 per cent. for the qualifying number of machines and cost plus 25 per cent. for any additional machines.

† The Gallaher patents concerned were the Aivaz patents covering machinery on which du Maurier cigarettes had originally been made. Imperial has told us that in fact it never obtained exclusive rights to a machine for making plugs and that patent licences were never sought or granted.

‡ An entry in Molins' records says that when Molins " negotiated the Wix Agreement we had to get special permission from Imperial to allow Wix to have a single machine for use in the British Isles and on condition that the cigarettes must be for export . . . only. Further, when the release of that machine [i.e. the axial assembler] was granted in 1949 it was plain from the Release Agreement that we could not, prior to the date of the release, let anyone have machines in this country even though the product was used exclusively for the export trade ".

321. Before the war the market for filter tipped cigarettes in the United Kingdom was small. After the war, however, there were, as we have explained in paragraph 84, discussions between the principal cigarette manufacturers leading to agreement that, as a means of conserving leaf and incidentally offering cigarettes at lower prices, filter tipped cigarettes should be generally introduced when each of the manufacturers participating in the discussions had had the opportunity of acquiring sufficient machinery to manufacture 5 per cent. of his total cigarette output in filter tipped brands.

322. There were at that time (about 1949) potentially four machines for making filter tipped cigarettes, namely (a) Molins' axial assembler, already in use by Imperial and Gallaher, but which could not be used by anyone else in the United Kingdom without Imperial's consent, (b) the Edwards machine, made under patents held by Filter Tips Ltd. (controlled by the Wix family), (c) an attachment for use with the Molins cigarette making machine, which had been invented by an employee of the Player branch and developed jointly by the branch and Molins, and (d) a machine invented by Mr. Hyman Policansky. With other cigarette manufacturers Imperial secured rights under the patents covering both the Edwards and the Policansky machines and all the four alternative machines were therefore available to it. In practice, however, the Molins axial assembler and the Player attachment were found to be the only successful machines at that time. In February 1949 Imperial released the axial assembler for use by all manufacturers, on condition that none of them (other than Gallaher) should sell any filter tipped cigarettes assembled on a Molins machine before Imperial itself placed such cigarettes on the market. Imperial also gave consent for the Player attachment to be supplied on the open market and in July 1949 the Molins cigarette making machine Mark VI was generally released when required for use with the attachment. In the autumn of 1949 a number of filter tipped brands were introduced. Since then the market for these cigarettes has expanded considerably and new machinery has been developed, notably the Molins attachment for use with the Mark VI cigarette making machine and machines developed by Hauni Werke Körber & Co. K.G. and by American Machine & Foundry Company. All have been available on the open market.

323. Another machine to which Imperial established exclusive rights of use under the terms of the 1927 machinery agreement was the hinged lid carton packer, a machine which both forms hinged lid cartons (see paragraph 10) and fills them with the required number of cigarettes. There are several variants of the machine; some form packets of 10 cigarettes and some packets of 20 and the cigarettes themselves may be arranged in either two or three rows. Molins has told us that although it had entertained great hopes for the machine Imperial was the only cigarette manufacturer to show any interest at all in the hinged lid carton before the war. In 1939 Imperial entered into two agreements with Molins as the result of which Imperial purchased three of these machines and secured an exclusive patent licence to use the carton against payment of a royalty of one-eighth of a penny per 1,000 cigarettes packed up to the first 4,000 million and of ¼d. per 1,000 thereafter, with a minimum payment after the third year of £1,500 a year. Imperial used the packet for marketing Top Score, a Churchman brand, but owing to war-time restrictions on materials the brand was not marketed in this packet after 1942 and royalty payments then ceased; the total amount paid in royalty up to that date was £75 11s. 1d. in respect of

some 145 million cigarettes. Orders from Imperial for four further machines were cancelled and the machines themselves were finally scrapped. The main patent concerned expired in September 1953 and the original licence agreement between Imperial and Molins therefore ended. Meanwhile towards the end of the war Molins had redesigned and improved the machine, and between October 1944 and May 1946 Imperial placed orders for 50 hinged lid carton packers at an agreed price plus a royalty of £125 per annum per machine with a minimum of £1,500 per annum. The orders were suspended in 1948 because of restrictions on capital expenditure and were cancelled in 1951. It is recorded that an application made through Molins by Gallaher to purchase a machine in 1950 was refused.*

324. Molins has told us that up to the end of 1953 the hinged lid carton packer had been " a complete and absolute commercial failure ", and that in view of the high cost of development " anything to offset some of that expense " was acceptable. Molins approached Imperial again and in February 1954 it was agreed that Molins should supply a minimum of four and a maximum of ten machines at a special price. There was to be a royalty on all machines ordered of £125 per annum per machine for three years, subject to a minimum total payment of £1,500 a year. Molins also agreed not to deliver machines to other manufacturers in the United Kingdom until three years after delivery of the first machine to Imperial. Imperial in fact ordered nine machines at that time and has since used the hinged lid carton for a number of its brands (including recently Player's Medium, where it is used as an alternative to the more conventional packet). Delivery of the machines was completed in March 1956, and from that date the royalty arrangements came into operation. They ceased in December of the same year in recognition of Imperial's action in waiving further payments by Molins on cigarette making machines sold to other United Kingdom manufacturers (see paragraph 316). Imperial had paid a total of £1,250, being ten-twelfths of the minimum.

325. Several applications from other manufacturers to purchase hinged lid carton packers are recorded from 1954 onwards. In a letter from Imperial to Molins dated 2nd July, 1954 Imperial expressed willingness to agree to the supply of one or more packers to Rothmans " on the understanding that the machine or machines are hired to them with a stipulation in the Hiring Agreement that the sales of the product are confined to certain specified territories, excluding Great Britain ". In the event no machine was supplied.† In July 1954 Carreras made a request through Molins for the supply of the hinged lid carton packer for the home market, which request was forwarded to Imperial. Imperial by a letter of 15th October, 1954 required that " the terms of the contract between us " should be adhered to and that such enquiries should no longer be referred to Imperial. The request by Carreras was accordingly refused. Other applications for the acquisition of these machines were made later in 1955. In March 1956 Molins asked Imperial for permission to offer the 3-row hinged lid packer on the open market before expiry of Imperial's exclusive rights, thus leaving Imperial with exclusive rights only to 2-row packers. A letter from Molins to Imperial dated 23rd April, 1956 points out that Molins' competitors were free to sell 3-row hinged lid packers in the United Kingdom, the company's

* Gallaher can find no record of the matter and doubts whether it made such an application.

† The application appears eventually to have been refused but we have not sufficient information to be able to say whether this was because Rothmans did not accept the terms proposed by Imperial.

" most dangerous competitor being Hauni, whose packet is a close copy of the Marlboro' packet made on Molins' machines in the United States ". On 25th April, 1956 Imperial gave up exclusive rights to use the 3-row hinged lid packer; a month later the company also released the 2-row packer for 10 cigarettes. The third, and last, type (the 2-row packer for 20's) was released in February 1957.

326. In two other cases where Imperial has established the exclusive right to use a machine it has also entered into patent licensing arrangements involving payment to Molins of royalties on the product of the machine. The first of these concerns Imperial's acquisition in 1932 of exclusive rights to the wallet packing machine which formed a new type of packet and filled it with cigarettes. The number of machines required to establish exclusive rights was reduced from 50 (as provided for in the main 1927 machinery agreement) to 25, and Molins granted Imperial an exclusive licence for the life of the relevant patents to make and sell the wallet packet against payment of royalty. Imperial used the packet for three of its brands (Three Castles Medium, Churchman's No. 1 and Top Score): all ceased to be marketed in this form during the war. An application for a machine made on behalf of companies controlled by members of the Wix family had been agreed in 1936. The wallet packing machine was released for sale on the open market in September 1953 and Molins agreed to pay Imperial the sum of £250 for each machine sold to other cigarette manufacturers in the United Kingdom: no machine was in fact so sold and no payments were made.

327. The second case concerns the machine known as the new 5's packer which was used for making a type of cup and slide packet for Woodbine cigarettes. In the United Kingdom this type of packet was used only for the one brand and only between the years 1935 and 1940. It was an alternative to the early paper packets made by Molins machines to which Imperial had acquired exclusive rights in 1924 (see paragraph 287) and achieved substantial sales at the expense of the earlier type of packing. By agreement with Molins in September 1933 Imperial, having already received one new 5's packer on trial, was deemed to have obtained the exclusive right to use the machine " whether or no the terms of the Principal Agreement [i.e. the 1927 machinery agreement] have been complied with ". A price for the machine was laid down. Molins granted Imperial an exclusive patent licence to make and sell the packet against payment of royalty, which came to an end in 1940 when this type of packet ceased to be used. The new 5's packer was released for sale on the open market in February 1957. No applications from other manufacturers to acquire the machine are recorded.

328. Imperial last exercised its option to obtain exclusive right to use a machine in 1954 (which was in respect of the hinged lid carton packer) and before 1954 it had not exercised its option for over ten years. The exclusive arrangements described above affected the supply of only some of the types of machinery used in tobacco and cigarette manufacture and of only some of the types made by Molins. Molins does not make preliminary leaf processing machinery or some of the types of machine required for the manufacture and processing of cigarette tobacco. The hull and slide packet, for many years the standard form of container in the United Kingdom and in which Imperial packs over 90 per cent. of its cigarettes, has at no time been the subject of exclusive rights: machines for making this type of packet are made both by Rose Bros. (Gainsborough) Ltd. and by Molins and the Molins machine was a

" marketed " machine in 1927. Imperial did not exercise its option in respect of the Molins tobacco cutting machine; Robert Legg Ltd. has long been established as a maker of cutting machines and Imperial uses both Legg and Molins cutters.

329. Imperial has told us that the arrangements which have existed between the two companies have been of advantage to Imperial because they provided a means of continuously encouraging the development and design of machinery (particularly cigarette making and packing machinery), with consequent reduction in cigarette and tobacco manufacturing costs, and because they secured to Imperial a continuous supply of Molins machines and priority rights in new machines on terms which Imperial considered reasonable; Molins had had the advantage of financial assistance and had acquired Brecknell, Munro & Rogers Ltd.; both Imperial and Molins had gained through the use of Imperial's manufacturing facilities for development and testing and through co-operation in design and development generally. B.A.T. has said that the machinery agreement gave it the advantage of co-operation in testing and design, with some priority in the supply of machinery at favourable prices; Molins gained in that large orders from B.A.T. and Imperial helped the company to develop certain types of machinery and to build up an organisation which has contributed to its large export trade.

330. Molins has said that the agreement by which the Associated Companies acquired a financial interest in Molins (see paragraph 296) and the 1927 machinery agreement " must be considered as a single transaction ". At the time Molins was a small company with inadequate financial resources. The need for finance both for development work and for the production of its machines " was virtually the reason " why the company entered into the machinery agreement. The arrangements offered great advantages, actual or potential, for Molins: " the relationship brought about by the Associated Companies' investment in Molins, coupled with the provisions of the Machinery Agreement and the acquisition of Brecknell . . . created a good prospect of substantial sales to the Associated Companies, which formed a large potential market for Molins' machines ". As a result Molins has been enabled, it is said, " to develop and exploit the inventions of its founders and their successors and thus ultimately to build itself up into the position which it occupies today ".

331. Imperial has said that it " has consistently collaborated with Molins in the design and modification of the latter's machines, and has been able to contribute valuable user experience ". Imperial has played " an active part " in the development of tobacco cutting machines; over 25 years ago Imperial built a rotary cutter to its own design and it also helped Brecknell (now the Thrissell Engineering Co. Ltd.) with the design of a tobacco cutting machine. By " its own experimental and design work, and by its close association " with Molins Imperial has assisted in the development of the Molins cigarette making machine; in fact Imperial " put so much . . . into this . . . machine, not only in money but also in the co-operative research effort, that [it] felt it was perfectly reasonable that [it] should have the exclusive use of those machines ", bearing in mind that alternative makes were available to other tobacco manufacturers. Much of the early development of cigarette packing machinery resulted from the joint work of Imperial and Brecknell, and " this collaboration was maintained " with Molins after Brecknell had become a subsidiary of Molins. In recent years Imperial has developed a combined weighing and packing machine for

tobacco and Molins has been granted a licence to produce this machine. Molins has said that since the war the Associated Companies have been very helpful, especially in connection with attachments for making filter tipped cigarettes: the Player branch " willingly handed over their designs " and gave Molins the order for the machine. Molins has also received considerable help from the Associated Companies in developing nucleonic control devices for its cigarette making machine. B.A.T. has been particularly helpful because of its wide experience of conditions overseas as well as in this country.* Molins adds that it has also received technical help from other manufacturers, including Carreras.

332. The records of Imperial and Molins which we have examined suggest that from time to time in the past there may have been some minor differences between the two companies. They also show that, at least from 1951 onwards, Molins was seeking revision of the exclusive provisions of the 1927 machinery agreement. In particular the company seems to have feared that the existence and operation of these provisions might give grounds for invoking the compulsory licensing powers under the Patents Act, 1949, and that the supply of machinery to the Associated Companies at preferential prices might be held to conflict with American anti-trust law and afford Amfoco an opportunity to seek " a complete embargo on all Molins goods entering the U.S. and/or Canada ". New terms offered by the Associated Companies in January 1952 proved unacceptable to Molins. They would have substituted " world prices less a discount " for prices determined on a cost plus basis in the case of sales to B.A.T. and Imperial, and would have omitted the exclusive provisions except for the option to acquire exclusive rights to use novelties. A subsequent proposal that the 1927 agreement should be amended by limiting exclusive rights on new machines to three years was also rejected by Molins, on the ground that this would not meet the company's legal difficulties. Reviewing the position in 1953, Imperial's Solicitor referred to Molins' dislike of exclusive rights and prices based on " cost-plus " and suggested that as Imperial had not established the right to exclusive use of any machines for ten years and had released " practically all " machines on which it had previously established exclusive rights, it would be " tidier " and would " reduce this possible risk of criticism " in the event of an investigation by the Monopolies Commission if all machines were released forthwith.† No action was taken at that time. In 1955 the question was again discussed. In a memorandum to the Executive Committee, which set out particulars of the machines to which Imperial still had exclusive rights the company's Solicitor and the Chief Engineer pointed out that such rights (for example in the hinged lid packer) could be important and that a " unilateral release of exclusivity " would give away a bargaining point which might be useful in negotiating some new arrangement with Molins. The Executive Committee accepted their recommendation that matters should be left as they were, but made it clear that they would like to abolish exclusive rights " when the portents are favourable ".

333. In 1956, at the time of the debates on the Restrictive Trade Practices Bill, Imperial's Solicitor pointed out that the machinery agreement would be

* Referring to developments since the termination of the 1927 agreement, Molins has also acknowledged the help it has received from Imperial and B.A.T. in connection with factory trials of the Mark VIII cigarette making machine (see paragraphs 336 and 338).

† In 1953 Imperial had exclusive rights to five machines. It re-established the exclusive right to use the hinged lid carton packer in 1954, under circumstances explained in paragraph 324.

registrable. Shortly afterwards B.A.T. suggested to Imperial that negotiations should be re-opened for a new agreement which would not be registrable. Both companies were ready to drop the exclusive provisions. In November 1956 Imperial decided to release all the machines to which the company still had exclusive rights and drafts were prepared of separate agreements between Molins and Imperial and between Molins and B.A.T. Molins appears to have felt that not only had external circumstances changed since 1927, but that the relationship between the parties had also changed. In the negotiations which followed Molins was concerned to limit the degree of priority of delivery to be accorded to the Associated Companies. Molins was unsuccessful in its endeavours to have the term of the new agreements limited to five years (on the ground that conditions were changing so rapidly) and to have the provision for a price ceiling of " Cost Plus 50 per cent." entirely eliminated (on the ground that " the inclusion of this clause in the Agreement will definitely be the subject of adverse comment by the Monopolies Commission ").

334. Referring to the 1927 machinery agreement Imperial has said that through the years the interpretation of the terms has " not been without difficulty "; the difficulties arose principally over the negotiation of prices and the definition of " actual cost ". By 1957 " there was a desire by all parties to revise an agreement which had then been in existence for 30 years ", many of the provisions of which had become obsolete, and which " required revision before registration of it became necessary under the Restrictive Trade Practices Act ". On 21st February, 1957 Imperial and B.A.T. entered into separate agreements with Molins; on the same date the 1927 machinery agreement was cancelled, together with all agreements relating to the supply of machinery supplemental to it. Exclusive rights still held by Imperial were released and royalty payments between Imperial and Molins ceased.

335. The new agreement between Molins and Imperial has a term of ten years and may thereafter be determined on twelve months' notice. By its terms Molins undertakes to supply all machinery ordered by Imperial at prices which are subject to certain maximum provisions. The effect of the price clauses is explained in detail in paragraph 386, but briefly they provide that Imperial is to buy machines at prices not exceeding the most favourable price granted by Molins to any other customer in the United Kingdom (subject to a limit of estimated cost plus 50 per cent. for some machines) and spare parts at prices not exceeding actual cost plus 25 per cent. Should Molins find it necessary to increase its prices, prices to Imperial on any outstanding orders for similar types of machine may, after negotiation, also be increased. Molins' undertaking to supply is subject to its ability to do so having regard to commitments to other customers and to agreement on price being reached. This undertaking and the terms of supply are expressed as being " in consideration of the contributions made in various ways in the past by the Imperial Company in the testing and development of machines and of their willingness to continue to make available facilities for production testing ".

336. Molins also undertakes that if it designs a new machine it will erect and run a prototype at one of Imperial's factories for a trial period of 60 days, during which time " Molins will not offer any such machine to any customer " for use in Great Britain or Ireland. Molins will give Imperial " the earliest possible delivery date ", having due regard to the date of order and the dates on which orders from other customers may have been placed; " in considering

the priority to be accorded under this clause Molins shall in allocating their manufacturing capacity have regard to reasonable and probable requirements of other customers ". If Molins invents " a new machine . . . which produces a novelty,* Imperial is to be given the opportunity of acquiring a licence under the relevant patents on terms not less favourable than those granted by Molins to other United Kingdom customers ". If Molins considers that maximum exploitation of the novelty will best be achieved by granting an initial short-term exclusive licence, the company must give Imperial a three months' option to accept the licence on the terms and conditions offered; if the two parties fail to agree on terms Molins is free to offer a similar licence to any other customer on terms not more favourable than those offered to Imperial.

337. The agreement between Molins and B.A.T. is similar to that between Molins and Imperial. All machines ordered by B.A.T. are, however, to be supplied at prices not exceeding the most favourable price granted by Molins to any customer in the country in which B.A.T. desires to use the machine. As in the case of Imperial, Molins is to supply spare parts at prices not exceeding cost plus 25 per cent. (for a summary of the price provisions see paragraph 386). There is no provision in the agreement with B.A.T. for the adjustment of price on outstanding orders. B.A.T. has the right to a 60-day trial for new machines, the machine to be erected for trial " not later than the earliest date on which the machine is shown or offered to any other customer ". There is no undertaking that Molins will not offer the machine to other customers during the trial period and there is no provision giving B.A.T. the opportunity of acquiring a licence to use " novelty " products.

338. It is still too early for the effects of the 1957 agreement to be clearly seen. Molins has placed only two new† machines on the market (the Mark VIII cigarette making machine and the latest attachment for making filter tipped cigarettes) and has produced no " novelties ". Imperial has told us that in its view the new agreement does not reflect any difference in the relative positions of Imperial and Molins or of their usefulness to one another. The 60-day trial gives Imperial " a slight start " and the company is normally able to appraise and order machines " a little ahead " of its competitors. In Imperial's view it must be an advantage to Molins in planning production and pricing policy to know the likely size of Imperial's order, and Imperial gets no " substantial advantage over its competitors ". Molins considers that the 1957 agreement is more favourable to the company than the 1927 agreement because it " enables Molins to exploit [its] . . . machinery to the fullest extent " and because the company is not restricted as to price (as it was under the previous agreement when Imperial established the exclusive right to use a machine). The new agreement has relieved Molins of much clerical work and has resulted in " simplification all round ". Molins has the advantage of tests under factory conditions and of technical help from Imperial and B.A.T. In Molins' view any advantage which the 60-day trial period may seem to give Imperial " is more apparent than real ": the trial period may enable both Imperial and B.A.T. to place their orders a little earlier than other customers but this gives them no priority in delivery. It also enables the companies' own engineers to test machines in their own

* A novelty is defined as " any feature or thing (not being a machine mechanical device apparatus or attachment or any combination of them) made designed or invented by Molins relating to cigarettes cigars tobacco or snuff or their packing or wrapping in respect of which a patent application has been filed or letters patent granted ".

† That is, new machines for the purposes of pricing under the 1957 agreement (see paragraph 386).

factories and to make suggestions for technical changes or improvements. " The few privileges which the Associated Companies retain . . . are no more than might reasonably be expected in view of their powerful position as customers of Molins, apart from their stake in the equity of the Company."

339. We have asked Imperial and B.A.T. whether they have, or have had in the past, a joint policy on the development, supply and production of tobacco and cigarette machinery. Both have told us that there has been no joint policy, except as stated below. B.A.T. has said that it has generally taken its own line and " Molins have manufactured machines to . . . [B.A.T.'s] particular requirements without either party conferring with " Imperial. There has been " little or no co-operation " on machinery between the two. Tests in B.A.T.'s factory at Southampton of the cigarette making machine Mark VIII were, however, carried out with the closest collaboration between the two companies and it is the present intention of both that " tests on new machinery . . . will continue to be carried out under similar circumstances ". Imperial points out that its requirements differ from those of B.A.T. in material respects. There has, however, been consultation between them on the development of particular machines; Imperial has " close contact with B.A.T. on technical matters " and Imperial's representatives attend trials in B.A.T.'s factory as observers, and vice versa.

CHAPTER 12. CONCLUSIONS AS TO THE CONDITIONS DEFINED IN THE ACT

340. We are required to report whether the conditions to which the Act of 1948 (as amended) applies prevail as respects the supply in the United Kingdom of machinery for the manufacture or packaging of cigarettes or of cigarette or pipe tobacco. The circumstances in which the conditions may be found to prevail are explained in paragraph 260.

341. The figures relevant to the positions of the largest supplier and the largest purchaser in recent years are the following:—*

	Total United Kingdom Supplies	Supplied by Molins	Supplied to Imperial
	£'000	£'000	£'000
1951	1,444·6	835·0 (57·8%)	676·5 (46·8%)
1952	1,464·2	847·1 (57·9%)	687·8 (47·0%)
1953	1,321·0	731·9 (55·4%)	658·6 (49·9%)
1954	1,469·2	623·7 (42·5%)	498·7 (33·9%)
1955	1,804·6	910·9 (50·5%)	819·0 (45·4%)
1956	2,470·9	1,470·8 (59·5%)	1,242·3 (50·3%)
1957	2,875·1	1,583·9 (55·1%)	1,401·3 (48·7%)
1958	3,836·6	2,166·4 (56·5%)	1,552·2 (40·5%)

Note: The figures for supplies by Molins include supplies by its subsidiary, Thrissell.

* Figures subsequent to 1958 are not available.

342. Thus in each of the years 1951 to 1958 Molins was responsible for more than one-third of the total supplies and more than one-third of the total was supplied to Imperial. On average over the eight years, Molins' proportion of the total supplies was about 55 per cent. and the proportion supplied to Imperial about 45 per cent. We conclude, therefore, that the conditions to which the Act applies prevail as regards the supply of the machinery in question.

PART III. THE PUBLIC INTEREST

CHAPTER 13. PRICES, COSTS AND PROFITS

I. Cigarettes and Tobacco

(1) Prices and Methods of Pricing

343. With some negligible exceptions the manufacturers prescribe the retail selling prices of their products. We have described in Chapter 5 the manufacturers' methods of distribution and the system of allowances off the retail prices on sale to distributors. The manufacturer's net realised price for any brand of cigarettes or tobacco varies to some extent according to the terms for which the customer qualifies and the bonus, if any, to which he becomes entitled; but the average net realised prices for products having the same retail price do not vary widely from product to product or from manufacturer to manufacturer. There are, however, considerable variations in the rates of profit which these prices yield. We deal with this matter in detail in paragraphs 368 to 370 and 380. It is sufficient to say here that most of the brands which yield little or no profit are in small demand and could hardly be marketed at all if their retail prices did not follow those of the more popular brands. The price levels for the popular brands, however, at any given time are to a very large extent dictated by costs which are virtually common to all manufacturers, by far the largest item of cost, i.e. the duty, being entirely outside their control.

344. This point may be illustrated by the table below which shows, approximately, the make-up of the prices in 1957 (before September of that year*) of a packet of 10 untipped cigarettes in the medium class and of an ounce of tobacco, both of well-known brands:

	10 Cigarettes		*1 oz. Tobacco*	
	s.	d.	s.	d.
1. Leaf		1½		4¼
2. Duty	1	5¼	3	3½
3. Manufacturer's other costs		1		4
4. Manufacturer's profit		¾		¼
5. Manufacturer's net realised price ..	1	8½	4	0
6. Distributors' margin		2½		5
7. Retail price	1	11	4	5

Having examined the detailed costs at the same date of a number of other untipped brands of cigarettes in the medium class we found that the item for duty did not differ in any of these cases by as much as ½d. from the figure of 1s. 5¼d. shown above, i.e. duty was always about three-quarters of the retail price. The position is similar in the small class. At that time untipped cigarettes in these two classes accounted for more than 90 per cent., by value, of the cigarettes sold in the United Kingdom or about 80 per cent. of cigarettes and tobacco taken together. The prices of tobaccos are less standardised and the

* Due to increases in duty and other costs the prices of the two brands concerned are now 2s. 0½d. and 4s. 10½d. (see paragraph 353).

make-up of price varies more widely than in the case of cigarettes, but the proportion of the retail price attributable to duty falls within the range of 70 to 80 per cent. in any costs we have examined.

345. These preliminary observations should be borne in mind in relation to Imperial's methods of fixing its prices, which are described in paragraphs 346 to 357 below. Duty forms so high a proportion of the price that relatively large variations in other costs may affect the retail price only to an extent which the consumer would regard as negligible or which could not easily be passed on to him in terms of the smallest unit of currency. Conversely, a variation of ½d. in the price without a corresponding variation in the cost, or vice versa, would have a very material effect on the company's total profits, an effect which is emphasised when the profits are expressed in relation to capital employed.*

346. Imperial has told us that its policy is " to give in all its brands the best possible value for money to the consuming public consistent with both a reasonable margin of profit to the company and a reasonable margin of profit to the distributive trade ". Although each branch of the company has its own brands and its own price list for those brands, all prices and terms are subject to central control through the Head Office and the Executive Committee. In exercising that control the company takes into account the general competitive situation, the ascertained gross profit† (or, when a new brand is to be marketed, the estimated gross profit) on each brand and each form of packing, and the prospective net profit to be earned by the company as a whole.

347. Immediately before the beginning of each financial year each branch prepares an estimate of profits for the year, based on a forecast of sales, estimated margins of gross profit for each brand and packing and a budget of overhead expenses. The estimates of the gross profit margins are prepared on the basis of (i) the existing specifications for each brand, which have been authorised by the Executive Committee and cover the brand formulae, the type and design of packing, the selling prices and, for cigarettes, the weight per 1,000, (ii) the expected costs of leaf, including duty, and packing materials, and (iii) current labour costs. As explained below, actual results in the ensuing year are compared with the estimates of cost and profit so calculated unless any alteration in the specifications or in the costs of leaf, packing materials or labour have made it necessary to prepare revised estimates.

348. The process of comparison with actual results is continuous. Each branch prepares monthly accounts which it compares with its own estimates, and the Head Office consolidates the branch figures and its own expenses to produce a monthly company profit and loss account and balance sheet, which enable it to keep the trend of total profits under review. Advertising expenditure, in particular, is controlled by Head Office through a system of "branch advertising requisitions ".

349. For the reasons mentioned in paragraph 345 relatively small changes in cost may have a substantial effect on the company's profits but cannot necessarily be reflected in changes of price. Imperial does not attempt to

* In recent years the ratio of Imperial's sales, inclusive of duty, to its capital employed (calculated on the basis of the historical cost of fixed assets) has been more than 3 : 1. Ten years ago, when leaf stocks were abnormally low, the ratio was more than 4 : 1. Immediately before the war it was about 2½ : 1.

† The company regards the gross profit as the proceeds of sales, less the direct costs of production, packing and despatch, but before deducting factory overheads.

price its products by a formula calculated to provide a uniform rate of gross profit on all brands. As far as cigarettes are concerned brands selling at the same retail price are expected to yield about the same gross profit per unit. Higher-priced cigarettes have generally been expected to yield a higher rate of gross profit than lower-priced ones, partly because expenditure on sales promotion, which has to be met out of the gross profit, is expected to be relatively heavier. At the present time this principle does not appear to be applied as between the small and medium classes (see paragraph 368) but mainly affects the large class. In practice it is accepted that the gross profits on the brands of the smaller branches or on those with a small turnover may be rather below the level for the better-selling brands. Generally speaking, from year to year, the established brands are unlikely to show any marked change in the relationship of the individual gross profits one to another, since movements in cost will normally affect them in a uniform manner. If the gross profit on a particular brand does fall below the desired level, the Executive Committee asks the branch to consider how the position can be improved. The branch may in such a case be instructed to change the specification; in extreme cases, production of the brand is discontinued. Since cigarettes are sold by number it is possible up to a point to vary gross profits by altering the weight of the product, but the company regards change of weight as a means which can be used only within narrow limits for correcting a fall in gross profits, whether for a particular brand or for cigarettes generally (see paragraph 357).

350. For tobaccos, which vary more widely than cigarettes in price and type, the Executive Committee lays down " guide margins " to indicate the minimum gross profit to be aimed at on a product selling at any given retail price. These guide margins are expressed in terms of cash per lb. Before the price increase of August 1959 they ranged roughly from 4½ to 7 per cent. as proportions of direct cost. In general, the guide margins are calculated to provide an increasing percentage of gross profit as the price advances to the higher end of the range. Before August 1959, however, there was for each price from 3s. 10d. to 4s. 9d. per oz. a higher, " Category A ", margin as well as the " Standard " margin, while for certain tobaccos there were special margins falling between the two scales. The " Category A " guide margins were applied to hand-rolling tobaccos, for which the market is regarded as more " buoyant " than that for pipe tobaccos, and the special margins to tobaccos which though mainly used for hand-rolling are also smoked in pipes. The company has informed us that since August 1959 it no longer aims at a higher rate of gross profit on hand-rolling tobaccos. The guide margins are not intended to be observed meticulously and in fact the gross profits on tobaccos selling at the same price vary considerably. As with cigarettes, when particular brands fail to yield the desired level of gross profit the branches concerned are asked to consider what steps can be taken short of an increase in price. Since tobaccos are sold by weight there is less scope for varying the specifications than in the case of cigarettes; on the other hand tobacco prices are set in a less conventional pattern than those of the principal brands of cigarettes, and price increases have on occasion been applied only to certain kinds of tobaccos. If sales of particular brands decline a point may be reached when the company decides to stop making them.

351. When new brands of cigarettes or tobacco are to be introduced the branches concerned first submit their proposals to Head Office showing, *inter*

alia, the specification, price and expected gross profit. The latter must be roughly in line with the level of gross profit on existing brands in the same price class (i.e., for tobaccos, at least up to the level of the guide margin for the price).

352. The continuous review of brand costs at the gross profit stage described in paragraphs 348 to 351 provides a general picture of the trend of costs and a standard for judging proposals for new products and deciding when the costs or prices of individual existing products should be re-examined. It is, however, the net profitability of the business as a whole—which, as indicated in paragraph 348, is kept under review by means of monthly consolidated accounts—that mainly determines the pricing policy of the company.

353. Since 1948 Imperial has made general increases in the prices of cigarettes on five occasions and in the prices of tobaccos on seven occasions.* Apart from these there have been a few alterations, either downward or upward, in prices of individual brands (or, in the case of tobaccos, of a group of brands) arising out of the review of gross profits. Of the general increases two, affecting both cigarettes and tobaccos, were occasioned by increases in customs duty; the others were due to increases in other costs. These general increases are illustrated in the table below showing the movements in the prices of cigarettes in the small and medium classes (other than filter tipped) and of three brands of tobacco in the low, medium and high price ranges respectively:—

	Cigarettes		Tobaccos		
	Small	Medium	Best Counter Shag	St. Bruno Flake	Player's Medium Navy Cut
	per 10 s. d.	per 10 s. d.	per oz. s. d.	per oz. s. d.	per oz. s. d.
From April 1948 to November 1950 ..	1 3½	1 9	3 7	3 11	4 2½
November 1950	1 3½	1 9	3 7	4 0	4 4
August 1951	1 4	1 9½	3 7	4 0	4 4
January 1953	1 4	1 9½	3 7½	4 1	4 5
June 1955	1 4	1 9½	3 8	4 2	4 6½
October 1955	1 4½	1 10	3 8	4 2	4 6½
April 1956 (*a*)	1 5½	1 11	3 10½	4 5	4 9½
September 1957	1 6	1 11½	3 11½	4 6	4 10½
August 1959	1 6	1 11½	4 1	4 8	5 0
April 1960 (*a*)	1 7	2 0½	4 3½	4 10½	5 2½

(*a*) Increase in customs duty.

354. In considering the amount and timing of any price changes the company has to bear in mind a number of factors besides the trend of costs and profits; these include the nature and degree of competition in the market, the possible effect of a price change on demand, any current indication of the Government's views on general price policy, the margin to the distributor, and the limitations imposed by the coinage. Broadly, the company aims at earning sufficient profit to provide adequate reserves (after allowing for taxation) and a reasonable return to shareholders. As we show in paragraph 363 the profits on capital employed

* In one of these cases (November 1950) not all tobacco prices were increased but approximately two-thirds of the company's tobacco trade was affected.

in trading in the United Kingdom (calculated on the basis of the historical cost of fixed assets) have varied between approximately 11 and 14 per cent. in recent years.

355. Since the war the company has advised the Board of Trade whenever it proposed to change its prices. In 1951 the company at first proposed to increase the prices of small cigarettes by ½d. for 10 and of those in the medium and large classes by 1d. for 10, at the same time increasing the weights (see paragraph 357). The Board of Trade called for an investigation by its Accountant Adviser and, after receiving his report, asked Imperial to modify its plans. As a result the increase in price for cigarettes in the medium class and for some of the higher-priced brands was limited to ½d. and the plans for adjustment of weight modified. This is the only occasion since the war when the Government has sought to influence the company's prices.

356. One of the aims of the company's pricing policy, as we have mentioned in paragraph 346, is to provide " a reasonable margin of profit to the distributive trade ". For this purpose it obtains from various sources, including its distributor subsidiaries, information about costs of distribution, turnover and numbers of outlets. On most recent occasions when retail prices have been increased distributors' allowances have also been increased. The structure of these allowances has been explained in Chapter 5; expressed as percentages of sales they vary from one type of product to another, but, on average, over the whole of Imperial's products they amount at the present time to about 10 per cent. of retail prices (see paragraph 203). In recent years the margins allowed on filter tipped cigarettes have represented rather higher rates on sales than the margins on the corresponding untipped cigarettes. In 1957 about one-twentieth of the total of distributors' margins allowed by Imperial was in the form of deferred bonus.

357. The weights of cigarettes are varied from time to time to meet small changes in cost which, because of the limitations of the coinage, cannot easily be reflected in changes of price. In recent years rising costs have produced a tendency to reduce the weights between price changes; these are increased again when prices are advanced. For example, between November 1956 and September 1957 the weights of Woodbine and Player's Medium were each reduced in successive stages by about three-quarters of one per cent. When prices were increased in September 1957 the weight of Woodbine was raised to a level about one-half of one per cent. higher than it had been in November 1956, while that of Player's Medium was almost restored to the November 1956 level. Weights of most cigarettes were reduced during the war and the ensuing period of control. There are also variations at any given time in the weights of different brands of cigarettes selling at the same price; in 1957 the maximum variation found between seven of Imperial's more popular brands of cigarettes in the medium class (other than filter tipped) was 3½ per cent. It is clear from our examination of the company's records that there is a general reluctance on the part of the Executive Committee to allow any reduction in quality or weight of the company's leading brands.

358. Since as explained in paragraphs 356 and 357 a price increase may be accompanied by increases both in distributors' margins and in the weights of cigarettes, the company itself does not usually benefit to the full extent of the addition to the retail price. Thus it was estimated that the price increase of

October 1955 would add £17½ million to the retail value of the company's cigarettes sold per annum; but of this amount some £3½ to £4 million would be taken up by an increase in distributors' allowances and some £10 million by increasing the weights, leaving some £3½ to £4 million to the company to meet increases in cost and maintain the desired level of profitability.

359. Imperial's pricing policy determines to a large extent the prices of other manufacturers, who usually follow the company's lead as soon as it announces a change.* Broadly speaking, the manufacturers concur in the opinion expressed by Gallaher Ltd. that " a number of factors, over which the trade has no control, largely determine retail prices ", namely the high duty rate, the basic costs of materials, packing and wages, the distributors' margins and, for cigarettes, the pronounced public taste for those of the two popular sizes. All agree that they must have regard to their competitors' prices, particularly Imperial's. While, therefore, Imperial must take account in its pricing policy both of the possible effect of a price change on the total demand and also of the effects of competition on the demand for its own products, it has for a long time been able to determine the general level of its prices in the confidence that it will not have to meet serious price competition.

(2) Costs and Profits

360. We have examined the sales, costs, profits and capital employed of Imperial and the five next largest manufacturers† relating to the products covered by the reference. For this purpose we have included as costs all normal production, selling and administration expenses and have taken as capital employed in any year the mean between the figures of the net assets employed at the beginning and end of the year. In this industry by far the largest part of the capital employed is represented by debtors and stocks (see paragraph 376). We have included fixed assets at their original cost less depreciation approximately at Inland Revenue rates. Imperial has certain leaf buying organisations overseas and we have followed the practice of that company of including in the leaf costs the expenses of these leaf buying branches, so that the figures represent the true cost of leaf to the company; as a corollary, we have included in capital employed the net assets of the leaf buying branches.

361. We have reviewed the financial results of Imperial for the twelve years 1948 to 1959, of Gallaher for the nine years 1951 to 1959 and of the other four manufacturers for the six years 1951 to 1956.‡ The information obtained from Imperial included detail as to the trading results of the individual branches. We

* As regards the products whose prices are less standardised—tobaccos and the higher-priced cigarettes—other manufacturers do not always alter their prices by precisely the same amounts as Imperial for brands which are more or less comparable. Moreover, on one occasion at least, Gallaher took the initiative in allowing more favourable quantity terms to distributors; Imperial followed this lead two years later. Imperial has also pointed out that other manufacturers can and do vary the weights of their cigarettes at different times from Imperial and to a different extent.

† i.e. the five regarded in the industry as being the most important after Imperial and which undoubtedly were so in terms of sales up to 1954. As we show in paragraph 4 some of these companies have not maintained their positions in recent years.

‡ One company's financial year ends on 30th June, those of three others (including Imperial) on 31st October, and those of the remaining two on 31st December. References to calendar years in this and subsequent paragraphs should be read in this sense.

also obtained from Imperial and Gallaher a considerable amount of information about the costs and profits of particular brands up to 1957.

