Neutral Citation Number: [2008] EWHC 804 (Comm)

Case No: 2005 FOLIO 185

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 18/04/2008

Before :

MR JUSTICE CHRISTOPHER CLARKE

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Between:

GALLAHER INTERNATIONAL LIMITED	**Claimant**
Claimant/Part 20 Defendant	
- and -	
TLAIS ENTERPRISES LIMITED	**Defendant**
(a company incorporated under the laws of Cyprus)	
Defendant/Part 20 Claimant	

AND BETWEEN

GALLAHER INTERNATIONAL LIMITED	**Claimant**
-and-	
PTOLOMEOS TLAIS	**Defendant**

- -
- -

Mr Lawrence Rabinowitz QC, Mr Daniel Toledano & Mr Simon Colton (instructed by **Slaughter & May, Solicitors, London**) for the Claimant
Mr Richard Hill, Mr Alastair Tomson & Mr Adam Holliman (instructed by **Picton Howell, Solicitors, London**) for the Defendant

Hearing dates:
23rd - 24th April, 2nd -3rd May, 8th –10th May, 14th – 15th May, 21st – 25th May, 5th – 8th June, 11th – 15th June, 18th – 22nd June, 26th – 28th June, 4th – 5th July, 9th – 12th July, 16th – 19th July, 24th – 27th July, 30th – 31st July, 1st August, 8th – 9th October, 15th – 17th October, 28th – 29th November 2007.

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE CHRISTOPHER CLARKE

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Overview

The main action

1 In the first of these two actions Gallaher International Ltd claims that by a letter dated 4th March 2005 it lawfully terminated a distribution agreement between it and Tlais Enterprises Limited ("TEL") whereby TEL was appointed as Gallaher's distributor in respect of certain specified brands of cigarettes. TEL disputes that TEL Agreement was lawfully terminated and counterclaims over $ 675 million by way of damages. In the second action Gallaher claims against Mr Ptolomeos Tlais, one of the beneficial owners of TEL, under a personal guarantee. In this judgment I use "Gallaher" primarily to refer to the claimant; but, on occasion, to refer generically to the Gallaher group.

2 The distribution agreement ("the TEL Agreement") commenced on 1st May 2002. Prior thereto Gallaher supplied cigarettes on the orders of companies owned or controlled by a Mr Charles Hadkinson, particularly Namelex Holdings Ltd (formerly Namelex Ltd). I refer to this company as "*Namelex*". A large proportion of those orders were financed by the Tlais family. From June 2000 Gallaher had had a distribution agreement ("the Namelex Agreement") with a company called Namelex Trading Agencies Ltd, of which Mr Hadkinson and Mr Tlais were beneficial joint (50/50) owners.

3 Mr Hadkinson had a number of associates, including a Mr Fadi Nammour, a Lebanese citizen whose family had interests in banking and a Mr Michael Clarke, who later became an employee of TEL.

4 The Namelex Agreement was terminated in circumstances where (a) JL Spirits and Tobacco, a company associated with Namelex, was a substantial debtor to Gallaher; (b) a large quantity of cigarettes had been manufactured for Namelex by Gallaher many of which had been shipped to Cyprus and Dubai, whilst other quantities remained in the UK; and (c) Mr Tlais claimed to have been given assurances by Mr Hadkinson as to the level of support that Gallaher would provide in the form of free cigarettes which had not been fulfilled, as a result of which he claimed to have suffered severe losses.

5 It is common ground that Mr Hadkinson, who had been employed by Gallaher for three years in the 1980s, was a rogue, but, so far as the parties are concerned, for different reasons. Gallaher so describe him because he strung them along with promises of letters of credit that never materialised; Mr Tlais because he made false representations to him about the support that he was to receive from Gallaher.

6 Under the TEL Agreement Gallaher appointed TEL as its exclusive distributor in 15 Territories in the Middle East, Africa and Latin America ("the Territories") in respect of the Sovereign, Dorchester and Stateline brands of cigarettes ("the Brands").

7 Each party had the right to terminate the TEL Agreement forthwith at any time on written notice if the other party committed a material breach of any of its terms and conditions; provided that, in the case of a remediable breach, no such notice could be given unless and until a notice had been served specifying the breach and requiring it to be remedied and 30 days had elapsed without it being remedied. The body of TEL Agreement also provided, by clause 10 (1), that each party was entitled to terminate TEL Agreement on 3 months' written notice to expire on, or at any time after, 1st May 2007. There is a dispute as to whether the parties effectively agreed an automatic renewal, subject to certain conditions, for a further period of five years until May 2012.

8 The TEL Agreement, as amended in January 2003, provided that all brands sold by Gallaher to TEL under TEL Agreement were intended for final sale via distributors to consumers in the Territories: clause 2 (v). Under TEL Agreement TEL was subject to a number of obligations designed to ensure that that intention was fulfilled and that cigarettes supplied under TEL Agreement were not smuggled out of the Territories into other markets, including the United Kingdom. Among these was an obligation on TEL to conduct its business in accordance with the Policy on International Trade of the Gallaher Group (the "ITP"). TEL was also obliged to procure that any sub-distributors conducted business in accordance with the ITP: clause 4 (xxi).

9 In addition the TEL Agreement required TEL to keep "*full, proper and accurate accounts and records showing clearly all sales transactions and inventories relating to the Brands*": clause 4 (viii).

10 Goods manufactured for TEL after May 2002 were, in accordance with clause 3 (ii) of the TEL Agreement, marked by Gallaher with unique pack codes which enabled them to be tracked and traced. A substantial proportion of the goods supplied by Gallaher to TEL were seized by Her Majesty's Customs and Excise ("HMCE")[1] or other Customs authorities.

11 According to Gallaher the volume of seizures notified by HMCE and other customs authorities in terms of individual cigarettes ("sticks") during 2002 to 2006 was at least in the region of the following figures (the stock in the third column being inclusive of the stock in the second):

Notifier	TEL coded stock	Stock only ever sold to TEL
HMCE	447 million	491 million
Overseas	243 million	264 million
Total	690 million	755 million
Total TEL coded Stock ever sold	2,176,660,000 Sovereign Classic 1,428,000.000 Dorchester International 3,604,660,000 (of which 690 million is 19.14%)	

[1] Now Her Majesty's Revenue and Customs. I shall refer to them by the acronym (HMCE) that they had at the time of the relevant events.