362. The total sales of Imperial amounted to about £640 million in each of the years 1955 to 1957, a little less in 1958 and about £600 million in 1959. In the last year tobaccos, as distinct from cigarettes, represented about 10½ per cent. of the total, whereas in 1948 they accounted for 13 per cent. In 1957 the company's turnover was made up approximately as follows:—

	Per cent.
Cost of leaf	7·4
Duty	83·3
Manufacturing and other costs	5·7
Profit	3·6
	100·0

363. We show in the table below the profits, in total and as percentages on capital employed, earned by Imperial through the trading of its manufacturing branches in tobacco products in the United Kingdom in the years 1948 to 1959:—

	£'000	Per cent.
1948	14,738	12·6
1949	17,330	14·7
1950	21,455	16·3
1951	21,933	15·0
1952	21,598	14·3
1953	21,930	14·4
1954	22,602	14·0
1955	23,476	13·3
1956 (*a*)	26,727	12·8
1957	22,996	11·8
1958	25,379	13·2
1959	21,415	11·2

(*a*) Excluding exceptional profit on re-valuation of stocks when customs duty was increased. It amounted to £2¼ million and, after deducting tax, the company placed the balance to reserve. If this profit were included the figure for 1956 would be 14·0 per cent.

The figures shown above do not cover the trading, as distributors, of the subsidiary companies, Bewlay (Tobacconists) Ltd. and the Robert Sinclair Tobacco Co. Ltd. On the other hand they include trading by the branches in cigars and snuff (which are outside our reference) and also in imported cigarettes and tobacco; but these items are of negligible importance and the figures may be taken as closely representing the results of the company's trading as a manufacturer of goods within the reference. The average profit on capital employed for the twelve years was 13·5 per cent., the range being from 11·2 to 16·3 per cent.; the higher rates of profit were earned from 1949 to 1951 when prices had been increased to meet the higher cost of replacement but when stocks of leaf acquired before the devaluation of sterling were still being consumed. In the pre-war period examined, 1936 to 1938, when the proportion of capital employed attributable to duty was very much lower than at present, the profit on capital employed was from 26 to 27 per cent., after deducting payments of about £1 million per annum under the Martin Agreement (see paragraph 64).

364. For the seven years 1951 to 1957 we have made separate calculations of profit or loss on capital employed for the individual branches: these results are summarised in the table below:—

	Player Branch	Wills Branch	Other Branches (together (*b*))
	%	%	%
1951	17·8	15·5	8·5
1952	17·9	14·7	6·3
1953	17·8	14·9	6·2
1954	17·3	14·5	4·9
1955	17·9	13·8	−2·0
1956(*a*)	16·3	13·3	−2·4
1957	14·4	12·5	−3·2

(*a*) If the exceptional duty profit were included the figures for 1956 would be 17·6, 14·5 and −1·4 respectively.

(*b*) The Mitchell branch was merged with Wills during 1957. Its figures are included in "Other Branches" up to and including 1956. But for the merger the rate for the Wills branch for 1957 would probably have been about 13 per cent.

Although we have not thought it necessary to calculate the capital employed in individual branches in 1958 and 1959 we ascertained the total profits for each branch in those years. It is clear that, following the price increase of September 1957, the Player and Wills branches must have earned higher rates of profit on capital in 1958 than in 1957 and the other branches incurred a lower rate of loss. In 1959, however, the profits of both Wills and Player fell sharply though the other branches slightly improved their position. Two of the small branches incurred losses in every year from 1953 to 1958 inclusive; by 1959 one of them had been closed but the other again incurred a loss. In 1956 and 1957 every branch other than Player and Wills incurred a loss. The pre-war figures show that some of the branches were incurring losses in the period 1936 to 1938 and, apart from the Player and Wills branches, only two were showing substantial returns.

365. During the period covered by this examination variations in turnover did not follow a uniform pattern from branch to branch. Since there were a number of changes of prices in this period this diversity as between the branches can best be illustrated by expressing their sales in weight, rather than in value, as shown in the table below:—

	Player Branch	Wills Branch	Other Branches (together)	Total Imperial as a whole
	'000 lb.	'000 lb.	'000 lb.	'000 lb.
1951	70·5	71·1	28·9	170·5
1952	72·4	73·9	30·3	176·6
1953	72·1	73·9	29·1	175·1
1954	75·2	77·4	27·3	179·9
1955	91·2	85·8	17·7	194·7
1956	94·2	80·8	15·2	190·2
1957	91·4	79·8	13·0	184·2
1958	86·8	76·7	13·1	176·6
1959	83·1	73·1	12·7	168·9

Note: The figures represent turnover in the branches' own brands (including cigars and snuff which are outside our reference but have a negligible effect on the figures). Some branches have, on occasion, made other branches' brands and have also made other manufacturers' brands but the figures do not cover these transactions.

The table shows that the turnover of the company as a whole in its own brands rose slightly from 1951 to 1954, being about 5 per cent. higher in the latter year;

in 1955 there was a further gain of about 8 per cent. but in subsequent years turnover declined until in 1959 it was about 1 per cent. lower than in 1951. The Player and Wills branches gained respectively by 7 per cent. and 9 per cent. up to 1954 and by a further 23 per cent. and 12 per cent. in the following year; the turnover of both branches has since declined but in 1959 the figure for the Player branch was 18 per cent. above that of 1951 as against 3 per cent. for Wills. The aggregate turnover of the other branches rose slightly in 1952 but declined thereafter, the sharpest fall occurring in 1955; the figure for 1959 shows a fall of more than 50 per cent. as compared with 1951. In 1951 the Player and Wills branches were together responsible for some 83 per cent. of the company's turnover in its own brands, but by 1959 this proportion had increased to nearly 93 per cent. In 1951 the sales of these two branches were approximately equal but by 1959 the Player branch's share of the company's turnover was nearly 50 per cent. as against 43 per cent. for the Wills branch.

366. As the figures in paragraph 364 show, the Player branch earned a substantially higher rate of profit on capital employed than the Wills branch in each of the seven years examined. Throughout the company's history the Player branch has been growing in importance and, as noted in the preceding paragraph, by 1955 it had a larger share than the Wills branch of the company's total sales. To a great extent, no doubt, this change of position is associated with the concentration of demand for cigarettes on a few brands. While the Wills branch has retained through the Woodbine brand its dominant position in the small cigarette class, its formerly popular Gold Flake brand in the medium class has gone out of favour and its share of that class as a whole has declined, while the Player branch's share has increased mainly through the demand for Player's Medium. In 1957 the Player branch was responsible for almost 80 per cent. of the company's sales in the medium class and the Wills branch for over 73 per cent. in the small class. As might be expected the respective contributions of the two branches to the company's profits have also changed over the years, as the following figures show:—

	1930	1938	1957(*a*)	1959(*a*)
	%	%	%	%
Percentage of Imperial's profits on its home trade in tobacco and cigarettes attributable to:				
Player Branch	32	44	57	54
Wills Branch	58	48	45	46

(*a*) The sum of the two figures for 1957 is more than 100 per cent. because the other branches incurred losses—see paragraph 364. In 1959 the other branches earned, in aggregate, a very small profit.

These relative contributions are, of course, the result in part of differences in turnover and in part of differences in rate of profit. The lower rate of profit earned by the Wills branch is to a considerable extent attributable to a higher rate of overhead costs. In 1954, when the sales of the two branches were approximately equal, the total overhead expenses of the Wills branch were more than 20 per cent. higher than those of the Player branch, and in 1957 they were still 15 per cent. higher, although the turnover of the Player branch by then exceeded that of Wills appreciably. The principal reasons for this appear to be that (1) Wills' main products—cigarettes in the small class—are cheaper per unit than Player's but some overhead expenses are not necessarily proportionately lower per unit, (2) Wills sells direct to more customers than Player and therefore its costs of distribution are higher, and (3) Wills' factories are more in number and more dispersed than Player's. The company made a detailed study of the overhead expenses of the two branches in 1956. It has told us that no major developments emerged but both branches keep their overhead expenses under continuous scrutiny and control.

367. We have found that both gross and net profits, if expressed as percentages of sales, have been consistently higher for cigarettes than for tobacco. This applies to the company generally and also, in practically all cases, to the individual branches.* Mainly because the expenditure on advertising is proportionately greater for tobacco than for cigarettes, the difference is greater at the net profit stage, as is shown by the following figures for the Player and Wills branches for 1957:—

	Cigarettes		Tobacco	
	Gross	Net	Gross	Net
	%	%	%	%
Player	6·3	4·2	5·1	1·1
Wills	6·7	3·8	6·1	1·8

Sales of tobacco represented about 4 per cent. of the turnover of the Player branch and about 6 per cent. of that of the Wills branch. The Player branch earns a higher rate of net profit than the Wills branch on its cigarette trade, but a lower rate on its tobacco trade.

368. The variations in gross and net profits on particular brands can be illustrated by the following table summarising the results for 1957 for cigarettes selling at the two standard prices which cover the bulk of sales:—

(Per 1,000 cigarettes in packets of 10)

	Gross Profit pence	*Net Profit* pence
Small class (excluding filter tipped)		
Principal brand (Wills' Woodbine)	108·5	68·2
Other brands—range	97·6 to 117·8	− 94·8 to 87·2
Medium class (excluding filter tipped)		
Principal brand (Player's Medium)	123·2	77·6
Other brands—range	73·6 to 145·2	− 490·6 to 91·8

Notes:

(1) New introductions—for which the costs, particularly those of advertising, are abnormal—are excluded.

(2) The retail prices per 1,000 were:

	Small Class pence	*Medium Class* pence
1st November, 1956–7th September, 1957	1,750	2,300
8th September–31st October, 1957 ..	1,800	2,350

Four brands (Player's Medium and Weights, and Wills' Capstan Medium and Woodbine) accounted for about 91 per cent. of the company's cigarette sales and about 93½ per cent. of the net profits on those sales. Statistics prepared by Imperial's Advertising Department show that unit advertising costs vary quite considerably between one established brand and another; our examination

* So far as gross profits are concerned there are no exceptions but occasionally a branch whose turnover in cigarettes is small has earned a lower net profit (or incurred a higher net loss) on cigarettes than on tobacco.

confirms this and shows that the wide range of net profits is partly due to these variations. The brands which incurred net losses were all those of the small branches, with the exception of the one showing the heaviest loss (490·6d.), which was a Wills brand;* and in aggregate they represented a very small proportion of the company's turnover in cigarettes.† Comparison with the results for 1951 shows that the difference in profitability between the two classes of cigarettes has narrowed. Thus the gross profit on Woodbine increased from 80·5d. (5·7 per cent. on sales) in 1951 to 108·5d. (6·9 per cent.) in 1957, and the net profit from 57·2d. (4·1 per cent.) to 68·2d. (4·3 per cent.); on Player's Medium, however, while the gross profit rose from 117·7d. (6·2 per cent.) to 123·2d. (6·0 per cent.), the net profit fell from 89·5d. (4·7 per cent.) to 77·6d. (3·8 per cent.). The retail prices during this period rose by identical amounts (see paragraph 353), the increase being, therefore, proportionately greater for small cigarettes.

369. In the period examined the profits earned on filter tipped cigarettes did not bear a consistent relationship with those earned on the corresponding untipped cigarettes. In 1951 the principal filter tipped cigarettes in the small and medium classes earned somewhat higher profits per 1,000, gross and net, than the untipped cigarettes of the same brands. By 1957, however, the profits on tipped Woodbine in the small class were substantially lower than on the untipped, the net profit being about 45 per cent. less per 1,000; the profits on Player's Bachelor tipped, on the other hand, were higher than on the untipped, the net profit being about 25 per cent. more per 1,000. This change in the position is attributable in part to the fact that the prices of Bachelor, tipped and untipped, were increased by the same amount in 1956 but the price increase for tipped Woodbine was less than that for the untipped.‡

370. Since there are no standard price levels for tobaccos it is not possible to make for them the same kind of broad comparison as we have made in paragraph 368 for cigarettes. Where brands were sold at identical retail prices, however, we found that there were some wide variations in profits, as the following table of results for 1957 shows:—

(Per lb. in 1-oz. packings)

	Gross Profit pence	*Net Profit* pence
6 brands selling at 4s. per oz.		
Range	26·8 to 38·4	−12·2 to 5·1
3 brands selling at 4s. 2½d. per oz.		
Range	31·2 to 54·3	− 5·6 to 30·2
3 brands selling at 4s. 6d. per oz.		
Range	41·3 to 51·4	4·1 to 12·5

Six brands accounted for about half of the company's sales of tobacco and earned, in aggregate, a net profit of about £350,000, but the company's net profit on

* Expenditure on advertising this brand was high in 1956 and 1957. Sales, which had been declining for some years, remained at a low level.

† We examined the costs of more than half the company's cigarette brands in 1957. Of those examined, brands earning net profits accounted for about 95½ per cent. of the company's total cigarette sales and those incurring losses for about 1½ per cent. The remaining 3 per cent. of the cigarette sales was made up of a number of small-selling brands, some of which probably incurred losses.

‡ It should also be noted that untipped Woodbine had a much larger turnover than tipped, whereas the reverse was the case for Bachelor. Both gross and net profits on Bachelor tipped were high, however, by comparison with those earned on Imperial's untipped cigarettes in the medium class generally.

all sales of tobacco was only £108,000. Of nearly 60 brands (covering approximately 70 per cent. of the company's tobacco sales) whose costs in 1957 we examined, about half showed net losses. These were for the most part the brands with the lowest volume of sales but they also included the brand with the second highest turnover; they were nearly all brands of the small branches.

371. We found that the average advertising costs of the company amounted to 6·1d. per lb. of sales in 1957 as against 3·6d. in 1938 and the average expenditure on travellers was 1·2d. in 1957 as against 0·6d. in 1938. This represents a substantial reduction in expenditure on these items in proportion to selling price; and although the latter is distorted by the increase in duty it is clear that the company was spending comparatively less on advertising and travellers in 1957 than before the war.* In 1957 the small branches, which were responsible for 7 per cent. of the company's sales, incurred 16 per cent. of the advertising expenditure and more than one-third of the travellers' expenditure.

372. So far as it was possible to compare the costs of making the same brand at more than one factory of the branch concerned—i.e. in the case of popular brands made by the Player and Wills branches—we found no significant differences. There were wider variations, principally in labour costs and factory overheads, when a Player brand was made in the factories of three of the small branches. The total cost in each case was higher than the cost in the Player branch's own factory.

373. The comparisons between brands in the preceding paragraphs relate to costs and gross profits for packings of 10 cigarettes and 1 oz. tobacco. We have also compared costings for different packings of the same brands. For cigarettes the principal packing other than in 10's is in 20's; some of the more popular brands are also packed in 50's and 100's and a few of them in 5's. As between packings in 10's and 20's the latter usually show the lower manufacturing cost per 1,000 cigarettes, there being economy both in packing materials and in labour. The principal exception is Woodbine, where a saving in labour is offset by a more expensive type of packet. The maximum difference we found was a saving of 0·15d. on a packet of 20 as compared with two packets of 10; it appears, therefore, that in 1957 the differences were not such as would justify differentiating by ½d. in the retail price, as has been done at times in the past. Packing in 10's is more economical than in 5's for Woodbine and Weights, plain,† but the reverse is true for Weights, corked tipped, and was also true of one other brand which was produced in 5's until 1955. Packing in 50's and 100's was invariably more expensive than in 10's or 20's in the years examined due to the form of box and to hand-packing, but there was no differentiation in price. For tobacco the standard packing‡ contains 1-oz. but many brands are also made up in 2-oz. tins and a few in ½-oz. packets. The manufacturing cost per lb. of a brand in 1-oz. packets is almost invariably lower than in 2-oz. tins, while the cost for ½-oz. packets is normally intermediate. The maximum difference as between ½-oz. and 1-oz. packings is a saving of rather more than

* In terms of money the ratio of advertising expenditure to selling prices, net of duty, was approximately 5·6 per cent. in 1938 against 4·4 per cent. in 1957; the corresponding ratio for expenditure on travellers was 0·9 per cent. in 1938 against 0·8 per cent. in 1957. As far as advertising is concerned the ratio has probably increased since 1957.

† Different forms of packet are used for 5's of these two brands.

‡ 1-oz. tins are now being made up for many brands as an alternative to packets. They are usually sold at a higher price. We have no information about their costs or about certain other forms of packing which are sometimes used for tobaccos (see paragraph 13).

½d. per oz. on the latter; but in a number of cases two 1-oz. packings show a saving of 2d. to 3d. as compared with a 2-oz. tin. There is, however, no differentiation in price between the 2-oz. tin and two 1-oz. packets.

374. We made some examination of the results of the two distributing subsidiaries of Imperial. Robert Sinclair, though primarily a wholesaler of tobacco products, also has some business in other goods. As we have mentioned in paragraph 155 the company incurred a loss in 1952 and was re-organised in the following year. The sale of goods other than tobacco goods, though still relatively small, has increased in recent years and has also yielded an increasing rate of gross profit; in 1957 these goods formed about 8 per cent., by value, of the total sales but provided more than a quarter of the gross profit. In the years 1954 to 1957 the gross profit on tobacco goods (which included the products of manufacturers other than Imperial—see paragraph 158) was about 2½ per cent. on sales. The net profits on the whole business in these four years, expressed as percentages on capital employed, were 4·0 per cent., 6·0 per cent., 8·2 per cent. and 10·8 per cent. respectively.* It was not possible to make a realistic allocation of the operating expenses and capital employed as between goods within and outside the reference, but according to the results of an investigation undertaken by the company in 1955 the tobacco side of the company, in spite of the low rate of gross profit, was the more profitable.†

375. Bewlay is primarily a multiple retailer of tobacco goods, but also sells some other goods (amounting to about 13 per cent. of total sales in 1954 and 17½ per cent. in 1957) and provides certain services. In addition it owns property which produces a substantial income. It was not possible to isolate the trading results for tobacco goods, but in each of the four years 1954 to 1957 the company incurred a trading loss on goods and services. In each year the total trading loss was more than offset by other income, but in no case was the resulting net profit sufficient to meet the preference dividend. In each year, therefore, Imperial had to make a payment to the company in accordance with the terms of its agreement (see paragraph 142); the total paid out over the four years amounted to rather more than £350,000.‡

376. The capital employed by Imperial in 1959 for tobacco products has been assessed at £191 million, comprising:—

	£ million	£ million
Fixed Assets (based on historical cost)		18
Net Current Assets		
Stock	137	
Debtors	57	
	194	
Less: Creditors	21	
		173
Total capital employed		191
represented by:		
Shareholder's capital	119	
Loan capital (including bank overdraft)	72	
		191

* As mentioned in paragraph 156 Imperial says that in 1959 Robert Sinclair's net profits on the whole of its business were some two-thirds greater than in 1957.

† The investigation covered the accounts of one of the company's branches for the twelve months to 31st October, 1955. Non-tobacco goods accounted for 5 per cent. of the sales and 24 per cent. of the gross profit but it was estimated that 36 per cent. of the total operating expenses were incurred in respect of them. As a result, tobacco goods showed a net profit of about 0·8 per cent. on turnover while the other goods showed a net loss.

‡ Imperial owns over 90 per cent. of the preference capital. In effect, therefore, the amounts paid out under guarantee are largely returned but Imperial receives no return on its investment in the preference or equity capital.

It will be noted that over 90 per cent. of the capital employed consists of net current assets—an abnormally high proportion for an industrial undertaking. This is explained by (a) the high rate of duty payable when tobacco leaf is withdrawn from bond but not recoverable from customers until the finished products are sold* and (b) the need to carry large stocks of leaf maturing in bond. The same factors may explain why Imperial is able to finance nearly 40 per cent. of its capital requirements by means of loan capital and bank overdraft. These circumstances, peculiar to the tobacco industry, make it difficult to compare the rates of profit earned by Imperial on its capital employed with the rates earned by manufacturing industry in general. Imperial admits, however, that, by reason of the high degree of capital security arising from the factors mentioned, it could not expect to earn as high a rate of profit as would be considered reasonable for manufacturing industry in general.

377. Imperial has submitted a computation of the rate of profit earned by manufacturing industry in general† (see Appendix 6). In its computation cash balances (including tax reserve certificates) have been wholly excluded from the capital employed; credit adjustments relating to earlier years have been excluded from profits. As explained in Appendix 6, we have adjusted Imperial's computation to ascertain what the result would have been had all cash balances been included in the capital employed and one-half of the credit adjustments relating to earlier years included in the profits. The rates of profit brought out by the method of computation we have used in previous reports, by Imperial's computation and by that computation as adjusted by us are compared below with the rates of profit earned by Imperial on capital employed for tobacco products:—

Rates of profit on capital employed

Year	Imperial	Manufacturing industry in general		
		By Method 1 (*a*)	By Method 2 (*a*)	By Method 3 (*a*)
	%	%	%	%
1949	14·7	N/A	22·4	18·7
1950	16·3	N/A	24·8	20·9
1951	15·0	19·4	25·7	22·2
1952	14·3	15·4	19·4	17·1
1953	14·4	16·6	20·2	17·6
1954	14·0	17·2	20·9	18·2
1955	13·3	17·3	20·4	18·0
1956	12·8 (*b*)	16·5	18·0	16·4
1957	11·8	15·4	16·7	15·5
1958	13·2	14·1	N/A	N/A
1959	11·2	N/A	N/A	N/A

N/A = not available (see Appendix 6).

(*a*) Method 1 is the method used in previous reports, based on statistics published in " The Economist ". Method 2 is the method used by Imperial based on statistics published in " Economic Trends ". Method 3 is our adjustment of Method 2.

(*b*) If exceptional profit on increase of duty were included this figure would be 14·0.

Information is not available for manufacturing industry in general on which to estimate the extent to which cash balances should be included in the capital employed. In Imperial's computation (Method 2) the capital employed is

* The then Chairman of Imperial in dealing with the accounts for 1957 drew attention to the fact that " day in and day out throughout the year we have some £85 million locked up in duty ".

† Based on Board of Trade statistics on the Income and Finance of Public Companies (" Economic Trends " February 1958, February 1959 and December 1959) and " Company Income and Finance 1949–1953 " (National Institute of Economic and Social Research).

probably under-stated by wholly eliminating cash balances; in our adjusted computation (Method 3), as in the computation used in previous reports (Method 1), it is probably over-stated since cash balances would include cash surplus to the requirements of the undertakings concerned. These points are discussed in Appendix 6.

378. Imperial has also submitted an approximate calculation of the effect on its profits of adjusting to provide for the replacement costs of fixed assets and of raw material stocks. The company estimates that the effect of this adjustment would be to reduce its "conventional profits" (i.e. the profits, before tax, calculated on the basis of historical cost) by slightly more than one-fifth. Some two-fifths of the "conventional profits" would therefore be required, the company says, to meet replacement cost after tax. On this basis Imperial calculates that its average rate of profit on capital employed over the nine years 1949 to 1957 was 10·9 per cent. before allowing for tax (or 8 per cent. after allowing for tax) as against 13·9 per cent. on the historical cost basis.

379. As explained in paragraph 360 we have also examined the results of five other cigarette and tobacco manufacturers. In 1956 these five manufacturers together with Imperial were responsible for more than 98 per cent., by value, of total supplies of cigarettes and tobacco in the United Kingdom. Their joint proportion was probably not significantly lower in the earlier years examined, but there were substantial changes between 1951 and 1956 in the individual shares of these six manufacturers. While their aggregate sales rose by nearly a quarter in value, the proportion attributable to Imperial declined by 3 to 4 per cent. Gallaher's increased more than threefold, and the shares of the other four manufacturers, taken together, fell by two-thirds. These changes are reflected in the profit figures. In the table below we show the rates of profit on capital employed earned by these six companies from their trade in goods covered by the reference:—

	Imperial	Gallaher	Carreras	Godfrey Phillips	J. Wix	Ardath
	%	%	%	%	%	%
1951 ..	15·0	9·6	14·4	7·3	(profit)	(profit)
1952 ..	14·3	10·1	12·5	2·0	(profit)	(profit)
1953 ..	14·4	10·1	11·5	− 2·9	14·3	(profit)
1954 ..	14·0	10·8	8·0	− 10·0	4·9	(profit)
1955 ..	13·3	12·3	− 3·1	− 14·2	− 5·7	(loss)
1956 ..	12·8	13·0	− 1·4	− 1·5	− 6·4	(loss)
1957 ..	11·8	14·0	N/A	N/A	N/A	N/A
1958 ..	13·2	14 approx.	N/A	N/A	N/A	N/A
1959 ..	11·2	14 approx.	N/A	N/A	N/A	N/A

Notes:

(1) N/A indicates that the results have not been examined (see paragraph 361); "profit" or "loss" indicates that although there has been an examination capital employed has not been calculated.

(2) Each of the companies made a profit on the change of duty in 1956. If these profits were included the results for this year would read: 14·0, 13·8, − 0·7, − 0·8, − 6·1, (loss).

Gallaher finances an even greater proportion of its capital requirements by means of loan capital and bank overdraft than Imperial.

380. We have compared some of the more detailed costing information obtained from Imperial and Gallaher. The principal points which emerge appear to be the following:—

(a) By 1957 Gallaher was earning a higher rate of profit on capital than the Wills branch of Imperial and practically the same rate as the Player branch (whose results have been consistently better than those of other branches of Imperial—see paragraph 364). In that year Gallaher's turnover was less than that of either the Player or the Wills branch.

(b) Gallaher did not incur a net loss on any of its principal brands of cigarettes or tobacco in any year from 1951 to 1957, except, for one year, on a newly introduced brand; as indicated in paragraph 370 Imperial has incurred losses on one of its most popular brands of tobacco. With the notable exception of Senior Service cigarettes (see (c) below), the profits per lb. of product earned by Gallaher on its main brands in 1957 compared favourably with those earned by Imperial on the nearest corresponding brands.

(c) The principal reason for the comparatively low rate of profit earned up to 1957 on Senior Service cigarettes appears to be the higher cost of leaf (as compared with, say, Player's Medium). Senior Service cigarettes were slightly heavier than Player's Medium in 1951 and 1957; and although Gallaher, like Imperial, has made small adjustments of weight between price changes the reductions in the weight of Senior Service have been slighter. We cannot say how far the higher cost of leaf in Senior Service was attributable to the greater weight and how far to differences in buying costs and in the quality of the leaf used.

(d) Gallaher's principal cigarette in the small class, Park Drive, on the other hand, contained a lower weight of leaf than Imperial's Woodbine or Weights. In 1957 it earned roughly the same rate of profit as Weights and more than Woodbine.

(e) Gallaher's advertising expenditure per lb. of sales was lower than Imperial's in 1957 but had been higher than Imperial's in the previous year. Its rate of expenditure on travellers in both years was substantially lower than Imperial's.

It should be borne in mind that the information on which these comparisons are based does not extend beyond 1957.

381. Ardath Tobacco Co. Ltd., whose home trade was controlled by Imperial, had the lowest figure of home sales of the manufacturers whose trade we examined, and in 1956 its turnover amounted to about £1½ million. While Ardath's trade in reference products—largely cigarettes—showed profits in the years 1951 to 1954, losses were incurred in 1955 and 1956. It was not practicable for us to calculate capital employed but in relation to cost the loss in 1956 was equal to 11 per cent. From 1955 Imperial, in accordance with its agreement with the British-American Tobacco Co. Ltd. (see paragraph 176), made payments to Ardath to re-imburse it in respect of its home trade losses.

II. Machinery

(1) Prices

382. The machinery with which we are concerned has a very narrow market in this country. It is purchased by tobacco manufacturers for capital equipment and Imperial is, naturally, the largest buyer in the United Kingdom. The market of the principal British manufacturer of machinery, Molins Machine Co. Ltd., is not, however, by any means confined to this country. It exports

some three-quarters of its output, and the scale of purchase of some of its individual export customers (including B.A.T. in its capacity as an overseas purchaser) equals or exceeds that of Imperial in this country. Molins' principal competitors for this world market are abroad, and its prices in the home market are determined to a great extent by the prices it is able to get in the world market. In these circumstances the question of price determination in the home market involves considerations which, to some extent, are outside our terms of reference. These terms do not cover exports and we have not sought full information about export markets. Molins has, however, drawn our attention to a number of matters which, in its view, are relevant and we have taken these into account.

383. Molins' principal products are cigarette making machines, cigarette packing machines, and tobacco cutting and weighing machines. There is constant development of these machines so that, quite apart from modifications and special adaptations of existing models which are made from time to time, each model of machine is liable to be superseded at fairly frequent intervals. The company has told us that for the purpose of its first negotiations for the sale of a new type of machine it establishes a provisional price on the basis of the estimated total cost—assuming production in batches of ten machines—plus a margin which has normally been 50 per cent. of that cost; if the machine produces a " novelty " (see footnote * on page 119) or is an exclusive design, a royalty on the product may be added. This price is quoted to prospective purchasers but it may remain provisional for some time after orders have been placed and the machines are in production. When a machine has been in production long enough for a reasonable degree of standardisation to have taken place and for the production cost to be known a list price is established. If, on the basis of ascertained cost, the provisional price is found to be yielding the percentage of profit originally budgeted for, then that provisional price is adopted as the list price. The company says, however, that owing to intervening improvements and changes of design it is frequently found that the budgeted profit is not being obtained. In that event the company has to decide, as a matter of policy having regard to the state of the market, whether to adopt the provisional price or a higher price.

384. The company does not publish its list prices but uses them as a basis for its quotations to individual purchasers.* It points out—and our accountancy investigation has confirmed—that it does not in fact achieve a profit level in any way approximating to 50 per cent. on cost, and says that its prices " are ultimately determined in the light of a number of . . . commercial considerations including the economic value of the machine to the user, the market for the machines, the existence and prices of competitive machines, and the quantity of a particular order ". Even when a reasonable degree of standardisation has been attained machines ordered by different manufacturers are rarely identical; such variations apart, the company says that, in general, it sells and has sold at uniform ex-works prices to all customers, both in this country and abroad, except for quantity allowances where appropriate, and subject to the effects of its agreements with Imperial and B.A.T. which are described in Chapter 11.

* B.A.T. is given a copy of Molins' office price list " for convenience of ordering " but the prices are subject to alteration without notice.

385. Until 1957 both Imperial and B.A.T. were entitled to an allowance of 15 per cent. (or one-half of Molins' profit at list price if that profit was less than 30 per cent.) off the " established selling price "—in practice, off the list price—for machines other than those for which exclusive rights had been established. Since B.A.T. did not exercise its power to establish exclusive rights the prices of its purchases were subject to this provision. Where Imperial established the exclusive right to a machine in the United Kingdom its purchase price was calculated on the basis of cost plus 50 per cent. for the number of machines required to be ordered to obtain the exclusive right, and cost plus 25 per cent. for any additional machines.

386. Under the terms of its current agreements with Imperial and B.A.T. which have been in operation since 1957 Molins undertakes that its maximum prices to these companies will be as follows:—

Imperial

for new* cigarette making machines (other than those of exceptional merit)—the most favourable price allowed to any other home market customer, or cost plus 50 per cent. plus royalty (where appropriate), whichever is the less;

for other new machines—the most favourable prices as above;

for old machines (i.e. machines marketed before the date of the agreement)—by negotiation based on list price with due regard to the size of the order;

for spares and replacements—cost plus 25 per cent;

B.A.T.

for all machines—the most favourable price allowed to any other customer in the country in which the machine is to be used;

for spares and replacements—cost plus 25 per cent. (provided this does not involve discrimination in favour of B.A.T. in a country where this would be illegal).

387. We are informed that the list prices for old machines were reviewed in 1957 and after some adjustment in the light of increased costs were found to yield an average profit of about 37 per cent. on cost. Imperial has placed orders since 1957 for eight types of old machines, in five cases at list price, in two cases at list price less 7 per cent. and in one case at list price less 12½ per cent. The discounts allowed are said to be in accordance with the agreement, having regard to the economies of continuous batch production arising from quantity orders for execution over a period. Molins says that its agreement with Imperial does not, in fact, afford that company any price advantage for these or other types of machines; any other customer placing a quantity order may negotiate for an allowance and the terms offered for the same conditions and size of order would be the same as those offered to Imperial. The most important item for which Molins has been taking orders since 1957 is, however, a new machine, the Mark VIII cigarette making machine. Although a number or large orders for this machine were placed and in course of execution, including an order for 280 machines from Imperial, the price remained a provisional one, based in this instance on estimated cost plus 40 per cent., until 1st April, 1960.

* " New " machines are machines of a pattern not marketed by Molins before the date of the agreement.

At that date a list price was established which was higher than the provisional price and became applicable immediately to deliveries throughout the world (except that in one overseas market it applies only to orders placed on or after that date). Imperial's order had been placed on the understanding that there would be an allowance off list price if there were found to be a saving in cost due to the large size of the order;* but Molins says that no such saving can be expected since the factory is working to full capacity and Imperial's order, which receives no priority, can only be executed in batches with large numbers of similar machines for other customers. All purchasers including Imperial and B.A.T., will, therefore, be charged the same price.

388. Thus up to 1957 both Imperial and B.A.T. enjoyed a price advantage over other customers of Molins, as provided for in the agreement then in operation. The present agreements with Imperial and B.A.T. do little more than ensure that no other purchaser in the countries in which those two companies will use any of Molins' machines may receive any price advantage over them.† They do not preclude the possibility of the two companies themselves receiving a price advantage, but Molins has assured us that such is not its intention‡ and it has in fact allowed them no advantage on the Mark VIII machine which represents a major part of its current production.

389. As we have mentioned, the provisional price of the Mark VIII cigarette making machine was based on estimated cost plus 40 per cent., although it has been Molins' practice in the past—and it is still its practice for other machines—to use a basis of estimated cost plus 50 per cent. The company has told us that when it decided upon this provisional price it had in mind to some extent the need to keep the price of what was in fact a revolutionary type of machine within the range which customers had hitherto expected to pay for cigarette making machines. It also hoped, however, to build the machines in sufficient quantities to effect a saving in the incidence of overheads. It told us in September 1959 that results so far had shown that, owing to increases in cost due to modifications of the machine, the profit was substantially less than 40 per cent. on cost, but it remained to be seen whether the prices must be increased or whether, when the machine was reasonably standardised and in regular and full-scale production, the existing price would yield the budgeted level or an even higher level of profit. In the event the company has raised the price.

390. In general Molins says that the quality of the machine, the after-sales service, and the economies in production which the tobacco manufacturers can expect to achieve by installing a particular machine are factors which are far more important than price in determining the placing of orders. Thus,

* The agreement makes no explicit provision for such an allowance on new machines, but the price provisions relate to maximum prices and leave it open to Imperial to try to negotiate lower prices.

† See paragraph 386. Molins does not undertake not to sell spares to other customers at prices more favourable than those specified for Imperial and B.A.T. It says that, in practice, it sells spares at uniform prices to all United Kingdom customers, irrespective of quantity. In its agreement with Imperial Molins does undertake on the other hand to give Imperial a price advantage on any new cigarette making machine which is not of exceptional merit if the lowest price to any other United Kingdom customer exceeds cost plus 50 per cent. (plus royalty, if any). We are informed that the only existing new cigarette making machine, the Mark VIII, is deemed to be of exceptional merit. The combination of circumstances envisaged in the provision appears unlikely to arise in practice.

‡ See paragraph 503 for Molins' views on the difficulties of pursuing a policy of price discrimination even if it wanted to do so.

price determination is largely a matter of arriving at a reliable estimate of cost and deciding the level of profit " that is considered necessary to operate ". We give in paragraphs 503–509 Molins' justification of the level of profit yielded by the prices it adopts.

(2) PROFITS

391. We have examined the sales, costs, profits and capital employed of Molins. Costs cover all normal production, selling and administration expenses relating to the machinery covered by the reference, including work done on behalf of Molins by its subsidiary, the Thrissell Engineering Co. Ltd. Sales do not include charges for delivery. For the purpose of calculating capital employed fixed assets have been included at original cost less depreciation at Inland Revenue rates; in certain years a part of the cash balance, which we are satisfied was surplus to the then requirements of the business, has been excluded from the current assets. Loans to the Molins Housing Association (whose purpose is the provision of houses for employees) have been included in the capital employed. The capital employed in the home trade has been estimated by ascertaining the ratio of the total costs of the company to its total capital employed and applying that ratio to the home trade costs. Capital employed on machines and spares respectively has been estimated similarly.

392. We reviewed the company's results for the eight calendar years 1951 to 1958, obtaining rather more detailed information about the first six of these years.

393. During the eight years 1951 to 1958 Molins' average annual sales of tobacco machinery amounted to about £4·3 million, of which some £1·1 million represented home market sales. About 15 per cent. of the home sales were of spares, the rest being of complete machines. In 1956, the costs of the home sales were made up approximately as follows:—

	Machines	Spares (*a*)
	%	%
Materials	23	48
Direct Wages	17	11
Factory Overheads	43	36
Factory Cost	83	95
Selling Expenses and General Administration	17	5
	100	100

(*a*) This is the breakdown of costs for all spares, including exports, since it is not possible to isolate costs of home sales.

In 1958 the factory cost was 72 per cent. of total cost for machines and 87 per cent. for spares. The change in the ratio of factory costs to overheads was due in some measure to abnormal development expenditure and scrapping of obsolete parts in 1958 but it also appears to indicate an increase in factory efficiency.

394. In the following table we show the total profits (including royalties) earned by Molins on its sales of tobacco machinery in the United Kingdom in the years 1951 to 1958. We also show these profits and the profits on sales of complete machines and of spares expressed as percentages of capital employed.

	In Total		Machines	Spares
	£'000	%	%	%
1951	158	42·7	45·8	27·5
1952	125	24·6	25·7	19·8
1953	148	28·2	30·5	15·7
1954	168	39·6	46·4	17·3
1955	170	29·2	33·1	11·5
1956	258	29·0	32·4	6·5
1957	395	45·6	49·1	29·0
1958	512	43·6	45·7	25·7
Average 1951 to 1958		36·2		

Note: Costs and profits for spares sold in the home and export trades have been ascertained in total on the assumption that the same rate of profit is earned in these two sections of the trade.

Royalties accounted for about 4 per cent. of the profits earned on complete machines in these years. The average profit on all sales of tobacco machinery in the home market during the eight years, expressed as a percentage on cost, was 28 per cent. Molins has submitted figures showing that its export business in these years yielded a substantially higher rate of profit on cost up to 1956; in 1957, however, the rate was only slightly higher than that for the home trade and in 1958 it was below the home level. The limited information we have about 1959 indicates that there was a sharp fall both in turnover and in profits on the home and export business as a whole. As indicated in paragraph 398, the Mark VIII machine is expected to bring the company an increase of business but the effect of this was not reflected in sales in 1959.

395. Molins has submitted some alternative calculations of the rates of profit earned on capital. The basis of these calculations was a professional valuation of the company's buildings made in 1959 from which replacement values for the years under consideration were estimated and substituted for the written-down historic cost values as determined by us. The consequential adjustments of depreciation charges were also made. Two methods of calculation were used, one amounting to a refinement of the other, but in neither were the values of plant adjusted, it being considered that the effect of the additional calculations required for that purpose would be relatively small. The rates of profit on capital employed in the company's home trade calculated by one of these methods are given in the table below and contrasted with those calculated on the basis of the historical cost of fixed assets (see second column of the table in paragraph 394):—

	Replacement cost basis	Historical cost basis
	%	%
1951	33·8	42·7
1952	19·7	24·6
1953	23·4	28·2
1954	34·7	39·6
1955	25·0	29·2
1956	24·0	29·0
1957	40·4	45·6
1958	38·2	43·6
Average 1951 to 1958 ..	30·8	36·2

The company's alternative method of calculation (which was only applied up to 1956) gave results which did not differ materially from those in the first column above. The company does not suggest that either method provides an entirely satisfactory estimate of the ratio of profit to capital employed on the basis of the replacement cost of fixed assets. The figures as calculated are open to criticism but we are satisfied that an accurate calculation of the profit ratios to capital employed on this basis would give figures substantially lower than those based on historical cost.

396. Molins drew attention to the results of seventeen manufacturers in the engineering industry whose businesses are, in the company's opinion, of a nature as near to its own as can be found among public companies. From the published accounts of these companies for their financial years ended during 1956 Molins calculated the rate of profit on capital employed for each. According to the figures it submitted to us the range of profits was from 5 to 52 per cent., the weighted average rate being 23 per cent. We set out Molins' representations based on a comparison between these figures and its own results in paragraph 509.

397. In the eight years 1951 to 1958 sales to Imperial and B.A.T. formed a high proportion of Molins' home trade, the percentages, by value, being as follows:—

	Machines	Spares	Total
	%	%	%
Imperial	57	64	58
B.A.T.(*a*)	15	15	15

(*a*) B.A.T. also makes substantial purchases from Molins abroad, which are not included here.

As we have explained, both Imperial and B.A.T. were able to buy from Molins at special prices until 1957. Since prices to other home purchasers are said to have been roughly the same as export prices, the terms of Molins' former agreement with Imperial and B.A.T. no doubt account substantially for the difference in profitability between the home and export business up to 1956 (see paragraph 394).

398. In two important respects Molins' position has changed since 1956, the last year for which we are able to give detailed information about the company's costs and profits. In the first place, the termination in 1957 of the 1927 agreement with Imperial and B.A.T. leaves it open to the company to sell its products to all purchasers on similar terms. Such, we are assured, is the company's intention, and, that being so, the home trade may be expected to be as profitable as the export trade in future; as indicated in paragraph 394 there was, in fact, little difference in profitability between the two sides of the business in 1957 and 1958. Secondly, the Mark VIII cigarette making machine is expected to bring the company an increase of business. Whether these two factors will lead to higher rates of profit on capital than in the past is likely to depend to a large extent on the price charged for the Mark VIII machine. As we have indicated, the price now fixed for this machine is higher than the provisional price which was used as a basis for orders, but this provisional

price is said to have yielded a rather lower rate of profit on cost than has been aimed at and obtained on some earlier machines. We are not in a position to say what rate of profit, on cost or on capital employed, will be earned on sales of the Mark VIII machine at the price now fixed.

CHAPTER 14. OBSERVATIONS OF MANUFACTURERS, PURCHASERS AND OTHERS ON CONDITIONS IN THE INDUSTRY

I. Cigarettes and Tobacco

399. In the course of our inquiry we have received from all sections of the tobacco industry (manufacturers, distributors and leaf merchants) and the Board of Trade, as the Government Department concerned with production, a number of observations and views on conditions and arrangements in the industry generally. These we summarise in the paragraphs which follow. In so far as they might appear to express or imply any criticism of Imperial as the chief supplier they have been made known to Imperial, whose own views are given in Chapter 15. Some of the views expressed, however, relate to the effect of developments such as the increase in the level of duty and war-time and post-war controls for which Imperial can hardly be held responsible; these views we have described briefly. It should be added that most of the evidence set out was originally obtained in 1957 and 1958, though in the more important cases it has since been brought up to date.

(1) THE MANUFACTURERS

400. We have received evidence from 28 manufacturers (apart from Imperial), four of whom have since ceased to manufacture in the United Kingdom, and from or on behalf of 22 undertakings which formerly manufactured goods covered by our reference but had ceased to do so before they submitted evidence to us.

401. A number of those who submitted evidence have referred to the increasing tendency for the manufacture of tobacco goods to be concentrated in the hands of a few manufacturers, to the relative size of the leading companies and their great financial resources, and to the difficulties which these circumstances present to smaller undertakings. The comments made are in some cases very general. Thus, for example, Carreras Ltd. says that it is becoming increasingly difficult for the smaller manufacturers to compete successfully with " the very large entrenched companies ". In Carreras' view the only remedy lies in amalgamations between small and medium-sized companies, which may thus hope to achieve a sufficient volume of trade to cover their fixed overheads.* A small company manufacturing pipe tobacco says that while it has " always enjoyed a cordial relationship with the big combines there is little doubt . . . that these organisations possess . . . the power to inflict the most serious damage " on its trade. The company considers that if the " combines " chose to do so, they could deprive it of its markets " by a combination of high-pressure advertising, which the combines can well afford, and intense price competition in which they would enjoy every advantage due to their powerful

* In 1959 Carreras in fact came under the control of the Rembrandt Tobacco Co. Ltd. (see paragraph 163).

position in the leaf market"; for in view of the size of their orders and the range of grades of leaf required, the large companies must necessarily be able to purchase at a much lower overall cost per lb. than a small manufacturer buying through merchants. This company feels, therefore, that it depends for its existence "on the goodwill of these powerful organisations". Another small company which no longer manufactures has referred to the great resources available to "all-powerful" Imperial for advertising expenditure and to the fact that Imperial controls and dresses a very high proportion of the window space of "many thousands of retailers".

402. Other general comments suggest that smaller manufacturers feel that they have, or have had, insufficient opportunity for expressing their views or that insufficient attention has been paid to their needs and difficulties. Thus a former cigarette manufacturer has said that the Federation of Home & Export Tobacco Manufacturers "does not fulfil that vigorous leadership of the companies outside the monopoly which should be its role" because the larger manufacturers dominate the Federation's Council. Another former manufacturer of cigarettes and tobacco expresses the view that as leader of the industry Imperial is open to criticism because it has "remained aloof", with the result that manufacturers' associations have not been fully representative.* The same manufacturer criticises Imperial for adding to the difficulties of the small manufacturer by failing to use its influence to bring about "an amelioration of punitive laws governing the industry", particularly those concerned with the level and method of payment of duty. In his view Imperial allows too long a credit period to the retail trade, and he criticises the company further for engaging in every branch of tobacco and cigarette manufacture and every section of the trade; he thinks Imperial might have left to the smaller manufacturer such sections of the trade as the supply of loose unbranded pipe tobaccos to the specialist retailer.

403. Three small manufacturers, including two of those already mentioned, consider that war-time and post-war controls worked in some measure to the benefit of the larger and the disadvantage of the smaller manufacturer. One of them maintains that the Tobacco Manufacturers' Advisory Committee (see paragraph 70) was not fully representative and that its advice in so far as it influenced policy on leaf rationing, "invariably benefited" the larger companies. Another considers that the Government's policy on leaf allocations showed "an apparent partiality for Big Business". There is no general criticism of controls by the larger manufacturers. Carreras has told us that war-time controls were "simple and efficient" and the arrangements which operated after 1945 have "generally been considered fair and equitable". The company believes that the successful co-operation between the Board of Trade and the industry was largely due to the work of the representatives of the leading manufacturers on the T.A.C. and to that of other committees set up by the manufacturers with the Board's approval. Gallaher Ltd., however, says that from 1947 onwards it repeatedly pressed for the method of allocating dollars for leaf purchases to be amended and suggests that the growth of the company's cigarette sales since 1955 shows that the method in force before that date had the effect of limiting competition.

* See paragraph 5. Imperial is not a member of the Federation, the only manufacturers' association now in existence in the industry.

404. Six small manufacturers (including two already mentioned) stress the difficulty of financing the high rate of duty which must be paid before manufacture, and even Gallaher regards this as " a big problem ".

405. Other comments relate more specifically to the effects on the manufacturing side of the industry of Imperial's price leadership, of that company's bonus system and of distribution arrangements in the industry generally. A number of those who have submitted evidence say that while there is no agreement on prices between manufacturers they in fact follow Imperial's prices very closely. Some add that, at any rate on certain goods, the margin of profit which they earn as a result is too low. Carreras told us in 1957, for example, that for competitive reasons it must keep its prices closely in line with those of Imperial, which it found in some cases to be " fundamentally uneconomic " in view of its own much smaller volume of sales.* Godfrey Phillips Ltd. says that the smaller manufacturer with his smaller turnover cannot compete on the profit margins which are acceptable to the larger undertakings; on the other hand the leading manufacturer is bound to set his own margins low because otherwise he would show abnormally high profits. Godfrey Phillips adds that the distributors' margins allowed by " the big company " become " automatically a minimum " for the smaller companies, which cannot risk alienating the trade by giving a lower profit margin. One small manufacturer considered that the profit margin on certain hard tobaccos (particularly twist) was " thoroughly uneconomic "; another, which prices its goods in relation to those of the largest manufacturers, said that standard lines of tobacco and cigarettes were sold " at least 10 per cent. below their fair price ".† Two former manufacturers refer to Imperial's price leadership as one of the factors which made it difficult for the small manufacturer to remain in business. One of them, whose main interest was in pipe tobacco, alleges that Imperial fixed uneconomic prices for some types of tobacco which are " bread-and-butter lines " for small undertakings, and subsidised them out of its profits on cigarettes.

406. We have been told by Imperial's main competitors and one smaller manufacturer that Imperial's bonus scheme makes it difficult for these companies to get adequate display facilities for their own brands. Godfrey Phillips says that other manufacturers have been seriously handicapped in launching new brands by the fact that signatories of Imperial's Bonus Agreement must reserve centre displays for Imperial brands. Carreras says that Imperial's " very large and insistent demands " upon its customers' display facilities are supported by " the fear of bonus stoppage ", which in many cases represents " a very severe economic sanction ". Carreras considers that in some respects Imperial's display requirements " operate virtually to the exclusion of other manufacturers' displays ", and particularly mentions that in some cases the use of fluorescent colour is reserved for Imperial (see paragraph 233). Carreras has the impression, however, that in the last few years Imperial has enforced its requirements with less severity. The Co-operative Wholesale Society Ltd. says that Imperial's bonus scheme has hindered its efforts to promote the sale of its own brands through the retail societies. According to the C.W.S., Imperial rigidly enforces its bonus conditions so far as window displays are concerned and has on occasion

* Carreras has since told us that " whilst accepting that a company having a large turnover is in a more advantageous position ", its " new management believes that a smaller concern can compete successfully provided that conditions of free enterprise exist in the market ".

† Since these two statements were made in 1957 the prices of both tobacco and cigarettes have been increased, see paragraph 217.

required retail societies to remove display material advertising C.W.S. brands, though it has been more lenient towards C.W.S. publicity material inside the shops. The Society adds that Imperial has not objected to the payment of dividends by retail societies on the Society's own brands only, although under the bonus agreement it could have done so.* One of the small manufacturers maintains that the effect of Imperial's bonus scheme has been to " arrest the competition and the growth " of the smaller companies.

407. With regard to the extent of direct trading by manufacturers with retailers three of Imperial's largest competitors say that they themselves encourage retailers to open direct accounts with them although this adds to their distribution costs. Gallaher thinks that in view of the protective wrapping now used few outlets are unsuitable for the sale of cigarettes, and it is the company's policy to encourage all types of potential retail outlet to stock its products. Carreras and Godfrey Phillips explain that as the wholesaler does little to promote small-selling brands they have to trade direct in order to maintain their turnover. At the same time both companies consider that the wholesaler performs a vital service to the industry in supplying the smaller retail outlets. The last point is also made by J. Wix & Sons Ltd., which says that the wholesaler is " essential " to the distribution of its products, since direct supply to the numerous small retail outlets would be uneconomic. Commenting on the extent to which trade has in recent years been diverted from specialist tobacconists to " mixed " outlets, a small tobacco manufacturer says that companies such as his own, which normally supplied the specialist tobacconists with tobacco for blending, have been adversely affected by the virtual disappearance of the " real tobacco shop ".

(2) The Leaf Merchants

408. We have received evidence from 25 leaf merchants. Twenty of them have said that their volume of business has been greatly reduced since the war because many of the small and medium-sized manufacturers have gone out of business or ceased to exist as separate entities. One leaf merchant says that whereas in 1950–51 there were at least 66 cigarette and tobacco manufacturers in the United Kingdom who purchased leaf from merchants, by 1958 the number was reduced to about 25; of these seven were very small and in a precarious position, while five obtained the bulk of their requirements through their own leaf buying organisations. Several witnesses say that official control of leaf purchases contributed to the present position where many manufacturers now buy their supplies direct (see also paragraphs 71–73). One explains that leaf merchants lost their share of the American leaf trade as the result of the arrangements whereby the Government first took over all purchasing of American leaf and later allocated dollars to manufacturers, who made their own buying arrangements; the merchants lost their share of the Rhodesian leaf trade because the London Agreement between the leading manufacturers (see paragraph 75) and the growers encouraged manufacturers to establish their own buying organisations in Rhodesia. Another says that the restrictions on the purchase of dollar leaf compelled merchants who had dealt in American leaf to " seek fresh business in other tobaccos already well catered for ". A third points out that it was only towards the end of the period of control that merchants received a

* Imperial's conditions of sale permit the payment of Co-operative Society dividends (see paragraph 205) on its (Imperial's) brands and do not appear to have any bearing on dividends paid on other brands.

small share in the allocation of dollars for the purchase of American leaf. Another witness, who does not himself buy direct in the leaf producing countries, says that his own suppliers buy in smaller quantities and on less favourable terms than the buying organisations of the large manufacturers.

409. Leaf merchants have suffered from the decline in the number of smaller manufacturers, which many of them attribute to the difficulty of financing the high rate of duty; this, they say, also discourages new entrants to the manufacturing industry. Two of them say that the larger manufacturers are in no way to blame for the position in which leaf merchants find themselves. Another, however, says that as the industry is " at present ruled in this country by Monopolies " there has been " practically no room left at all for leaf tobacco merchants, dealers or agents ", and a fourth that as there are now so few potential customers merchants have difficulty in disposing of parcels of tobacco which may be too small to be of interest to the larger manufacturers. On the other hand several merchants have told us that the larger manufacturers, including Imperial, do give merchants an opportunity of quoting for a part of their requirements and, where prices and quality are competitive, continue to buy from them. A merchanting undertaking which acts as selling agent in the United Kingdom for Indian leaf explains that in placing orders for this leaf it is Imperial's practice to give all the recognised merchants a share of the business; Imperial is said to have been very fair to leaf importers over the years and " without reproach " in its dealings with this agent.

(3) The Distributors

410. We have received evidence from the Wholesale Tobacco Trade Association, from the National Union of Retail Tobacconists, from two trade associations many of whose members sell cigarettes and tobacco although they are not primarily concerned with this trade,* from the Parliamentary Committee of the Co-operative Union on behalf of Co-operative Societies, and from about 200 individual distributors, some 60 of whom are wholly or mainly engaged in the wholesale side of the trade. Some of the distributors who have submitted evidence individually are also members of one or other of the distributors' associations. Both wholesalers and retailers refer to the reduction in recent years in the number of smaller manufacturers, to the dominant position of the larger ones (and especially Imperial), and to Imperial's price leadership throughout the industry. Both are concerned with what they regard as the low profit margins allowed to distributors on falling turnover, but while the former principally deplore the diminution in the wholesale trade due to direct dealing many of the retailers are more inclined to lay stress on the loss of turnover suffered by specialist tobacconists as a result of an excessive number of retail outlets. We have described the negotiations between manufacturers and distributors on terms and related matters in paragraphs 216 to 225.

(a) *The Wholesalers*

411. The W.T.T.A. says that Imperial gives " first class value at a very reasonable price " and considers that the fact that the company enjoys so large a share of the market has not on the whole been harmful to the interests

* Namely: The National Federation of Grocers' & Provision Dealers' Associations and The National Federation of Off-Licence Holders' Associations of England and Wales.

of distributors or consumers. At the same time it points out that the decline of the smaller manufacturers results in the disappearance from the market of many of their brands and in a narrower choice of goods for the consumer. On the question of price leadership the Association alleges that the smaller manufacturers, who feel that Imperial " keeps an eye on " them, are unwilling to alter prices unless Imperial does so first; it considers, however, that prices are probably lower than they would be if Imperial did not take the lead. Several individual wholesalers comment unfavourably on the extent to which the market is dominated by Imperial (or by Imperial and Gallaher). One maintains that wherever one of Imperial's competitors has gained a footing he has been either " subdued by the power of advertising " or, as in the case of the Walters Tobacco Co. Ltd. (see paragraph 68), " bought out ". Others consider that Imperial is " too autocratic " and suggest that the company should consult both with other manufacturers and with the distributors to a greater degree than it does. The main criticisms made, however, relate to the system of distribution and to the terms allowed by manufacturers to distributors.

412. The W.T.T.A. considers it wrong that the terms allowed by manufacturers do not recognise the status of the wholesaler who, although he performs very real services in breaking bulk, making up mixed parcels combining the goods of different manufacturers and distributing goods to retailers in all parts of the country, is only allowed the same quantity terms as the retailer who performs none of these functions; in the Association's view the wholesaler should receive a special wholesale discount. As a consequence it is a further " source of great dissatisfaction " that the wholesaler has to sell to the retailer at prices higher than manufacturers' best terms (see paragraph 201). The Association says that the wholesaler's gross margin is so low that many of its members are finding it necessary to deal in other goods besides tobacco goods. In its view this is not in the interests of efficient and economical distribution; the distribution and storage of tobacco goods is a specialised field and, partly because of the risk of contamination, cannot conveniently be combined with the wholesaling of other goods such as confectionery. The W.T.T.A. emphasises, however, that its members are more concerned to maintain their turnover than to obtain improved profit margins; the present margins would be adequate if it were not for the leading manufacturers' policy of trading direct with retailers, which results in their taking away many of the wholesalers' most profitable accounts. The Association adds that direct trading has increased as the result of amalgamations between manufacturers. It criticises this method of distribution because it encourages smaller retailers to buy in quantities too large for their rate of sale, with the result that they keep their stocks too long, and because, in order to be able to take the necessary minimum quantities to qualify for a direct account, the smaller retailers tend to stock only the most popular brands. The W.T.T.A. suggests that Imperial encourages direct trading because this qualifies the trader for admission to the company's bonus scheme.* In the Association's view small direct accounts could be handled more economically by wholesalers and it questions whether any manufacturer can make a profit on supplying orders for 5,000 cigarettes of mixed brands.† Its members dislike

* Imperial says that this has only a minor influence on its policy with regard to direct trading.

† Imperial's undertaking to increase the minimum order to 10,000 cigarettes so far as new accounts opened by its two main branches are concerned (see footnote † on page 71) was given since this evidence was submitted.

the use of " pioneer " salesmen (see paragraph 215) and other similar sales promotion schemes of the larger manufacturers (see paragraph 197) when these are used as a means of inducing retailers to open direct accounts. In recent years the W.T.T.A. has always been " on friendly terms with the manufacturers both collectively and individually "; no request to discuss matters of mutual interest has ever been refused, but negotiations to obtain any benefits have been " slow and difficult or even abortive ".

413. The evidence obtained from individual wholesalers is generally in accordance with the views expressed by the W.T.T.A. A few say that the terms offered by manufacturers are reasonably satisfactory but about two-thirds have told us that they consider their profit margins low or inadequate; some add that, as a result of low margins and loss of turnover due to an increase in direct trading, they cannot afford to pay sufficiently good wages to attract the most efficient staff, others that they are obliged to stock other types of goods to augment their profits.* Some regret that (in 1956) Imperial's two main branches reduced the quantity qualification for the maximum allowance from 100,000 to 50,000 cigarettes and others think that manufacturers should give additional allowances to buyers of very large quantities of tobacco goods. There is fairly general objection to direct trading; among the matters especially criticised are the small size of purchases necessary to qualify for a direct account, the active canvassing methods employed by manufacturers to obtain new accounts, and the restricted choice of goods available to the consumer which results from it. There is also criticism of the fact that the wholesaler cannot supply the retailer who is qualified for a direct account except on terms less favourable than those the manufacturer would give the retailer. Some wholesalers say that direct trading adds to the cost of distribution and there are those among them who suggest that if distribution were left to the wholesaler the consequential saving in costs might even make it possible to reduce retail prices. One wholesaler considers that if manufacturers, wholesalers and retailers were to " consult as equals " and each party to concern itself with its own efficiency instead of " greedily snatching " trade from the others, they could together bring about changes in the system of distribution which would " ultimately result in lower prices to the public ". All wholesalers who comment on the services provided by manufacturers regard them as satisfactory and some describe them as " very good " or " excellent ".

414. Although critical of the margins allowed to distributors, the W.T.T.A. recognises that the heavy duty element in all tobacco prices leaves " little room for manoeuvre within any price structure "; no manufacturer could increase prices sufficiently to give distributors a reasonable profit without his sales suffering. Several individual wholesalers have referred to the financing of duty as a serious problem for themselves as well as for the manufacturers. One says that the capital required for his business is for this reason now nearly five times greater than it was before the war. Another, the greater part of whose business is in goods other than tobacco goods, says that he has to maintain cigarette and tobacco stocks worth £40,000 of which about £34,000 represents duty on which he gets " no return ". He points out that with every duty change he has to find more working capital to maintain the same quantity of stock.

* This evidence was given before the increase in margins on tobacco of August 1959 (see paragraph 226).

415. There is necessarily a close connection between the terms allowed to distributors and manufacturers' bonus schemes. The W.T.T.A. says that without bonus payments the wholesaler would not be able to show a net profit. The Association criticises Imperial's bonus scheme on the grounds that payments are made in arrear and that the amounts distributed are ultimately related to the company's net profits and dividend, over which distributors have no control. In the Association's view a display bonus should be a fixed payment for services rendered. It considers that Imperial's display requirements are sometimes enforced in a very severe and apparently unreasonable manner and it criticises the company's Bonus Agreement for not defining exactly the extent of a signatory's obligations; it says that, as a result, the wholesaler signatory, for whom loss of bonus would be a very severe penalty, is virtually compelled to accept Imperial's interpretation as to what is contrary to the spirit of the agreement. Nevertheless the W.T.T.A. thinks that in practice most wholesalers give little preferential treatment to Imperial in return for the bonus payment, knowing that if their customers are encouraged to increase their purchases of Imperial brands they will ultimately open direct accounts. The Association has no criticism of the bonus schemes of other manufacturers, which it regards as " a means of giving extra profits of a fixed amount without any real conditions ".

416. Most individual wholesalers who have given evidence have criticised Imperial's bonus scheme, although a few say that deferred payments provide an acceptable " lump sum " or think that the agreement serves as a deterrent to price cutting since payment of the bonus can be withheld if its terms are not complied with; one wholesaler says that the scheme has been a most stabilising influence in the trade. Of the majority who dislike Imperial's scheme, many object to the fact that the bonus is paid in arrear, that the amount is unknown until it is received and that the recipient has then no means of checking whether it is correct. Others point out that the basis of calculation is such that if Imperial's total profits on its home trade are reduced in a particular year a distributor may receive a lower bonus payment even though his own sales of Imperial's goods have increased. Many clearly regard the bonus as a necessary part of their profit margin and some think the money paid out in bonus should be used for improving distributors' basic terms. One wholesaler submits that the " ostensibly voluntary " Bonus Agreement is in fact " almost compulsory ", as distributors cannot afford to do without it. The W.T.T.A.'s criticism that the extent of a signatory's obligations are not clearly defined is repeated; one wholesaler says that Imperial takes a very arbitrary view of these obligations and that it objects to distributors engaging in activities such as press advertising which in the view of the witness are not contrary to the spirit of the agreement. There is little criticism of the bonus schemes operated by manufacturers other than Imperial, although a few wholesalers dislike all bonus schemes on the grounds that they restrict window displays to the goods of a few manufacturers or are used as an inducement to retailers to buy direct from manufacturers.

(b) *The Retailers*

417. The N.U.R.T. has told us that the annual net profit made by a typical tobacconist's shop has decreased since the war, with the result that the number of specialist tobacconists is declining and they are " gaining a reputation as

bad employers " because they cannot afford to increase wages. It says that, although through no fault of his own the scope of the services which the specialist tobacconist can offer is not as wide as in the past, by providing a wide choice of brands and proper facilities for the introduction of new lines he still plays an important part in stimulating competition: to force the tobacco trade to be " everyone's sideline and no one's speciality " would, in the Union's view, be against the interests of both the trade and the public. The Union adds that Imperial has recently shown a more tolerant and sympathetic attitude towards the specialist tobacconist. In September 1957, for example, it increased the distributors' margin on filter tipped cigarettes (see paragraph 224), although not sufficiently in the Union's view to compensate fully for the reduction in money turnover resulting from the increased proportion of these lower-priced brands in sales. In August 1959, moreover, Imperial raised distributors' margins on tobaccos to a level more nearly comparable to those on cigarettes. As with the wholesaler, however, the size of the margin is of less importance to the retailer than turnover. The N.U.R.T. maintains that, although the number of licensed outlets is lower by some 100,000* than in 1939 and consumption of tobacco goods has increased considerably since 1948, there has been no appreciable increase in the volume of sales of individual retail tobacconists. This it attributes principally to the " enormous growth " in the number of industrial canteens during and since the war, to the " tremendous increase " in the volume of tobacco goods sold through these canteens, and to the fact that wholesalers, having lost many of their accounts since 1955 as a result of direct trading, have been forced to open up new retail outlets which direct trade away from the specialist retailer. The N.U.R.T. recognises that the present distribution system is to the advantage of its smaller members. The minimum quantities specified are small enough to enable them to qualify for direct accounts and thus to buy more cheaply than if they had to deal through wholesalers. The Union would nevertheless welcome a change which would enable wholesalers to supply on the same terms as manufacturers. In the Union's view the " precarious position " of the average retail distributor of tobacco goods is due to the " phenomenal number " of outlets and it estimates that there is at present one outlet to approximately every 40 smokers. With a larger turnover the specialist retailer could manage on a smaller margin and the N.U.R.T. suggests that efficient distribution could be achieved at lower cost by reducing the number of points of sale and increasing the proportion of the trade which passes through the specialist outlets ; " rationalisation " on these lines would also assist the smaller manufacturers and thus increase competition, to the benefit of distributors and the public. The N.U.R.T. believes that there must be some saving to manufacturers on very large orders and agrees with the wholesalers that additional allowances should be given on orders for more than 50,000 cigarettes. It admits, however, that any improvement in terms on large quantities would benefit only its larger members.

418. The two associations of retail distributors whose members distribute, although they do not specialise in, tobacco goods have told us that the profit margins on these goods are too low in relation to overheads, and one says that they compare unfavourably with the margins on other types of goods sold by its members.

419. The views of individual retailers closely support those advanced by the associations. Many say that the margins fixed by the manufacturers are

* The Union attributes the reduction in the number of outlets principally to a decrease in the number of home cabinets and automatic vending machines at present in use.

inadequate and compare unfavourably with those earned on other types of goods.* They also say that there are too many retail outlets (some of them, such as fish and chip shops and garages, unsuitable) and suggest that the existence of so many outlets, many of them small, increases the overall cost of distribution, reduces the turnover of the specialist retailer and restricts the consumer's choice of brands. Some of them say that as a result of low margins and reduced turnover they have been obliged to stock other types of goods. Other retailers who do not specialise in tobacco goods say that they must supply these goods as part of their service to customers but do not regard them as a profitable part of their trade. A few refer to the difficulty of paying adequate wages, while others criticise the manufacturers for allowing the Co-operative Societies to pay dividends on their goods. Several suggest (in contrast to the views of the N.U.R.T.) that the size of order necessary to qualify for quantity allowances is in some cases too large, or think it unsatisfactory that orders for cigarettes and tobacco may not be combined to make up the necessary quantities to qualify for best terms. One retailer has said, however, that competition between manufacturers is " so keen " and the N.U.R.T. " so watchful " of the terms they allow that no manufacturer can " force a lower profit margin ". Another, while regarding the margin as inadequate, nevertheless praises the manufacturers for keeping retail prices as low as possible and so ensuring that the consumer gets the best possible value. The comments made by retailers on the service given by manufacturers are almost without exception favourable. In the opinion of one of the largest multiple retailers the credit terms offered by all manufacturers are " reasonable and compare very favourably with other trades " and their delivery services are " extremely good "; this retailer adds that the willingness of manufacturers to allow full credit for any goods returned as out of condition is " a considerable boon " to the retailer and of great benefit to the public.

420. The views of retailers on the bonus schemes of manufacturers are not very different from those of the wholesalers. The N.U.R.T. says that it objects to Imperial's bonus scheme because it demands a definite service in return for a bonus payment that is " nebulous " (in the sense that the trader does not know what the rate of bonus will be), delayed and can be withheld. We are told that Imperial will not agree to suggestions that like other manufacturers it should allow a fixed rate of bonus as a deduction from invoice, or to the N.U.R.T.'s own proposal that the company should give additional payments to tobacconists who provide " substantial and prominent " window displays. We are told that Imperial demands " strict compliance " with the terms of the Bonus Agreement. In the past some members of the N.U.R.T. have resented being forced to display Imperial's material to an extent which they considered unfair in relation to the bonus paid; there have also been instances where the " overzealousness " of a bonus representative has caused a distributor, through fear of losing his bonus, to devote a larger percentage of his display space to Imperial brands than the company would in fact require.† Although Imperial

* As in the case of wholesalers, this evidence was given before August 1959, see footnote on page 150.

† With regard to the views of the N.U.R.T. expressed in this and the two preceding sentences, Imperial has told us that it would be reluctant to abandon a method of payment of bonus which has a long tradition behind it and which many traders seem to prefer. It thinks that any scheme which involved placing a valuation on different locations and types of display would be cumbersome to administer and might not in the end produce a fairer solution than the present scheme. As regards the alleged " overzealousness " on the part of bonus representatives Imperial points out that in the absence of specific instances it is difficult to comment but believes that when a distributor devotes a larger part of his display to the company's brands than the company requires this is usually because he considers it good for his business and not through fear of losing his bonus.

has enforced its bonus conditions less severely in recent years, it is still a cause of complaint by the N.U.R.T. that the company, while refusing to put up neon signs of its own on traders' premises, threatens the retailer with loss of bonus if he displays another manufacturer's neon sign. Other manufacturers are said to make few demands on their bonus customers, but the N.U.R.T. thinks it unfair that in most cases bonus is paid indiscriminately to all traders, whether or not they give any display. In its view, bonus schemes are only tolerated because profit margins are so low that tobacconists cannot afford to sacrifice the small sums they yield.

421. A few individual retailers (most of them not specialist tobacconists) have told us that they regard all bonus schemes as satisfactory, and several like Imperial's system of deferred payment because it means a substantial cheque twice a year. With these few exceptions, however, the evidence suggests that Imperial's bonus scheme is not popular among retailers. The Co-operative Union has told us that some Co-operative Retail Societies while glad to receive Imperial's bonus dislike being unable to check the calculation of the amount received; others object to being tied by the agreement to Imperial's conditions of sale or would like Imperial to discontinue the bonus and allow better basic terms. A great many other retailers object to the bonus being an unknown amount which is paid retrospectively. Some of them emphasise that distributors are obliged to participate in Imperial's scheme because they cannot afford to forego the bonus. Several have told us that Imperial's display requirements are exacting, while others point out that the proportion of the available display facilities required by Imperial is not clearly laid down in the agreement or criticise Imperial for paying bonus to some distributors who provide little or no display. No criticism is made of the bonus schemes of other manufacturers, who are said to be very reasonable in their demands for display.

(4) The Board of Trade

422. Comments submitted by the Board of Trade are confined to those matters, such as Government controls, on which the Board has had the closest contact with the industry.

423. The Board says that in making proposals to the industry it had regard to the position and particularly to the commercial experience of Imperial, and that for its part Imperial, in its dealings with the Board, had displayed the kind of responsibility, both to the Government and to the interests of the smaller companies, that was to be expected from a company of its size and importance in the industry. During the period of official controls some of the trade may have wished to go further than Imperial in opposing the Government's policy, and Imperial may in such circumstances have helped the trade to a better understanding of the objects of Government policy. In operating and altering the controls the Board (with the knowledge of the T.A.C.) frequently invited Imperial to produce its own figures and estimates.

II. Machinery

424. We summarise below some observations and views on the supply of machinery which we have received from cigarette and tobacco manufacturers other than Imperial and from machinery manufacturers other than Molins Machine Co. Ltd. In so far as the views given express or imply any criticism

of Molins as the chief supplier or of Imperial as the largest purchaser of machinery, they have been made known to the two companies, whose own views are given in Chapter 15. The summary is based on evidence received in 1957 and 1958 from the cigarette and tobacco manufacturers referred to in paragraph 400 and from 22 machinery manufacturers. In important cases, however, the evidence has since been brought up to date.

425. Cigarette and tobacco manufacturers appear generally to find arrangements for the supply of machinery and relations with machinery manufacturers satisfactory. Several of the larger ones have told us, however, of difficulties they have experienced in the past in obtaining certain machines made by Molins. Gallaher, for example, has told us that there have been many occasions in the past when the company was unable to try out a Molins machine, although it would have liked to do so with a view to placing an order if the machine were found suitable. Gallaher has " known for many years that an agreement has existed between Molins and Imperial which put certain restraints on Molins regarding the supply of machinery to manufacturers generally ", but it has never known the details. Latest models of the Molins cigarette making machine would not have been available to Gallaher in the past. The company cannot quote specific occasions when it has been refused machines, since any enquiry it made on such matters would have been on a personal basis and by telephone; but it recalls that it would have liked before the war to purchase Molins cigarette making machines, and that if it had wanted to buy a hinged lid carton packer a few years ago its order would have been refused.* Recently the position has changed to the extent that Gallaher thinks it can now get any machine it wants, except that it would not be permitted to have a new type of machine on trial until Imperial had tested it for 60 days. Carreras has also mentioned that it occasionally had difficulty in obtaining new types of machinery made by Molins. The company was unable to purchase the hinged lid packer from Molins in 1954 because, so it understood, Imperial had exclusive right to use this machine. Carreras had also been told in 1948 that Molins would not supply the auto-control weighing device with the Mark V cigarette making machine for which Carreras had placed a trial order, although Molins later agreed to do so. Under its present management Carreras has experienced no difficulty in obtaining from Molins the machines it wants. Godfrey Phillips has said that Molins at first raised difficulties about supplying Mark V cigarette making machines for which it placed an order in 1948, although again in this case the order was eventually accepted. Godfrey Phillips also says that some time passes before it is possible to discover that Molins has brought out a new type of machine; the company feels, however, that there is some advantage in letting Imperial " get the ' bugs ' out of " a new type of machine before it is supplied to other manufacturers.

426. The smaller cigarette and tobacco manufacturers, whose orders for machines are in general small and infrequent, have made few comments. One company which ceased manufacture recently has told us that when it wanted to make filter tipped cigarettes in 1946 Molins, " the only people producing a filter

* See paragraphs 312, 313 and 323 to 325. The Molins cigarette making machine Marks I–IV was released for sale on the open market in 1948, the Mark V with auto-control or any auto-weigher in 1949, and the Mark VI (subject to Molins consulting Imperial) in 1953. The hinged lid machine was generally available for a few months in 1953–54 and was finally released in 1957.

tip assembler ", refused to supply the machine.* Molins offered the assembler to this company in 1949, by which time it had developed a machine of its own. Two other former manufacturers say they understand that Imperial had exclusive rights to use certain of the most efficient machines. One of them also alleges that old machines were scrapped and not allowed to come on the second-hand market.

427. The machinery manufacturers themselves have no criticism to offer. Three who have either co-operated with Imperial in developing machines or made machines to drawings supplied by Imperial say that they have been free to supply these machines to all customers. The only machinery manufacturer who makes any general comment on relations with cigarette and tobacco manufacturers says that these have been " of an amicable and co-operative character ".

CHAPTER 15. THE CASE FOR THE LEADING SUPPLIERS

I. The Imperial Tobacco Company (of Great Britain and Ireland) Limited

A. Cigarettes and Tobacco

(1) General

428. Imperial submits that despite the degree to which the supply of tobacco goods in the home market is concentrated in the company's hands, the existence of active competition ensures the achievement of the objectives laid down as criteria in Section 14 of the Monopolies and Restrictive Practices (Inquiry and Control) Act, 1948, which the company expresses in summary form as: " (i) the efficient production and distribution of goods which best meet the requirements of the market; and (ii) progressive improvements in efficiency and the encouragement of new enterprise ". The company maintains that active competition in the industry obliges a manufacturer to make constant efforts to supply goods that appeal to the smoking public and are better value than those offered by other manufacturers. The value that a manufacturer can offer depends on his efficiency over the whole field of his operations from the buying of tobacco leaf and other raw materials through to the finished product.

429. The company attributes the decline in the number of manufacturers over the years " to the nature of the products and to the conditions under which they can be manufactured and marketed economically ". It explains that the production of cigarettes lends itself to mechanisation; this requires heavy capital expenditure on buildings, plant and machinery in addition to capital to finance stocks. The resulting high overhead costs can, Imperial says, be covered only by a considerable volume of output. On the marketing side also there is a strong tendency for demand, especially in the case of cigarettes, to be concentrated on a relatively small number of brands partly, the company believes, because smoking " is a social habit and . . . choice of brand is influenced

* See paragraphs 318 to 322. Imperial says it received no application. Molins points out that Gallaher " had been granted exclusive rights in the use of this patented invention, the patents for which did not expire until 20th September, 1949 ". Molins submits that " under the Patents and Designs Act in force, until the 1949 Act, it was a perfectly proper thing to do to grant exclusive licences as was done in this case provided that no abuse of monopoly could be shown ". (See also paragraph 498.)

by inclinations to conformity ". Effective sales promotion is essential to establish a large-selling brand, and this is both costly and risky. In Imperial's view all these factors give the large manufacturer an advantage. There are cases where a small unit (both outside and within the Imperial group) has produced a successful brand but Imperial thinks it natural that there should be comparatively few manufacturers in the industry and that the number should have declined as demand shifted from tobacco to cigarettes. We are told that the tobacco industries in other countries have shown a similar trend.

430. Imperial says that concentration of demand has not precluded " active and effective competition " and that the changing proportions of the trade held by different manufacturers reflect the varying degrees of success achieved by their competitive efforts. The company attributes its own position in the industry principally to the successful use of the competitive weapons open to any manufacturer rather than to any particular arrangements it has made, such as the bonus scheme or the agreements with Molins Machine Co. Ltd. In this connection it submits that such advantages as were derived from its arrangements and actions in the past have accrued equally to all the company's branches; it says that the fact that some branches have been more successful than others " strongly suggests that the factors which governed success were primarily those which were not common to all branches ". Imperial emphasises the importance and reality of internal competition within the group. We are told that the success of outside competition has varied and the existence of internal competition is " an important additional safeguard ". The company says that it is using and may be expected to use in a reasonable way and with due regard to the public interest the power which necessarily accompanies the size of its business and its established position in the industry. It maintains that its rate of profit is reasonable, that distributors' margins on its goods give a reasonable and fair return while keeping prices to the consumer at a minimum, that research and development are among the company's " prime concerns " and that in the field of smoking and health it has acted with full awareness of the wider responsibilities of its position as the leading company in the industry. The company says that it has " always taken great pride in the good relations that have been established with employees at all levels " and that it has been " virtually strike-free " throughout practically the whole of its history.