12 The number of cigarettes seized by Customs authorities is only a small proportion of those smuggled. In "*Measuring and Tackling Indirect Tax Losses – 2004*" HMCE set out its total seizures over a period of years and its estimate of the volume of cigarettes successfully smuggled in those years. It is possible from that data to estimate the percentage of seizures to total smuggled product as follows:

Year	**2000-01**	**2001-02**	**2002-03**	**2003-04**
Volume seized (billion sticks)	2.8	2.6	1.9	1.8
Successfully smuggled (billion sticks)	16.0	14.5	11.5	10.5
Total market (billion sticks)	18.8	17.1	13.4	13.3
Percentage seized	14.9%	15.2%	14.2%	13.5%

13 These percentages are consistent with a specific calculation contained in the '*Comptroller and Auditor General's Standard Report on the Accounts of HM Customs and Excise 2004-05'*, published 7th October 2005 which states that "*Over that period [2000-04] HMRC believed it had continued to successfully intercept a broadly consistent proportion (around 14.75 per cent) of smuggled cigarettes*".

14 Since the quantity of goods successfully smuggled can never be known, these estimates must, at best, be broad ones. But they indicate that, in overall terms, it is necessary to multiply the volume of goods seized by about 7 to arrive at the likely volume of smuggled goods. If that factor is applied to the TEL seizures the resultant product implies that virtually all, or, at any rate a very substantial majority of the TEL coded goods sold to TEL that were not destroyed were smuggled.

15 Gallaher set out and described the breaches that it relied on in its written notice of termination of 4th March 2005, which it served on TEL on the same day as it commenced the main action. In essence Gallaher relies, firstly, on TEL's failure to prevent smuggling of cigarettes into the UK and TEL's alleged complicity in smuggling. It contends that the volume of seizures over a five year period, despite repeated warnings by Gallaher of increasing concern on the part of HMCE and itself and a "red card" (see paragraph 172 below) from HMCE in respect of TEL in January 2005, could not have arisen without breaches on the part of TEL of various obligations under the TEL Agreement. Gallaher relies in this respect on certain schedules of sales made by Adam Trading, TEL's master distributor, between 2002 and 2005, (the "Adam Trading Schedules") which showed sales to a number of destinations outside the Territories.

16 Gallaher also relies on TEL's failure to keep adequate accounts and records. TEL accepts that it did not keep any accounts during the period of the TEL Agreement (save for one set from 1st November 2002 to 31st December 2003 which manifestly fails to record TEL's level of trading). In order to support its claim for very large damages TEL has had to reconstruct accounts for the entire period. Gallaher say that the reconstruction is flawed, that the problems thrown up by the exercise are the very type of problem that the clause was designed to prevent, and that the failure to keep proper records affords an independent ground of termination.

17 Gallaher also relies on alleged breaches by TEL of, inter alia, its obligations under TEL Agreement (a) to supply evidence of shipment of Brands to the appropriate Territory, (b) to sell the Brands in amounts commensurate with the estimated demand in the intended markets within the Territories, (c) not to resell the Brands to any person whom it knew or had reason to believe was engaged in any illegal trade in cigarettes and (d) to resell them only to persons where there was no reasonable cause to believed that such persons would sell them outside the Territories.

18 TEL denies that it was in material breach of the TEL Agreement, and claims that, if and insofar as it may have been, any such breach has been consented to, waived or acquiesced in by Gallaher, or that Gallaher is estopped from relying on it. It contends that the large quantity of cigarettes seized does not signify any breach on its part. Rather it is attributable to a number of factors including the following:

(i) Sovereign cigarettes became a smugglers' favourite and Gallaher failed to replace Sovereign with a different brand at an early stage;

(ii) Gallaher fostered an environment that was tolerant of smuggling;

(iii) TEL took over a lot of old stock from the Namelex era, which, if it was to be disposed of, had to be mixed with new stock in Cyprus and Dubai rather than shipped direct to its ultimate destination;

(iv) Gallaher supplied Dorchester cigarettes which were defective and which had to be disposed of in non core markets;

(v) Gallaher and HMCE failed to provide timely ("real-time") information giving details of seizures so as to enable TEL to prevent smuggling.

19 Gallaher also contends that the terms of the ITP permitted it to reconsider its relationship with TEL and to terminate it if TEL was behaving improperly, or if Gallaher had reason to believe that it might be – as Gallaher contends to be the case.

The 365 day goods

20 In addition to its claim for a declaration that it lawfully determined the TEL Agreement Gallaher claims $ 3,239, 450 plus interest, being the price of certain goods that it supplied to TEL on 365 days' credit. TEL says that it is not bound to make payment because the agreed method of payment, namely a $ 10 supplement on cases of Sovereign, became incapable of fulfilment when Sovereign was removed as a brand in May 2004.

TEL's counterclaims

21 TEL's principal counterclaims in the main action, as pleaded, are for:

(i) loss of profits caused by breaches during the lifetime of the TEL Agreement;

(ii) loss of profits for the unexpired portion of the TEL Agreement, which TEL claims would have continued until 2012;

(iii) losses in respect of the damaged Dorchester stock; together with

(iv) a number of other very large claims.

The personal action

22 Gallaher seeks to recover $ 4 million from Mr Tlais under a personal guarantee dated 30th April 2002. Mr Tlais provided that guarantee to Gallaher in connection with the placement by Gallaher of $ 5,000,000 into a blocked deposit account at Banque du Liban et d'Outre Mer ("BLOM") in Cyprus.

23 By a letter agreement dated 29th April 2002, which Mr Tlais signed, Gallaher set out the terms of the arrangements agreed with BLOM whereby Gallaher would open an account in its own name with BLOM in Limassol and pay $ 5,000,000 into it. BLOM was to pay Gallaher interest on this money at the rate of 5% per annum. The monies in the account were to stand as security against various accounts at BLOM numbered 895296 upon which Mr Tlais and his brothers Fahad and Mohammed Tlais and others were signatories. BLOM agreed not to seek foreclosure of the Tlais' accounts within a period of five years. During the life of the deposit Mr Tlais was to repay to Gallaher not less than $ 1,000,000 per annum on the anniversary of the deposit up to a maximum of $ 5,000,000. At the end of a period of five years BLOM was obliged to use the deposit monies to cover any debts of the signatories to those accounts and to pay the surplus over to them. The terms of the deposit were set out in a letter of 30th April signed on behalf of Gallaher and BLOM.

24 By a letter agreement of 30th April 2002 Mr Tlais gave to Gallaher his irrevocable and unconditional personal guarantee that if he failed to make any annual payment of $ 1,000,000 in accordance with TEL Agreement set out in the last paragraph he would within six months of Gallaher's demand reimburse Gallaher the difference between the $ 5 million and the amount that he had repaid Gallaher at the date of the demand.

25 Mr Tlais arranged for payment of the first of the five instalments in May 2003 by persuading BLOM to release $ 1,000,000 from the deposit account to Gallaher. But he failed to make any further payment, and on 10th May 2005 Gallaher demanded repayment of the $ 4 million balance.