431. The scope for co-operation with the Government is said to have been especially wide in the tobacco industry because of the high rate of duty and the war-time and post-war shortage of tobacco leaf. So far as the duty is concerned Imperial asserts that it plays an important part in ensuring the efficient working of the fiscal system. Government controls during and after the war are said to have imposed special duties on the company in connection with the procurement of supplies and their equitable distribution (see paragraphs 70–79). These duties were, Imperial submits, performed unselfishly, without regard to its own interests. The company says that when rationing was about to end and the temptation was strong to expand its sales at the expense of leaf stocks, it refrained from doing so at the request of the Board of Trade and in consequence entered the freer market conditions after 1954 in a weaker position than some of its competitors (see paragraph 87). It has been Government policy to develop Commonwealth sources of supply of tobacco leaf with the objects of increasing the wealth of the territories concerned and saving expenditure of dollars; the company says that it has spent large sums of money to implement this policy,

particularly in Southern Rhodesia and Nyasaland (see paragraph 111). We are told that since 1946 Imperial has spent over £2 million on capital projects in Central Africa, excluding its large pre-war investments; the company's current expenditure in Central Africa is about £12½ million a year and it is a large employer of both African and European labour. Imperial claims that by its research and by advice and encouragement given to growers it has helped to improve the quality of Commonwealth tobacco and made its substitution for American leaf more acceptable to the British smoker; it points out that in 1958 over a quarter of all leaf supplied to the United Kingdom came from Rhodesia and Nyasaland while other Commonwealth countries contributed over one-fifth.

432. Imperial submits that it has also co-operated " in a very remarkable way " with the policy of dividend restraint and the retention of profits urged by successive Chancellors since the war. In 1946 the company paid the amount of £7·7 million (net of tax) as dividend on its ordinary and preference stock; this sum was not exceeded until 1959 when the net dividend amounted to £8·8 million. During the same period the dividends received by Imperial from its investments increased from £2 million in 1946 to £4·2 million in 1959. The company says that it has ploughed back into the business a high percentage of its trading profits.

433. Referring to the circumstances in which Imperial was formed (see paragraphs 102–103) the company points out that the American Tobacco Company was a powerful organisation rooted in the country which was the main source of supply of the tobacco leaf used by United Kingdom manufacturers. Imperial questions whether Commonwealth countries would subsequently have developed as important suppliers of leaf if American Tobacco had succeeded in capturing the home market at that time. It also doubts whether, if they had not amalgamated, the relatively small British companies could have offered any effective resistance to American Tobacco, and suggests that had American Tobacco succeeded in gaining control of the market some might have been forced out of business. Thus without the formation of Imperial there might have been, it is said, less rather than more competition.

434. While the amalgamations of 1901 and 1902 and the subsequent arrangements with American Tobacco " laid a foundation on which a powerful and efficient enterprise could be built ", Imperial argues that they gave " no assurance whatever of continuing strength, and certainly no assurance of a dominant position in the trade ". Though competition from American Tobacco was eliminated for the time being, Imperial " still had to face considerable competition from other United Kingdom tobacco manufacturers " and American Tobacco itself re-entered the market when it acquired J. Wix & Sons Ltd. in 1927.* Imperial emphasises that despite any initial advantages which it may have enjoyed, " if, in a market which has always been a highly competitive one, [it] had not conducted its operations efficiently it would not have remained powerful ".

435. To illustrate the existence of competition and its contention that the industry is " a far from static " one, Imperial has submitted statistical information which shows, *inter alia*, that in the years since 1929 at least four, and more often six, of the twelve leading brands of cigarettes on the home market have

* The company which acquired J. Wix was the reconstituted American Tobacco Company —see paragraph 54.

been other manufacturers' brands.* Broadly speaking, between 1905 and 1960 Imperial's estimated percentage share of a more or less continuously expanding home market for tobacco and cigarettes has varied from 52 per cent. to 79 per cent. The company has illustrated by a series of charts the development of the total home tobacco trade and its own trade, and the fluctuations in its proportion of the total trade, during this period. They show that between 1921 and 1933, principally as the result of coupon trading, the company's share of the cigarette trade fell steadily from 93 per cent. to 66 per cent. and its share of the total trade from 75 per cent. to 62 per cent. In 1934 its share rose to 79 per cent. for cigarettes and 72 per cent. for the trade as a whole, and from then onwards until 1955 its proportion of the cigarette trade fluctuated between 77 and 83 per cent. and of the whole trade between 72 and 79 per cent. After the relaxation of controls Imperial's share of the cigarette trade fell from 81 per cent. in 1955 to 65 per cent. in 1959 and its share of the total trade from 79 per cent. to 64 per cent.

436. From January 1955 onwards Imperial's main brands, with those of all other manufacturers, were supplied freely on the market. Sales of Imperial's main brands, with those of Gallaher, increased considerably at the expense of virtually all others. Imperial says that from about the middle of 1956 sales of Senior Service and Park Drive began to make inroads into its own sales. Other market developments during these years were the gradual increase in the sale of tipped cigarettes, the re-emergence of coupon trading in 1956 and a continuing movement away from the smaller-sized to the medium-sized cigarette brands, " attributable presumably to rising living standards ". Imperial says that it has reacted, and is reacting, to the present situation first by giving the best value and quality it can in all its brands, and supporting this policy by research and development in a variety of fields and by the closest possible control of costs; secondly by sustaining its established brands by the most vigorous sales promotion; and thirdly by marketing new brands. It says that in the four years up to March 1960 it introduced 11 new brands, while other manufacturers introduced 25; all the signs of active competition can, Imperial says, be seen in the streets and in the newspapers and " there can be no doubt whatever " that competition is " fierce ".

437. The company has given a great deal of factual information and explanation relating to its arrangements and activities. Where appropriate we have incorporated this in earlier chapters. We set out the company's main submissions in greater detail below.

(2) The Branch System and Number of Brands Manufactured

438. Imperial submits that the branch system (which we have described in paragraphs 113 to 126) gives the benefit of both internal competition and large-scale production and " reinforces the effects of outside competition in stimulating progressive increases in efficiency of manufacture and marketing and in ensuring a constant search for products which will best meet the requirements of the public ". The advantages of the system have, it says, been all the greater in periods when the company was responsible for a very large share of the total trade. In the company's view any economies which might have resulted from greater centralisation of production and marketing would have been outweighed by the effect on efficiency of loss of competitive incentive.

* According to the information given, other manufacturers' brands were generally at the lower end of the list and until 1959 had not risen above fifth place. In that year Gallaher's Senior Service and Park Drive moved to third and fourth place respectively.

439. Imperial says that its objective is to leave the branches as much freedom of effort as possible in manufacture, selling and cost control. At the same time it is able to review the company's activities as a whole from the centre and to ensure that the group gets the maximum benefit from its collective bargaining power. Thus economies are achieved by central purchasing of certain materials and in the provision of capital and of specialist services; but although materials are bought centrally they are ordered to each branch's own specifications and requirements. As far as advertising is concerned, the company says that although the Executive Committee controls expenditure its decisions are very largely conditioned by what the branches feel is necessary to support their business in the existing competitive situation, and branches' proposals are usually approved " provided they seem . . . reasonable in relation to brand gross profits and sales prospects ". We are told that the success of one branch in relation to another is to a great extent attributable to the comparative public appeal of its brands; the virtue of competition between branches is that all are constantly striving to achieve that appeal and there is very wide scope for branch initiative in advertising.

440. Although in a number of fields reference must be made to the Executive Committee, we are told that the branches have a considerable degree of autonomy and a great deal is left to their initiative. Imperial says that there are in fact a number of important differences in the manufacturing methods used by different branches; brand specifications are devised by the branches concerned and are not disclosed to other branches. While it is true that branches must obtain central approval for introducing new brands or modifying existing brands, the company says that the Executive Committee itself has many times approved the introduction of a brand by one branch at a price which would place it in direct competition with the established brands of another branch. To do otherwise than to approve would, in Imperial's view, make nonsense of the whole branch system and in any case the company considers that this policy on the whole enables it to sell more of its products.

441. The Executive Committee's control over brands is directed at the margin of gross profit which each will yield and the company has standards for these margins which the branches must maintain; we are told that as a result of the central control " each brand brought out by each branch at a price level which competes should yield a gross profit margin roughly comparable with the company standard at that price. That means that we are putting each branch in the position of being able to compete in terms of the value offered in the product equally ". As regards the prices charged by the branches, Imperial acknowledges that the bulk of the company's sales of cigarettes are made at one of three levels of retail price but quotes two instances where branches' proposals to vary their prices have been approved. In the first case the Executive Committee authorised a reduction in the price of Wills' Bristol brand cigarettes to enable it to compete more effectively with Player's Bachelor; the reduction was accompanied by a change in specification and in the size of the cigarette. In the second case a reduction in the price of Churchman's No. 1 was authorised to compete with Carreras' Piccadilly No. 1 and the size of the cigarette was reduced. Imperial explains that price cannot be reduced without a change in specification and that it is dangerous to change the specification of an established brand. The company maintains that in any case " price

competition between cigarettes of roughly comparable size is not a very compelling thing "; competition centres primarily on other factors, namely, " the recipe, the smoking characteristics and the satisfaction the cigarette gives ".

442. Imperial's history, it is said, shows clearly that competition between branches has been " very real and effective "; to support this the company points out that between 1905 and 1958 Player's share of Imperial's total sales rose from 7·8 per cent. to 49·4 per cent. and Wills' share from 32·6 per cent. to 43·5 per cent., while Ogden's fell from 17·3 per cent. to 3·2 per cent. In the company's view the history of sales of various brands provides an " equally striking demonstration of the reality of competition between Branches ". As the maintenance of effective competition between branches is " an essential tenet of Company policy ", proposals submitted by branches are normally approved by the Executive Committee unless there is some compelling objection; none of the limitations imposed by central control on competition between branches is in any sense severe.

443. Imperial says " it is inherent in the system that some Branches will be more successful than others, and that both their size and profitability will vary ". It claims that the smaller branches can compete effectively with Wills and Player in some fields (the hand-rolling and pipe tobacco sectors of the trade, for example) and that, as in the case of Player, the system does not prevent small branches from growing. The position of individual branches is kept under constant review. Imperial points out that between 1902 and 1947 the number of branches was reduced from fifteen to eleven, that there are at present six (of which only five manufacture), and that a further merger (of the Churchman, Ringer and Lambert & Butler branches) will be effected by February 1961, thus reducing the number to four.

444. Imperial submits that it is never easy to decide whether to close a branch since there is always the possibility on the one hand that its trade might revive and on the other that transfer of the manufacture of its brands to another branch may result in a loss of goodwill and sales to the company as a whole. Other considerations are the need for maximum competition within the company and the question of hardship to employees. Before the war, when there was considerable unemployment, the company was " inevitably influenced . . . in the direction of going pretty slow with closing down old established businesses "; in the 1930's it was perhaps slower to act than might have been expected from the figures of branch results, but it questions whether it would have been in the public interest if it had closed a branch in an area where unemployment was acute. The company says that after the war, until 1954, some of the small branches were for a time quite profitable. Although in retrospect it may seem that from 1955 onwards the company was slow to act in some cases, this is being wise after the event; Imperial has been loth to remove one of the competing branches until the odds were heavily against its economic survival. Imperial says, however, that the " last thing " it would want to do would be to maintain unprofitable branches indefinitely.

445. Over the years Imperial has reduced not only the number of branches but also the number of brands made. When one branch takes over another it normally continues to market only those brands that are considered to have some prospect of success. In addition, the management periodically goes through every branch's price list with the branch concerned and considers which

brands should be discontinued, having in mind each brand's sales potential, its contribution at gross profit level and the saving which would result if it were withdrawn. We are told that Imperial keeps the position under " close review "; as a result, the number of brands marketed has been reduced between 1938 and 1960 from 191 to 57 for cigarettes and from 596 to 183 for tobaccos.

446. The company says that it is fully alive to the need to reduce fixed overheads where possible by reducing surplus manufacturing capacity and that it has been doing so. It points out, on the other hand, that a reduction in the number of brands marketed would not necessarily create surplus plant and says that although sales of a brand at a given time may be very small it does not follow that they will always remain so.

447. Referring to the brands at present marketed, Imperial says that each differs from the others and that all are necessary to meet the tastes of the smoking public. So far as cigarettes are concerned, all the brands have different recipes producing different flavours and smoking characteristics. In addition there are differences in size and price and as between tipped and untipped brands. There are many types of pipe tobacco (shags, flakes, navy cuts and so forth) and within each type there are differences in recipes and in smoking characteristics; the 183 brands of tobacco comprise twenty different types and for some types there are a considerable number of price levels. No tobacco recipe is sold under more than one brand name. Many brands enjoy only local sales. The company points out that it supplies about two-thirds of the cigarette market and about 60 per cent. of the tobacco market, but its competitors, with a smaller share of the trade, collectively market more brands—namely 160 brands of cigarettes and 250 brands of tobaccos. The company says that it has tried to eliminate both unprofitable brands and unprofitable units; in so far as it has maintained brands, and possibly branches, which may not always have been economic, its aim has been to keep or improve its share of the market. The company's case on the relative profitability of cigarettes and tobaccos is set out in paragraph 487 below.

(3) IMPERIAL'S FINANCIAL INTERESTS IN AND RELATIONS WITH SUPPLIERS OF MATERIALS USED IN MANUFACTURE

448. Imperial says that its financial interests in companies producing cigarette paper and certain packing and packaging materials and the preferential arrangements relating to supply which it has made with certain manufacturers of other materials (see paragraphs 130–140) have contributed to its overall efficiency. Subsidiaries were set up or acquired " because it was felt to be both economic and expedient " that Imperial should control its sources of supply " in large degree ", particularly as in some cases by so doing it was able to lessen its reliance on imports. It submits that the existence of subsidiaries supplying the bulk of the parent company's requirements of certain materials has not hindered other tobacco manufacturers; alternative sources of supply exist and other tobacco manufacturers buy from Imperial's subsidiaries on terms which produce profit margins " not substantially different from " those obtained on sales within the Imperial group. It is said similarly that Imperial's arrangements with manufacturers of other types of materials have not affected supplies of these materials to other tobacco manufacturers and that any price advantage accruing to Imperial does no more than reflect the size of the company's orders.

(4) IMPERIAL'S FINANCIAL INTERESTS IN OTHER TOBACCO MANUFACTURERS

(a) *British-American Tobacco Co. Ltd.*

449. Referring to the formation of B.A.T. in 1902, to Imperial's financial interest and to the arrangements which gave B.A.T. the right to use Imperial's brands in overseas markets but precluded it from supplying the home market (see paragraphs 103 and 104), Imperial says that B.A.T. is an extremely successful company which satisfies the criteria of Section 14 of the 1948 Act in that it is very effectively meeting the need for the efficient production and distribution of goods which are best suited to the requirements of overseas markets. We are told that B.A.T. is the largest producer of cigarettes in the world and that an important part of its business rests on ownership of the goodwill and trade marks of Imperial's brands in overseas markets; the strength of these brands in the home market is a major asset to B.A.T. Imperial says there is a considerable degree of consultation between B.A.T. and itself which would not continue if the two were in competition; if consultation stopped it would be " a positive disadvantage " to B.A.T.'s export business. Imperial maintains that in any event, without competition from B.A.T., there is sufficient competition in the home market, both between Imperial's branches and between Imperial and other manufacturers, to ensure that the industry will be efficient and will meet the home market's requirements. The present division of interests between the two companies is, in Imperial's view, rational. Imperial adds that in any case the agreement which precludes B.A.T. from entering the home market has been registered under the Restrictive Trade Practices Act, 1956, and " it is for the Restrictive Practices Court to decide whether the agreement is against the public interest ".*

(b) *Ardath Tobacco Co. Ltd.*†

450. Imperial says that when it acquired its interest in Ardath in 1925, Ardath's home trade was small, representing only about one-half of one per cent. of the total cigarette market, and that the company's share in recent years has been so small as to be without material effect on the proportion of the trade controlled by Imperial. Ardath has been in competition with Imperial and with other manufacturers. We are told that, although Imperial has controlled some aspects of Ardath's activities (including brand specifications and profitability) on a basis similar to its control of the branches, in others (including the purchase of leaf and other materials and of machinery) Ardath has worked independently. Imperial does not consider that Ardath has been unduly restricted or inhibited in its competitive effort in the home market by virtue of its association with Imperial. The company has had as much freedom of action as any of Imperial's branches but has not been successful.

451. Imperial says that the only material difference between Ardath's trading methods and those of the branches is that Ardath markets two coupon brands, introduced in 1957 on its own initiative when its trade had declined very seriously. Imperial considers coupon trading undesirable and would not authorise its branches to introduce coupons unless forced to do so by public demand, because once Imperial entered the field the method would inevitably spread. It says that the entry of Ardath, a small and weak home trade supplier, into this field

* For this reason we do not deal with these arguments in our Conclusions (see paragraph 551).

† The arguments in paragraphs 450 and 451 were submitted before the reorganisation of the Ardath business—see paragraph 182.

seemed unlikely to have this effect and that the proposed coupon brands were therefore authorised. It adds that after making allowance for the cost of Ardath's coupon scheme, the coupon brands show a gross profit similar to that earned by Imperial's brands selling at a similar price; this result is achieved by a reduction in the size and weight of the Ardath cigarettes.* Although Imperial regarded Ardath's re-entry into the coupon market as a " mild form of insurance " against competition from other manufacturers' coupon brands, the company says that it has not used Ardath as a " fighting company " for the purpose of putting a competitor out of business or to compete unfairly in any other way with other manufacturers. In recent years Ardath has incurred losses on its home trade and these Imperial has had to make good, but it made no such subvention payments until 1955. Ardath's losses were due, Imperial submits, not to unfair methods of competition but to the fact that the volume of its sales in the home market was insufficient to support its overheads. We are told that up to the time of the recent reorganisation of the business (see paragraph 182) Ardath had made strenuous efforts to rebuild its trade, though without much success.

(c) *Gallaher Ltd.*

452. Imperial says that it acquired its financial interest in Gallaher in 1932 in order to prevent American Tobacco from gaining control (see also paragraph 172). Imperial's original investment in Gallaher cost £1¼ million; the total amount invested over the years has been about £9½ million and the current market value is £34 million. The investment has, therefore, shown " very substantial capital appreciation " but the company says that in 1932 it was " far from clear " that such appreciation was likely as Gallaher was not then Imperial's chief competitor. The return the company obtains from an increase in Gallaher's trade is, however, less than it can derive from sales of its own brands, and it therefore prefers to increase its own sales at Gallaher's expense. Imperial's present objective is to recover trade lost to Gallaher and " to review the future of our holding . . . as an investment in the light of our success in doing that ". We are told that Imperial's financial interest in Gallaher has " at no time had any effect whatever on the degree of competition " between the two companies; Gallaher's success has not been due to any help which it has received from Imperial. Imperial suggests that, while Gallaher has at present the second largest share of the market, this may not always be the case; other competitors are " actively trying to increase their share ".

453. For the reasons given above Imperial does not consider its investment in Gallaher to be against the public interest. It says it has not contemplated regaining control of Gallaher by acquiring further shares and cannot envisage any circumstances in which that would be its aim. While it may not continue indefinitely to consider a holding of as much as 42½ per cent. in Gallaher's equity desirable, the investment aspect is not the only consideration that will affect its policy. Although the company believes that no other British tobacco group would be in a position to acquire control of Gallaher in the foreseeable future it says it still cannot rule out the possibility that an American group might do so and that the most effective safeguard against this is that Imperial should continue to hold a substantial proportion of the equity. On these " commercially protective grounds " Imperial might, therefore, think it prudent

* It should not be assumed that all makes of cigarettes sold under coupon schemes at the present time are of smaller size or lower quality than other brands selling at the same price.

to retain its investment even if Gallaher's trading were to prove less successful, and the investment less profitable, in the future. Imperial says that in the light of its experience in the early years of this century it would " much prefer that the control of a business like Gallaher did not pass to the Americans ", and it believes that in this respect its own interests and the national interest are not in conflict.

454. Referring to the fact that its interest in Gallaher is registered in the name of nominees, Imperial says that if it disclosed that it held 42½ per cent. of Gallaher's equity it would be quite widely assumed by the public and the distributive trade, whatever Imperial might say to the contrary, that Gallaher was " in some way under our wing ". Although it is fairly generally believed that Imperial has a substantial holding, this does not enjoy the same credence as it would if the company were to acknowledge its holding publicly, and Imperial thinks that " it would be quite wrong for there to be an impression abroad that we in fact in any way control or influence Gallaher's trading policy and that competition between us is in some way blurred and inhibited ". Imperial points out that although in 1946 the Cohen Committee recommended the disclosure of trade investments the Government did not implement this recommendation, " presumably because it saw no really satisfactory way through " the difficulties involved; the company argues that if its holding in Gallaher were disclosed it would be difficult to keep the market and the public informed of changes in the extent of that holding. Relations between the two companies being what they are, Imperial sees no advantage to itself, its stockholders or the public in disclosing its interest. It says that similar arguments apply to disclosure of its interests in Ardath and in Finlay & Co. Ltd. (see paragraphs 450 and 461).

(5) Relations with other Tobacco Manufacturers

(a) *The Martin Agreement*

455. We have described in paragraph 63 the circumstances in which the leading manufacturers entered into the Martin Agreement in 1933. Referring to this agreement Imperial says that it considered the use of coupons an undesirable form of trading in that cigarettes were sold not on their " intrinsic value " but on the value of the gifts offered in exchange for coupons; for this reason Imperial did not enter the coupon market itself until " compelled to do so in self-protection ". We are told that late in 1932 the Wills branch introduced a coupon brand (Four Aces) which within nine months had captured 20 per cent. of the coupon trade and that it was by then very clear to all concerned that Imperial's share of this trade could have been expanded much further. Imperial says that if it had put all its strength into coupon trading it would probably have regained, and might have increased, its previous share of the market. The company submits that it is " impossible to argue " that the agreement for terminating coupon trading established Imperial in a stronger trading position *vis-à-vis* its competitors than would otherwise have been the case. It adds that the agreement " left all the parties . . . with real inducements to expand their trade by methods other than coupon trading ": the scale of payments did not compensate in full for loss of profit and those manufacturers who received compensation " knew that the Agreement could not go on for ever " and were anxious to achieve maximum sales. Imperial says that there was no lack of competitive effort; between 1934 and 1939, for example, other manufacturers introduced over 35 new brands at various prices. The company adds that

when the rules of the Tobacco Trade Association were amended in 1933 with the object of eliminating coupon trading the decision to do this was taken " with the support of all sections of the trade ".

(b) *Walters Tobacco Co. Ltd.*

456. Imperial explains that the Walters Medium brand " represented a new form of competition " (see paragraph 68); by the end of 1936 sales of the brand amounted to about 4 per cent. of total sales of small cigarettes. As it was building up " a substantial sale ", Imperial decided to launch a competing brand. If all the leading manufacturers had done the same the area of competition in this type of cigarette would have spread " and would have increased the threat " to the existing trade in small cigarettes. The other large manufacturers therefore came to an understanding with Imperial before the company, in January 1937, introduced its Tenner Medium brand which " halted the rising tendency of Walters Medium ". Imperial explains that the manufacturers concerned considered that " the most effective way of controlling this trade " was for one of their number to control both brands; Imperial's action in acquiring the Walters company in January 1938 did not therefore result from any desire on the company's part to obtain a monopoly of that particular section of the market. Imperial adds that in fact, although a willing party, it did not take the lead in making the arrangements; the trade of the other manufacturers concerned was suffering more severely from Walters' competition than was that of Imperial's own standard brands and the initiative came from them. The competition offered by Walters Medium was in Imperial's view unfair in that the presentation and packing adopted resembled that used by the Player branch and there were " inspired " rumours suggesting some kind of association between Walters and that branch. Imperial maintains that when it acquired Walters that company's trade was already falling and it was no longer a major competitor. We are told that Imperial would still have launched Tenner Medium even if there had been no arrangements with other manufacturers and that whatever benefit Imperial gained as a result of the arrangements was short lived owing to the narrowing of the duty preference from 1939 onwards.

457. Imperial submits that the arrangements relating to Walters must be viewed against the economic background of the 1930's when similar restrictive arrangements were entered into in a number of industries for the purpose of maintaining stability of employment and of business generally. The company says that the arrangements were protective but maintains that it did not agree to suppress the trade; while not pushing sales of this type of cigarette Imperial continued to satisfy the demand for both brands and the sales of both remained considerable until the outbreak of war. Imperial adds that while one effect of the arrangements was to limit this type of cigarette to two brands it is not sure that adequate supplies of low-grade leaf would have been available if other manufacturers had introduced similar brands.

(c) *Arrangements relating to the Use of Neon Signs*

458. Imperial says that when the arrangements described in paragraph 247 were made in 1936, the other manufacturers concerned recognised that the erection of neon signs might prove an expensive form of competition. A proliferation of such signs would result in many of them becoming ineffective and any attempt to confine signs to premises where they would be an economic proposition might, we are told, have resulted in loss of distributors' goodwill.

The company acknowledges that as neon signs cannot easily be " balanced " they would, if widely used, make administration of the bonus scheme difficult. It submits, however, that its policy in relation to neon signs is not an unfair limitation on competition since it has also denied itself the opportunity of using them.

(d) *Arrangements relating to the Introduction of Tipped Cigarettes*

459. Referring to the arrangements entered into between the leading cigarette manufacturers in 1949 (see paragraphs 321 and 322) Imperial says that the intention in introducing tipped cigarettes at that time was to economise in tobacco leaf; the main object of the arrangements was to ensure that none of the manufacturers concerned should have an advantage over the others in regard to patents and machinery supplies. Imperial submits that if the arrangements had not been made it would have had the commercial advantage of being able to introduce tipped cigarettes in advance of the other manufacturers concerned. The effect of the arrangements was, the company says, to place all the leading manufacturers on equal terms.

(e) *Arrangements between Imperial and Godfrey Phillips Ltd.*

460. Imperial's reasons for entering (through its subsidiary Ardath (U.K.) Ltd.) into the recent arrangements with Godfrey Phillips have already been set out in paragraph 187. As we explain there, Imperial says that it entered into these arrangements primarily with a view to putting the Ardath home business on a more profitable basis than in the past.

(6) Imperial's Financial Interests in Distributors of Tobacco Goods

461. We are told that Imperial acquired its interests in the Robert Sinclair Tobacco Co. Ltd., Bewlay (Tobacconists) Ltd. (formerly Salmon & Gluckstein Ltd.) and Finlay & Co. Ltd. to forestall attempts by other manufacturers to gain control, rather than as a means of promoting sales of Imperial goods, and that in fact only about 2 per cent. of the company's sales passes through these three companies. Imperial states that the companies do not buy Imperial's goods on preferential terms; they have always sold the goods of other tobacco manufacturers and have been under no obligation to promote sales of Imperial's goods at the expense of those of other manufacturers.

462. Referring to Sinclair's former activities as a manufacturer, Imperial submits that although the need to conform to Imperial's standards may have made it more difficult for the company to compete effectively (see paragraph 155), the main reason why Sinclair stopped manufacturing was that its business was largely confined to roll tobacco which was a declining trade. Imperial has been concerned in the past few years to reduce Sinclair's overheads and to expand its business as a wholesale distributor.

463. Referring to Bewlay, Imperial says that the main purpose of this company has been to provide high-class displays of tobacco goods. The self-imposed restrictions under which Bewlay still operates (see paragraph 145) originated in Imperial's wish to make it clear to the distributive trade that it did not intend to use the company (then Salmon & Gluckstein) to dominate the distribution side of the industry. Imperial maintains that if it were to increase its share of the retail trade unduly it would incur considerable ill-will from distributors; in fact, however, Bewlay's share of the total trade has declined.

464. Imperial submits that Bewlay's position is exceptional. Some of its shops, which are on " particularly expensive sites ", have not been profitable (although others have); furthermore, Bewlay's shops stock only tobacco goods and smokers' requisites. They stock an extremely wide range of brands and this benefits the smaller manufacturer, but to the extent that they advertise smoking in general that, Imperial says, "is of benefit to the whole trade and, since we have a large share of the whole trade, it is to our benefit ". Thus Imperial considers the subvention which it makes to Bewlay " as a kind of general advertising charge " on its own business. Imperial adds that steps have been taken in recent years to make the Bewlay business more profitable; the company's results have in fact improved in recent years and in 1959 it made a profit, due mainly to the elimination of unprofitable shops. In the case of Finlay, Imperial does not interfere to any substantial extent in the management or trading policy of the company.

(7) PRICES AND DISTRIBUTION

465. Imperial accepts that generally, in the sense that its policy has for long influenced the decisions of other manufacturers, the company " may be described as the acknowledged price leader in the industry ". Imperial points out, however, that in the case of cigarettes variations in weight offer an alternative to changes in price and that although the company's leadership probably also operates in this field it is by no means as pronounced; in the case of pipe tobaccos the extent of price leadership as a whole is less easy to assess, partly because of the wide range of types and prices.

466. Referring to the various discussions and arrangements which have taken place since 1933 with other manufacturers and with distributors about reselling prices and terms (see paragraphs 216–225) Imperial says that, while " it is true that most brands of cigarettes are now sold at one of three levels of retail price . . . and that there is a fair degree of uniformity in distributors' margins on brands selling at the same prices ", there are exceptions and it doubts whether the situation would have been substantially different if there had been no discussions. Most other manufacturers, the company says, would probably have considered it unwise to increase prices before the company did so, and when increased costs did compel Imperial to raise its prices other manufacturers were no doubt in the same position. The company submits that other manufacturers have never been obliged to follow its lead in raising prices nor, except in so far as trade margins have been agreed from time to time, has there been anything to prevent a manufacturer fixing his prices and margins at any level he wishes. Discussions with distributors have generally been concerned with the adequacy of their profits on tobacco goods; they have not led to any arrangements. Discussions with other manufacturers and distributors on the general considerations affecting distributors' margins have, Imperial says, assisted each manufacturer in deciding the appropriate level of distributors' margins on his own goods.

467. Imperial says that it is its policy that selling prices to the trade should cover the company's costs and provide a fair return to its shareholders and that reselling prices should give distributors an adequate, but not more than an adequate, margin. If the policy has placed other manufacturers at a disadvantage (see paragraph 405) this, Imperial submits, must be because its prices have been lower than other manufacturers liked; Imperial cannot believe that it would

have been in the public interest for the company to sell its goods at higher prices than it judged right for its own business. Imperial agrees that the smaller manufacturer whose business was primarily in pipe tobaccos probably could not earn a reasonable profit at the prices set by Imperial, even if his costs were no higher than those of the company. It points out that those of its own branches which were mainly concerned with pipe tobaccos have not been " very profitable " and that as a result some of them have been merged with other branches. While theoretically it might be possible for Imperial to fix its cigarette prices at a level which would absorb losses on its tobacco trade, the company says that it has not in fact done this and that the cigarette and pipe tobacco sections of its business are treated quite separately for pricing purposes.

468. With regard to the level of distributors' margins, Imperial has submitted figures showing that in 1959 the retailer's gross profit per packet of cigarettes was 100 to 150 per cent. more than in 1938 and about 250 per cent. more per oz. of tobacco (though the increases were rather smaller for retailers not buying direct from Imperial); the increase in the wholesaler's gross profit over the same period was 150 to 250 per cent. per packet of cigarettes and about 425 per cent. per oz. of tobacco. The total gross profits of distributors on all manufacturers' goods are estimated to have risen from £35 million in 1938 to £111 million in 1959 (i.e. from £3½ million to £10 million for wholesalers and from £31½ million to £101 million for retailers). Imperial estimates that distributors' costs have risen to about 2¾ times the level before the war. It acknowledges that distributors' margins form a lower proportion of the retail price than in this industry before the war and in some other industries at the present time. Imperial sees no justification, however, for increasing the margins *pro rata* every time the duty changes, particularly as distributors' stocks are largely financed by the long-term credit facilities afforded by the manufacturers.* The company also says that whenever prices have been raised for any reason it has aimed at adjusting distributors' margins to cover increases in their costs and to give them a reasonable profit.

469. With regard to the retail section of the trade Imperial says that for the convenience of the public tobacco goods are sold in a large number of outlets, few of which have a turnover sufficiently large for such goods to be a " heavily predominant part of the business "; some 5,000 of the 440,000 retail outlets are specialists, however, with 80 per cent. or more of their turnover in tobacco goods. These specialist businesses are normally located in areas where turnover is likely to be considerable, and unless (as in the case of certain shops operated by Bewlay) their sites involve disproportionately high rents margins on tobacco goods are, in Imperial's view, adequate for economical operation. The company explains, however, that the great majority of distributors of tobacco goods have always found it profitable to deal in other types of goods as well. With the spread of population and the increasing concentration of demand on a few brands these mixed businesses have increased their proportion of the total retail trade in tobacco and cigarettes while many of the former specialists have found their turnover adversely affected and have themselves diversified.

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* Imperial says that if it were to reduce the present credit period (of about five weeks on average) some compensating increase in trade margins would almost certainly be required. The company adds that it would cost distributors more to obtain credit than it costs Imperial and that the cost to Imperial of collecting payment of its accounts would be substantially increased (see also paragraph 484).

Imperial believes that, in terms of actual profit per transaction, retailers' margins on tobacco goods are as remunerative as those on many other types of goods sold by mixed outlets and it has given figures of gross profit to support its belief. It acknowledges that margins on pipe tobaccos, as distinct from cigarettes, were until recently on the low side, but points out that the company's own profits on tobacco were also low. Imperial submits that the public interest is best served by arrangements which secure adequate facilities for daily purchases by millions of people, with reasonable distribution costs consistent with a fair return to the distributive trade. The company says that individual retailers' profits could only be significantly increased by a larger individual turnover resulting from a limitation on the number of retail outlets or by a higher margin at the consumer's expense. We are told that the company keeps the situation under review; it considers the retailers' present margins fair and the existing number of outlets not unreasonable in relation to the total number of consumers.

470. The question of the adequacy or otherwise of wholesale margins is necessarily closely bound up with the question of direct trading between manufacturers and retailers. Imperial explains that from 1940 to 1954, although total cigarette sales rose, the number of retail outlets fell by 20 per cent. and manufacturers opened new retail accounts only in exceptional circumstances. As a result turnover per outlet was considerably higher in 1955 than it had been in 1939; many retailers dealing through wholesalers were capable of placing orders large enough to qualify for direct accounts and had been pressing Imperial's branches to let them do so. Imperial says that the wholesalers were protected from the effect of these changed conditions for some fifteen years and that even when this protection came to an end in 1955 the company's branches at first canvassed new accounts only to a limited degree. The reorientation of distribution has now been completed and for some time past the branches have been opening few new retail accounts.

471. In Imperial's experience it is impossible to determine " precisely the point " at which direct supply becomes more economic than supply through a wholesaler, but its studies lead it to think that the break-even point is probably in the region of an order for 10,000 cigarettes in each trading period (of five to six weeks). The company says that 95 per cent. of the cigarette trade of the Wills and Player branches is with customers (both retail and wholesale) who take more than this quantity. The company considers that the additional cost to it of dealing direct with the small customers who take the remaining 5 per cent. must be very little in relation to total distribution costs. In the company's view this additional cost is " money well spent ", if only because it enables Imperial to maintain direct contact with some 25,000 small retail outlets and to ensure that its products " are properly displayed and stocked in good condition". In September 1959 Imperial gave the Wholesale Tobacco Trade Association an undertaking that neither of the large branches would open any new retail account unless the customer was likely to take regularly at least 10,000 cigarettes from the branch concerned. Nevertheless, we are told that direct trading with retailers has always been " an important element in the active competition which exists in the trade ", and if Imperial ceased to have direct contact with smaller outlets through its sales representatives it would be " obliged on competitive grounds to canvass many of them—even though their orders were placed through wholesalers ".

472. Imperial says that since 1954 the proportion of the total trade passing through wholesalers has probably fallen from 50 per cent. to 35 per cent.; the company would not expect this proportion to vary very much in the future. The impact on wholesalers would admittedly have been mitigated if this reduction had been spread over the years from 1940 onwards, but Imperial does not agree that in itself the present division of trade between direct sales to retailers and sales through wholesalers renders wholesale business in the tobacco trade uneconomic. It says that out of a total of 440,000 retail outlets in the United Kingdom, there are some 300,000 who receive their supplies entirely through wholesalers and with whom it would never be economic for manufacturers to trade direct. Many of the remaining 140,000 while dealing direct with the larger manufacturers get supplies of smaller manufacturers' brands through wholesalers.

473. For the reasons given, Imperial does not think it reasonable to assume that the wholesaling of tobacco goods is uneconomic. It says that for many years a number of tobacco wholesalers have dealt in a variety of other commodities, and they in turn supply outlets similarly diversified. Imperial does not consider itself under any obligation to ensure by its policy on margins that a distributor can earn a living by dealing in tobacco goods alone. A recent examination by the company of the published accounts of a number of wholesalers suggests, it is said, that the majority are earning between 15 and 20 per cent. on capital employed. Imperial submits that there is little prima facie evidence to suggest that the wholesaler's profits on other lines are more remunerative than those on tobacco goods and it has given figures of gross profit to illustrate its contention. Imperial quotes in this connection the results of Sinclair's analysis of the net profitability of tobacco goods and other goods for one of its branches (see paragraph 374). Whether or not other goods are more remunerative, however, Imperial does not think it follows that diversification of the wholesaler's business is against the public interest.

474. Finally, Imperial tells us that generally speaking its relations with the distributors' associations and the branches' relations with individual customers have been, and are, good.

(8) Imperial's Bonus System and Window Dressing Arrangements

475. We have described in paragraph 238 the origins of Imperial's bonus scheme. The company says that while the scheme began as a means of giving customers a share in Imperial's prosperity it has always been regarded as " a competitive weapon of some importance ", and Imperial acknowledges that it may have contributed in some degree to establishing the company's dominant position. The Bonus Agreement is intended to offer an inducement to distributors, over and above the normal margin of profit, to stock and promote the sales of the company's goods and to ensure that it obtains " a reasonable share " of such point-of-sale display as the distributors care to devote to tobacco goods.

476. Imperial maintains that the obligations of distributors under the agreement are explained to new signatories and are well known both to signatories and to competing manufacturers; for this reason it sees no need to include a precise definition in the text of the document itself. It says that the principle of " balance " which it applies to its interpretation of the Bonus Agreement " requires that a bonus signatory shall not give to a competing manufacturer

more than a certain share of the display he devotes to tobacco goods ". Imperial submits that, for a number of reasons, this is not unfair. It says that the company's share of the total United Kingdom market over the past thirty years has never been much less than two-thirds and has often been about 75 to 80 per cent. This is more than the proportion of available display for which the company asks, namely 50 per cent. (unless it dresses the window when it requires 75 per cent.). The company points out that there are about 100,000 Bonus Agreement signatories, who own about 140,000 of the 440,000 retail outlets for tobacco goods in the United Kingdom. It says that according to a sample survey made in 1958 it had 67 per cent. of the display of distributors who were Bonus Agreement signatories and 56 per cent. in the case of those outside the scheme.

477. Imperial submits that most other manufacturers make display bonus allowances in addition to the normal gross profit margin on their goods. The company says that the only difference is that under Imperial's scheme bonus takes the form of a deferred payment related to profits, whereas other schemes " are more or less cash down related to sales "; the company maintains that a good many of its customers prefer a bonus paid twice yearly and that, although there is some uncertainty about the rate of bonus, in fact over the years its dividends—on which the rate depends—have been relatively stable. The scale of bonus payments made by other manufacturers is, Imperial says, similar to its own, and since the Bonus Agreement does not stipulate that Imperial's goods must form a given proportion of sales the total profit of a trader who sells less of the company's brands and more of those of another manufacturer (or vice versa) is not significantly affected.

478. Imperial points out that cancellation of the agreement does not deprive a distributor of the company's goods but only of the amount of bonus; in fact since 1945 only about 90 out of 100,000 agreements have been cancelled, in virtually every case because the signatory did not wish to comply with the terms. The company says that the amount of the bonus " is not a major factor in a retailer's profit from tobacco goods "; the retailer with a direct account makes a gross profit of 10 per cent. on sales, while the average bonus payment has been about one-half of one per cent. on sales. The company suggests that there is nothing to prevent other manufacturers who require " predominant display " from obtaining it by compensating the distributor for loss of Imperial's bonus, and that if they do not do so this is because they consider the money better spent on other forms of advertising.

479. Imperial says that the window dressing arrangements are intended to offer the company's customers (whether Bonus Agreement signatories or not) an expert service which will help to promote sales of the company's goods to the mutual benefit of the company and the customer; the company's window dressers will include not only Imperial's own display material but also—subject to the limitations imposed by the 75 per cent. requirement—any which may have been supplied to the distributor by a competing manufacturer.

480. More generally, Imperial argues that if it tried to impose unreasonable conditions it would lose the goodwill of the trade. It says that " for this very valid commercial reason [it has] . . . always been conscious of a compelling need to operate the bonus agreement fairly and reasonably ". We are told that

without the Bonus Agreement and window dressing arrangements the company would continue to regard point-of-sale display facilities as an important part of its advertising and sales promotion, and to compete for these facilities with other manufacturers.

(9) Resale Price Maintenance

481. The company considers that on the whole resale price maintenance is desirable in this industry and that the advantages which it offers to the consumer, the distributor and the manufacturer outweigh any possible disadvantages.

482. The company acknowledges that from the consumer's point of view the abandonment of price maintenance might at first sight appear to offer benefits in the form of lower prices for tobacco goods at some outlets. Against this, however, Imperial points out that the prescribed minimum prices for tobacco goods are in practice the standard retail prices charged and that there is no overcharging. The company submits that, if a situation arose in which cigarettes were being sold at different prices in different outlets, some outlets such as hotels and the more expensive shops might well charge higher prices than they do at present with the net result that the consumer would be no better off. The company also submits that if price cutting were widespread in certain areas, a reduction in the number of outlets might follow. This would, it considers, be to the disadvantage of the consumer.

483. Imperial says that the distributors for their part are strongly in favour of resale price maintenance because a commodity such as cigarettes might be used as a " loss leader " and they feel that they need protection against this form of trading.

484. From its own point of view Imperial believes the manufacturer's trade to be best protected if the consumer's convenience is satisfied by the provision of a large number of retail outlets. Further, if the retail section of the trade were dislocated through price cutting, bad debts might become prevalent and the company might have to restrict the credit period which it at present allows. If as a result distributors had to finance their own stocks, Imperial thinks they would need larger profit margins. Imperial adds that it has always recognised that resale price maintenance can only be justified if distributors' profit margins are " assessed and fixed in the fairest possible way "; this the company has consistently tried to do.

(10) Costs and Profits

485. Imperial makes two general observations on matters relating to costs and profits. The first is that as the company has to face competition it " cannot make what profits it likes ". The second is that net profits or losses per brand or class of product " do not measure the contribution which each brand or class of product makes to the Company's total profits " because a material proportion of overhead expenses is " relatively fixed ". For this reason " the withdrawal of a brand showing a small net profit or indeed a net loss could result in a substantial reduction in profits ".

486. The company explains that control of prices and profit margins is based on brand gross profits and that broadly the company's aim is to earn the same gross profit on all brands selling at the same retail price. Uniformity of net profit would, in Imperial's opinion, be neither practicable nor desirable, since to achieve it the small branches would have either to offer goods of lower quality or to spend less on sales promotion. The higher net profits earned by

the company's leading brands of cigarettes reflect their higher turnover, and variations in net profits appear to the company to be " an inevitable feature of any industry comprising businesses—and branded lines—that vary considerably in size of turnover ". Thus the higher levels of profit earned by the Wills and Player branches as compared with that earned by the company as a whole merely reflect the fact that as the makers of the most popular brands they are the most successful branches. Imperial adds that its competitive position depends largely on the popularity of its leading brands; if it sought to inflate the prices of these brands in order to compensate for the lower profitability of other brands it would risk the loss of this popularity.

487. The company says it considers profit margins on cigarettes and tobaccos separately. Its profits on cigarettes are not higher than they would otherwise be in order to compensate for the lower yield on tobaccos; the overall result has been rather that the company has not achieved the total profit over the whole of its business which it would consider reasonable. We are told that there are several reasons why tobaccos have earned lower rates of profit on sales than have cigarettes. In the first place consumption of tobaccos has been falling steadily and demand tends to be concentrated increasingly among older people, many of whom are living on pensions. Secondly, duty increases have aggravated the problem of recovering increased costs by increasing prices. Thirdly, variation of weight does not provide an alternative to price increase as it does in the case of cigarettes. Finally, Imperial says that because of the diversity of demand and the nature of the manufacturing processes involved, there is much less scope for economy through mechanisation in the case of tobaccos. In fact prices of tobaccos have risen more steeply than have prices of cigarettes; still greater increases would, in Imperial's view, accelerate the decline in demand, and as this would not be replaced by increased demand for cigarettes the company is faced with a choice " between a small profit and none at all ". The overall saving achieved by eliminating the manufacture of brands for which there is little demand has, we are told, been very small; when a brand is discontinued this usually results in a contraction either in the total market for tobaccos or in Imperial's share of that market. Increases in prices of tobaccos in 1955 and 1957 resulted in some increase in profits, and Imperial estimated that following the further price increase in August 1959 it would earn, in spite of lower turnover, a profit amounting perhaps to 5 or 6 per cent. on the capital employed in this side of its business in the year ended October 1960. Such a return, while an improvement on the return obtained on tobaccos during the years covered by our investigation, would still in the company's opinion be inadequate.

488. More generally Imperial says that although in 1957 about half the brands of tobacco and one-third of the brands of cigarettes for which costing data were obtained showed losses according to the method of computation used by the Commission's accountants these brands were in fact making a contribution towards overheads. It adds that the profitable brands of cigarettes yielded profits of £22¼ million, while the unprofitable brands showed a total loss of £300,000, so that although a number of brands and several branches may not have been very profitable, this has had little effect on the company's overall profits. The company submits that it is not possible to say, from looking at the accounting figures, whether the company would make greater profits if it ceased to produce a brand than if it continued to do so.

489. Imperial submits that the rate of profit it has earned on capital employed has been substantially below that earned by manufacturing industry generally. In paragraph 377 and Appendix 6 we have set out and discussed figures submitted by the company in support of this contention. We have also referred in paragraph 378 to Imperial's approximate computation of its average rate of profit on capital employed over the nine years 1949 to 1957 after adjusting to provide for the replacement cost of fixed assets and raw material stocks. As indicated in that paragraph the company estimates that some two-fifths of its profits (calculated on the " conventional ", or historic cost, basis) would be required to meet replacement cost. On the basis of data in the National Income Blue Book and the Third Report of the Cohen Council Imperial has calculated that for manufacturing industry generally the proportion required for this purpose would be only one-quarter. Applying this calculation to its own computation of the average profits of manufacturing industry (on the " conventional " basis—i.e. as shown under " Method 2 " in paragraph 377) the company infers that whereas its own average rate of profit in the years 1949 to 1957 is reduced to about 11 per cent. the corresponding figure for manufacturing industry generally would be about 18 per cent.

490. Imperial acknowledges that because of the high degree of security resulting from the unusually high proportion of net current assets to fixed assets, due in large measure to the amount of capital employed in financing duty and leaf stocks,* " a rate of profit as high as that earned by the generality of manufacturing industry would not be justified ". The company says, however, that any correspondence between the amount of capital " locked up in duty " and the amount of the company's loan capital (as distinct from shareholders' capital) is fortuitous, and it deprecates the suggestion that the profitability of its business might be considered in terms of the profits earned on the equity capital rather than on the whole of the capital employed. Imperial says that in the years following the large increases of duty in 1947 and 1948 it considered that a figure of 14 per cent. on capital employed (calculated on a historic cost basis), as compared with 20 per cent. earned by manufacturing industry generally (calculated on a similar basis) represented the minimum return which it was desirable for the company to earn. In the seven years 1948 to 1954 Imperial's profits in fact averaged about 14½ per cent. For the five years 1955 to 1959, however, as the result of increased costs, the relative unprofitability of the pipe tobacco business and the success of its competitors, the company's profits have averaged 12·5 per cent. Imperial concludes that in recent years the level of its return on capital has been rather lower than it would wish or than it considers reasonable.

B. Machinery

(11) IMPERIAL'S FINANCIAL INTEREST IN MOLINS MACHINE CO. LTD.

491. We are told that while Imperial's financial interest in Molins and the arrangements which it has entered into with that company regarding the supply of machinery have contributed to Imperial's efficiency they have not been a material factor in establishing Imperial's dominant position. Imperial agrees that as the holder of a 25 per cent. interest in Molins' equity it is theoretically in a position to exercise some influence on Molins' policy. The company

* See paragraph 376.

submits, however, that before it could induce Molins to adopt a policy which that company would not otherwise have adopted it would be necessary in the first place for the views of B.A.T., as the other outside holder of 25 per cent. of the equity, to be identical with its own; this, we are told, " is by no means axiomatic ". The two shareholding companies would then need to take the responsibility of challenging the commercial judgment of the Molins management, which would be " foolhardy " unless the business showed serious inefficiency or was yielding a poor return on investment. In any case Imperial and B.A.T. have not the necessary majority at either a general meeting or a board meeting to carry a proposition against the wishes of the other parties interested, and Imperial says that in practice it exercises no more influence than that appropriate to a large buyer of Molins machinery.

(12) The Supply of Machinery under the 1927 Agreement

492. Under the terms of the 1927 machinery agreement Imperial established exclusive rights in eleven machines (see paragraph 311); the company maintains that only in the case of the three cigarette making machines was the arrangement of practical consequence. Imperial believes that the superiority of those machines in some respects gave the company " some advantage over other manufacturers ", although this was " of limited importance competitively ". It says that other makes of machine were available and that it derived little if any advantage from the fact that most cigarette manufacturers in the United Kingdom had to depend on imported machines; before the war importing presented no real problems and the small duty charged " has never been a material factor ". Imperial thinks that there is little difference in manufacturing costs between one modern cigarette making machine and another. From the point of view of the purchasers the main factors to be considered in weighing one machine against another are, it says, the economies which may be achieved through savings in the amount of tobacco used and any possible improvement in the quality of the product.

493. Imperial says that in 1927 Molins was a small and unproved company. Imperial gave no undertaking to buy its machines, but helped Molins to achieve its present position by technical assistance in developing the cigarette making machine,* by initial investment and, later, by subsidies amounting to over £½ million (see paragraph 314). Imperial says that in doing this it took a considerable risk and thought it not unreasonable that it should have exclusive rights when the machine proved successful. We are told that after the war the exclusive provisions were " in practice substantially relaxed " and that no applications from other manufacturers to purchase cigarette making machines were refused after 1945. As regards the price advantages enjoyed by Imperial under the 1927 machinery agreement on machines to which the exclusive provisions were not applied, Imperial submits that allowance should be made for the size of the company's orders and, where appropriate, for the financial and technical contributions which it made to the development of the machines concerned.

(13) The Supply of Machinery under the 1957 Agreement

494. Imperial submits that Molins, and other cigarette and tobacco manufacturers, benefit technically from the trial period provided for under the

* See paragraph 331.

current agreement because the machine may be modified or improved in the light of experience under working conditions and as the result of co-operative effort by Molins and Imperial. We are also told that the arrangement is helpful because it enables Imperial to decide the likely size of its order and Molins to plan its production and pricing policy on an economic basis. Imperial concedes that the trial period normally enables it to appraise, and possibly to order, new machines a little ahead of its competitors and this it considers reasonable in view of the help in development given during the trial (see paragraph 338). It points out, however, that the agreement gives Imperial no priority in deliveries, since the agreement recognises that Molins' interest is to sell as many machines as possible both at home and abroad and that Molins' delivery policy must be devised to achieve this end. Imperial says that the only influence it can bring to bear on Molins in this respect is that of a large customer anxious to get machines as soon as possible after order. As regards prices under the current agreement, Imperial expresses the view that although the provisions vary with the type of machinery (see paragraph 386) for practical purposes the price payable by the company is " the most favourable price " granted to other United Kingdom purchasers from Molins. The company contends that " it cannot be said . . . that any of these provisions gives [Imperial] a substantial advantage over its competitors ".

II. Molins Machine Company Limited

495. Molins submits that its dominant position as a supplier of machinery is and has been due primarily to " ability to invent and develop better machines than its competitors ". It is not the only supplier of the types of machine which it makes. It has given particulars of alternative suppliers both in the United Kingdom and overseas and has emphasised the strength of the competition which it has to meet throughout the world, particularly from the " main, most dangerous adversaries ", American Machine & Foundry Co. and Hauni Werke Körber & Co. K.G. Molins believes that despite this competition it has supplied more than half of the machines at present in use by the world's tobacco manufacturers and more than 60 per cent. of all cigarette making machines in operation in the United States; these facts, the company says, demonstrate that its growth and present position " are due to the superior merit of its products ".

(1) Patents

496. While acknowledging that its patents have been of assistance in preserving " the fruits of inventions " Molins says that it has never adopted a restrictive patent policy. At one time, when the company itself had difficulty in meeting the demand for patented machines, licences to manufacture were granted to other undertakings, but in general its policy has been to put itself in a position to supply all the machines that the market required. Molins submits that its patent policy has been " extremely moderate " and it has not applied " anything like the restriction " which the law permitted.

(2) The Connection with Imperial and B.A.T.

497. Molins says that it has benefited from its association with Imperial and B.A.T., since the capital they provided enabled Molins " to proceed with development in a manner and at a rate which might not otherwise have been possible ". It has also been helped by the facilities afforded by the Associated

Companies for production trials and by the potential market they offered provided it produced good machines. While acknowledging that " the possession of a 50 per cent. joint shareholding in the voting equity of a company must place the holders thereof in a position to influence the policy of the company ", Molins says that " the Associated Companies have never in fact sought to influence the policy " of Molins. Imperial and B.A.T. have not the power to secure a majority on the Molins board: in fact they have not exercised their right to nominate directors at all, and the alternate directors who represent them at board meetings (see paragraph 300) hold no more than a watching brief. Molins asserts that " in all the years since 1927 the Board of Molins has exercised full and independent control of the policy and affairs of the company ".

498. We have already given in paragraph 330 Molins' account of its reasons for entering into the two agreements of 1927 (the share agreement and the agreement for the supply of machinery), and as we have shown in that paragraph the company stresses that these agreements should be considered as a single transaction. With regard to the effect of the supply arrangements, Molins says that between 1927 and 1957 the Associated Companies no doubt did obtain advantages over their competitors both as regards supply and as regards prices and royalties; B.A.T., however, did not exercise its rights to obtain exclusive use of machines and by 1949 Imperial had released most of the machines to which it had established such rights.* Molins submits that " the grant of exclusive rights or preferential terms as to prices or royalties to one of a number of competing traders cannot be termed unfair without bringing into question the policy of the Patents Acts. The legislature has not seen fit to regard such arrangements as unfair, unless they result in an abuse of monopoly rights, in which case special remedies are provided ". In any event, Molins says, if B.A.T. and Imperial had held a majority interest in Molins instead of 49 per cent. the question of " unfair advantages " would not have arisen. In Molins' view Imperial and B.A.T. could reasonably expect to enjoy advantages in consideration of the risks which they had taken in investing money without any guarantee that Molins would produce the best inventions. Moreover, Molins says, two competitors of Imperial and B.A.T. had their own domestic sources of supply of machinery and alternative sources of supply have always been generally available.

499. With regard to the current (1957) machinery agreements with B.A.T. and Imperial, Molins contends that the provisions do not operate, and are unlikely to operate, against the public interest. The provisions which give Imperial and B.A.T. the right to a 60-day trial for new machines (including in Imperial's case an undertaking by Molins that it will not during the period of trial offer the machine to another customer for use in Great Britain and Ireland) " confer some benefit upon the Associated Companies, though not, it is submitted, a considerable one ". Both, it is said, obtain a trial under factory working conditions, whereas their competitors order on the strength of a demonstration at Molins' factory; Imperial is also " given some protection " against its competitors obtaining priority of delivery but does not itself automatically get priority over others on orders which it may place during the trial. On the other hand the trials " are of considerable value to Molins and ultimately

* In this connection Molins explains that although the Mark VI, at that time the principal cigarette making machine, was not formally released until 1957, all applications for this machine by other cigarette manufacturers had in fact been granted for some years previously.

. . . to all Molins' customers, for they enable the performance of the machines under factory conditions both in the United Kingdom and abroad to be determined, and lead to the suggestion of appropriate modifications ". It is pointed out that the Mark VIII cigarette making machine was shown to everyone as soon as trials had been successfully completed: customers all over the world benefit from " this rigid and very searching trial carried out by people who are the best judges of the performance of the machine ". Molins says that delivery dates for the Mark VIII are being arranged to ensure that each customer gets a fair proportion of the machines available for delivery at a given time.

500. The provisions of the current agreement concerning prices do not, in Molins' view, give B.A.T. any or Imperial any substantial advantage over their competitors. In effect the prices of new machines sold to either of these two companies must not exceed the most favourable prices granted to other customers in the territories in which the machines are to be used (though, exceptionally, for any new cigarette making machine which is not deemed to be of exceptional merit, Imperial has the option of accepting the most favourable price or actual cost plus 50 per cent. plus any royalty payable by Molins, whichever is the less). The limit based on cost is, Molins says, " merely an upper limit which [Imperial] have fixed beyond which they consider that in view of their size as a customer in the United Kingdom they should not be asked to pay ". We have described Molins' current price policy in paragraphs 387 and 388; in effect it is to sell at uniform ex-works prices to all home and overseas customers subject only to any quantity discounts that may be justified by savings in cost. In these circumstances Molins considers that the only real advantage which Imperial and B.A.T. now derive from their connections with Molins is the return on their investment.

501. In general, Molins suggests that the connections with Imperial and B.A.T. are not now so important to its business as they may appear to be if the home market is considered in isolation. It points out that since the war from 75 to 80 per cent. of its sales have been in export markets, and that according to figures published in the United States,* which it believes to be accurate, Imperial's share of the world trade in cigarettes (excluding the Eastern Area) is 8 per cent. and B.A.T.'s 17 per cent. while the aggregate share of United States manufacturers, with whom Molins has " no agreement or tie-up of any kind, sort or description ", is 31 per cent. Molins estimates, nevertheless, that 60 per cent. of all cigarettes produced in the United States are made on Molins machines and 90 per cent. of all tobacco used there is cut on its machines. Molins goes on to say that, catering as it does for a world market of the greatest diversity, it has had to create an efficient and flexible organisation which can not only sell the machines but also provide instruction in their use and after-sales service. The company submits that it has, in fact, given " a striking example of British ingenuity and enterprise which has secured for this country and maintained for this country a predominant position in the United States domestic market without any reliance whatever on any agreements or restrictions ". If the connection with Imperial and B.A.T. has helped Molins to achieve these results then, in Molins' view, that is " a very fortunate circumstance " for this country.

* In an article entitled " Who makes the 1,200 billion cigarettes manufactured each year? " appearing on 23rd August, 1957 in the periodical " Tobacco ".

502. Molins denies that its arrangements with Imperial and B.A.T. have had any material effect in inducing other tobacco manufacturers to set up or acquire machinery manufacturing interests of their own. The company knows of only two tobacco manufacturers who have done so. It points out that one of them, Carreras, had a machinery-making subsidiary long before 1927, and that the other, Gallaher, relied on sources other than Molins both before and after 1927; it believes that Gallaher acquired its machinery-making subsidiary in 1944 mainly in order to make spare parts for existing machinery of German origin.

(3) PRICES AND PROFITS

503. Molins submits that the level of profits earned by the company is reasonable. Home trade represents only 24 per cent. of the company's total trade, and profits on home sales are " in terms of money quite modest ". Molins argues that home and export prices have of necessity to be at the same level. If export prices were higher than home prices the fact would become known and export customers would either buy through associates in the United Kingdom or " develop sales resistance ". There would also, according to Molins, be the risk of strong pressure from overseas machinery manufacturers which might lead to an embargo on Molins' products in certain countries. It is said that it might be possible to obtain such an embargo in the United States, which is the largest market for tobacco and cigarette machinery.* Molins says that for these reasons it could not reduce home prices without a corresponding reduction in export prices, which would be detrimental not only to the company's profits but also to this country's balance of payments. The maintenance of the company's level of profits on home sales, which represent a minor part of the business, is therefore, it is said, in the public interest.

504. Molins acknowledges that, in so far as Imperial and B.A.T. were able to buy at preferential prices under the agreement in force up to 1957, it has not always sold at uniform prices. It says, however, that with that exception it has always tried to sell on the basis of uniform ex-works prices, and that uniform prices are all the more essential now that Molins' interest in the United States market has grown to its present proportions.

505. Molins argues that its prices are, in any event, justified because they are competitive and, from the point of view of the tobacco manufacturers who pay them, economic prices. It says that every machine it sells has its competitive counterpart and that its success not only in the British market but in foreign markets as well is in itself evidence that its prices are reasonable. Tobacco manufacturers, Molins submits, are not primarily concerned with differences in first price when deciding whether it is worth their while to get rid of an old machine and buy a new one; they are concerned with the savings in their own costs to be achieved by using the new machine and with how long it will take for the machine to pay for itself in terms of these savings. The company has quoted a number of instances of savings to be achieved by using the machines it has marketed. Thus the Mark VIII cigarette making machine is said to produce $\frac{1}{2}$ million cigarettes a day, using tobacco of a value, in the United Kingdom, of more than £4,000, and to achieve a saving in tobacco of 2 per cent.;

* Molins has drawn attention to the Special Customs Invoice which it has to complete when exporting goods to the United States. This requires the current home price and the price for export to the United States to be declared. Molins suggests that the information given may be used in the United States for purposes other than assessment of customs duty.

this would represent a saving of some £25,000 per annum for an outlay of £8,600 on the machine. In countries where the level of duty on tobacco is lower than in the United Kingdom the saving in cost is not so great, but Molins says that in general its prices are " such as will in any export market enable the machine to pay for itself in three years ". The company argues that since the life of most tobacco machinery can be prolonged indefinitely it depends for its existence on its ability to develop new machines which afford such savings and to sell them at prices which will allow for a rate of amortisation of this order.

506. Molins goes on to say that, since depreciation of machinery accounts for ¼d. or less in the price of 20 cigarettes, any reduction in the home price of its machines would, in any case, have a quite insignificant effect on the tobacco manufacturers' costs.

507. As further factors justifying the level of profit earned Molins mentions the cost of research and development* and the fluctuations which are bound to occur over the years in the overall level of earnings. With regard to the first factor Molins says that it must spend considerable sums annually in the search for new ideas and improvements to existing machines. It estimates that from 15 to 20 per cent. of the company's total expenditure on labour and materials is for research and development; although such expenditure is eventually recovered in the prices charged it may bring no immediate return. Moreover development, including expansion of the business, has required a capital outlay of £1·2 million in six years. In Molins' view, therefore, it is justified in earning a level of profit high enough to enable it to set aside a proportion for financing these requirements. With regard to the second factor Molins argues that it is unusually vulnerable because it depends on the custom of a few large purchasers any one of whom can produce a serious effect on its business by placing his orders elsewhere, because its machines may be copied in certain countries, and because curtailment of capital expenditure is one of the first results of any kind of trade recession. For these reasons, and because market success must be preceded by a period of development, years of low profitability may occur from time to time. Molins says that 1959 was such a year (see paragraph 394).

508. We have set out in paragraph 395 the results of an alternative calculation —roughly on a replacement cost basis—of the rates of profit earned by Molins on capital employed. The company says that on this basis it was earning on its home trade in the six years 1951 to 1956 an average annual profit of £168,000 on an average capital of £649,000. It argues that, assuming a reasonable return to the proprietors on capital employed would have been 8 per cent., this would leave some £48,000 per annum for retention in the business after allowing for income tax and profits tax. This, it says, is a modest amount to retain to meet expansion and, being approximately 30 per cent. of the profits, would be " generally regarded as reasonable ".

509. We have also referred in paragraph 396 to the information submitted by Molins about the results of seventeen public companies in the engineering industry. It points out that while, according to its calculations, the weighted average rate of profit on capital for these companies was 23 per cent. in 1956,

* The profits earned by Molins, as recorded in Chapter 13, have been arrived at after charging expenditure on research and development as a cost.

the range varied from 5 per cent. to 52 per cent. Molins says it would expect, as a private company, to earn a higher than average rate of profit and, since it has been a very successful company, it would expect to be near the top of the range.

(4) CONCLUSION

510. In conclusion, referring to the effect on the public interest generally, Molins repeats that the concentration of demand on the company's products results from superior inventiveness and efficiency, which enable the company to sell at competitive prices " machines which their customers consider to be superior to the machines of Molins' competitors ". This concentration, it is argued, serves the public interest " since the research and production facilities which Molins command in part as a result of their predominant position both give rise to economies of scale and enable them to compete the more effectively in export markets ". The market for machinery of the types Molins makes is relatively small; the greater the concentration, the greater the scope for savings in costs. Molins explains that it usually manufactures in batches of ten machines, although the current orders may be for less. This results in a saving which Molins could not achieve if its market were smaller. It submits that there is no natural market for the machines of any tobacco machinery supplier; each manufacturer must be perpetually creating demand by providing at competitive prices better machines than his competitors; the company says that it would cease to hold its present position if it ceased to fulfil this condition. It adds that there is nothing to prevent the company's existing United Kingdom competitors from expanding or newcomers from entering the field, nor anything to prevent Molins' major foreign competitors from exporting to the United Kingdom.

CHAPTER 16. CONCLUSIONS ON THE PUBLIC INTEREST AND RECOMMENDATIONS

I. Cigarettes and Tobacco

(1) INTRODUCTION

511. The value of manufacturers' sales in the home market of cigarettes and tobacco covered by the first of our references was about £933 million in 1959. The retail value of these goods was probably about £1,050 million. Customs duty represented on average more than 70 per cent. of the retail price, or more than 80 per cent. of the manufacturers' selling price.

512. Consumption of tobacco products in this country, measured in terms of weight, is now about three times what it was at the beginning of the century. The amount sold in the form of cigarettes is some twenty times higher, but consumption of tobacco in other forms has fallen by more than one-half; cigarettes which accounted for little more than one-tenth of total sales in 1900 account for nearly nine-tenths today. The retail prices of cigarettes are some ten times higher than they were 60 years ago, while retail tobacco prices have risen rather more steeply. Although progressive increases in the rate of duty, which is now more than twenty times what it was in 1902, have contributed largely to this increase in prices, it may be noted that at least until 1939 increases

in duty were not conspicuously out of proportion to increases in the other costs of tobacco products. From 1900 until 1939 the proportion of duty in the total retail expenditure on tobacco goods remained at about 45 per cent. Very sharp increases during and after the war brought the proportion up to practically 80 per cent. in 1947. Although there have been three further increases in the rate since 1947, duty now forms, on average, a rather lower proportion of price than in 1947. As a result of the various factors we have mentioned—the increases in the quantity of tobacco consumed, in the duty and other costs, and in the proportion consumed in the form of cigarettes—the turnover in value of the tobacco industry has multiplied some 40 times since 1900.

513. Imperial has been the dominant supplier of cigarettes and tobacco in this country since the beginning of the century. In 1903, after the existing American competition had been eliminated, its share of the home trade was nearly 50 per cent. By 1920 the proportion had risen to more than 70 per cent. and it has remained between 70 and 80 per cent. since then except in the period around 1930, when coupon trading was at its height, and again in the last few years when the company has lost ground to Gallaher Ltd. In 1959 Imperial's share of the trade was 63½ per cent.

514. The process of concentration in the manufacturing industry has continued fairly steadily up to the present time but has not affected Imperial's proportion which is little greater now than it was at the beginning of the 1914–18 war. The number of manufacturers has fallen from about 500 in 1900 to about 25 today. Most of the existing manufacturers have never had more than a minute share of the trade; some sell only in a small local area and some do not make cigarettes. Moreover, except for Gallaher, Imperial's larger competitors have lost ground in recent years. In 1959 Gallaher's share of the trade, at nearly 30 per cent., was larger than that of any individual competitor of Imperial throughout its history. Gallaher's advance has been made at the expense not only of Imperial but also of Imperial's other competitors.

515. The fall in the number of manufacturers may be explained to some extent by the elimination of small producers of pipe tobacco as the popularity of their products has declined; by the circumstance that a larger unit is able to effect economies in the manufacture of cigarettes as a result of quantity production; and by the increasingly onerous capital commitment required not only for plant and stocks of leaf but also for financing the duty (which the manufacturer has to pay on removal of the leaf from bond and which he does not recover until several weeks after the sale of his product). We are not convinced, however, that the present structure of the industry is due to these factors alone. We see no reason why production units smaller in size than Imperial, or than Gallaher, should not be able to operate on an economic basis if they were able to rely on a steady demand for their products. Public taste has become concentrated, however, on a few proprietary brands of cigarettes. Demand of this kind cannot be built up or sustained without heavy and continuing expenditure on advertising. The experience of Imperial's competitors generally over the past 25 years suggests that it is becoming increasingly difficult for the smaller or medium-sized manufacturer to maintain a steady level of business without quite disproportionate expenditure on brand promotion. Nevertheless, the history of Gallaher in recent years has shown that, given good management and the necessary financial resources, a comparatively small manufacturer can still expand his business by building up demand for a brand to a scale commensurate with the demand for

Imperial's most popular products. It may be that with the growth in consumption of filter tipped cigarettes popular demand will become more varied but, in any event, it appears probable that the bulk of the cigarette trade will remain in the hands of a very few manufacturers.

516. Having regard to our conclusion in paragraph 262, we are called upon to consider whether the conditions which prevail in the case of Imperial (because it has some two-thirds of the trade in the United Kingdom), or all or any of the things done by Imperial as a result of or for the purpose of preserving the conditions, operate or may be expected to operate against the public interest. It is relevant to our judgment on Imperial's present position to consider how that position developed and what use the company has made of its power during the period of its dominance. Other matters which require consideration are the level of profit earned by Imperial, its financial interests in certain other manufacturing and distributing companies, the degree of efficiency of its organisation (with particular regard to the branch system and the number and profitability of brands marketed), and its terms to and relations with the distributive trade (including questions about distributors' margins, direct sale to retailers, the Bonus Agreement and resale price maintenance). All of these matters call for review in order to determine whether the "conditions" as such operate or may be expected to operate against the public interest and some of them may also be considered to be "things done" as a result of, or to preserve, the conditions.

517. Arising from the conclusion in paragraph 263 we also have to consider the practice of resale price maintenance in a wider context. We have found that conditions to which sub-section (2) of Section 3 of the Act applies prevail because nearly all the cigarettes and tobacco supplied in the United Kingdom are supplied at all stages by manufacturers or distributors who restrict competition in as much as they operate this practice. We must, therefore, form a judgment upon the questions of public interest arising from this finding.

(2) The Development of Imperial's Position

518. There is no evidence that those responsible for the formation of Imperial in 1901 set out to monopolise the United Kingdom market, but it was clearly their view that only a much larger unit than any of the businesses which contributed to the amalgamation could hope to offer successful resistance to the competition from American interests which was being experienced at that time. The agreement with the Americans which followed shortly afterwards not only eliminated that competition but also reinforced Imperial's dominant position among British manufacturers through the acquisition of Ogden's Ltd. Imperial says that these early arrangements "laid a foundation on which a powerful and efficient enterprise could be built" but gave "no assurance whatever of continuing strength, and certainly no assurance of a dominant position in the trade". The company's dominant position is attributable, it says, principally to its successful use of the competitive weapons open to any manufacturer.

519. Since acquiring Ogden's Imperial has not absorbed any other substantial competitor.* It has, however, acquired interests in two tobacco manufacturers

* It has recently obtained control, however, through Ardath (U.K.) Ltd., of the manufacture and marketing of most of Godfrey Phillips' brands of cigarettes and tobacco, a matter to which we refer in paragraph 548.

(Gallaher and Ardath Tobacco Co. Ltd.) and in a machinery manufacturer (Molins Machine Co. Ltd.); it has acquired additional interests in the distributive side of the trade; it has developed its own leaf buying organisation and manufactures many of the other materials it requires. In the field of distribution the Bonus Agreements, which make the grant of an additional deferred allowance to distributors conditional on the grant of display facilities to Imperial, were introduced at an early date in the company's history and have remained a feature of its arrangements up to the present. At various times in the past Imperial has been a party to restrictive agreements and arrangements with other traders but these are no longer in force. Some of them—the Martin Agreement for the elimination of coupon trading and the arrangements of the Tobacco Trade Association for collective enforcement of manufacturers' prices and conditions of sale—were long-term arrangements affecting the whole of the cigarette and tobacco trade. Other long-term arrangements—those under which Imperial obtained some preferential treatment for its products from the Savoy Group of Hotels, J. Lyons & Co. Ltd. and the British Automatic Co. Ltd., and the understanding with certain other manufacturers not to install neon signs on distributors' premises—were of much narrower significance. Others were temporary arrangements to deal with particular situations; these included the arrangements entered into before the war to deal with competition from the Walters Tobacco Co. Ltd., those made after the war concerning the introduction of filter tipped cigarettes, and understandings reached from time to time as a result of discussions with other manufacturers and distributors about resale prices and trade terms for cigarettes.

520. Imperial says that though some of the matters mentioned in paragraph 519 have contributed to the efficiency of its undertaking, none of them, except possibly the bonus arrangements, has contributed significantly to the company's dominant position in the trade. It is scarcely necessary for us to determine whether this is so as regards the growth of Imperial's subsidiary interests in the manufacture of materials (see paragraphs 130–139), since we see no reason to criticise the development by the company of a degree of self-sufficiency in this respect and are satisfied that it has not hampered Imperial's competitors in any way. Of the arrangements which have now been brought to an end, those concerned with preferential treatment for Imperial's products (see paragraphs 208–210) and the arrangements about neon signs (see paragraph 247) can have had no material effect. The matters which call for further comment in relation to the development of Imperial's present position are the acquisition or extension of its interests in other manufacturing and distributing companies in the industry, the bonus system and, among former arrangements, the Martin Agreement, the T.T.A., the arrangements concerning Walters and the introduction of filter tipped cigarettes, and the occasional understandings about prices and terms for cigarettes.

521. In 1932, when Imperial bought a controlling interest in Gallaher (see paragraphs 172 and 173) the latter company was not Imperial's principal competitor. It had become a public company only a few years earlier and had not yet acquired the Senior Service or du Maurier brands of cigarettes or the Old Holborn brand of tobacco, all of which have played a great part in the company's subsequent success. We see no reason to believe that Imperial foresaw either the formidable nature of the competition it would have to face from Gallaher or the future value of the investment it was making. Imperial's

motive was to prevent control of Gallaher passing into the hands of the American Tobacco Company, which had already gained a footing in the United Kingdom market by acquiring J. Wix & Sons Ltd. and was believed by Imperial to be negotiating through that company for an interest in Gallaher. Imperial's action was, therefore, taken in order to preserve its own position against increased competition from that quarter. Imperial's interest ceased to be a controlling one in 1946. Both before and since that date Imperial has quite clearly carried out so far as the home market is concerned its undertaking not to interfere in any way in the management of Gallaher's business.

522. Except as mentioned in the previous paragraph we have seen no evidence that any American tobacco manufacturer has seriously contemplated entering the British market on a large scale since 1902. Having regard to the circumstances in which the company was formed Imperial was, no doubt, pre-disposed to fear renewed competition from this source. The acquisition by Imperial of an interest in Gallaher alone could hardly have been sufficient in itself to prevent such an incursion had the Americans been determined to make the attempt. That action was not designed to weaken the competition which Imperial had to meet from British manufacturers and had no such effect. The subsequent growth of Gallaher's business has led to a situation which differs materially from that existing in 1932 and raises issues in relation to the public interest which we deal with in paragraphs 542 to 547.

523. There is no very clear motive for Imperial's acquisition in 1925 of its interest in Ardath (see paragraphs 175 and 176). Ardath at that time had little home trade and it may be presumed that the transaction by which Imperial and the British-American Tobacco Co. Ltd. jointly purchased the equity was principally due to B.A.T.'s initiative. Ardath's home market business, which Imperial manages,* appears to have enjoyed its period of greatest success in the years around 1930 when it practised coupon trading. It has made use of coupons again since 1957 but so far apparently without much success. On each occasion Imperial permitted Ardath to issue coupons at a time when it refrained from practising this method of trading for its own brands (though on the first occasion Imperial eventually issued coupons itself). Whatever Imperial's purpose may have been when it acquired its interest in Ardath, there is some evidence that it came to regard the company as a useful potential weapon against competitors who might use methods of trading which Imperial itself was not willing to adopt (see paragraph 180).

524. Imperial's interests in cigarette and tobacco distributing businesses (see paragraphs 141–158) appear to have little bearing on the development of the company's monopoly position. Imperial does not control, and has not at any time controlled, more than a very small proportion of the wholesale and retail channels of supply. Nor has it used those distributive outlets which it did control to discriminate against the products of other manufacturers. The shareholdings are said to have been acquired for fear that they would otherwise have fallen into the hands of competing manufacturers. Had that been allowed to happen we doubt whether Imperial's trade would have suffered much injury by discrimination against it. The investments, like that in Ardath, have not been very profitable for Imperial. We return to these matters when considering the current situation in paragraph 549.

* Under the recent reorganisation the home business has now been taken over by Ardath (U.K.) Ltd., a wholly owned subsidiary of Imperial (see paragraph 182).

525. The relations between Imperial and Molins have an important bearing on the Machinery reference and are discussed mainly in Part II of this chapter. So far as they are also relevant to the Tobacco reference we comment upon them in paragraph 552. In our view they have probably made only a limited contribution to the development of Imperial's monopoly position.

526. The Bonus Agreement (see paragraphs 238–251) is, as we have said, the only one of the matters mentioned in paragraph 519 which, in Imperial's view, may have contributed significantly to establishing the company's dominant position. The company says, in effect, that such advantage as it may have gained has been obtained by the perfectly proper use of a competitive weapon. We consider the merits of this argument in paragraphs 569 to 573. For our immediate purpose it is sufficient to note that while many of Imperial's competitors have tried to imitate its bonus arrangements none has succeeded in establishing so firm a link between the bonus allowed and the amount of display obtained. Only a supplier who was already in a dominant position could have applied such an arrangement systematically, and we have little doubt that it has helped to preserve Imperial's dominance.