26 Mr Tlais' defences are:

(a) that his obligation to repay the $ 4,000,000 was conditional on Gallaher's performance of the TEL Agreement and he was released because of Gallaher's unlawful termination of it;

(b) that he is entitled to set off against Gallaher's claims his own claim for $ 30,000,000 against Gallaher in relation to Gallaher's alleged participation in Mr Hadkinson's alleged fraud on him in the Namelex era; and

(c) that the parties agreed that he could set off against the $ 4,000,000 any amounts owed by Gallaher to TEL in respect of damaged Dorchester supplied to TEL.

27 Gallaher says that the obligation to repay the $ 4,000,000 was not conditional as alleged; that Mr Tlais waived any claim for damages for fraud or conspiracy, which is, in any event, ill-founded; and that the parties did not agree the set off claimed. The last of these issues is now moot because Gallaher are prepared to proceed as if such a set off had been agreed.

Scheme of the judgment

28 The facts that underlie the dispute extend over a 6-7 year period and are of considerable complexity. I propose to set out the core facts (including, where relevant my findings on disputed issues) before further identifying the issues (see paragraph 567) and my conclusions on them. In doing so I have adopted the general format of the parties' final submissions and, on occasion, their summary of events. My conclusions on the relevant issues may be found in the following paragraphs:

Gallaher's claim against TEL	**Paragraphs**
Grounds for Termination	
1. Non compliance with the ITP	587 - 645
2. Belief that TEL behaving improperly	646 - 658
3. Failure to keep proper accounts	659 - 749
4. Failure to supply evidence of shipments	750 - 780
5. Failure to sell commensurate with demand	781 - 850
6. Failure to sell to appropriate customers/distributors	851 - 955
7. Failure to take proper steps to distribute and sell	956 - 972
8. Failure to secure proper business conduct	973 - 986
The significance of the red card	990 - 991
The term of TEL Agreement: 5 years or 10?	992 - 1001
Mr Tlais' conviction and its effect	1002 - 1018
Damaged Iranian coded Dorchester	1019 - 1087
The 365 day goods	1088 - 1101

The parties

Gallaher International Limited

29 Gallaher International Ltd was until 1997, when Gallaher Limited was floated on the London and New York stock exchanges, owned ultimately by American Brands Inc., a US based conglomerate with many interests, including cigarettes. It and Gallaher Ltd, the main UK operating company, were at the material times subsidiaries of Gallaher Group PLC. In March 1999 Gallaher acquired from RJ Reynolds, the worldwide trademarks for Dorchester (excluding some Middle Eastern countries) and Dickens & Grant. In the summer of 2000 it acquired Liggett-Ducat, a Russian cigarette manufacturer and distributor, whose brands included Prima, Novost and LD. In November 2001 Gallaher completed the acquisition of Austria Tabak.

30 On 15th December 2006 the boards of Japan Tobacco Inc ("JT") and Gallaher Group Plc announced that they had reached agreement on the terms of a recommended cash offer made by a JT subsidiary for the entire issued (and to be issued) share capital of Gallaher. The necessary scheme of arrangement received Court approval in April 2007.

Premises

31 Gallaher's head office is in Weybridge. One of its many factories is in Lisnafallan in Northern Ireland, where it produces all of its cigarettes for the UK market, together with Virginia blend cigarettes for export to markets in Europe and around the world.

Business Divisions

32 In the late 1990s the development of new markets was the responsibility of the New Business Development ("NBD") division. In September 2002 Gallaher created a new business unit – the AMELA (Africa, Middle East and Latin America) Division - and business in those three markets together with the businesses of Austria Tabak were reorganised into that unit, which, in early 2004, was itself incorporated into the Developing Markets division.

Trade marks and markets

33 In 1993 Gallaher agreed with BAT to cede to it the Silk Cut trademark outside Europe and to receive from BAT the Benson & Hedges trademark inside Europe. The effect of this was to allow Gallaher to focus on its European business. In the mid 1990s the markets of the former Soviet Union began to open up and Gallaher began to sell its cigarettes, particularly Sovereign and Stateline, into Russia, and then into Kazakhstan. At this stage Gallaher's international, i.e. non UK, business was divided into four divisions (i) European domestic business; (ii) European duty free business; (iii) the Far East division; and (iv) a trading division. The international business was then a relatively small part of Gallaher's business, contributing £ 66 million of operating profit in 1998 as against £ 324 million profit from sales in the UK. The figures for 1999 were £ 73 million and £ 347.4 million. Gallaher had no business in the Middle East.

Mr Tlais and his family

34 Mr Ptolomeos Tlais, who is also known as Abu Hameed or Abdul Aziz Tlais, comes from a large and powerful family, owning substantial property in Lebanon and Cyprus, including land, restaurants, petrol stations and a partially built hotel. He is a Lebanese national living in Cyprus. He has 10 brothers and 2 sisters. His eldest brother is Fahad Ahmed Ismail, also known as Abu Ahmed ("Abu Ahmed"). Another brother is named Mohammed.

35 Mr Tlais had been a distributor for a number of international cigarette companies between the mid 1970s and 1998, including Philip Morris, Japan Tobacco and BAT. He ceased to be one because, as he told me, Philip Morris had decided to cease selling cigarettes on a transit basis because of concerns about organised criminal gangs of smugglers and because his family had experienced difficulties with powerful Eastern European mafia groups who wanted to be supplied with cigarettes to smuggle, which the family had refused.

Tlais trading companies

Highstreet Enterprises Ltd

36 The Tlais family carries on business through the medium of a number of limited companies. In Cyprus their primary trading vehicle is Highstreet Enterprises Ltd ("Highstreet"). This company was established by Abu Ahmed, although the, or a, registered owner is Hassan Albabi, a Bulgarian who used to work with Abu Ahmed and who is a friend of Mr Tlais. The nominal directors are (i) Mr Albabi, (ii) Mr Constantinos (Dinos) Saveriades, who is Mr Tlais' lawyer, and (iii) Mr Saveriades' secretary. The beneficial owners are Mr Tlais and Abu Ahmed. Mr Tlais ran its business and signed on its behalf.

Namelex Trading Agencies Ltd

37 Mr Tlais was the owner of 50% of Namelex Trading Agencies Ltd, a company created by Mr Charles Hadkinson for the purpose of entering into the Namelex Agreement with Gallaher on 5th June 2000 – see paragraphs 111-115 below. The other 50% was beneficially owned by Mr Hadkinson.

Tlais Enterprises Ltd

38 TEL was beneficially owned[2] by Mr Tlais and Abu Ahmed. They were both directors, together with Mr Saveriades. It came to be established because Gallaher wanted a clean break at the end of the Namelex era so that they no longer dealt with Highstreet; and to have a new distribution agreement with a different company.