527. The Martin Agreement of 1933 (see paragraphs 63–65) marks the beginning of a period, lasting until about 1956, when the trade was regulated largely by agreement between the leading manufacturers (though during and for some years after the war Government controls were superimposed). Imperial argues that the Martin Agreement itself served to preserve the positions of its competitors rather than its own, and that if there had been no such agreement Imperial would have been compelled to put all its strength into coupon trading. There is considerable force in this argument and it is, no doubt, one of the principal reasons why Imperial's competitors entered into the agreement. Once the agreement was in operation, Imperial quickly regained the share of the market which it had formerly enjoyed, and until 1945 it was paying compensation to its competitors, most of whom lost the business they had gained by coupon trading. At the same time there was close co-operation between the manufacturers in suppressing not only coupon trading but price cutting by distributors (see paragraphs 60 and 61), and this naturally led to discussions and understandings about margins and terms of sale. Imperial says that the measures taken with regard to margins and against price cutting affected all manufacturers alike; each manufacturer remained free to fix his own retail prices. In effect, under Imperial's leadership the period of unrestricted competition was brought to an end.

528. The developments referred to in the last paragraph helped Imperial to consolidate its position. Imperial's action in the case of Walters (see paragraph 68) contributed to the same result. In that case Imperial argues that it met a " new form of competition "—from a cigarette made of cheaper (Empire) tobacco which, though larger than the standard small cigarette, sold at the same price—primarily by successfully marketing a similar cigarette. By the time Imperial acquired Walters that company was, Imperial says, no longer a major competitor. Since the leading manufacturers were concerned to preserve their existing trade in small cigarettes of standard size they agreed that Imperial alone should launch a brand of the new type (Tenner Medium), while Imperial undertook that if it acquired Walters it would not then seek to increase sales of this type. We do not think this explanation justifies the action taken. Walters provided a cigarette for which there proved to be a substantial demand.

It was natural and proper that other manufacturers should try to meet this competition by marketing similar cigarettes but we can see little justification for concerted measures by the leading manufacturers to preserve the market for their own established products. As it happened Imperial obtained some special advantage from these measures because demand for the new type of cigarette remained unexpectedly high until the beginning of the war and Imperial alone was in a position to satisfy it. Manufacture of these brands ceased, as to Tenner Medium in 1949 and as to Walters in 1953.

529. The arrangements in 1949 whereby the leading manufacturers co-operated in introducing filter tipped cigarettes to the market and procuring the necessary machinery (see paragraph 84) do not appear to us to have any significant bearing on the problems with which we are concerned. They were entered into at a time when competition between manufacturers was in any event limited by scarcity of leaf and by Government controls. Imperial contends that if there had been no arrangement it could probably have gained an advantage over its competitors and we see no reason to dispute this.

530. There remain some features of Imperial's organisation and commercial policy over the years on which it is appropriate to comment. Imperial has told us that the circumstances in which it was formed " have had a profound effect on its organisation and structure ". Each of the constituent businesses had a long tradition behind it and was anxious to retain as much as possible of its individuality. Although many changes have since taken place in the company's structure and in particular the number of branches has been drastically reduced, Imperial is still organised, as it was in 1901, in a number of semi-autonomous manufacturing and selling branches of very unequal strength. Imperial defends its branch system on the grounds that it " reinforces the effects of outside competition in stimulating progressive increases in efficiency of manufacture and marketing and in ensuring a constant search for products which will best meet the requirements of the public ". It believes, therefore, that it enjoys the advantages both of internal competition and of large-scale production. The company recognises that it is inherent in its system that some branches will be less successful than others and ultimately may have to be suppressed as uneconomic; it points out that as a result of closing down unsuccessful branches the number has now been reduced to six (of which one does not manufacture) and will be further reduced to four in February 1961.

531. We have noted that there were still eleven branches in 1932 and that up to 1954 this number had been reduced only by one (see Appendix 4). It is, in fact, from 1954 onwards that the more drastic action has taken place. Such evidence as we have suggests that the branches which have now been closed were making little, if any, contribution to Imperial's profits for many years before they were closed. Imperial says it has always been reluctant to close any branch, first because the branch's fortunes might revive, secondly because the transfer of brands to another branch may lead to loss of goodwill and sales, thirdly because it believes in the highest possible degree of internal competition, and fourthly because it feels responsibility towards the employees involved. It is fairly clear that in the 1930's and during and for some years after the war considerations such as these were decisive in the minds of the management. It is arguable that the speeding up of the process of closing branches which has occurred from 1954 onwards is due not so much to a change of policy as to the

fact that the branches concerned were more conspicuously unsuccessful than they had been before. However this may be, we think it significant that when Imperial began to experience more determined and successful competition than it had had to meet for at least twenty years it found that it could no longer afford to maintain its branch structure in all the former diversity. The importance to be ascribed to internal competition must be taken into account when we come to consider the efficiency of Imperial's present organisation (see paragraphs 577–580), but it seems to us to be highly relevant that for many years Imperial was under no strong compulsion to count the cost of retaining its original structure. We think that the branch structure, as it existed up to about 1954, could not have survived for so long had Imperial been faced throughout its history with competition of the kind it faces today.

532. As a natural corollary of the structure adopted at its formation the company continued to market the brands of the component businesses it absorbed. Although there was some co-ordination of policy thereafter, the withdrawal of old brands and the issue of new ones were matters primarily of branch policy. Thus the number of brands marketed by the company as a whole was very large. We are informed that in 1938 Imperial was selling 191 brands of cigarettes and 596 brands of tobacco. By 1960 the figures had been reduced to 57 and 183 respectively. This reduction in numbers is to some extent connected with the closing of branches, many of the least successful brands being those of the least successful branches; but there has also been a considerable pruning of the brands of branches which remain in being. Imperial argues that a brand selling on a very small scale and which when considered in isolation appears to be unprofitable may nevertheless be making a useful contribution towards overheads. We discuss the question of unprofitable brands further when considering Imperial's current policy (see paragraphs 581–584). Whatever view may be taken as to the number of brands being marketed at present, we consider that Imperial's past policy in this respect, like its attitude to the closure of branches, reflected a state of affairs in which it was not under pressure to develop the maximum degree of efficiency.

533. Although in reviewing the history and development of Imperial we have mentioned certain points of criticism, we are of the opinion that, in general, the company has shown responsibility and restraint in the use of its monopoly position. We consider, however, that at any rate from 1933, when coupon trading was brought to an end, until 1954, when the full vigour of Gallaher's competition began to be felt in a free market, the absence of any effective stimulus to efficiency was reflected in Imperial's organisation and commercial policy. The episode of Walters apart, the matters arising from this review which require special consideration are the bonus arrangements and the company's shareholding in Gallaher—both of which have been of long duration and are still current—and any continuing effects on the company's efficiency of its comparative immunity from competition in the past.

(3) The Level of Profit

534. We have calculated the profits earned in certain years by Imperial on its capital employed in producing and supplying cigarettes and tobacco in the United Kingdom, capital being computed on the basis of the historical cost of fixed assets less depreciation at Inland Revenue rates. We have made similar

calculations for other leading cigarette and tobacco manufacturers, but in view of the loss of business suffered by most of them in recent years there is little purpose in comparing their results, except for Gallaher's, with Imperial's.

535. We have also, as in previous inquiries, examined the published results of a wide range of public companies in order to estimate as far as possible the average profits earned by manufacturing industry in general in the relevant years. Since all companies in their financial accounts do not value their fixed assets on a common basis, some values being at historical cost and others at replacement cost or arrived at in some other way, any average figure derived from the limited information given in published accounts is open to criticism if used as a standard with which to compare the results of a particular company computed on a particular basis. Imperial has put forward its own computation of average manufacturing profits, and in paragraph 377 we have set out the results of that method of calculation, as also of a variation of that method, and of the method which we have used in earlier inquiries. None of these methods can be claimed to provide a precise yardstick against which the separately computed results of individual companies can be judged, but in view of the conclusions at which we have arrived the question of the relative merits of these various methods is of purely academic interest and we do not feel called upon to express any views upon them.

536. The profits on capital employed earned by Imperial are, accordingly, compared with those earned by Gallaher and by manufacturing industry generally in the following table:—

	Imperial	Gallaher	Average for Manufacturing Industries		
			By Method 1(*a*)	By Method 2(*a*)	By Method 3(*a*)
	%	%	%	%	%
1949 ..	14·7	N/A	N/A	22·4	18·7
1950 ..	16·3	N/A	N/A	24·8	20·9
1951 ..	15·0	9·6	19·4	25·7	22·2
1952 ..	14·3	10·1	15·4	19·4	17·1
1953 ..	14·4	10·1	16·6	20·2	17·6
1954 ..	14·0	10·8	17·2	20·9	18·2
1955 ..	13·3	12·3	17·3	20·4	18·0
1956 ..	12·8(*b*)	13·0(*b*)	16·5	18·0	16·4
1957 ..	11·8	14·0	15·4	16·7	15·5
1958 ..	13·2	14 approx.	14·1	N/A	N/A
1959 ..	11·2	14 approx.	N/A	N/A	N/A

N/A = not available (see Appendix 6).

(*a*) The percentages computed by Method 1 are based on statistics published in "The Economist", those computed by Methods 2 and 3 on statistics published in "Economic Trends". For further details of the three methods of computation see Appendix 6.

(*b*) If exceptional profit on increase of duty were included these figures would be 14·0 for Imperial and 13·8 for Gallaher.

In the light of these figures, after making all due allowance for difficulties of comparison, it appears that throughout the period under review, whatever method of computation is adopted, Imperial's rate of profit in relation to the capital employed in its cigarette and tobacco business has been lower than average. It is also clear that in the last few years it has earned a lower rate of profit than Gallaher.

537. The fact that Imperial's rate of profit on capital has been consistently lower than the average for manufacturing industry does not in itself afford grounds for concluding that its profits are reasonable from the standpoint of the public interest. As we have mentioned, the circumstances of the tobacco industry are in some respects such as to falsify a comparison with industry at large. The proportion of net current assets to fixed assets is—principally because of payments in advance on account of duty—unusually high, and this exceptional degree of liquidity, combined with the stability of demand for the products of the tobacco trade, suggests that in the tobacco industry a return on capital employed lower than that in manufacturing industry generally might be regarded as acceptable. It might even be said that the special circumstances of the duty payments, along with the comparatively low degree of general risk, make it readily possible to finance the business to a large extent by loan capital without the need to offer the expectation of a relatively high return on equity capital, and indeed it happens to be the case that the fixed interest borrowing by Imperial approximates in amount to the sum locked up in duty.

538. Imperial, however, while agreeing that a lower return on total capital employed is acceptable in the circumstances of the tobacco industry has implied that there are no grounds for saying that any part of such capital should (or should not) be raised by borrowing rather than as equity, and that it would be artificial and academic to prescribe or assume a proportion of fixed interest borrowing. This we accept.

539. It is also possible to argue that Imperial, because of its dominant position in the industry, should be content with a lower return on capital employed than would be appropriate for a manufacturer facing more widespread competition. Imperial is not of course a monopolist in the absolute sense and is indeed at the present time exposed to vigorous and effective competition. None the less, we think that the relative security of Imperial's turnover and its present position of price leadership are factors to be taken into account in forming a judgment on the level of Imperial's profits.

540. Taking into account all the matters considered in paragraphs 536 to 539, we think that the profits achieved by Imperial are not unreasonable in today's conditions. With the recent appearance of really vigorous competition in the industry and the consequent increased exposure of Imperial's operations to the market test (on the assumption that these conditions are maintained), we see no reason to think that its rates of profit in the future are likely to be excessive.

(4) Interests in other Companies engaged in the Home Tobacco Trade

541. Imperial at present owns, directly or indirectly, 42½ per cent. of Gallaher's equity, 100 per cent. of Ardath (U.K.) Ltd.'s, Sinclair's and Bewlay's, and 49 per cent. of Finlay's. Gallaher is a manufacturer, Sinclair is a wholesaler and Bewlay and Finlay are both multiple retailers of tobacco products; Ardath (U.K.) markets its own brands of cigarettes and tobacco in this country though these are manufactured by Imperial.* The managements of Sinclair, Bewlay and Ardath (U.K.), which are subsidiaries of Imperial, are subject to control by the parent company. Gallaher and Finlay are under independent managements.

* As explained in paragraphs 182 and 183, the Ardath business has recently been reorganised. Previously Imperial and B.A.T. each had a 50 per cent. interest in Ardath Tobacco Co. Ltd., its home trade being managed by Imperial and its export trade by B.A.T. Ardath (U.K.) Ltd. has now taken over the home trade of Ardath Tobacco Co. Ltd. and the latter company is to become a wholly owned subsidiary of B.A.T.

542. Imperial's substantial holding in Gallaher, its principal competitor, is by far the most important of these interests. As we have indicated, we accept fully the evidence which both companies have submitted to the effect that Imperial does not interfere in any way in the management of Gallaher and regards itself as bound not to do so in future. We have discussed in paragraphs 521 and 522 Imperial's reasons for acquiring the shareholding in 1932 and have recorded our belief that Imperial at that time was very far indeed from envisaging the situation that has since developed. In the present context we have to consider the effects, not of what Imperial did in 1932, but of the existing situation. Since 1932 Gallaher's business and competitive strength have undergone such a transformation as to attach a significance to the relationship between the two companies entirely different from that created by the original purchase of shares. Imperial now has a large minority holding in the shares of its only really formidable competitor.

543. Imperial submits that the competitive position in the industry has not been and is not affected by its financial connection with Gallaher. Gallaher's progress is not, it says, in any way a consequence of the relationship. Nor would Imperial agree that its keenness to compete with Gallaher is blunted by the consideration that success on the part of Gallaher brings benefits to Imperial in the form of dividend income and capital appreciation of its investment; for it contends that the loss of profit when it loses trade to Gallaher outweighs the return from Gallaher. Imperial recognises, of course, that viewed simply as an investment the holding in Gallaher has been a very profitable one; and it does not consider that the moment has yet arrived when it would be advisable from the point of view of a prudent investor to dispose of the shares. It accepts, however, that its motives are more than those of the ordinary investor and that its future actions will not necessarily be dictated solely by its judgment in that capacity. It contends that there is still a danger that American tobacco manufacturers will attempt to regain a footing in the United Kingdom; since it would view with disquiet competition from this quarter, and also thinks this would be contrary to the national interest, it continues to regard the investment as an insurance against that risk.

544. As to the possible effects of the investment on the competitive position, we think that Imperial's submissions leave a number of considerations out of account. We accept that Imperial would prefer to maintain its own turnover rather than obtain such possible higher return from its investment as a loss of trade to Gallaher might produce. But we think it is also inherent in the present situation that Imperial, if it is to lose trade, must prefer to lose it to Gallaher rather than to any other competitor. Moreover the situation of an investor whose commercial interests as an independent trader may conflict with the interests of the company whose shares he holds might well become untenable. We have no doubt that Imperial gave in good faith its undertaking not to interfere in the conduct of Gallaher's business and that the present management of Imperial intends to continue to observe it. Circumstances could, nevertheless, arise where such an undertaking might be felt to conflict with the interests of Imperial's own shareholders. While we appreciate that it would be difficult to specify the precise effects of either of the considerations we have mentioned, we believe that they must tend to minimise the pursuit of the outright competition which we think desirable. In particular we think that Imperial's

investment in Gallaher has developed into a partial insurance against loss of profit due to loss of trade to Gallaher.

545. Imperial has stated its reasons for refraining from making any public announcement of its holding. Apart from the difficulties—which we do not think insuperable—of keeping the public advised of major changes once the existence of the investment has been announced, the company argues that public disclosure of the shareholding would inevitably lead the rest of the tobacco trade to assume a degree of control by Imperial over Gallaher which does not in fact exist; it goes on to say that " it would be quite wrong for there to be an impression abroad that we in fact in any way control or influence Gallaher's trading policy and that competition between us is in some way blurred and inhibited ". In fact, as Imperial agrees, it is widely assumed and has been repeatedly stated in the press that Imperial owns a large minority of Gallaher's shares, though the exact proportion is not known. We find it difficult to understand in these circumstances why Imperial should regard publication of the true facts as harmful.

546. We are not in a position to judge whether Imperial's view of the " danger " that American manufacturers might wish to gain control of Gallaher is a correct one. We think that more active competition with Imperial would have been beneficial in the past and that it is desirable to maintain the highest possible degree of competition in this industry in the future. We do not agree with Imperial that it would necessarily be contrary to the interest of the United Kingdom if competition were to be strengthened by foreign investment in a British manufacturer.

547. We have indicated in paragraphs 531 to 533 our view that, before it began to experience determined competition from Gallaher, Imperial was not compelled to exert its maximum effort. The company has lost trade to Gallaher in recent years and is now taking steps to recover its position. We consider that the stimulus to efficiency which Gallaher's competition provides might have been even greater if Imperial were not through its investment in Gallaher insured to some extent against the potential loss of profit. Imperial's interest in Gallaher renders less financially serious to Imperial the effect of any increase in Gallaher's share of the market at Imperial's expense, and this might tend to weaken Imperial's incentive to achieve the highest possible standard of competitive effort. In our opinion it is in the public interest that Imperial should be continuously exposed to the most strenuous competition and, although we see nothing improper in the company's attitude in this matter, we think for the reasons given above that the continuance of Imperial's investment in Gallaher operates and may be expected to operate against the public interest.

548. The circumstances surrounding Imperial's investment in Ardath are very different from those we have just reviewed since Imperial actively controls the Ardath business in the home market. As we have mentioned, Imperial appears, at times at any rate, to have regarded the Ardath business as a potential weapon against competitors but there is no evidence that it was effectively used for this purpose. It may be suggested that under independent ownership Ardath might have become a more formidable competitive factor in the market; but this is to suppose that Ardath's experience would in that event have differed from that of the majority of Imperial's independent competitors. On the whole we agree with Imperial's view that its investment in Ardath and control

of the home business have had only a limited effect on the competitive situation. As a result of the recent reorganisation the home and export businesses are now conducted by different companies. The company responsible for the home trade (Ardath (U.K.) Ltd.) is wholly controlled by Imperial; it does not manufacture but markets its own brands which are made for it by Imperial. Ardath (U.K.) is also entering into an agreement with Godfrey Phillips Ltd. under which it will control the manufacture and marketing in the United Kingdom of most of the latter company's brands of cigarettes and tobacco (see paragraphs 185–188). It is expected that manufacture of the Godfrey Phillips brands will be undertaken by Imperial and, in any event, it is clear that Imperial will in future have effective control of the supply in the home market of these brands as well as the Ardath brands. The home business of Godfrey Phillips, like that of Ardath, has not been successful in recent years, and this is no doubt the main reason why the two companies are virtually amalgamating their home cigarette and tobacco businesses. Although the initial approach was made by Godfrey Phillips the agreement may be regarded from Imperial's point of view as one of the steps it is taking to put its investment in the Ardath business on a more profitable basis than in the past. We think that Imperial's control of that business in the home trade, in itself, does not have, nor is likely to have, any material effect on the public interest, but that, for reasons we mention when considering Imperial's position as a whole (see paragraph 587), it is desirable that the connections between Imperial and Ardath should be known.

549. Imperial's interests in Sinclair, Bewlay and Finlay do not appear to us to be of serious significance. They do not give Imperial control of any substantial part of the distributive channels on which its competitors have to rely. There is no evidence whatever that Imperial has ever desired to obtain such control or that it is likely in future to regard its holdings as the nucleus of a more comprehensive distributive system to be built up under its control. We have had no complaints of discrimination against other manufacturers by Sinclair or Bewlay, whose position as subsidiaries of Imperial is public knowledge, or by Finlay, whose connection with Imperial is perhaps less well known. Although the two companies which Imperial controls have not proved very profitable investments, steps have been taken recently to improve their efficiency. Sinclair is, we understand, now operating on a reasonably profitable basis. As regards Bewlay, Imperial submits that its business is of an exceptional kind because it remains virtually a specialist retailer of tobacco goods and smokers' requisites and a number of its best shops occupy expensive sites. Imperial regards Bewlay's specialist shops as a medium for advertising smoking in general; " to the extent that they do that, that is of benefit to the whole trade and since we have a large share of the whole trade, it is to our benefit ". We think that Imperial's investments in these three distributor companies, like its investment in Ardath, do not have, and are not likely to have, any material effect on the public interest. The question of the desirability of public knowledge of such connections, which is pertinent to the case of Finlay, is referred to again in paragraph 587.

(5) Interests in other Companies connected with the Tobacco Industry

550. Imperial has four subsidiary companies which make packing materials and cigarette paper. As we have indicated in paragraph 520 we find no grounds for criticism of Imperial in this connection. The other interests of Imperial which call for comment are those in the British-American Tobacco Co. Ltd.

and in Molins. B.A.T. manufactures cigarettes and tobacco in the United Kingdom and overseas but does not sell in the United Kingdom. Imperial owns 28½ per cent. of its equity. Molins' activities as a manufacturer of machinery for the cigarette and tobacco industry are fully described in this report. Imperial owns 25 per cent. of its equity, another 25 per cent. being held by B.A.T.

551. Imperial's minority interest in B.A.T. derives from the arrangements made in 1902 with the American tobacco manufacturers, which also gave rise to the agreement between Imperial and B.A.T. which is still in existence (see paragraphs 51, 52 and 102–104). We think that the effects of this shareholding and of the agreement cannot properly be considered apart from one another, but we are precluded from pronouncing upon the agreement because it is registered with the Registrar of Restrictive Trading Agreements. Furthermore, B.A.T.'s trade is conducted outside this country and is, therefore, beyond the scope of our reference. In these circumstances we are not called upon to express any opinion about the bearing upon the public interest of Imperial's holding in B.A.T.

552. Imperial's interest in Molins is a matter we have to take into account in relation to the supply of machinery (see paragraphs 600 and 601). Here we are concerned with that interest only in so far as it may be relevant to Imperial's dominant position as a supplier of cigarettes and tobacco. To the extent that it has assisted Molins to develop and supply machines which many tobacco manufacturers appear to regard as the best of their kind this financial relationship has benefited the whole of the tobacco industry. It is true that during the period of development Imperial and B.A.T. had the right to claim exclusive use of new machines produced by Molins, a right which Imperial exercised extensively until about 1945 and thereafter less freely up to 1957. During the greater part of this period, however, Molins did not occupy the position of pre-eminence in the field of machinery that it now enjoys, and there is no evidence that any competitor of Imperial has been seriously hampered through inability to buy machines from Molins. We do not think that Imperial is to be criticised for acquiring its financial interest in Molins or for taking steps to ensure that if the investment proved a successful risk it should have some priority in benefiting from the results. Nor do we think that the public interest has suffered or is likely to suffer by reason of Imperial's holding in Molins.

(6) Distribution Policy

553. The principal features of Imperial's existing system of distribution which call for comment are, first, the extent to which it trades directly with retailers rather than through wholesalers, secondly, the level of the margins it allows to its distributors, thirdly, the company's practice of fixing and maintaining the resale prices of its products at all stages of supply, and fourthly, its practice of making an additional allowance by way of bonus to distributors who enter into an agreement under which they undertake, *inter alia*, to allow certain display facilities to Imperial.

554. None of these matters can be considered entirely in isolation. The company's policy on margins is, obviously, closely connected with its policies as to trading with retailers and as to the additional margin represented by the bonus. Moreover, unless resale prices are maintained the original supplier can

have no control over margins. It may be noted also that one of the undertakings given by distributor signatories of the Bonus Agreement is to maintain Imperial's prices. These four matters, therefore, need to be reviewed both individually and collectively.

555. We see no reason why Imperial should not trade direct with retailers to whatever extent may be compatible with maximum efficiency and minimum cost. Imperial, while observing that the " break-even point " cannot be determined precisely, tells us that its own studies of the question have led it to believe that retailers who can take 10,000 or more cigarettes at each delivery can be served most economically by direct sale rather than by sale through wholesalers. We are not in a position either to confirm or to dispute this opinion. In a fully competitive situation each manufacturer would be under compulsion to seek the right economic balance between sale to retailers and sale through wholesalers as a means of minimising his costs. In the tobacco industry competitive forces certainly affect the position. Imperial has told us that " the obtaining of direct accounts with retailers has always been an important element in the active competition which exists in the trade ", and that " if we ceased to have direct contact with . . . smaller outlets through our sales representatives we should be obliged on competitive grounds to canvass many of them—even though their orders were placed through wholesalers ". This means, in effect, that Imperial —and probably most of its competitors as well—regards some part of the cost incurred in maintaining accounts with retailers as a sales promotion cost rather than an inevitable distribution cost.

556. There is nothing unusual or improper in this attitude. If the " active competition " to which Imperial refers were primarily price competition there would be little, if any, risk that direct trading with retailers could be pursued by any manufacturer to a point where it became economically unjustifiable. In the present situation in the industry, where price competition between the leading manufacturers is limited and they are prepared to spend heavily on sales promotion, there is some risk that all of them may adopt methods of selling which though well designed to increase sales are detrimental to low-cost distribution. The rise in the proportion of sales going direct to retailers which has occurred since 1955 (roughly from 50 per cent. to 65 per cent.) is explained by Imperial as due to the operation of a free market at the end of the period of control in correcting a pattern of distribution which had become out of accord with current trading conditions. The average quantity sold per retail outlet was much higher in 1955 than in 1939 because the number of retail outlets had during the interval fallen by 20 per cent. and consumption had increased. In normal circumstances this would automatically have led to an increase in direct trading, but this did not happen during the period of control because few new direct accounts were then being opened. While the removal of controls partly explains the increase in direct trading since 1955 we think this increase is also attributable to keener competition in the industry during this period. We think that Gallaher has probably been at least as active as Imperial in encouraging direct trading and that this is not a practice stemming from Imperial's monopoly position. We discuss in paragraph 557 the effect of this tendency on the position of the wholesaler. In general we have no reason to think that direct sale by manufacturers to the larger retailers in inconsistent with efficient distribution.

557. That both wholesalers and retailers would prefer larger margins than those they are allowed is only to be expected. It is particularly understandable

that wholesalers may feel some sense of grievance about their position. They have seen the large manufacturers tend increasingly to by-pass them in distributing their products, and most of the smaller manufacturers, who could not have dispensed with their services, go out of business. Their status as wholesalers receives no recognition in the terms on which they are allowed to buy since they pay the same price as retailers buying direct from a manufacturer, subject only to quantity discounts which are open to both wholesalers and retailers. The retailer who buys from a wholesaler must, therefore, expect to pay a higher price than if he is able to buy direct from the manufacturer. As a result the function of the wholesaler tends to be confined to providing a service for the small retailers who do not qualify for direct accounts with manufacturers.

558. Specialist retailers, and those for whom the sale of tobacco goods is something more than a side line, support the wholesalers' arguments up to a point. The National Union of Retail Tobacconists, which is fairly representative of this class of retailer, says that the manufacturers' price structure leads to the proliferation of retail outlets, the wholesaler having no option but continually to seek new customers in order to maintain his business (see paragraph 417). It thinks, therefore, that wholesalers should be able to sell on the same terms as manufacturers, and it goes on to say that the costs of both manufacturers and retailers could be reduced by channelling trade through specialist outlets; in particular a larger turnover would enable the specialist retailer to manage on a smaller margin. The N.U.R.T. does not condemn direct trading with retailers, though it has told us that its members would probably not object to buying from wholesalers if they were able to do so on the same terms as the manufacturers offer them. We do not think that these various proposals amount to a coherent plan for an alternative price structure, but they do bring out the genuine feeling on the part of the more highly specialised retailers that they, like the wholesalers, are not encouraged to perform the kind of service for which they believe they are especially equipped. Both classes of trader think, in effect, that distribution would be more efficient if a higher proportion of supplies passed through their hands; both think that if their turnover is to be reduced their margins should be raised.

559. Arguments such as these are naturally put forward from time to time by groups of traders whose livelihood depends to some extent on their ability to drive a bargain with their suppliers. Although Imperial's point of view about many of these matters differs from that of the distributor, it says its relations with the distributive trade are on the whole good. The company says it endeavours, while keeping the retail price at a minimum, to provide the wholesaler and retailer with a reasonable and fair return for the services they perform. On the other hand it does not consider itself to be under an obligation to fix its margins with a view to ensuring that either a wholesaler or a retailer can earn a living by trading only in tobacco goods. Nor does it think the interests of the consumer would be better served by a policy which would tend to restrict the number of retail points of sale. It agrees that the margins it provides, if expressed as percentages of selling prices, appear low by comparison with many other industries. (These margins are approximately 10 per cent. for retailers—though rather lower if they buy from wholesalers—and between 2 and 3 per cent. for wholesalers—see paragraph 203.) It argues, however, that any such comparison is vitiated by the incidence of customs duty in the price, which has caused the manufacturers to grant terms of credit which have the

effect of financing a substantial part of their customers' stocks. Although the retailer's margin before the war was approximately 20 per cent. of his selling price, Imperial contends that the subsequent reduction is wholly justifiable for this reason, and it has put forward certain estimates designed to show that the increased cash yield of the margins since 1938 is approximately in line with the average increase in distributors' costs (see paragraph 468). It also suggests that rapid turnover and ease of handling are factors which justify a relatively low margin of gross profit, and has drawn attention, by way of illustration, to the analysis of the net profitability of wholesaling tobacco goods and other lines which was undertaken by Sinclair (see paragraph 374).

560. On the whole we find Imperial's attitude to this matter a reasonable one. The handling of these goods is not a service that calls for any great degree of skill. We agree that it should not be Imperial's aim to restrict it to a specialised class of trader. We think that the public prefers to be able to buy cigarettes and tobacco at as many points as possible, and that a policy which enables this service to be provided is not objectionable so long as it can be carried out economically and with due regard to the distributor's claim to a proper return. We do not think that the level of margins actually allowed could be said to be excessive. They appear, nevertheless, to be sufficiently attractive to induce a large number of persons to stock and sell the goods. Though we appreciate the difficulties of the specialist trader, it has to be recognised that the demand for his services has been declining over a long period, owing principally to the increasing demand for packed cigarettes and tobaccos of well-known brands. We think that there are no grounds for saying that Imperial should offer them higher margins or a greater volume of business with a view to arresting this trend. Leaving aside the question whether there is anything undesirable about the practice of fixing distributors' margins—a matter which we discuss in paragraphs 561 to 568—we do not think exception can properly be taken to the level of margins at present operating.

561. By prescribing and enforcing the prices at which its products shall be sold at every stage of supply Imperial ensures, first that the public pay uniform prices for identical products without regard to the particular cost of conveying the product to the particular customer, and secondly that each distributor's gross profit per unit sold is fixed without regard to his particular costs. Imperial argues that the practice of maintaining resale prices is of benefit to the distributor because he can rely on a known and reasonable rate of profit and on protection against " loss leader " tactics by his competitors; to the manufacturer because sufficient numbers of distributors are encouraged to stock and sell his goods; and to the public, which likes a standard price and a large number of buying points. An additional argument which has been advanced is that the risks of allowing credit to distributors would be greatly increased if their selling prices and margins were not protected. While some distributors might, even in face of the withdrawal of credit facilities, be able to cut prices, others would find that they would need a higher margin to finance their stocks and, if they could not secure it by increasing prices, they could not continue to trade and the number of retail outlets would to that extent be reduced.

562. We have not invited other manufacturers or the distributors to submit evidence as to the merits of this practice, but it is clear that it has the general support of the industry in which, in this country, it is applied without significant exception. It is not a practice peculiar to this industry. It has been found to

operate in a number of industries which the Commission have already investigated, and has also been reported upon as a general practice on a number of occasions, the most recent comprehensive report on the subject being that made in 1949 by the Lloyd Jacob Committee.* Since that report was made resale price maintenance as formerly practised in many industries, including the cigarette and tobacco industry, has been modified in conformity with Part II of the Restrictive Trade Practices Act, 1956. This Act on the one hand prohibited agreements for the collective enforcement of conditions as to resale prices and on the other hand strengthened the powers of individual suppliers to enforce their conditions by legal proceedings. Each of the principal cigarette and tobacco manufacturers prescribes the prices at which his products shall be bought and sold by any subsequent distributors; they were doing so before 1956 and have continued to do so since. Until 1956, however, the relevant conditions of sale were collectively enforced by the body of manufacturers and distributors represented in the T.T.A. Since 1956 there has been no collective agreement on the subject of resale price maintenance and enforcement has been a matter for the individual manufacturer. As we have explained in paragraph 263 the conditions we have to consider in their bearing upon the public interest arise from the fact that nearly all the cigarettes and tobacco supplied in the United Kingdom are supplied at all stages by persons who practise resale price maintenance and who are therefore restricting competition in as much as each of them acts in such a way as to prevent price competition in the supply of particular brands.

563. If this practice were terminated each distributor would be free to determine and vary his own margins according to his knowledge of his costs and of his own particular market. The ostensible advantage would be more intensive competition among distributors, leading in turn to an increased effort to reduce costs. In theory at least, the lower cost distributors would be able to reduce their selling prices and expand their turnover, while those with higher costs might be compelled to find ways of reducing them or to be satisfied with lower margins or to stop selling these goods or, if the services they offered were sufficiently attractive to the public, to charge higher prices to recoup themselves. Thus the public would have some choice of prices for identical goods, and would buy from the higher-price suppliers only in so far as they were prepared to pay for the services offered; the general tendency would be to encourage purchase through the most economical channels and, therefore, to reduce the total cost of distribution. Moreover, manufacturers, who with few exceptions do not at present compete with one another in price for products of the same class, might be more willing to vary their own selling prices if there were no longer any standard retail prices.

564. There are, however, several factors to be taken into account which, in this industry, may detract from the apparent benefits of terminating resale price maintenance. Principally because of the high rate of customs duty, distributors' margins in this trade account for a lesser percentage of the end price than usual. We have already concluded that the margins ruling are, in general, not excessive (see paragraph 560). We think in these circumstances it might well be the case that any reduction in price which even the most efficient distributor could make while still trading on an economic basis could only be small. One of two results might then be expected to follow. On the one hand the public might not think it worth while to seek out the " cut-price " shop

* Report of the Committee on Resale Price Maintenance: Cmd. 7696, June 1949.

for the sake of a small cut. On the other hand if a sufficient number of smokers took their custom to the " cut-price " shops there might be a substantial reduction in the number of retail outlets. It might be said that the advantages gained by some smokers through reduced prices were counter-balanced by the inconvenience caused to others by a reduction in the number of sources of supply and by the possible damage to those engaged in the trade generally.

565. Another point that needs consideration is the possible emergence of " loss leader " selling. Cigarettes are sold in a very large number of shops and in most of them the cigarette turnover is small compared with the turnover in other goods. It is not improbable that some retailers, if free to do so, would sell some cigarettes at prices below cost for the purpose of attracting customers into their shops. We do not suggest that there is any impropriety in following this practice but we think that there are two reasons why, so far as this particular industry is concerned, the argument based upon it cannot be ignored. In the first place, for the reasons mentioned above, cigarettes lend themselves more than most commodities to the use of such methods. Secondly, if they were to be used at all they would be used principally by way of cutting the prices of the most popular brands. The effect would be to increase the sales of these brands to the detriment of other manufacturers. In practice this might well mean that Imperial in the first place, and Gallaher secondarily, would benefit at the expense of other manufacturers. We do not think it would be desirable to weaken the competition Imperial has to meet from other manufacturers for the sake of intensifying competition in the distributive trade.

566. Imperial, as we have mentioned, has also suggested that if distributors could no longer rely on fixed margins the manufacturers might have to reconsider their terms of credit, since the incidence of bad debts might be greatly increased. This again is a consideration which could be more important in this trade than in most others, because the value of retailers' and wholesalers' stocks, financed at present by the manufacturers, is at all times very high owing to the level of the duty. Any considerable withdrawal of credit on the part of manufacturers would presumably have to be accompanied by an increase in distributors' gross profits to allow for the cost of financing their own stocks. It is unlikely that all the individual distributors could borrow as cheaply as the manufacturers, so that the total cost of financing stocks by distributors might well be higher than it is at present. We doubt whether the withdrawal of resale price maintenance would be a determining factor in the granting of terms of credit but in so far as this may be so we think that the effects of terminating the practice might be disadvantageous.

567. In weighing the arguments set out above consideration must be given to the effect of Imperial's position as the dominant supplier, even though we are satisfied that the policy of maintaining resale prices has not been adopted for the purpose of preserving that position. Thus it may be argued that Imperial can, in effect, determine the method of retail trading for the great bulk of the supply, and that it may be considered a disadvantage from the standpoint of the public interest that opportunities for doing business on terms other than those at present imposed should be so narrowly limited, since this produces uniformity and rigidity in trading methods to the detriment of experiment and innovation in distribution.

568. On a balance of the foregoing considerations we conclude that in this trade (with which alone we are concerned), and so long as competition between

manufacturers continues on the present scale, resale price maintenance does not, either as a practice of Imperial or generally, operate against the public interest nor may it be expected to do so.* We wish to emphasise that this conclusion relates only to the cigarette and tobacco industry and must not be taken to imply any judgment on the desirability of the practice as applied in other industries.

569. As to the linking of bonus payments with the grant of display facilities, Imperial says that the practice originated as a means of giving customers a share in the company's prosperity but is also regarded as " a competitive weapon of some importance ". It argues that it has not been a decisive weapon nor has it been abused; it is intended to offer an inducement to distributors, over and above their normal margin of profit, to stock and promote the sales of Imperial's products and to ensure that the company is given a reasonable share of such point-of-sale display as is devoted to tobacco goods. Imperial says that the principle of " balance " in display, as applied by the company in practice, although preventing the signatory distributor from giving to competing manufacturers more than a certain share of the display he devotes to tobacco goods, does not operate unfairly against those competitors. In support of this submission it tells us that a sample survey undertaken in 1958 showed that the average proportions of display given to Imperial's goods by traders who were signatories of the Bonus Agreement and by those who were not were 67 per cent. and 56 per cent. respectively (see paragraph 476). These figures show, it is argued, that the proportion of display stipulated by Imperial for the purpose of bonus (50 per cent.), besides being lower than Imperial's share of the trade, is below the average proportion of display which traders tend to give to Imperial in their own interests. The bonus, it is said, forms a very small part of the average margin—about one-twentieth for retailers; and since other manufacturers allow a roughly equivalent bonus the distributor does not lose if he sells more of their products and less of Imperial's. Imperial adds that it is open to any competitor to buy the right to predominant display by offering a distributor the equivalent of the amount of bonus he would lose if he were to abandon his agreement with Imperial. While agreeing that the obligations of the distributor signatory in relation to display are not precisely defined in the agreement, the company thinks there is little or no danger that he will give more than is necessary to qualify for his bonus for fear of giving less; it says that its own interpretation of the obligations is well understood by its competitors, who are only too ready to correct any misunderstanding on the part of a distributor.

570. So far as we can judge Imperial does not obtain, on average, a share of the space allotted by distributors to display of tobacco goods which is larger than the company's share of the trade; it may well be smaller. The value of display cannot, of course, be measured solely by the proportion of space occupied. By interpreting the agreement to mean not only that it must have 50 per cent. of the display but that it must have preference for " centre displays " (see paragraphs 245 and 246) Imperial does, we think, effectively ensure that more than half of the value of signatories' displays accrues to the company. The answer to the question whether Imperial's share of display, in terms of real advertising value, is in line with its share of the trade, or above or below it, is, therefore, rather more open than the company has suggested, but it is not a question that we can or need to answer.