Tlasco Trading Company and Tlais Trading Company

39 These are two companies in the Tlais family stable. Mr Tlais' connection with them is somewhat unclear. Tlasco Trading Company (sometimes known as Tlasco Company for General Trading, Import and Export) is a Lebanese company, owned by Abu Ahmed, Mr Tlais' brother, in which Mr Tlais had no role, save as a family member in respect of a family business. It acted as TEL's sub-distributor in the Lebanon. TEL has, however, disclosed Tlasco invoices to a company called CT Tobacco which match dealings on an account of CT Tobacco with Tlais Trading ("the CT Tobacco account"), which has also been disclosed.

40 Tlais Trading Company Limited was also a Lebanese Company which Mr Tlais transferred to his brother some time between 1998 and 1990, when he became a citizen of Cyprus. Mr Tlais' evidence was that he stopped doing business through that company. But the CT Tobacco account is a statement of account from May 2000 down to autumn 2001 with Tlais Trading, and Mr Tlais appears to rely on the balance of about $ 5 million due to Tlais Trading shown in it as part of his $30 million claim: see paragraphs 1163-1193 below. Tlais Trading Company Limited, under Mr Tlais' signature, issued invoices for goods sold to Iran in the TEL era.

[2] The legal registered owner is a trustee company. In his oral evidence Mr Tlais initially described the company as owned by Mr Saveriades and Mr Saveriades' brother.

The cigarettes the subject of the TEL Agreement

41 A number of features distinguish one brand of cigarette from another. One feature is the image of the brand. Imported brands, especially if imported from markets associated with quality cigarettes such as the UK and the USA, are usually much preferred to domestic brands. Another is taste, which may be a smooth "Virginia blend", a more flavoursome "American blend", or other blends, including cigarettes with flavours such as menthol. Another is tar content, some consumers preferring, and some legislation requiring, lower level tar cigarettes ("Lights"). Lastly there is price, which is often put into three categories, which may overlap: premium (or super premium/luxury); mid-price and value/low price. These three segments apply to imported cigarettes. Locally produced cigarettes may form a still lower price category since they can often be produced more cheaply on account of a more favourable tax regime.

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42 The brands the subject of the TEL Agreement were as follows:

(i) *Sovereign Classic*. This is a Virginia blend brand available in both full flavour and Lights variants. Sovereign Classic (hereafter "Sovereign") is the export version of the Sovereign brand and was positioned by Gallaher as a low mid-priced brand (or high-end value brand).

(ii) *Dorchester International*. Gallaher acquired the Dorchester trade mark in territories around the world in 1999. Dorchester International (hereafter "Dorchester") is a version of the brand designed in 1999 for the export markets. It is a Virginia blend brand, available in both full flavour and Lights. Gallaher positioned it in the value segment.

In Europe Sovereign and Dorchester are only sold in the UK (where the UK style brand is clearly distinguishable from the Sovereign Classic and Dorchester International brand by design, colouring, health warning and tax stamp) and in duty-free outlets aimed at British travellers.

(iii) *Stateline*. This is an American blend initially used for the trading business developed by Gallaher. There is no real market for the brand in the UK.

43 Gallaher also owned a range of other brands outside the EU including Ronson, Sobranie, Memphis and LD. Ronson is a low- to mid-price Virginia brand marketed mainly to Africa. Memphis is a mid-price American blend. LD is also usually an American blend, generally in the low-price segment. Sobranie is a premium brand, sold in a number of variants.

44 Cigarettes in the Territories the subject of the TEL Agreement, were usually sold in packs of 20 cigarettes ("sticks"), wrapped in "outers" of 10 packs (200 sticks) and packed in cases containing 50 outers (10,000 sticks). A 40 foot shipping container will hold about 800 cases (8 million sticks). Prices are normally quoted either in $ per 1,000 or in $ per case.

Smuggling

45 The rate of tax and duty charged on cigarettes and tobacco, particularly in the UK (where there is a high specific duty based on the number of cigarettes rather than their price), is so high that very large sums of money can be made, illegally, by importing cigarettes into a territory without paying the tax and duty due. Commensurately large sums are lost by the Customs and Revenue authorities (and thus the taxpayers) of the territories concerned. Smuggling is widespread. The US Department of Agriculture estimated that in 2002 929 billion cigarettes were exported worldwide but only 624 billion officially imported.

46 The same factors make the sale of cigarettes to a tax free or low tax destination a potentially attractive opportunity. Thus it was that, following a substantial tax increase on UK cigarettes in 1993, exports from the UK to Andorra, which is not within the EU, increased from 13 million sticks in 1993 to 1.52 billion in 1997. In the period from 1995 to 1997 Gallaher's exports to Andorra increased by a factor of 6, whilst those of Imperial Tobacco increased 35 – fold. This volume of imports was such that every Andorran man, woman and child, would have had to be smoking about 140 cigarettes a day to match the number of cigarettes imported. Large quantities of these imports must have been smuggled out of Andorra. Cigarettes made in Gallaher's factory in Ballymena could return to the UK in a week.

47 Given the scale of tax losses resulting from such smuggling, OLAF, the EU anti-fraud unit, sent in an investigation team. It noted that, although imports of brands popular in the UK and Eire had significantly increased, Andorrans had not suddenly acquired a taste for such brands; rather imports were far in excess of demand. Following this investigation the Spanish and Andorran authorities had a crackdown on smuggling.

48 The EU's chief fraud investigator expressed the view that cigarette manufacturers must have been aware that the sudden increase in Andorran imports could not be explained by legal supply to a normal commercial market; and that it was difficult to see how they could avoid knowing that they were selling to smugglers. Gallaher realised (and said publicly) that its increased sales were probably attributable to the smuggling of its product into the UK: see its 1997 Annual Report and the evidence of Mr Peter Wilson, Gallaher's then Chairman and Chief Executive, to the House of Commons Select Committee on Thursday 27th January 2000.

49 The stance that Gallaher then took (it was to change over the course of 1999-2000[3]) was that, provided the sales that it made were legal, what happened to the cigarettes afterwards was not its concern. On the BBC Money Programme on 8th November 1998 Mr Wilson said:

> "*We will supply our cigarettes wherever there is a legal, legitimate demand for them, knowing that if we don't, someone else will.*"

[3] Mr Byrne reckoned that he first began to engage with the tobacco manufacturers (including raising the possibility of adverse comment in the media) in early 2000. Before then the manufacturers were not sure to what extent HMCE meant business.

> *[Interviewer] "Even if they're going to be smuggled back to this country and you know they're going to be smuggled back to this country"*
>
> *"We will sell legally to our distributors …. If those distributors subsequently sell those products on to other people who are going to illegally bring them back into this country, that is something totally outside our control and is a direct function of the enormous levels of tax in this country compared to the levels of tax on cigarettes in other countries ".*

When it was suggested to him that Gallaher could just stop supplying such distributors he said that that would do nothing to influence the degree of smuggling because the smugglers would just bring back someone else's product.