* See Note of Dissent by Professor Allen regarding resale price maintenance (paragraphs 612–618).

571. Point-of-sale display is, of course, a valuable advertising medium. It is natural and proper that manufacturers should compete for their shares of display. They can do so only by offering rival inducements to the distributors who control it. Imperial, however, does not pay for display by amount. It pays for a proportion of display; that is to say it ensures that if a competitor is given a good display its own will be still better, and conversely that if its own goods are poorly displayed its competitors will receive worse treatment. The effect of this, over a high proportion of the most valuable retail display, is that the division of display facilities between Imperial and other manufacturers tends to become stabilised, and it therefore appears to us to be a device which does have some restrictive effect on competition. We do not think that the artificial division of such facilities is compatible with free competition between manufacturers. Manufacturers in competition with one another require to be free to conduct concentrated advertising campaigns at particular times and in particular places. The effect of Imperial's bonus arrangements appears to us to be that that company is in a position to use a majority of the most desirable point-of-sale display space and deny it to its competitors.

572. There is no doubt some force in Imperial's argument that it is open to its competitors to buy these facilities at roughly the price that Imperial pays. But we think this argument leaves out of account some of the effects of Imperial's dominant position in the industry. Imperial's competitors themselves allow a bonus to distributors which is about equal to Imperial's bonus. They do so primarily because tbey could not hope to compete with Imperial unless their terms to distributors were, in total, at least as good as Imperial's. Though they do their best to obtain some minimum of display in consideration of the bonus they allow, none of them has been able to make this a firm condition of the allowance. Thus any competitor of Imperial who bought a predominant share of display by compensating the distributor separately for the loss of Imperial's bonus would in effect be making an extra payment for facilities which Imperial obtains by allowing no more than the equivalent of the normal trade terms allowed by other manufacturers. Moreover, he would have to compensate the distributor over a considerable period even if he did not need the display facilities over the whole of it. This situation arises because only a manufacturer in a dominant position could successfully have operated a scheme such as Imperial's.

573. Imperial's bonus scheme therefore limits the extent to which competing manufacturers can obtain display facilities. This is a clear case of restriction of competition and in view of the importance we attach to strenuous competition in this industry we conclude that the scheme operates and may be expected to operate against the public interest.

574. Our review of the four features of Imperial's system of distribution mentioned in paragraph 553 has not led us to make any substantial criticism except in relation to the bonus scheme.* It does not appear to us that abandonment of that scheme must imply a radical reconstruction of the whole of the system. The system considered as a whole is, we think, reasonably efficient and economical and, with the exception we have mentioned, does not disclose any undesirable use of monopoly power.

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* See Note of Dissent by Professor Allen regarding resale price maintenance (paragraphs 612–618).

575. We should also refer to another scheme operated by Imperial in relation to point-of-sale advertising. In selected cases Imperial is (independently of the bonus scheme) prepared to dress the windows of a distributor without payment for the service, provided that 75 per cent. of the display is given to Imperial (see paragraphs 233 to 235). This arrangement appears to us to be a legitimate method of advertising Imperial's own goods, paid for in services outside normal trade terms, and is therefore unobjectionable.

(7) IMPERIAL'S MONOPOLY POSITION AS A WHOLE

576. Our review of the development of Imperial's monopoly position has led us to conclude that the absence of the stimulus of effective competition was reflected for many years in the company's organisation and commercial policy but that in spite of certain points of criticism Imperial has exercised responsibility and restraint in making use of its power as a monopolist (paragraph 533). In examining certain features of the existing position we have also concluded that Imperial does not earn a rate of profit which is so high as to be contrary to the public interest and, in the conditions of present-day competition, is not likely to do so (paragraph 540); that it is contrary to the public interest that Imperial retains its substantial investment in the equity of Gallaher (paragraph 547) but that its interests in Ardath, Sinclair, Bewlay and Finlay are of little significance (paragraphs 548 and 549); that its interests in Molins and in companies making packing materials and cigarette paper are unobjectionable (paragraphs 550 and 552); and that its distribution system is unobjectionable* except for the bonus arrangements, which are contrary to the public interest (paragraphs 573 and 574).

577. We have mentioned (in paragraph 531) the drastic reduction in the number of Imperial's branches which has occurred from 1954 onwards and recorded our opinion that this is connected with the intensity and success of the competition experienced recently. By February 1961 the branches will consist of Wills, Player, Ogden and the newly formed Churchman, Lambert and Ringer branch. As reorganised, therefore, the company will consist of the two principal and two smaller branches. In recent years the Player branch has been responsible for nearly half the company's sales and the Wills branch for another 40 to 45 per cent.

578. Imperial, as we have mentioned, defends its branch structure on the ground that internal competition is a stimulus to efficient manufacture and marketing. It is clear that the branches are marketing products which compete with one another as well as with the products of manufacturers other than Imperial. Although the small branches do not cover the whole of the field there is no exclusive allocation of any part of the field to particular branches, either geographically or by type of product. Nevertheless, competition between branches is regulated to some extent by central control, as described in paragraphs 115 to 126. Imperial has told us that " our objective in the whole of this control of the company from the centre is to leave as much freedom of effort in manufacture and in selling and cost control to our branches [as practicable] while endeavouring from the centre to look at the whole company picture and to ensure that as a group we get the maximum benefits we can from our collective bargaining power . . . in terms of purchasing, finance and so forth ". The company goes on to say that as a result of central control " each brand brought out by each branch at a price level which competes should yield a gross profit margin roughly

* See Note of Dissent by Professor Allen regarding resale price maintenance (paragraphs 612–618).

comparable with the company standard at that price. That means that we are putting each branch in the position of being able to compete in terms of the value offered in the product equally ".

579. As we have explained in paragraph 349 the standard gross profits are not rigidly enforced, and it is accepted that gross profits on brands of the smaller branches and on those with a small turnover may be rather below the level for the better-selling brands. In as much, however, as each brand is expected to earn a certain minimum level of gross profit, the system may be presumed to offer some incentive to any branch whose manufacturing costs are high to find ways of reducing them. Apart from this it does not appear that Imperial values inter-branch competition primarily as a means of providing comparisons to indicate ways of reducing costs. Nor indeed would the branch system be necessary for such a purpose so long as the company continued to produce at a number of factories. The company in its explanations appears rather to place the emphasis on market competition between the branches. We are told that, although advertising expenditure is subject to approval by the Executive Committee, the branches' proposals are normally approved provided they seem reasonable in relation to brand gross profits and sales prospects, and that " there is very wide scope for Branch initiative in the advertising field ".

580. The merits claimed for the branch system are not susceptible of proof or disproof. We have already expressed the opinion that in the past the survival of numerous branches could be attributed to the absence of external competition. We think that some of the branches were retained partly out of reluctance to disturb a long-established structure and partly for fear of diminishing the company's share of the total market, though not all branches were profitable. Imperial's position was such that it could maintain relatively or wholly unprofitable branches and yet continue to earn, for the company as a whole, a level of profit which it regarded as sufficient. According to our computation of profits from 1951 to 1957 the Player branch earned a substantially higher rate of profit than the undertaking as a whole, as to a lesser extent did the Wills branch. Competition between the branches may provide some incentive to effort and enterprise, but in our view internal competition is at best a poor substitute for real competition and it is perhaps significant that the recent emergence of powerful outside competition has in fact caused Imperial to make very considerable changes in its branch structure. There can be little doubt in our opinion that the result of these changes must be an improvement upon the structure that existed up to about six years ago.

581. Much of what has been said on the subject of the branch system is also relevant to the question of the number of brands which the company markets. In March 1960, Imperial was selling 57 brands of cigarettes and 183 brands of tobacco (as well as many types of loose tobacco). The numbers, as we have shown (paragraph 532), represent a substantial reduction from the corresponding figures for 1938. In 1957 about 91 per cent. of the company's cigarette sales were accounted for by four brands and about half its tobacco sales by six brands (see paragraphs 368 and 370). The four leading brands of cigarettes earned about 93½ per cent. of the total profit on cigarettes; the remaining brands were therefore not all unprofitable though we found that a number of them incurred net losses. The six leading brands of tobacco, however, earned a profit of £350,000 although the company's total profit on tobacco was only £108,000; of the remaining brands more than half incurred losses.

582. Although some brands of cigarettes are unprofitable, the small-selling brands as a whole contribute to the company's profits. The position with regard to tobacco brands needs to be examined more closely, first because, as we have shown, most brands have been incurring losses which in aggregate have offset a high proportion of the profits earned by the few successful lines; and secondly because tobaccos as a whole have been earning a much lower rate of profit than cigarettes. We have noted in this connection the complaints made to us by one or two small tobacco manufacturers to the effect that Imperial fixes prices for its tobacco brands which are " uneconomic " but which other manufacturers must, in practice, follow; the complainants infer that Imperial is able to do this by subsidising its tobacco trade out of its profits on cigarettes.

583. Imperial argues that the principal reason for the relative unprofitability of tobacco is that the trade has for many years been a declining one. Although there has been some increase in demand for tobacco for hand-rolling of cigarettes this is more than offset by the fall in demand for pipe tobaccos. Moreover, pipe smoking tends, we are told, to be increasingly concentrated among older people, many of them of limited means. For many years, therefore, Imperial has had to face the problem of deciding as a matter of commercial judgment whether price increases which appeared to be justified by increases in costs would only result in such a further loss of turnover as to reduce rather than increase the profitability of the tobacco business. In these circumstances the company has charged the prices it believed the traffic would bear, and in its judgment tobacco will not bear prices which yield the same level of profit as can be earned on cigarettes.

584. These arguments appear to us to be reasonable. We do not think that Imperial can be expected to abandon its trade in pipe tobaccos so long as there is any significant demand for them, but we recognise that the trade is not a buoyant one and is scarcely likely to be a very profitable one for any manufacturer. We doubt, therefore, whether the small manufacturers whose complaints we have mentioned would find that they could afford to charge higher prices even if they felt free to do so, and we do not think that Imperial is to be criticised on this score. The company says that the large number of brands marketed is due principally to the fact that there are some twenty types of tobacco, each catering for a different taste on the part of the smoker, and that each type is made in a number of different qualities at different price levels. Whether the number is justified at any given moment is, we think, a matter of commercial judgment which the company alone is in a position to decide.

585. In the instance mentioned in paragraph 582, what was represented to us by one or two witnesses as being the result of undue exercise of monopoly power on the part of Imperial appears in fact to be largely a consequence of factors which are outside Imperial's control. The same may be said of many other representations which have been made to us. The criticism received during this inquiry has been large in volume though, for the most part, moderate in tone. Some of it is directed against particular practices of Imperial, such as the bonus arrangements, trading with retailers, or the margins allowed to distributors; we have taken these representations into account in dealing with the arguments about those matters. Some of the criticism, however, is not focussed particularly on Imperial but either is directed towards the larger manufacturers in general or consists rather of complaints that developments in the industry are to the disadvantage of the witnesses in question. We have drawn attention

in paragraphs 514 and 515 to the continuing process of concentration in the manufacturing industry, which is not associated with any increase in Imperial's share of the trade. We think much of the complaint and criticism is a result of this process rather than of Imperial's dominant position; this applies especially to the representations from manufacturers and former manufacturers, who say that they cannot compete with the " big combines ", and to those from leaf merchants, whose trade has diminished with the elimination of the many small manufacturers who formerly depended upon their services.

586. In spite of these criticisms, therefore, we have formed the view that Imperial continues to observe restraint in exercising the power derived from its still dominant position in the trade. We think this restraint is evident in its policy on prices and profits and in its responsible attitude to the rest of the industry. Even in the matter of the bonus although we have found grounds for criticism we think we should also record that the company appears to have been more accommodating in recent years than formerly; it has made some effort to meet the objections of its competitors and has enforced its agreements less stringently. Although we may not agree with Imperial's views at all points we are satisfied that the company has long been conscious that because of its dominant position it must pay special regard to the public interest. Our own criticism is rather that during the long period of its dominance its structure and commercial policies have not been designed to achieve the maximum degree of efficiency. Successful competition from Gallaher has caused Imperial to make some radical changes and we believe that the company is now better equipped to meet competition from this or any other quarter than it was a few years ago.

587. A question which calls for some further comment before we record our findings on Imperial's monopoly position is that of the disclosure of its substantial minority interests in certain other companies in the industry. The reasons advanced by Imperial for not making any public announcement of its holding in Gallaher (see paragraph 545) also apply to its interests in Finlay, Molins and Ardath Tobacco Co. Ltd. It follows, of course, from our conclusion that Imperial's retention of its holding in Gallaher is contrary to the public interest that we think the existence of that holding should be known. In any event we consider it desirable that unless there are very compelling reasons to the contrary the full extent of the interest of a monopoly supplier in the industry concerned should be known, and we do not think that Imperial has advanced any such reasons.*

588. What we have called, for convenience, Imperial's " monopoly position " has been, over the past 50 years, a position in which the company's share of the total home trade in cigarettes and tobacco has varied roughly between 60 and 80 per cent. Its share at the present time does not greatly exceed 60 per cent. and the competition it is now experiencing is probably more intense and certainly more concentrated than at any time in the company's history. The competition provided by Gallaher in recent years is a welcome development. We consider that a situation in which there are two very large manufacturers competing with each other is preferable to the former position where Imperial had no competitor of comparable stature; competition from Gallaher has

* So far as Ardath is concerned the relationship which Imperial preferred not to disclose—namely, that with Ardath Tobacco Co. Ltd.—will shortly cease to exist. Imperial has not, as far as we are aware, yet publicly disclosed the fact that Ardath (U.K.) Ltd. is its wholly owned subsidiary (see paragraph 182).

already led Imperial to put its organisation on a more economical basis. This is not to say, however, that the present situation in the industry is an entirely satisfactory one.

589. Imperial has submitted that the decline in the number of its competitors is due to forces largely outside its control; that its predominant position is due principally to its successful use of competitive weapons which are open to any manufacturer; that outside competition is nevertheless active and effective; that the existence of competition within the company is an important additional safeguard for the public interest; that it has exercised its power with moderation and has not impeded its competitors unfairly; and that it has been active in promoting the public interest by research, by the development of Commonwealth sources of leaf, and by co-operation with the Government. We can agree with some of these submissions. We think the company takes a responsible attitude in its relations with the Government and we agree as to the value of its research and its efforts to develop new sources of leaf. We consider that Imperial's predominant position is due to a number of causes, including the high quality of its products, the circumstances of the company's formation, its success in exploiting the demand for mass-produced cigarettes in its earlier years, and the various steps it has taken to preserve its influence in the market as indicated in the foregoing chapters. We do not regard the internal competition provided by the company's branch structure as a substantial safeguard of the public interest or a satisfactory substitute for external competition. We think it essential that Imperial should continue to feel the stimulus of such competition.

590. As we have indicated we think it desirable to eliminate the risk that competition between Imperial and Gallaher might be inhibited by the existence of a financial link between them. We consider that the retention by Imperial of its shareholding in Gallaher is a " thing done " by Imperial to preserve its monopoly position which operates and may be expected to operate against the public interest. We have also indicated that Imperial's practice of allowing a bonus to distributors conditional on the grant to the company of a proportion of their display facilities has an undesirably restrictive effect on competition in the industry generally. We consider that this practice is a " thing done " by Imperial as a result of and for the purpose of preserving its monopoly position which operates and may be expected to operate against the public interest. We have made some other criticisms of Imperial, and particularly of matters which reflect upon the company's efficiency in the past. The company no longer enjoys the degree of dominance which it had before the war, but the points of criticism referred to arise largely from the continuing effects of its former situation. While we do not think that Imperial's present practice in regard to its branch structure and the range of brands is contrary to the public interest we have no doubt that the company will continue to review its policy in these respects. The competitive conditions now prevailing in the industry are likely, in practice, to compel the company to make any further changes that may be necessary in order to minimise its costs.

591. In spite of the criticisms we have made of particular practices we do not think it can be said to be undesirable that Imperial should continue to be responsible for a high proportion of the trade so long as outside competition remains as intense as it has been in recent years. We do not find, therefore, that the conditions which prevail by reason of Imperial's share of the trade operate or may be expected to operate against the public interest.

II. Machinery

592. Sales of cigarette and tobacco machinery are naturally liable to fluctuate from year to year. Average annual sales in the United Kingdom in the eight years from 1951 to 1958 were approximately £2·1 million. The principal manufacturer, Molins Machine Co. Ltd., was responsible for about 55 per cent. of these sales. About 45 per cent. of the total home sales, including about 58 per cent. of Molins' home sales, went to Imperial.

593. The machinery with which we are concerned covers many different types, and few manufacturers can supply the whole range. Molins makes many of the most important types, including cigarette making and cigarette packing machines. Molins exports, on average, about three-quarters of its output and its principal competitors in its export markets are manufacturers in Western Germany and in the United States. Western Germany also exports to the United Kingdom and has enjoyed a rising percentage of total sales, amounting to about 11 per cent. in 1958. Some United States machinery made under contract in the United Kingdom is also sold here. None of the other British manufacturers is a serious competitor with Molins in the field of cigarette making machines though one of them has been making such machines for its parent company, Gallaher.

594. In the light of our conclusions in paragraph 342 we have to consider whether the conditions which prevail—in the case of Molins by reason of the proportion of total supplies for which it is responsible, and in the case of Imperial by reason of the proportion which it purchases—operate or may be expected to operate against the public interest, and we must also consider the " things done " by the two parties.

595. Molins and its predecessors have been operating in this country for more than 60 years, but it is during the past 30 years that the developments have occurred which have transformed a comparatively small business into one of the world's leading specialists in cigarette and tobacco machinery. Molins says that its present position is mainly due to its " ability to invent and develop better machines than its competitors ". It acknowledges, however, that in building up that position it has benefited from its connections with the Associated Companies (Imperial and B.A.T.). Through its financial and trading agreements with the Associated Companies it obtained (i) capital to proceed with development " in a manner and at a rate which might not otherwise have been possible ", (ii) facilities for production trials of its machines, and (iii) a potential though not guaranteed market if it produced good machines. Molins acknowledges that the trading agreement gave the Associated Companies certain advantages over competitors up to 1957, namely preferential terms as to prices and royalties and the right (which only Imperial exercised) to obtain exclusive use of certain machines. It contends that it was reasonable that the Associated Companies should enjoy such advantages having regard to the risks they took in investing in a company whose inventions had still to be proved better than those of anyone else. It adds that it is a common practice to grant advantages of this kind under the terms of patent licences, and that in the present instance the competitors of the Associated Companies had access to a number of alternative sources of supply of machinery. Finally it is said by Imperial—whose arguments generally support those put forward by Molins—that although the trading agreement of 1927 remained in being until 1957 Imperial exercised its exclusive rights much less rigidly from 1945 onwards than it had done before the war.

596. We see no reason for criticising either Molins or Imperial for the actions and arrangements which have led to Molins' present dominant position. In 1927 Molins' subsequent success could by no means have been taken for granted. It has been achieved through superior inventions and the ability to develop and apply them commercially, and through enterprising management backed by the financial resources of Imperial and B.A.T. We do not think that Molins can be blamed in any way for seizing the opportunity presented by such an association or for accepting the terms on which it was offered. It was reasonable on the part of the Associated Companies that they should expect some preferential advantages from any success Molins might achieve. It is no doubt true that some of their competitors, as they have told us (see paragraphs 425 and 426), would have bought certain Molins machines earlier than they did had not the exclusive arrangements prevented it, but none of them has alleged that this had a serious effect on their competitive position. It would be a different matter if the Associated Companies had persisted in maintaining all their advantages long after Molins had established itself as the leading manufacturer of these machines. In fact, the trading agreement of 1927 was terminated in 1957, and the residual advantages to Imperial and B.A.T. afforded by their current agreements with Molins are of a very limited nature.

597. The terms of the present trading agreements together with those of the financial agreement of 1927 which is still operative constitute two of the principal matters whose bearing upon Molins' current monopoly position we have to consider. A third consideration to be taken into account is the level of profit Molins has been earning. We deal with these three matters below before considering Molins' monopoly position as a whole.

598. Under Molins' present trading agreements with Imperial and B.A.T. the two latter companies have the right to a 60-day trial of any new machine and are afforded certain safeguards as to the prices to be paid for all types of machinery, including spares. We have described the trial provisions in paragraphs 336 and 337. In its agreement with Imperial, Molins undertakes not to offer the machine under trial to a competitor of Imperial until the trial is completed, but the agreement with B.A.T. contains no similar provision. Both Molins and Imperial contend that the trials are of substantial value to Molins and ultimately to all Molins' customers, since they frequently lead to modification of the machine in the light of its performance under factory conditions. They also observe that Imperial gains little, if any, advantage over its competitors as to deliveries since the agreement provides that " Molins shall in allocating their manufacturing capacity have regard to reasonable and probable requirements of other customers ". The price provisions of the two agreements are explained and discussed in paragraphs 386 to 388; as we have said there they do little more than ensure that no other purchaser in the countries in which Imperial and B.A.T. will use the machines may receive any price advantage over them.

599. We see every advantage for Molins and for all Molins' customers in the provisions for testing new machines. We do not think the advantages are likely in practice to be greater for Imperial than for any other customer except in so far as Imperial buys on a larger scale than its competitors. The price provisions confer no material advantage on Imperial or B.A.T., but do not preclude either company from using its bargaining powers. It appears to us, indeed, that these two agreements are of very little significance except for the testing provisions.

600. By the terms of the financial agreement of 1927, Imperial and B.A.T. each now owns 25 per cent. of the voting shares of Molins as well as approximately 25 per cent. of the rest of the share capital. The two companies have the right to nominate directors to the board of Molins, but the number so nominated must always be less than half of the total number of directors. This right has never been exercised though representatives of Imperial and B.A.T. have been appointed alternate directors for members of Molins' board. Molins says that Imperial and B.A.T. " have never in fact sought to influence the policy of the company ". The alternate directors, it is said, " hold no more than a watching brief ", and the board of Molins " has exercised full and independent control of the policy and affairs of the company ". Imperial has expressed similar views, saying that it exercises no more influence on Molins' policy than " that appropriate to a large buyer of its machinery ".

601. The evidence we have had generally supports the case submitted by Molins and Imperial. Although the representatives of Imperial and B.A.T. who act as alternate directors of Molins receive monthly reports and attend board meetings, this appears to be no more than a means of keeping the two shareholding companies informed without giving them executive authority. It is clear that the management of Molins has been anxious to maintain its independence and that Imperial and B.A.T. have respected its wish to do so. We have already indicated our view that the association of Imperial with B.A.T. in holding 50 per cent. of Molins' equity is not a matter that calls for criticism so far as it is relevant to Imperial's position as a monopoly supplier of cigarettes and tobacco (see paragraph 552). We see no reason to take a different view after considering the matter in relation to the supply of machinery.

602. The profits earned by Molins in its home trade in the eight years 1951 to 1958, expressed as percentages of capital employed (computed on the basis of the historical cost of fixed assets less depreciation at Inland Revenue rates), were as follows:—

	Per cent.
1951	42·7
1952	24·6
1953	28·2
1954	39·6
1955	29·2
1956	29·0
1957	45·6
1958	43·6
Average for 8 years	36·2

There is no United Kingdom manufacturer of this machinery with a business which resembles that of Molins sufficiently to make any comparison of profits as between it and Molins worth while.

603. When we compare Molins' profits with the average for manufacturing industry generally we find that, after making all due allowance for the difficulties of comparison to which we have already referred (see paragraph 536 and Appendix 6), it is quite clear that during these eight years Molins' level of profit on its home business was much higher than the average. Molins does not dispute this but has submitted certain figures designed to show that some other specialised engineering businesses earn very high rates of profit and has

put forward a number of arguments in justification of its own profits (see paragraphs 396 and 503–509). We do not necessarily accept these arguments in their entirety but deal below with those that appear pertinent.

604. Molins sells only about a quarter of its products in the home market. As we have shown in paragraph 394, a higher level of profit was earned on exports than on home sales during most of the period covered by our survey. This was due principally to the preferential terms provided for in the company's former agreement with Imperial and B.A.T., which was not terminated until 1957. In 1958 the rate of profit on exports was rather below that for the home trade. Molins contends that a price policy which discriminates between one customer and another or one market and another is a dangerous one to adopt, since it lays the seller open to counter-measures, amounting possibly to a complete embargo, in some countries. The company says that it would always have preferred to sell at uniform prices and that it is now doing so and intends to continue to do so, subject only to any quantity allowances that may be justified by savings in cost. It says, accordingly, that the profits it earns in the home market must depend upon the prices it fixes for the whole of its market, and that any reduction in prices and consequently in profits on home sales must be accompanied by a corresponding reduction on export sales.

605. Molins' high profits have been earned in the face of formidable competition because its customers have been willing to pay the price for a Molins machine; its prices, that is to say, have passed the test of the market. It is catering for the special needs of a small number of purchasers in a market which is world-wide and its operations in the home or any other particular market cannot be considered in isolation. Its principal competitors are overseas. It depends for its livelihood on its ability to remain ahead of its competitors in inventiveness and in practical application of inventions. The company can have no assurance that its business will remain profitable; the risks are high because the market is a narrow one and a competitor who produces a better machine can quickly obtain a great part of the potential custom.

606. A high rate of profit is not necessarily against the public interest. Molins is exposed to a high degree of risk and earns its profits in fully competitive conditions. Although exports, as such, are not within our terms of reference we cannot but have some regard to the inter-dependence of Molins' home and export business and to the benefits which the latter brings to the national economy. For all these reasons we do not find that Molins' pricing policy or the level of profit which results from it are against the public interest.

607. To a large extent our review of Molins' trading and financial agreements with Imperial and B.A.T. and of its level of profits has covered the considerations that have to be taken into account in forming a judgment upon Molins' position as a monopoly supplier. Molins says that its dominant position is due to its inventiveness and efficiency which enable it to sell at competitive prices machines which its customers consider superior to the products of its competitors. The company goes on to say that concentration of production and supply of this machinery serves the public interest " since the research and production facilities which Molins command in part as a result of their predominant position both give rise to economies of scale and enable them to compete the more effectively in export markets ". There is, it is said, no danger that this concentration

could have harmful effects in the future, since Molins is not protected from competition and can retain its dominant position only for so long as it keeps the lead in inventiveness and sells its products at competitive prices.

608. In general we accept these submissions as justified in relation to Molins' present position. Although in reaching its present position the company benefited, as it acknowledges, from its connections and agreements with Imperial and B.A.T., we do not think that the existing relations between the three companies afford Molins any material advantage over its competitors. Molins does not, in fact, enjoy the assured market of a monopolist but its exposed to strong competition. We conclude, therefore, that neither Molins' monopoly position nor anything done by the company as a result of or for the purpose of preserving that position operates or may be expected to operate against the public interest.

609. Imperial's position as the purchaser of more than one-third of the machinery supplied in this country is a result of its monopoly position in the cigarette and tobacco trade. The only question of any practical consequence we need consider is whether anything done by Imperial as a result of that position is contrary to the public interest. It follows from what we have said on the subject of Molins that we do not think Imperial's connections and agreements with that company have had undesirable effects. Imperial, as we have said, contends that it exercises no more influence on Molins' policy than that appropriate to a large buyer of its machinery. We think it desirable that Molins should continue under independent management and without interference on the part of Imperial. We know of no other action on the part of Imperial that calls for remark in this connection, and we conclude that neither Imperial's position as the predominant buyer of machinery nor anything done by the company in that capacity operates or may be expected to operate against the public interest.

III. Summary of Conclusions: Recommendations

610. Our conclusions as to the bearing upon the public interest of the " conditions " and the " things done " with which we are concerned under these two references may be summarised as follows:—

Cigarettes and Tobacco

Imperial's monopoly position, as such, does not operate against the public interest nor may it be expected to do so. The retention by Imperial of its shareholding in Gallaher and Imperial's practice of allowing a bonus to distributors conditional on the grant to the company of a proportion of their display facilities are both, however, things done by Imperial, in the one case for the purpose of preserving its monopoly position and in the other both as a result of and for the purpose of preserving that position; both of these things operate and may be expected to operate against the public interest (paragraphs 590 and 591).*

For the reasons given in paragraph 551 we have not considered the effects of Imperial's agreement with and shareholding in B.A.T.

Machinery

Neither Molins' monopoly position nor Imperial's position as the predominant buyer nor any things done by either company operate or may be expected to operate against the public interest (paragraphs 608 and 609).

* See Note of Dissent by Professor Allen regarding resale price maintenance (paragraphs 612–618).

611. We are required to consider whether any, and if so what, action should be taken by way of remedy for the matters which we have found to be against the public interest in connection with the Tobacco reference.

(*a*) So far as Imperial's shareholding in Gallaher is concerned we recommend that Imperial should divest itself of any direct or indirect financial interest in Gallaher.

(*b*) As regards the bonus arrangements we recommend that (1) Imperial should terminate its existing Bonus Agreements, (2) any bonus or allowance granted to a distributor by any tobacco manufacturer, whether by written agreement or otherwise, should in future be related solely to that distributor's turnover in the products of the manufacturer concerned, (3) any such bonus or allowance should be completely dissociated from the grant of continuing advertising or display facilities by distributors (special arrangements for "campaign" advertising are in our view in a different category and unobjectionable), and (4) no tobacco manufacturer should in future enter into an arrangement with a distributor the effect of which is that if the distributor advertises a competing product he must also advertise that manufacturer's product.

R. F. LEVY (*Chairman*)

G. C. ALLEN
(*Subject to Note of Dissent below*)

ANDREW BLACK

BRIAN DAVIDSON

I. C. HILL

W. E. JONES

FRANK SHIRES

A. S. GILBERT (*Secretary*)
6th January, 1961

Note of Dissent by Professor G. C. Allen

612. To my mind the convincing arguments against resale price maintenance that are advanced in paragraphs 563 and 567 are not disturbed by anything said in favour of that practice in paragraphs 564 to 566. I, therefore, dissent from the conclusion reached in paragraph 568. I consider that the weight of evidence and argument shows that resale price maintenance in the tobacco industry is against the public interest and that this restrictive practice should be abolished.

613. The argument in favour of the practice opens with the statement (paragraph 564) that " the margins ruling are, in general, not excessive ". This statement, in my view, is irrelevant in that it refers to *average* margins throughout the trade. What is significant in this context is the divergence of costs among the various distributors in circumstances in which cost differences cannot be reflected in the retail prices charged. The Commission proceed to speculate on what might happen if resale price maintenance were abolished and if some retailers sold their goods at lower prices than others. One possibility, they think, is that there would be little or no change in the way customers distribute their favours. If this result were at all likely, I find difficulty in understanding why the manufacturers should have bothered to prescribe uniform resale prices —a policy that must have cost them money and trouble—or why in the past the trade should have devised elaborate methods for ensuring that the fixed prices were maintained. Experience supports my scepticism. In the days when the evasion of resale price maintenance was possible the cut-price shops did a thriving business. The Commission then turn to what I regard as the more probable outcome, namely the transference of a good deal of custom to the shops that reduce their prices. They think that this would diminish the number of retail outlets and would cause inconvenience to certain customers, presumably to those for whom low-price shops would have little attraction or, in other words, those to whom a choice between high and low prices for cigarettes is a matter of comparative indifference. For my part, I can see no reason why consumers in general should be prevented by the arbitrary decisions of the manufacturers from choosing how they shall distribute their custom—as between buying their cigarettes at high-cost and high-price shops which may afford them some convenience of location and service, or at low-cost shops which are ready to pass on their economies to the purchasers. If resale price maintenance were abolished the number of retail outlets and the structure of the distributive trade in cigarettes would come to depend on the preferences of consumers as expressed in the way they chose to spend their money, and not, as at present, on the manufacturers' dictate which frustrates their freedom of choice in one important respect. If the number of outlets were reduced this would be because an insufficient number of customers was prepared to pay a price high enough to cover the costs of supplying them at certain high-cost points of sale— in other words, because of the effective competition of the low-price shops. Surely, nothing is here for complaint!

614. The Commission's contention that the amount of any possible price reduction would be very small is debatable. Over a period of months even a moderate smoker might save a substantial sum by buying from low-cost retailers. Further, it must be stressed that the present habits of purchasers have been moulded by the existing restrictive arrangements. Under a system of resale

price maintenance purchasers have no inducement to seek out low-cost distributors or to make purchases in quantity. If freedom in pricing were allowed then shopkeepers in search of the advantages of a high turnover would doubtless reduce prices for purchases in quantity (as occurs in the cigarette trade in some countries). This would affect the consumer's purchasing habits and, by enlarging the unit of sale, would open the way to additional economies in distribution. At a time when revolutionary changes in retail distribution are rendering resale price maintenance obsolete in many branches of retailing, it is hard to understand why purchasers of cigarettes should be excluded from the benefits of such changes.

615. The objections to the present system are all the stronger because of the structure of the tobacco manufacturing industry. The Commission say (paragraph 567) that " it may be argued that Imperial can, in effect, determine the method of retail trading for the great bulk of the supply ". This is an understatement. It appears to me that, because of its dominant position, Imperial can exert a decisive influence on methods of sale throughout the trade. The Commission go so far as to admit that it is *arguable* that it is " a disadvantage from the standpoint of the public interest that opportunities for doing business on terms other than those at present imposed should be so narrowly limited, since this produces uniformity and rigidity in trading methods to the detriment of experiment and innovation in distribution ". I should have thought that this proposition was self-evident.

616. In paragraph 565 the Commission predict that freedom in pricing would lead to " loss leader " selling, a practice which (they think) would be objectionable in this industry because it might bring about a further concentration of production. But " loss leader " selling is effective only for those goods for which standard, uniform retail prices have been fixed and are widely known to the public. Where such prices do not exist (and they would cease to exist in the tobacco trade if resale price maintenance were abolished) the practice of " loss leader " selling can have few charms. Even if some retailers, in an attempt to attract to themselves the goodwill created by manufacturers for certain popular brands, offered those brands at exceptionally low prices, it cannot be taken for granted that Imperial would be the chief beneficiary of their policy. Gallaher might benefit to an even greater extent. Indeed, under a regime of freedom in pricing, the way would be open for enterprise and innovation in distribution and the effects on the structure of the industry cannot be foreseen. Greater concentration among the manufacturers is thus only one of several possible results that might attend the introduction of price competition into the retail trade. Can one justify a policy that retards improvements in distribution and deprives consumers of access to cheaper supplies simply in order to provide a safeguard against a danger that may never appear? Even if the Commission are correct in their prediction, it is very doubtful indeed if restrictive practices should be kept in being and price competition excluded for the purpose of preserving a fringe of independent firms which, *ex hypothesi*, would be those which were unable to supply the market as effectively as the dominant producer or producers.

617. There is another argument against resale price maintenance as it affects this trade that has not been examined in the report. It is possible, indeed probable, that retailers, if they themselves were subject to keen price competition, would bring pressure on the manufacturers to reduce prices to the trade. In

other words, price competition among retailers might work back to the manufacturers. If, as is probable, the latter's marketing efforts were then to be diverted from the forms of competition that raise selling costs (e.g. competitive advertising) to such forms as lead to lower prices, then the public interest would be promoted.

618. Finally, I refer briefly to the argument (paragraph 566) that in the absence of resale price maintenance the incidence of bad debts might increase with the result that the manufacturers might have " to reconsider their terms of credit ". Obviously this effect would relate only to the marginal retailers, for the credit of those who enlarged their turnover would be improved—and doubtless their bargaining power *vis-à-vis* their suppliers. It would be reasonable to expect that the danger predicted by Imperial would be confined to the period of transition to the new distributive system when those retailers who had previously been sustained by the restrictive practice were under the pressure of effective price competition. If improvements in the ordering of economic affairs were to be successfully resisted whenever it could be shown that their first impact would have disagreeable consequences for a minority of high-cost traders, then little material progress would be possible.

G. C. ALLEN

APPENDIX 1

(Referred to in paragraph (i) of the Introduction)

THE REFERENCES MADE BY THE BOARD OF TRADE

THE MONOPOLIES AND RESTRICTIVE PRACTICES ACTS, 1948 AND 1953,
AS AMENDED BY THE RESTRICTIVE TRADE PRACTICES ACT, 1956

REFERENCE TO THE MONOPOLIES COMMISSION

I. Cigarettes and Manufactured Cigarette and Pipe Tobacco

Whereas it appears to the Board of Trade that it is or may be the fact that conditions to which the Monopolies and Restrictive Practices (Inquiry and Control) Act, 1948, (hereinafter called " the Act of 1948 ") as amended by the Restrictive Trade Practices Act, 1956, (hereinafter called " the Act of 1956 ") applies prevail as respects the supply of cigarettes and manufactured cigarette and pipe tobacco:

Now, therefore, the Board of Trade, in pursuance of Section 2(1) of the Act of 1948, as amended by the Act of 1956, hereby refer to the Monopolies Commission for investigation and report the matter of such supply.

The Commission shall as respects such supply investigate and report on:—

(1) whether the conditions to which the Act of 1948, as amended by Section 29 of the Act of 1956, applies in fact prevail and, if so, in what manner and to what extent;

(2) the things which are done by the parties concerned as a result of, or for the purpose of preserving, those conditions; and

(3) whether the conditions in question or all or any of the things done as aforesaid operate or may be expected to operate against the public interest.

Dated this 29th day of November, 1956.

G. H. ANDREW
A Secretary of the Board of Trade.

II. Machinery for the Manufacture or Packaging of Cigarettes or of Cigarette or Pipe Tobacco

Whereas it appears to the Board of Trade that it is or may be the fact that conditions to which the Monopolies and Restrictive Practices (Inquiry and Control) Act, 1948, (hereinafter called " the Act of 1948 ") as amended by the Restrictive Trade Practices Act, 1956, (hereinafter called " the Act of 1956 ") applies prevail as respects the supply of machinery for the manufacture or packaging of cigarettes or of cigarette or pipe tobacco:

Now, therefore, the Board of Trade, in pursuance of Section 2(1) of the Act of 1948, as amended by the Act of 1956, hereby refer to the Monopolies Commission for investigation and report the matter of such supply.

The Commission shall as respects such supply investigate and report on:—

(1) whether the conditions to which the Act of 1948, as amended by Section 29 of the Act of 1956, applies in fact prevail and, if so, in what manner and to what extent;

(2) the things which are done by the parties concerned as a result of, or for the purpose of preserving, those conditions; and

(3) whether the conditions in question or all or any of the things done as aforesaid operate or may be expected to operate against the public interest.

Dated this 29th day of November, 1956.

G. H. ANDREW
A Secretary of the Board of Trade.

APPENDIX 2

(Referred to in paragraph (iii) of the Introduction)

PRINCIPAL SOURCES OF EVIDENCE

Ardath Tobacco Co. Ltd.
Board of Trade
Carreras Ltd.
Co-operative Wholesale Society Ltd.
H.M. Customs and Excise
Gallaher Ltd.
The Imperial Tobacco Co. (of Great Britain and Ireland) Ltd.
Molins Machine Co. Ltd.
The National Union of Retail Tobacconists
Godfrey Phillips Ltd.
Rothmans Ltd.
Scottish Co-operative Wholesale Society Ltd.
The Wholesale Tobacco Trade Association
J. Wix & Sons Ltd.