50 This approach, driven by a desire for profit and adopted by other tobacco companies at the time, was not the action to be expected of a responsible international company, as Mr Goel, Gallaher's expert accepted. Gallaher and other tobacco companies were producing and supplying goods greatly in excess of legitimate demand in the knowledge that a substantial proportion would end up being smuggled.

Types of business and terminology

51 "*Domestic duty paid*" business is what its name implies. The manufacturer (or a distributor) sells directly to a distributor in the country concerned which is the final destination for the product. Duty is paid as the cigarettes enter the market. In "*Domestic duty free*" business the goods are sold to the intended destination but without payment of duty because the cigarettes are to be sold in duty free outlets or zones.

52 International tobacco companies also engage in "*transit business*" or "*transit trade*". Whilst these terms have no exact definition they characteristically involve the sale of goods to wholesalers/distributors in intermediate markets without the payment of duty (as the goods have not reached their final destination), which are then sold on to other markets. Some of this business results in the goods being exported back to high duty markets, such as the UK, without payment of duty. The goods will then be sold to the consumer at a much lower price than that payable for duty paid goods. As a result, whilst it is obvious that not all goods "*in transit*" are being smuggled, the expressions "*transit business*" or "*transiting*" or "*transit trade*" have become, for some people, a euphemism for smuggling (i.e. importation without payment of the relevant duties or in breach of import controls or restrictions), or at least for the supply of goods where there is good reason to believe that they may end up being smuggled.

53 Tobacco companies also engage in "*trading business*", which again lacks exact definition but involves the sale of cigarettes at low cost and with minimal brand support to distributors who will legitimately sell them in one or more markets.

54 A Gallaher disclosed document of uncertain date and provenance[4] headed *"Transit and Trading*" describes "*trading*" as "*selling on a "cost plus" basis with minimum support in the expectation that the goods will remain in the primary market*" and "*transit business*" as "*selling close to normal market price in the expectation that the product will enter a secondary market without payment of full duties*". It describes the "*Reasons to transit*" as "*To enter a closed market; to overcome import quotas; to mitigate duties"*.

Gallaher's overseas business

55 In the late 1990s Gallaher was increasingly interested in developing new markets overseas. This was for a number of reasons. Russia's economic collapse and the fall in the value of the rouble in 1998 had brought with it a very sudden downturn in sales. Duty free sales in Europe were soon to be abolished; and sales in European markets had been diminishing or stagnating in the light of increasing taxes (particularly in the UK after the change of government in 1997), advertising bans and increased public awareness of the risk to health posed by smoking. The export of large volumes to Andorra had been severely curtailed; and demand for Gallaher's brands had declined in the UK.

56 At the same time Imperial Tobacco, Gallaher's major competitor, which was then generally regarded in the City as being more successful in adapting to the challenges that the industry faced, was supplying significant volumes to the transit market which were being smuggled back into the UK, undercutting Gallaher's domestic duty paid brands.

57 Gallaher was reluctant to reduce production levels at its Lisnafallan factory, which it had recently equipped with ultra high speed manufacturing units, because it wished (a) to avoid redundancies; and (b) to enjoy economies of scale by ensuring that its factory was run at full capacity.

Trading business

58 Gallaher decided that, in respect of AMELA, it would establish a "*trading*" business. Instead of investing heavily in advertising and marketing so as to build the reputation of its products (*"building brands*") and establishing its own distribution network, or acquiring factories of its own in target territories, or appointing and itself supervising in-market distributors with their own distribution network, Gallaher would focus on selling to regional distributors who would themselves build up the market. Gallaher would keep the price low with a view to those distributors stimulating demand in their territories. In the long run it hoped to move in and take control of what would have become an established and flourishing market. But in the early stages Gallaher's main interest was simply to sell as much as possible and get paid for it.

[4] The document bears no date. I was told that Gallaher did not believe that it came from Mr Norman Jack, the Gallaher employee who was responsible for dealing with Namelex and TEL, although the index to the bundle in which it appears describes it as "*14/01/97 Presentation Norman Jack*".

59 Mr Wilson specified the approach to be taken in a memorandum of 14th May 1999 circulated to Gallaher's senior management outlining Gallaher policy:

> *"The essence of trading business is that we are not seeking to build brands. To some extent, this position is forced upon us by the fact that we do not own our premium brands outside Europe. However, we do own Sovereign, Mayfair, Dickens & Grant and Dorchester in most markets, and it is acceptable to use those brands (i.e. Sovereign Black) for trading opportunities on the clear understanding, to be confirmed by any customers, that they will not sell on for re-shipment back into the UK. The established reputation of these brands in the UK could be exploited in trading markets such that they could sell for a higher price than Sovereign Classic, etc".*

By "*trading opportunities*" Mr Wilson meant selling to distributors for on-sale by them to a number of markets.

HMCE

60 Smuggling began to become a matter of significant concern to HMCE in the early 1990s. The implementation of the single European market in 1993 and the subsequent relaxation of the limits previously imposed on travellers bringing cigarettes in from abroad for personal consumption meant that smokers in the UK became more accustomed to smoking cigarettes manufactured and sold abroad. Reduction in border checks reduced the risk of detection for smugglers and the increases in taxes on cigarettes at above the annual rate of inflation increased the willingness, and the economic incentive, for UK smokers to smoke cigarettes with foreign pack markings, if cheaper.

61 Over the course of the 1990s HMCE's concerns increased. When in 1999 HMCE quantified, for the first time, just how much revenue was being lost by smuggling, the issue became one of political significance. The Government appointed a Tobacco "Tsar" to make recommendations on how to combat tobacco smuggling, which he did in November 1999. In response HMCE developed a concerted plan of action to tackle smuggling and on 22nd March 2000 the Government published its strategy "*Tackling Tobacco Smuggling*". In July of the same year Mr Nigel Northridge, who had become Gallaher's Chief Executive in January 2000, wrote to the Prime Minister expressing the belief that one third of the cigarettes smoked that year would be smuggled.

62 A key part of HMCE's strategy for tacking tobacco smuggling was to secure the co-operation of tobacco manufacturers, a task undertaken by Mr Terry Byrne, then one of the Commissioners for Customs and Excise, who gave evidence.

63 Whatever may have been the apparent indifference displayed by Mr Wilson in his 1998 interview to the fate of Gallaher's cigarettes after they had been legally sold, it is apparent to me that smuggling of tobacco was by 2000 a matter of considerable

commercial concern to Gallaher; and that personnel in Gallaher at a senior level aimed to cooperate with HMCE.

64 As to commercial concern, smuggling of cigarettes may increase the overall volume of goods sold but, insofar as it reduces the quantity of cigarettes sold by Gallaher in developed markets such as the UK, it reduces sales in Gallaher's most profitable market to an extent that may be difficult to match by any increase in low margin sales. It also undermines the position of Gallaher's distributors, who expect the manufacturer to play a part in protecting their interests, and who may be tempted to favour rival bands, if it does not. It also involves a lack of control of the supply chain and a disorderly market.

65 It was in Gallaher's interests to co-operate with HMCE both because smuggling was against its commercial interests in the respects to which I have referred, and because, if it did not cooperate, or was thought not to be doing so, it might appear either indifferent, or, at worst, a party, to illegal tax evasion; with a resultant risk to its reputation, and the possibility of unwelcome governmental measures or involvement in civil or criminal proceedings.

66 Gallaher's cooperation came in several different forms including (i) providing HMCE with the results of pack swap surveys[5] which produce information about the type of cigarettes currently circulating in the UK market, which can be used to assess levels of non-UK duty paid cigarettes smoked in the UK; (ii) regular meetings between HMCE and Gallaher representatives; (iii) alterations to the make-up of packs to make it easier to distinguish smuggled product; (iv) provision of monthly sales data in respect of overseas sales of goods manufactured by Gallaher in the UK as well as details of Gallaher's customers; and (v) routinely assisting HMCE with "track and trace" requests, where Gallaher would examine samples of seized product to see whether it was genuine or counterfeit, when and where it was made, and for what markets, and providing witness statements verifying this information.

67 TEL contends that whatever public stance Gallaher, in company with other cigarette manufacturers, was constrained to adopt in the face of political and regulatory pressure, it was in truth content to acquiesce in, and had no particular concern about, smuggling, provided that it was not smuggling into the UK or, latterly, elsewhere within the EU. Gallaher, TEL submits, remained focused on volume selling to international markets with little concern for the legitimate demand for its brands in those markets and regardless of whether its products might enter some markets illegally.

68 Reliance was placed in this respect on a World Health Authority report in 2003 on "*The cigarette "transit" road to the Islamic Republic of Iran and Iraq. Illicit tobacco trade in the Middle East*". This concluded that smuggling occurred with the compliance of the cigarette manufacturers; and that the strategy of the international tobacco companies in Iran had been to penetrate the market through illegal imports; weaken the state monopoly's market share by this means; next convince the

[5] In which a person approached is either offered a new pack in return for the one he has on him or is asked questions about what he is currently smoking.

authorities to authorise legal imports or production of foreign brands; and then stop fuelling the illegal market and operate in a legal way. Smuggling was difficult to combat given the absence of adequate marking of tobacco products with details of the chain of sale and by the existence of the transit regime. Other reports contained a similar message.

69 The utility of this evidence, which marries up in some respects with the Gallaher document referred to in paragraph 54, is reduced by its generality and its date. The Andorran episode shows that Gallaher was in the late 1990's indifferent to whether its products ended up being smuggled. It does not follow that the same indifference, or worse, subsisted over the following years.

The development of Gallaher's trading business

70 The individual at Gallaher who was put in charge of Gallaher's trading business from its inception was Mr Norman Jack. He was formally appointed to the role in about April/May 1999, when the New Business Development division took shape. He became the Divisional Manager responsible for the development of sales in emerging markets. Mr Jack was a long time Gallaher employee. He had held a senior role in national sales in the UK and had recently taken charge of managing Gallaher's sales in the CIS. He was not, however, one of Gallaher's senior executive management.

71 Mr Jack reported to Mr Nigel Simon, the Gallaher director responsible for its international division, and occasionally consulted Ms Sue Jones, whose job title was Finance and Operations Director, on finance matters and Mr Christopher Fielden, Gallaher's Group Legal Director until November 2002, on legal and regulatory matters. But he enjoyed a large measure of autonomy. Gallaher came to regard him as having become far too close to Mr Tlais.

72 The price charged in respect of trading business took account only of the variable or direct costs of making the product ("marginal costing") as opposed to a price ("full costing") which took account of all direct and indirect costs and, included, therefore, the cost of depreciation of machinery and fixed assets. The aim was to make £ 1 of margin for every thousand cigarettes. Sovereign Classic and Dorchester International were the Virginia blend brands selected as the core of the trading business. Mr Jack's approach was to appoint master distributors in a number of different regions.

73 Mr Jack told Mr Nigel Espin, Group Security and Brand Protection Manager, on more than one occasion after he joined Mr Espin's department in September 2004, that, when he took responsibility for the Middle East in 1999, he was asked by Mr Wilson to develop a trading business which would match the level of export volume achieved by IT. He said that this involved selling high volumes, without being concerned about precisely where the goods ended up, even though there was a risk that some might come back to the UK. He said that Mr Northridge and Mr Simon, neither of whom gave evidence, were aware of this strategy.

74 Mr Espin thought that the idea that Mr Wilson asked Mr Jack to conduct a trading business which involved selling without being concerned about the goods coming

back to the United Kingdom was a "*war story*" told to impress him as a new arrival (he had arrived in December 2003). Since Mr Wilson displayed a similar lack of concern in respect of supplies to Andorra it seems to me that he may well have expressed such a view to Mr Jack in 1999. His memorandum of 14th May shows that he was concerned that no one to whom Gallaher sold should sell for re-export to the UK. Gallaher did not want its cigarettes coming back to the UK because of the impact that would have on the home market. But he may well have been less concerned if they ended up somewhere else.

75 Mr Jack appears to have recognized that the trading business he was building up might lead to smuggling. In 2000 he produced a paper in which he put forward a target of 10 billion cigarettes per year from the trading business. In it he observed that dealing through master distributors would give a manufacturer a "*necessary degree of separation from some of the harsher market realities*", one of which, I infer, was that distributors further down the chain might be smugglers.

76 A number of aspects of Gallaher's trading business gave rise to a risk of smuggling. These included (i) the fact that Gallaher supplied large quantities to Namelex without, according to Ms Jones any detailed due diligence; (ii) the fact that the goods were shipped to Cyprus and not to their ultimate destination; and (iii) that most of the cigarettes had health warnings in English.

77 As to (i), Ms Jones' evidence was that distributors were told not to sell back into the UK and to let Gallaher know where the product was being sold, and that there were market visits. Apart from that no other step was considered to ensure that the product was going to the right place. As to (ii), the supply of goods to a destination in which they are not intended to end up increases the likelihood that they will end up being smuggled. The shipper will not know the person to whom they are ultimately to go and cannot gauge the demand which they are to be used to satisfy. As to (iii), cigarettes with an English health warning have a cachet which makes them more acceptable to consumers and, therefore, smugglers.