We also obtained evidence from other manufacturers and former manufacturers of cigarettes and tobacco, from a number of leaf merchants, from a large number of wholesale and retail distributors of tobacco goods, from other trade associations representing distributors and from the Parliamentary Committee of the Co-operative Union Ltd. (on behalf of a number of Co-operative Societies), from other machinery manufacturers, and from the former Tobacco Controller.

APPENDIX 3

(*Referred to in paragraph* 106)

THE IMPERIAL TOBACCO COMPANY (OF GREAT BRITAIN AND IRELAND) LIMITED
AUTHORISED CAPITAL 1901–1960 AND ISSUED CAPITAL 1960

Year	Preference Shares	Preferred Ordinary Shares	Deferred Ordinary Shares			Total	Remarks (Based on Memorandum and Articles of Association of the Company)
AUTHORISED	£	£	£			£	
1901	5,000,000	5,000,000	5,000,000			15,000,000	At incorporation 10.12.1901.
1902	6,000,000	6,000,000	6,000,000			18,000,000	By resolution of 11.11.1902.
1909			'A' Deferred Ordinary Shares 3,000,000	'B' Deferred Ordinary Shares 3,000,000			Division of Deferred Ordinary shares into 'A' and 'B'
1914				'B' Deferred Ordinary Shares	Restricted 'B' Deferred Ordinary Shares		"Certain of the 'B' Deferred Ordinary shares were converted into Restricted 'B' Deferred Ordinary shares."
				3,000,000			
1915	'A' 5½ per cent. Cumulative Preference Shares	'B' 6 per cent. Non-Cumulative Preference Shares	'C' 10 per cent. Non-Cumulative Preference Shares	Ordinary Shares	Restricted Ordinary Shares		Change in the nomenclature of the shares.
1916				6,000,000		21,000,000	By resolution of 9.5.1916. The 3,000,000 new shares comprised 2,642,206 Ordinary shares and 357,794 Restricted Ordinary shares.
1918				9,000,000		24,000,000	By resolution of 6.3.1918. The 3,000,000 new shares comprised 2,646,693 Ordinary shares and 353,307 Restricted Ordinary shares.
				Ordinary Shares			"Restrictions upon the transfer of Restricted Ordinary shares were removed [in 1918] and the Restricted Ordinary shares thereupon became Ordinary shares."
1919				18,000,000		33,000,000	By resolution of 7.8.1919.
1920				30,000,000		45,000,000	By resolution of 16.3.1920.
1923				35,000,000		50,000,000	By resolution of 19.6.1923.
1929				40,000,000		55,000,000	By resolution of 19.2.1929.
1932							By resolution of 16.2.1932. "The existing capital of the Company (whether Preference or Ordinary) which had been issued and fully paid up was converted into Stock."
1952				70,000,000		85,000,000	By resolution of 12.8.1952.
AUTHORISED 1960	6,000,000 'A' 5½ per cent. Cumulative Preference Stock	6,000,000 'B' 6 per cent. Non-Cumulative Preference Stock	3,000,000 'C' 10 per cent. Non-Cumulative Preference Stock	70,000,000 Ordinary Stock		85,000,000	
ISSUED	4,959,249	5,260,469	2,638,218	60,100,880		72,958,816	

APPENDIX 4

(*Referred to in paragraphs* 113 *and* 531).

THE IMPERIAL TOBACCO COMPANY (OF GREAT BRITAIN AND IRELAND) LIMITED
MERGERS BETWEEN BRANCHES IN THE UNITED KINGDOM SINCE THE FORMATION OF THE COMPANY IN 1901

Date of acquisition or formation by Imperial	Branch	Branches in									
			1923		1946		1957		1959		1961 (Projected)
1901	W. D. & H. O. Wills		W. D. & H. O. Wills		W. D. & H. O. Wills	1957	W. D. & H. O. Wills		W. D. & H. O. Wills		**W. D. & H. O. Wills**
1901	Stephen Mitchell & Son		Stephen Mitchell & Son	1932	Stephen Mitchell & Son						
1901	F. & J. Smith	1918	F. & J. Smith								
1901	D. & J. Macdonald										
1901	John Player & Sons		John Player & Sons		John Player & Sons		John Player & Sons		John Player & Sons		**John Player & Sons**
1902	Ogden	1923	Ogden								
1901	William Clarke & Son			1930	Ogden		Ogden				
1901	Hignett Bros. & Co.										
1901	Hignett's Tobacco Co.	1902	Hignett Bros. & Co.					1959	Ogden		Ogden
1901	The Richmond Cavendish Co.										
1902	W. & F. Faulkner		W. & F. Faulkner	1946	W. & F. Faulkner						
1901	Adkin & Sons		Adkin & Sons			1954	W. & F. Faulkner				
1902	W. T. Davies & Sons		W. T. Davies & Sons		W. T. Davies & Sons						
1902	W. A. & A. C. Churchman		W. A. & A. C. Churchman		W. A. & A. C. Churchman		W. A. & A. C. Churchman		W. A. & A. C. Churchman		
1901	Lambert & Butler	1923	Lambert & Butler		Lambert & Butler		Lambert & Butler		Lambert & Butler	1961	Churchman, Lambert and Ringer
1911	Allan Ramsay										
1901	Edwards, Ringer & Bigg		Edwards, Ringer & Bigg		Edwards, Ringer & Bigg	1957	Edwards, Ringer & Bigg		Edwards, Ringer & Bigg		
1901	Franklyn, Davey & Co.		Franklyn, Davey & Co.		Franklyn, Davey & Co.						

APPENDIX 5

(*Referred to in paragraph* 239)

COPY OF THE IMPERIAL TOBACCO COMPANY'S BONUS AGREEMENT

TO THE IMPERIAL TOBACCO COMPANY
(OF GREAT BRITAIN AND IRELAND), LTD.
BRISTOL, 3.

CUSTOMER'S UNDERTAKING.

I, THE UNDERSIGNED, hereby request you to admit me to the benefit of your customers' bonus scheme and in consideration of your so doing I WILL during the continuance of the subjoined agreement stock your bonus-bearing goods and display them prominently and effectively in my windows and elsewhere in my premises, and will reserve for them at least fifty per cent. of the slots in Automatic Machines for the sale of tobacco goods on my premises, and will display your show cards and other advertising matter received from you in my windows and inside and outside my premises so far as the nature of my business permits, and will make all proper and reasonable efforts to extend the sale of your goods and to promote your interests, and will conform in every respect to your prices and terms (so far as applicable to my purchases) as set forth in your Wholesale and Retail Schedules respectively and in your Conditions of Sale or otherwise from time to time in force, AND I WILL not knowingly sell or supply directly or indirectly goods bought from you to any person, firm, or company who does not conform in every respect to your said prices and terms, nor to any person, firm, or company after receiving notice or information that you have refused to supply your goods to such person, firm, or company. I WILL at all times perform the foregoing stipulations until you or I shall by fourteen days' previous notice in writing determine this agreement, AND I WILL from time to time, if required by you, declare that I have performed the said stipulations as a condition of my receiving any payment of bonus.

The certificate of your Auditors upon all questions necessary for ascertaining the bonus payable to me is to be accepted as final.

N.B. (*a*) The signature of a MANAGER cannot be accepted.

(*b*) EXECUTORS, ADMINISTRATORS, TRUSTEES, ETC. should state themselves to be such, after their names.

(*c*) In the case of LIMITED COMPANIES, the Secretary or a Director must sign, stating his capacity.

DATED this day of , 19 .

TO BE FILLED IN BY PROPRIETOR OR *ONE* PARTNER

Usual Signature here(1)............. {Mr. / Mrs. / Miss} {Married woman / Widow} Strike out whichever does not apply.
(NOT Block Capitals)

FULL Christian Names here } (2)....................................

FULL Names of other Partners } (3)........................ (4)........................ {Please state " Mr.", " Mrs." or " Miss " after EACH partner's name.

*All goods must be ordered in the *TRADING NAME*, otherwise they may not be entered in the Bonus List. If differing from name of proprietor(s), the trading name should be registered under the Registration of Business Names Act.

*TRADING NAME (the name in which goods are ordered) (5)....................................

FULL Postal Address including County (6)....................................
....
....
....
....

Description of Business ....

Addresses of Branches....................................
(or furnish separate list) ....
....
....
....
....
....
....

TO THE ABOVE NAMED CUSTOMER.

IMPERIAL TOBACCO COMPANY'S UNDERTAKING.

IN pursuance of the foregoing Request and for the considerations therein set forth WE, THE IMPERIAL TOBACCO COMPANY (OF GREAT BRITAIN AND IRELAND), LIMITED, hereby admit you to participate in our customers' bonus scheme as herein set forth upon condition of your observing all the stipulations on your part set forth in the said request, and henceforth during the continuance of this agreement forthwith after the declaration of a final Dividend for any financial year upon our Ordinary Stock (whether preferred or deferred) we will cause our Auditors to certify as accurately as may be practicable what proportion of the amount required for the Dividends declared on all the said stock in respect of such year has arisen from net profits on our sales in that year within the United Kingdom, and forthwith after receiving each such Certificate we will set apart a sum equal to two-fifths of the said proportion and will cause our Auditors to certify what percentage the said sum so set apart will provide upon the amount of all our sales during the said year (less goods returned) of bonus-bearing goods, that is to say goods so described or referred to in our Schedules or Price Lists from time to time in force, and within six months after the payment of such final dividend we will pay to you the certified percentage (less any such interim payment as hereinafter provided) upon all bonus-bearing goods bought by you from us (and not returned) during the same year and paid for before the expiration of the said six months. And we further undertake that we will within four months after the expiration of the first half of each financial year, cause our Auditors to certify what is a fair percentage to be paid on account of bonus upon our aforesaid sales of bonus-bearing goods during such half-year, and we will, in the next succeeding month of January, pay to you the percentage so certified upon all bonus-bearing goods bought by you from us (and not returned) during the same half-year, and paid for by you, and the amount so paid by us to you shall be taken as an interim payment on account of the bonus payable to you in respect of the entire financial year. This agreement with you shall continue in force until you or we shall by fourteen days' previous notice in writing determine it, unless we shall be of opinion that you have failed to perform the stipulations on your part contained in the said Request, and then and in such case we may, by notice in writing to you, wholly or partially annul your participation in the benefits of the said bonus scheme, and you will wholly or partially (as the case may be) lose your right or interest in the bonus, whether accrued or accruing. Any customer while indebted to us becoming subject to a Receiving Order or offering a composition or suspending payment or committing any other act of bankruptcy, will thereupon forfeit all claim to bonus both accrued and accruing.

DATED this day of , 19

THE IMPERIAL TOBACCO COMPANY
(OF GREAT BRITAIN AND IRELAND) LIMITED

Secretary.

Owing to a change in the nomenclature of our stock the expression " our ordinary stock (whether preferred or deferred) " used above now includes in addition to our ordinary stock our B 6%and C 10% non-cumulative preference stock.

APPENDIX 6

(*Referred to in paragraphs* 377, 489, 536 *and* 603)

PROFIT AS YIELD ON AVERAGE CAPITAL EMPLOYED

1. In three earlier reports we have recorded our computations of the weighted average profit ratios in relation to capital employed of some 2,000 public companies in manufacturing and non-manufacturing industry, and have compared them with the profit ratios in the industries with which the reports were concerned.* These computations were prepared from statistics of Industrial Profits and Assets which appear quarterly in " The Economist ". It was assumed that the profits shown in the accounts published in the first three quarters of any calendar year would have been earned mainly in the preceding calendar year; figures from accounts published in the fourth quarter, which were thought likely to relate approximately equally to the previous year and to the year in which they were published, were omitted from our calculations. Capital employed was calculated by taking the total assets, excluding outside investments and goodwill items but including cash balances, and deducting therefrom current liabilities and provisions. Profit yields were based on the published profits (i) before deduction of tax, (ii) before payment of interest (which was estimated in accordance with current interest rates) on loans and overdrafts, and (iii) after deducting one-half of the non-recurring profits to eliminate the tax element therein and other non-trading items. Thus capital employed was represented not only by share capital but by all forms of borrowing (including debentures and bank overdrafts) and by capital and revenue reserves (including provision for future taxation); and the profit ratios represented the yield, before tax, on that capital. Although we found it convenient to start from the data assembled by " The Economist " the method of computation was our own. The average profit ratios for manufacturing industry computed by this method (Method 1) are given in paragraph 7 below.

2. As we have mentioned in paragraph 377, Imperial has submitted a computation of the average rate of profit earned by manufacturing industry in general based on an alternative statistical source. The profit ratios calculated by this method (Method 2)

* See Report on the Supply of Certain Industrial and Medical Gases (H.M.S.O., 1956), Appendix 16 and paragraph 260; Report on the Supply and Exports of Electrical and Allied Machinery and Plant (H.M.S.O., 1957), Appendix 12 and paragraphs 644 and 762; Report on the Supply of Chemical Fertilisers (H.M.S.O., 1959), Appendix 9 and paragraphs 544 and 649.

are also given in paragraph 7 below. The company bases its calculations on data relating to manufacturing industry which have only recently become available as a continuous series, namely the analysis of the accounts of some 3,000 public companies quoted on the United Kingdom Stock Exchanges which was first published in a book entitled " Company Income and Finance 1949–53 ", issued for private circulation by the National Institute of Economic and Social Research, and is now being kept up to date by the Board of Trade, the results being published in " Economic Trends ".

3. The principal differences between the two sources are the following:—

(*a*) The figures in " Economic Trends " are assembled by grouping individual accounts whose financial years ended within each fiscal year and describing the aggregates so obtained as relating to the calendar year ended within the fiscal year. The figures given by " The Economist " on the other hand are grouped by taking individual accounts published within each quarter of a year and, as we have mentioned, we have based our calculations for a given calendar year on the accounts published in the next three succeeding quarters.

(*b*) " The Economist " covers a smaller number of companies than " Economic Trends ". The difference is further widened by our omission of accounts published in one quarter of the year.

(*c*) The figures in " Economic Trends " are arrived at after excluding as far as possible companies which operate primarily overseas. The figures published in " The Economist " do not generally exclude such companies.

(*d*) " Economic Trends " provides a more detailed analysis of the published figures than " The Economist ".

The relevant data provided by " The Economist " have so far been available considerably earlier than those published in " Economic Trends ".

4. Apart from the adoption of a different statistical source, Imperial's method of computation differs from that described in paragraph 1 above in one important and some minor particulars. The main divergence is that we have included cash balances and tax reserve certificates in our calculations of capital employed while Imperial excludes both of these items. The minor differences arise at least partly from (*d*) above. Imperial argues that the exclusion of cash from capital employed is justified as the greater part of it is " temporarily unemployed capital ", much of it on call or short-term deposit. This may over-state the case. The cash balances of all businesses fluctuate, and some part of the aggregate will be necessary working capital. Moreover, there may be a tendency on the part of some companies at least to have an abnormally high degree of liquidity on the dates to which their balance sheets relate. We recognise, nevertheless, that the aggregate cash balances of industrial companies are liable to include some element of genuinely surplus cash. As Imperial has pointed out, we have from time to time excluded surplus cash balances when estimating the capital employed by certain individual companies with which our inquiries have been concerned; we have done so, for instance, in the case of Molins (see paragraph 391). In such cases, however, our purpose has been to arrive at a reasonable estimate of the capital employed by the company in producing and selling the particular goods with which our report was concerned; we have satisfied ourselves that the amounts of cash in question were not capital required by the company for that purpose at the relevant times.

5. In the period from 1949 to 1959, for which we have made an examination of profits, industry as a whole appears to have been carrying an unusually large amount of cash at least up to 1955, and a proportion of this was probably surplus to its requirements. Information is not available, however. on which to estimate the extent to which cash balances should be included in the capital employed either up to 1955 or more recently. In Imperial's computation (Method 2) the capital employed tends to be under-stated and profit ratios over-stated by wholly eliminating cash balances; in our own computation (Method 1) capital employed is over-stated, and profit ratios under-stated, to the extent that cash surplus to the requirements of the undertakings concerned may be included. We have made a further series of calculations based on the statistical source used by Imperial but applying thereto the method of computation we have hitherto used. The profit ratios for manufacturing industry computed by this method (Method 3) are given in paragraph 7 below. The differences between the figures arrived

at by Methods 1 and 3 can be attributed to the different statistical sources used, and between those arrived at by Methods 2 and 3 to the different treatment of cash balances.

6. All three series of profit ratios are arrived at by averaging figures derived from the published accounts of a number of companies whose accounting methods differ. In particular, while most companies continue to value their fixed assets on the basis of historical cost, the number of those which have revalued their assets on a replacement cost basis is growing, especially among larger companies. Such information as we have leads us to believe that the average figures are likely still to be heavily weighted on the side of historical cost; nevertheless, it must be presumed that all three sets of profit ratios would be somewhat higher if it were possible to readjust to a uniform historical cost basis. Our information is not sufficient to enable us to make the adjustment. The three methods can only be regarded as providing a broad indication of the level of profit in manufacturing industry.

7. The weighted average profit ratios for manufacturing industry in general arrived at by the three methods described above are as follows:—

	Method 1	Method 2	Method 3
	%	%	%
1949	N/A	22·4	18·7
1950	N/A	24·8	20·9
1951	19·4	25·7	22·2
1952	15·4	19·4	17·1
1953	16·6	20·2	17·6
1954	17·2	20·9	18·2
1955	17·3	20·4	18·0
1956	16·5	18·0	16·4
1957	15·4	16·7	15·5
1958	14·1	N/A	N/A

N/A = not available (see Note below).

Note: For the purpose of Method 1, " manufacturing industry in general " means the seventeen industry groups comprised under the heading " Manufacturing " in the tables given in previous reports (e.g. Appendix 9 of the Report on the Supply of Chemical Fertilisers). Methods 2 and 3 cover approximately the same field, subject to differences in selection of companies which we have described. We have not thought it worth while to make separate calculations for non-manufacturing industry, or to make the calculations by Method 1 for manufacturing industry for 1949 and 1950. The relevant data for making the calculation for 1958 by Methods 2 and 3 only became available shortly before the signature of this report.

APPENDIX 7

Table 1

(Referred to in paragraph 7)

UNITED KINGDOM IMPORTS OF UNMANUFACTURED TOBACCO

1900–1959

Year	Country of Consignment										Total
	U.S.A.		Canada		Rhodesia and Nyasaland		India		Other		
	lb. '000	% of Total	lb.'000	% of Total	lb.'000	% of Total	lb.'000	% of Total	lb.'000	% of Total	lb.'000
1900	88,805	90·3	29	neg.	...	...	0	neg.	9,515	9·7	98,349
1901	76,467	90·4	6	neg.	...	...	1	neg.	8,147	9·6	84,621
1902	116,129	92·0	0	neg.	...	...	9	neg.	10,083	8·0	126,221
1903	73,626	87·6	—	—	...	...	19	neg.	10,407	12·4	84,052
1904	94,643	88·7	6	neg.	...	...	3	neg.	12,018	11·3	106,670
1905	73,226	88·0	15	neg.	...	...	3	neg.	9,933	12·0	83,177
1906	104,408	90·4	—	—	—	—	20	neg.	11,098	9·6	115,526
1907	86,632	87·7	0	neg.	176	0·2	3	neg.	11,969	12·1	98,780
1908	107,020	89·9	27	neg.	79	0·1	7	neg.	11,903	10·0	119,036
1909	114,007	89·8	0	neg.	899	0·7	15	neg.	11,991	9·5	126,912
1910	98,951	88·9	1	neg.	1,426	1·3	1	neg.	10,879	9·8	111,258
1911	104,608	88·0	1	neg.	1,827	1·5	40	neg.	12,331	10·5	118,807
1912	121,830	88·5	8	neg.	1,558	1·1	43	neg.	14,297	10·4	137,736
1913	142,043	87·5	0	neg.	2,065	1·3	7	neg.	18,251	11·2	162,366
1914	138,985	87·6	1	neg.	2,372	1·5	457	0·3	16,878	10·6	158,693
1915	184,237	90·9	24	neg.	3,178	1·6	495	0·2	14,717	7·3	202,651
1916	152,581	92·9	21	neg.	5,151	3·1	750	0·5	5,763	3·5	164,266
1917	40,789	87·6	51	0·1	1,103	2·4	699	1·5	3,901	8·4	46,543
1918	162,928	94·9	124	0·1	4,485	2·6	631	0·4	3,471	2·0	171,639
1919	315,933	90·5	140	neg.	6,018	1·7	3,844	1·1	22,972	6·7	348,907
1920	177,508	81·0	215	0·1	5,662	2·6	9,590	4·4	26,068	11·9	219,043
1921	214,757	94·3	174	0·1	4,952	2·2	1,415	0·6	6,539	2·8	227,837
1922	166,822	90·2	855	0·5	7,095	3·8	3,935	2·1	6,150	3·4	184,857
1923	154,859	89·5	956	0·6	6,258	3·6	4,575	2·6	6,390	3·7	173,038
1924	156,938	86·0	1,787	1·0	7,609	4·2	8,412	4·6	7,677	4·2	182,423
1925	162,719	86·1	1,859	1·0	8,102	4·3	7,785	4·1	8,516	4·5	188,981
1926	161,410	81·8	4,914	2·5	11,389	5·8	11,854	6·0	7,637	3·9	197,204
1927	177,442	79·8	5,813	2·6	24,870	11·2	8,433	3·8	5,707	2·6	222,265
1928	171,839	78·9	6,029	2·8	24,453	11·2	10,339	4·7	5,125	2·4	217,785
1929	205,376	85·6	5,025	2·1	15,858	6·6	9,181	3·8	4,586	1·9	240,026
1930	197,765	83·4	4,041	1·7	17,124	7·2	13,041	5·5	5,057	2·2	237,028
1931	157,218	81·0	6,273	3·2	17,438	9·0	9,347	4·8	3,770	2·0	194,046
1932	125,176	71·6	10,672	6·1	26,215	15·0	9,208	5·3	3,641	2·0	174,912
1933	159,896	75·7	13,961	6·6	20,807	9·9	12,968	6·1	3,476	1·7	211,108
1934	188,945	79·1	8,055	3·4	28,798	12·1	9,798	4·1	3,279	1·3	238,875
1935	202,550	80·5	7,076	2·8	25,637	10·2	11,587	4·6	4,770	1·9	251,620
1936	213,525	78·8	9,289	3·4	28,436	10·5	13,695	5·1	5,954	2·2	270,899
1937	203,349	76·0	8,649	3·2	28,353	10·6	19,150	7·2	7,959	3·0	267,460
1938	256,716	74·4	16,093	4·7	32,737	9·5	32,552	9·4	6,760	2·0	344,858
1939	128,041	60·5	30,232	14·3	27,338	12·9	21,149	10·0	4,712	2·3	211,472
1940	59,060	41·8	8,471	6·0	34,742	24·6	18,747	13·3	20,410	14·3	141,430
1941	129,441	60·6	2,470	1·2	33,009	15·4	26,077	12·2	22,740	10·6	213,737
1942	180,335	68·1	10,685	4·0	39,512	14·9	22,697	8·6	11,678	4·4	264,907
1943	291,054	82·2	9,122	2·6	34,496	9·7	16,961	4·8	2,427	0·7	354,060
1944	180,285	78·4	8,895	3·9	28,141	12·2	4,715	2·1	7,889	3·4	229,925
1945	309,812	84·0	12,097	3·3	33,030	9·0	10,122	2·7	3,750	1·0	368,811
1946	365,798	84·5	9,227	2·1	34,369	7·9	17,614	4·1	5,724	1·4	432,732
1947	201,235	68·1	22,224	7·5	35,635	12·1	22,942	7·8	13,585	4·5	295,621
1948	172,383	61·4	12,686	4·5	59,181	21·1	22,815	8·1	13,710	4·9	280,775

Table 1—*contd.*

Year	Country of Consignment										Total
	U.S.A.		Canada		Rhodesia and Nyasaland		India		Other		
	lb.'000	% of Total	lb.'000	% of Total	lb.'000	% of Total	lb.'000	% of Total	lb.'000	% of Total	lb.'000
1949	154,117	51·2	12,983	4·3	65,520	21·8	38,361	12·7	30,182	10·0	301,163
1950	143,699	47·0	15,834	5·2	80,033	26·2	48,139	15·7	18,099	5·9	305,804
1951	212,005	59·7	21,664	6·1	67,674	19·1	40,120	11·3	13,415	3·8	354,878
1952	66,798	29·9	32,709	14·6	70,620	31·6	38,319	17·1	15,272	6·8	223,718
1953	174,110	55·1	24,087	7·7	68,723	21·8	31,435	10·0	17,380	5·4	315,735
1954	159,552	51·2	24,879	8·0	76,013	24·4	36,250	11·6	14,960	4·8	311,654
1955	178,496	51·9	40,007	11·6	72,058	21·0	36,404	10·6	16,740	4·9	343,705
1956	160,267	50·3	21,677	6·8	84,384	26·5	40,017	12·6	12,026	3·8	318,371
1957	168,056	52·7	25,647	8·0	79,932	25·1	35,601	11·2	9,595	3·0	318,831
1958	163,902	51·9	23,434	7·4	74,607	23·6	44,696	14·1	9,333	3·0	315,972
1959	N/A		N/A		N/A		N/A		N/A		300,658

0 = less than 500 lb.
neg. = negligible.
— = nil.
... = not separately specified.
N/A = not available.

Source: Annual Statements of the Trade of the United Kingdom.

Notes: (1) Imports for 1900 to 1903 inclusive were accredited to the country of final shipment, subsequently to country of consignment.

(2) Figures for India in 1936 and earlier years include imports from Burma.

(3) Since 1900 United Kingdom exports of imported unmanufactured tobacco have never been more than 20 million lb. in any year. In recent years they have been substantially less.

APPENDIX 7

Table 2

(Referred to in paragraph 36)

UNITED KINGDOM IMPORTS OF CIGARETTES AND MANUFACTURED TOBACCO (OTHER THAN CIGARS AND SNUFF)

1900–1959

Year	lb. '000	Year	lb. '000	Year	lb. '000	Year	lb. '000	Year	lb. '000
1900	3,632	1912	1,817	1924	960	1936	818	1948	240
1901	4,471	1913	1,807	1925	927	1937	902	1949	248
1902	2,826	1914	1,342	1926	590	1938	808	1950	185
1903	2,628	1915	1,848	1927	609	1939	720	1951	209
1904	2,201	1916	2,091	1928	638	1940	325	1952	244
1905	1,640	1917	2,264	1929	720	1941	172	1953	277
1906	1,630	1918	4,639	1930	697	1942	184	1954	283
1907	1,702	1919	6,215	1931	636	1943	183	1955	325
1908	1,740	1920	2,436	1932	570	1944	229	1956	414
1909	1,820	1921	906	1933	648	1945	178	1957	459
1910	1,669	1922	827	1934	750	1946	409	1958	415
1911	2,120	1923	863	1935	736	1947	308	1959	564

Source: Annual Statements of the Trade of the United Kingdom.

Notes: (1) The figure for 1959 includes snuff.

(2) United Kingdom exports of imported cigarettes and manufactured tobacco (other than cigars and snuff) since 1950 have been as follows:

	lb. '000		lb. '000		lb. '000
1950	54	1953	10	1956	27
1951	34	1954	16	1957	26
1952	18	1955	18	1958	37

APPENDIX 7

Table 3

(Referred to in paragraph 29)

CUSTOMS DUTY ON TOBACCO LEAF

BASIC DUTY: 1900–1960

Period	Basic duty per lb.	
	Full	Preferential
	s. d.	s. d.
to 5.3.1900	2 8	—
6.3.1900 to 12.4.1909	3 0	—
13.4.1909 to 21.9.1915	3 8	—
22.9.1915 to 2.5.1917	5 6	—
3.5.1917 to 15.7.1917	7 4	—
16.7.1917 to 22.4.1918	6 5	—
23.4.1918 to 31.8.1919	8 2	—
1.9.1919 to 30.6.1925	8 2	5/6ths of full rate
1.7.1925 to 30.6.1926	8 2	$\frac{3}{4}$ of full rate
1.7.1926 to 11.4.1927	8 2	6 $1\frac{1}{2}$
12.4.1927 to 10.9.1931	8 10	6 $9\frac{1}{2}$
11.9.1931 to 25.4.1939	9 6	7 $5\frac{1}{2}$
26.4.1939 to 27.9.1939	11 6	9 $5\frac{1}{2}$
28.9.1939 to 23.4.1940	13 6	11 $5\frac{1}{2}$
24.4.1940 to 23.7.1940	17 6	15 $5\frac{1}{2}$
24.7.1940 to 14.4.1942	19 6	17 $5\frac{1}{2}$
15.4.1942 to 12.4.1943	29 6	27 $5\frac{1}{2}$
13.4.1943 to 15.4.1947	35 6	33 $11\frac{1}{2}$
16.4.1947 to 6.4.1948	54 10	53 $3\frac{1}{2}$
7.4.1948 to 17.4.1956	58 2	56 $7\frac{1}{2}$
18.4.1956 to 4.4.1960	61 2	59 $7\frac{1}{2}$
5.4.1960 to	64 6	62 $11\frac{1}{2}$

Source: H.M. Customs and Excise.

Note: The rates given above are those applicable to unstripped leaf tobacco containing not less than 10 per cent. of moisture. For current rates applicable to other tariff headings see Table 4.

APPENDIX 7

Table 4

(*Referred to in paragraphs* 29 *and* 35)

CUSTOMS AND EXCISE DUTIES, DRAWBACKS AND ALLOWANCES ON TOBACCO GOODS EFFECTIVE FROM 5TH APRIL, 1960

CUSTOMS DUTY

Tariff Heading	Rate of Duty	
	Full	Preferential
	per lb. £ s. d.	per lb. £ s. d.
Unmanufactured tobacco; tobacco refuse:		
(A) Unmanufactured tobacco:		
(1) Unstripped:		
(*a*) Containing 10 per cent. or more by weight of moisture	3 4 6	3 2 11½
(*b*) Other	3 5 6	3 3 9½
(2) Stripped:		
(*a*) Containing 10 per cent. or more by weight of moisture	3 4 6½	3 2 11⅞
(*b*) Other	3 5 6½	3 3 9⅞
(B) Tobacco refuse	Prohibited	
Manufactured tobacco; tobacco extracts and essences:		
(A) Manufactured tobacco:		
(1) Cigars	3 14 5	3 11 5⅝
(2) Cigarettes	3 10 0	3 7 7½
(3) Cavendish or negrohead:		
(*a*) Manufactured in bond..	3 7 0	3 5 0½
(*b*) Other	3 9 0	3 6 9
(4) Snuff:		
(*a*) Containing more than 13 per cent. by weight of moisture	3 6 6	3 4 7⅞
(*b*) Other	3 9 0	3 6 9
(5) Other	3 7 3	3 5 3½
(B) Extracts and essences	Prohibited	

EXCISE DUTY

Class or description of goods	Rate of Duty
	per lb. £ s. d.
TOBACCO:	
Unmanufactured:	
Containing 10 lb. or more of moisture in every 100 lb. weight thereof	3 2 9½
Containing less than 10 lb. of moisture in every 100 lb. weight thereof	3 3 7½
Manufactured:	
Cavendish or negrohead manufactured in bond and so in proportion for any less quantity	3 5 0½

Class or description of goods	Rate of Drawback (where duty was paid at rate appropriate on and after 5th April, 1960) Full	Preferential
	per lb.* £ s. d.	per lb.* £ s. d.
TOBACCO:		
(1) Tobacco manufactured in the United Kingdom—upon being, by any licensed manufacturer, exported as merchandise, shipped as stores, exported by post or warehoused for use as stores or for exportation by post:		
Cigars	3 8 10	3 7 3½
Cigarettes	3 5 6	3 3 11½
Cut, roll, cake or other manufactured Tobacco..	3 5 3	3 3 8½
Snuff (not being offal snuff)	3 5 0	3 3 5½
(2) Stalks, shorts or other refuse of tobacco, including offal snuff—upon being, by any licensed manufacturer, exported as merchandise, or warehoused for exportation as merchandise or for the purpose of being denatured or converted into nicotine, sheep-wash, hop-powder or some other article or compound for agricultural or horticultural purposes, etc.; or for abandonment in an approved Queen's Warehouse	3 4 9	3 3 2½

* The rates of drawback specified are allowed on tobacco, etc., containing 14 per cent. of moisture, proportionate increase or reduction being made if the moisture is less or more than 14 per cent.

A deduction is made from the drawback for every lb. of inorganic matter in excess of 22 per cent. (calculated on the tobacco, etc., exclusive of water). The Commissioners of Customs and Excise are, however, empowered to waive this deduction except in the case of snuff or offal snuff, where they are satisfied that there has been no artificial increase of inorganic matter during manufacture.

No drawback is allowed on the exportation of any cavendish or negrohead tobacco manufactured in bond and delivered for home use.

Where duty was paid, at a rate in force before 5th April, 1960, drawback will be at the rate appropriate to the duty paid.

EXCISE DRAWBACKS AND ALLOWANCES

Class or description of goods	Rate of Drawback
TOBACCO	Rates corresponding to the Preferential rates of customs drawback.
	Rate of Allowance
TOBACCO, in a marketable condition and fully cured—upon being exported from warehouse or curer's premises or upon being manufactured into cavendish or negrohead tobacco in bond	2d. per lb.

Source: H.M. Customs and Excise Tariff in operation on 1st January, 1960 (as amended).

APPENDIX 7

Table 5

(*Referred to in the footnote to paragraph* 29)

IMPORTED UNMANUFACTURED TOBACCO

QUANTITIES RETAINED FOR HOME CONSUMPTION AND NET DUTY RECEIPTS

1900–1959

Year	Quantity Retained for Consumption	Net Receipts	Year	Quantity Retained for Consumption	Net Receipts	Year	Quantity Retained for Consumption	Net Receipts
	lb. '000	£'000		lb. '000	£'000		lb. '000	£'000
1900	75,425	10,072	1920	146,409	59,270	1940	199,970	117,177
1901	80,214	12,014	1921	136,139	55,002	1941	190,249	172,591
1902	65,432	9,795	1922	135,167	54,585	1942	235,581	220,497
1903	77,953	11,675	1923	124,754	50,201	1943	228,632	329,746
1904	79,756	11,946	1924	127,847	51,216	1944	220,895	386,858
1905	80,896	12,508	1925	128,159	51,267	1945	218,369	380,443
1906	83,184	12,713	1926	133,836	52,840	1946	235,423	410,062
1907	84,222	12,667	1927	136,101	53,233	1947	254,376	443,911
1908	87,797	13,173	1928	137,076	57,486	1948	211,039	568,527
1909	88,303	13,250	1929	141,054	58,439	1949	211,906	608,774
1910	84,340	15,104	1930	150,624	62,155	1950	212,790	609,713
1911	89,724	16,562	1931	153,940	63,511	1951	214,436	613,945
1912	91,424	16,749	1932	144,820	62,804	1952	218,315	623,924
1913	91,054	16,655	1933	150,065	66,869	1953	219,597	628,026
1914	96,513	17,651	1934	151,618	67,089	1954	223,710	639,200
1915	102,707	18,772	1935	158,389	70,162	1955	231,849	662,648
1916	108,629	25,125	1936	168,141	74,494	1956	238,629	681,940
1917	99,648	26,918	1937	173,836	76,766	1957	238,264	715,831
1918	102,586	32,737	1938	187,234	82,284	1958	241,129	725,006
1919	111,757	44,683	1939	191,327	84,284	1959	243,935	733,662

Source: H.M. Customs and Excise.

Notes: (1) Years ended 31st March.

(2) In the year ended 31st March, 1959 receipts from Customs and Excise duties on tobacco were as follows:—

	£
Customs Duty Receipts:	
Gross Receipts	930,202,116
Less Drawbacks and Allowances	193,010,259
Less Repayments, Rebates and Payments to Isle of Man	1,031,113
Net Receipts	736,160,744
Excise Duty Receipts:	
Net Receipts	—
Total Customs and Excise Duties Net Receipts	736,160,744
Total Net Receipts were made up as follows:—	
Tobacco: Unmanufactured	733,662,458
Cigars	965,632
Cigarettes	360,323
Other Manufactured	1,223,324
	736,211,737
Less amount repaid in respect of relief to Old Age Pensioners from increased tobacco duty	50,993
Net Receipts	736,160,744

APPENDIX 7

Table 6

(*Referred to in paragraph* 32)

TOBACCO MANUFACTURERS' LICENCES ISSUED

1900–1959

Year	Licences issued	Year	Licences issued	Year	Licences issued	Year	Licences issued	Year	Licences issued
1900	502	1912	360	1924	293	1936	206	1948	163
1901	503	1913	346	1925	282	1937	199	1949	160
1902	502	1914	334	1926	281	1938	192	1950	154
1903	482	1915	332	1927	271	1939	185	1951	151
1904	462	1916	342	1928	268	1940	179	1952	155
1905	441	1917	346	1929	260	1941	175	1953	140
1906	429	1918	353	1930	257	1942	168	1954	128
1907	415	1919	366	1931	251	1943	168	1955	113
1908	415	1920	404	1932	230	1944	166	1956	109
1909	407	1921	384	1933	220	1945	166	1957	101
1910	383	1922	328	1934	216	1946	162	1958	97
1911	364	1923	309	1935	211	1947	166	1959	94

Source: H.M. Customs and Excise.

Notes: (1) Years ended 31st March.

(2) From 1900 to 1921 inclusive the figures are of licences issued for Great Britain and the whole of Ireland; from 1922 the figures are of licences issued for Great Britain and Northern Ireland only.

(3) The figures include licences issued solely for the manufacture of cigars and snuff. Separate figures for these are not available, but in 1957 only about ten licences were held solely for the manufacture of cigars and snuff.

(4) The figures do not represent the actual number of tobacco manufacturers or factories operated; many distributors have their own brands made for them and hold manufacturers' licences in order to claim drawback on exports.

APPENDIX 7

Table 7

(*Referred to in paragraph* 39)

TOBACCO DEALERS' LICENCES ISSUED

1900–1959

Year	Licences issued	Year	Licences issued	Year	Licences issued	Year	Licences issued	Year	Licences issued
1900	344,865	1912	393,565	1924	419,205	1936	540,319	1948	411,605
1901	346,323	1913	396,572	1925	433,482	1937	533,063	1949	407,689
1902	352,243	1914	401,872	1926	439,635	1938	531,385	1950	408,788
1903	359,289	1915	407,594	1927	443,819	1939	530,409	1951	410,484
1904	365,899	1916	404,827	1928	458,171	1940	519,278	1952	409,688
1905	367,772	1917	392,392	1929	465,474	1941	478,540	1953	409,276
1906	374,522	1918	370,507	1930	475,630	1942	429,641	1954	411,135
1907	380,825	1919	338,589	1931	486,882	1943	419,996	1955	417,660
1908	386,260	1920	378,238	1932	490,828	1944	411,056	1956	423,610
1909	390,437	1921	403,795	1933	508,269	1945	404,788	1957	419,265
1910	383,700	1922	389,637	1934	531,637	1946	404,273	1958	419,777
1911	390,024	1923	413,749	1935	540,519	1947	412,624	1959	422,464

Source: H.M. Customs and Excise.

Notes: (1) Years ended 31st March.

(2) From 1900 to 1921 inclusive the figures are of licences issued for Great Britain and the whole of Ireland; from 1922 the figures are of licences issued for Great Britain and Northern Ireland only.

INDEX

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