Mr Michael Clarke and Mr Charles Hadkinson

78 Mr Clarke's career has been spent largely in the retail sector. In the late 1970s he worked for a convenience retail company called Sperrings, where he met and was trained by Mr Hadkinson. Mr Hadkinson, who has a Lebanese mother and speaks Arabic, left Sperrings and after a short period in the UK went to work in the Middle East. In the 1980s he was a regional manager of Gallaher's Middle East division.

79 Mr Clarke kept in touch with Mr Hadkinson with whom he got on well. In the summer of 1997 Mr Clarke met Mr Hadkinson and Mr Fadi Nammour in Cyprus, where Mr Clarke owned a property. They told him about their businesses, and, in particular, the HRH Group. This was said to have numerous commercial activities including commodities trading and consumer product trading on an international scale. Mr Hadkinson asked Mr Clarke to join him in the business, telling him that he would be fully involved, would have a free role in the HRH Group, and would share profits with himself and Mr Nammour.

80 Mr Clarke was introduced to Mr Richard Reynolds, a respected UK businessman and former main board director of National Grid Plc, who was the executive Chairman of the Group. Mr Clarke was appointed a director of, and made a minority shareholder in, H & R Distribution Ltd ("H & R"), which was based in Warwickshire. He remained a director until he located permanently to Cyprus in 1998 where he worked for H & R and companies in the Group in various ventures not including tobacco.

81 Namelex Holdings Ltd ("Namelex"), previously Namelex Limited, was a member of the HRH Group. It had had some involvement in the tobacco business. It became the ostensible purchaser of cigarettes from Gallaher between 1999 and 2002. Mr Clarke became a director of Namelex in late 1998. The other directors appear to have been Mr Fadi Nammour and Mr Richard Reynolds.

82 In late 1998 Mr Clarke visited Georgia with a colleague to discuss, inter alia, the importation of pharmaceutical products. During the visit his colleague met several cigarette importers. Mr Clarke was then asked to contact several tobacco companies, including Gallaher and IT, to enquire about purchasing a consignment of cigarettes for distribution in Georgia. This was Mr Clarke's first involvement in the international cigarette business.

83 Mr Clarke contacted Mr Jack, then in Moscow, with a view to Namelex purchasing two containers of Sovereign Red. Nothing came of this because Gallaher's price was unacceptable to the end customer. But in April 1999 Mr Jack got in contact with Mr Clarke. In a telephone conversation he told him that Gallaher was restructuring the business and expressed interest in developing business with the HRH Group in the Middle East.

84 After this conversation a meeting took place between Mr Clarke and Mr Jack at Chilworth, just outside Southampton, in order to discuss how the HRH Group could work with Gallaher to sell its brands in the Middle East. Mr Jack made it plain that Gallaher was interested in volume selling[6]. Mr Clarke's evidence was that, during the course of the conversation, Mr Jack asked if the HRH Group was involved in smuggling and made it clear that Gallaher realised that there would be "*leakage*" of product back to the UK and elsewhere; but would be relaxed so long as HRH Group were not smugglers and were not selling to smugglers. Mr Clarke assured him that the HRH Group did not and would not sell to smugglers; and was told that, if HRH mirrored Gallaher's policies and procedures they could never be accused of any illegality. I have no reason to doubt this evidence and accept it – Mr Jack's comments would not have been inconsistent with the approach that was being taken by Mr Wilson.

85 Mr Clarke and Mr Jack identified the need to work with partners who would provide the finance necessary to purchase the cigarettes from Gallaher and who would have the contacts necessary to promote the brands.

[6] On 28th June 2002 he described his approach to HMCE as "*sell a little, see the results, sell a little more*". In fact the emphasis was on selling as much as possible.

The beginning of Gallaher's dealings with Namelex

86 In May 1999 Mr Jack came to Cyprus to discuss HRH Group's plans for developing business in the Middle East and North Africa. He made it plain that Gallaher's prime objective was to compete with IT's export business. It was agreed that H&R would solicit orders for, inter alia, Sovereign Gold and Silver, in North Africa (east of the Algerian/Libyan border) and in the Middle East but excluding Afghanistan. This would be for both domestic and duty free business but would exclude the open Cyprus market. Payment was to be by Letter of Credit with credit of 90 days after invoice. Prices for different brands were agreed. The business was agreed on the basis of Mr Clarke's assurance that H & R would do their utmost to ensure that the product was sold on the basis that the goods would not be returned to the UK market: see Mr Clarke's letter of 19th May 1999.

87 The basic model agreed was that Gallaher would manufacture goods on the strength of a Namelex order which was to be funded by a third party. Gallaher would then ship the consignment to a bonded facility in Cyprus – such as Attheshlis Bonded Stores Ltd. If payment by letter of credit had not already been secured, Gallaher would retain title to the goods. Namelex would then pay the storage charges for the goods and would introduce a customer who would pay Gallaher directly.

88 Gallaher's trading strategy aimed at achieving high volume rather than high profit in the opening years; and did not involve spending on advertising or product promotion (other than some point of sale material). Some form of support was, however, necessary to persuade distributors to buy, promote and distribute Gallaher brands. This support took two forms – rebates and free goods.

Rebates and free goods

89 As a result of the discussions in May 1999, the manner in which business was conducted was that Gallaher would issue invoices for the goods supplied at the full price and would then pay Namelex or some other company nominated by it, such as Quickbeam Enterprises Ltd or Intoco Overseas Ltd, what were termed "*commission payments"*, "*rebates*" or "*marketing allowances*". Since the opener of the letters of credit paid the full price, it was unaware of the commissions or rebates that were being paid out of it. The ultimate beneficiaries of these rebates were Mr Hadkinson and his associates.

90 Gallaher also agreed to provide some goods free as a bonus. Thus the first 50 containers of Dorchester International were provided on a 1 free out of every 10 basis. By a letter to Mr Clarke of 3rd April 2001 Mr Jack proposed that 10% of the goods should be free, provided certain targets were met. Thereafter the amount of free goods to be provided was determined by Mr Jack, and some of the rebate was also provided in the form of free goods.

91 The idea was that Namelex in turn would provide free goods to its sub-distributors, in order to encourage them to promote the new brands at a non-discounted price. As trade grew, sub-distributors could then be weaned off free goods so that the price received by Namelex rose. This was thought to be more attractive than offering cigarettes at an initial discount and then removing it, on account of the apparent

sensitivity of Middle Eastern consumers to increases in the price of products. Namelex's customers would be told that the free goods came from Gallaher – as a means of showing that Gallaher was committed to the business and was providing support to the end customers.

92 In a memo attached to an e-mail of 5th September 2001 to Mr Northridge and others Mr Jack explained that:

> *".. [Namelex's] understanding of our start point was that we wanted volume and profit from day one and were not prepared to take credit risk. They therefore set up a duality, where Gallaher were paid on a secure basis at a level higher than the actual invoice price, with a proportion of the rebate thus due being paid in free goods: at the same time, they presented their business to their partners as one in which Gallaher invested heavily in free goods to support the market, thus securing the partners support and commitment. They added additional volumes of free goods from their own resources and gave open credit to their customers on an unsecured basis".*

93 According to Mr Jack's memo the thinking behind this arrangement was that, after 12-18 months, a turning point would be reached where the prices effectively charged for goods would be on a rising trend, allowing more profit to Gallaher and Namelex, which would justify the risks taken at the early stage. But these expectations were confounded by a problem that arose in respect of product that was or became spotted. Thereafter, according to the e-mail, Namelex (i) replaced spotted stock in the market and sold the recovered stock at a loss "*in markets where they did not operate*"; (ii) gave additional free goods to allow reductions in price to achieve quick sell through; and (iii) extended further credit to distributors, presenting to their partners downstream that "*this was a fully funded Gallaher initiative, which would be consistent with past practice of our multinational competitors*".

94 The quantity of cases supplied by Gallaher free of charge over the course of the Namelex era was sizeable: a total of 648,919,000 cigarettes i.e. nearly 65,000 cases, to Namelex or Namelex related companies, of which 282.5 million were Sovereign Classic for Highstreet.

95 Trading with Namelex began on the basis that if a sufficient volume was achieved after a trial period, Namelex would be given a contract granting them exclusive distribution rights for certain territories and brands.

Trading with Namelex

96 As is apparent from paragraph 87 above Gallaher did not want to take the credit risk and Namelex did not do want to do so either. That was to be borne by others. Namelex and other companies were to earn profit from rebates paid or free goods supplied by Gallaher to the extent that the rebates were not used to buy goods to be provided free (or the free goods were themselves provided) to sub-purchasers.

97 Despite the fact that Mr Clarke and Mr Nammour, who was also a director, were in day to day charge of the Namelex business, Mr Clarke's evidence was that he had no contact with the financial side of the business which was the responsibility of Mr

Nammour as was shipping. He was thus unaware of a continuing build up of Namelex's indebtedness to Mr Tlais in respect of free goods promised. Mr Hadkinson did not involve himself in the day to day operation of Namelex. In 1999 Mr Clarke found some customers in Djibouti and Dubai; but, following criticism by Messrs Hadkinson and Nammour that he had agreed too low a price, his involvement with the sales side steadily declined.

98 One of the first customers introduced by Namelex was a company called Tbeili Group SAL ("Tbeili"), which placed an order worth about $ 1.2 million in the late summer of 1999. Another was Mr Tohme. These customers appear to have been told by Mr Hadkinson and/or Mr Nammour that Namelex had secured customers who would pay them for the goods they were financing, so that they would secure a quick profit. This turned out not to be the case and the companies came under financial pressure.

99 The product initially supplied to Namelex consisted of Sovereign Black, Dorchester Black, and Mayfair which was in packaging originally produced for the UK domestic market with English health warnings and English pack design. Cigarettes thus packed would be attractive to smugglers, and would have some lack of attraction to legitimate distributors because these brands were not in demand in the territories supplied by Namelex and were sold to it at a high cost. They were also in paper outers, and not the hard outers favoured in the markets in which Namelex was dealing, and which Namelex had sought. According to Mr Clarke the price was $ 150 per case[7] as opposed to $ 60 - $ 70 a case, which was the sort of level that distributors were accustomed to pay.

100 On 24th September 1999 Mr Jack told Mr Clarke that two orders in hand for Sovereign Black and Mayfair would have to be postponed. Gallaher had decided to stop supplying cigarettes (other than for supply to duty-free outlets, the armed forces, and Gibraltar) with pack markings identical, or practically identical, to those used for UK domestic cigarettes, a practice about which HMCE had been highly critical since it believed that it increased the risk of smuggling. Gallaher had also decided that it would implement this decision immediately and destroy existing materials and packed stock. Mr Clarke's evidence, which I accept, was that he had warned Mr Jack from the beginning that to sell these brands at these prices and in this format would lead to them being smuggled[8]. Quantities of Mayfair King Size supplied to Namelex were in fact seized in 2001 (3.2 million), 2002 (24.8 million), 2003 (11.2 million), 2004 (3.5 million), 2005 (3.3. million) and 2006 (4.2. million): see Schedule A2 to the Amended Particulars of Claim ("APOC").

101 In its place Gallaher manufactured cigarettes with an English language health warning on the side, as opposed to the front. This is known as a "*global English*" health warning. Gallaher's current policy is to insist on market specific health warnings except for the duty free market.

[7] The L/Cs opened by Mr Tlais have figures of $ 200- 210 per case; but these will not reflect any rebates.
[8] See paragraph 4 of page 4 of Mr Clarke's letter of 10th September 2001.

Namelex finds Mr Tlais

102 Namelex needed to find an alternative financier who would purchase Tbeili and Mr Tohme's cigarettes and finance the ongoing business. The Tlais family came to fulfil that role.

103 In late 1999 Mr Hadkinson, who had known Mr Tlais for several years, contacted Mr Tlais and told him that he had been given the right to sell Gallaher's brands worldwide, except in the UK and Western Europe, in order to build an international business for them. He said that Gallaher was a fantastic company, for which he had worked, and that Mr Northridge, the now Chief Executive, had worked for him in the past and that they remained close. He represented himself as having influence with Gallaher and said that Gallaher was committed to building a business for their brands in territories that Mr Tlais knew about.

104 Mr Tlais was reluctant to consider doing business at first, particularly when he was told that Gallaher was asking $ 110 a case for Sovereign and $ 90 for Dorchester, prices which he regarded as far too high if Gallaher intended to build a domestic business from nothing. Mr Hadkinson said that he appreciated this, as did Gallaher, and that he could ignore these prices. He should focus on generating demand in domestic markets at whatever initial price was appropriate and Gallaher would compensate him for the loss that he made on each case at the price at which he had bought it. Mr Hadkinson indicated that, if things went forward, Mr Tlais should contact him before making a sale in order for Mr Hadkinson to confirm that Gallaher would provide the free goods necessary to make up the loss to be incurred in selling at that price. He pressed Mr Tlais to take on the Gallaher business.

105 Mr Hadkinson indicated that he wished to concentrate on Russia. Mr Tlais expressed a wish to focus on the Middle East and, in particular, Iran, where he believed there was high potential. Mr Hadkinson said that, if all went well, Gallaher would offer Mr Tlais an exclusive distributorship for a wide range of territories.

106 A little later at a meeting in Dubai with potential distributors, predominantly from the Iranian market, the distributors suggested that business should start with 6,000 cases free of charge and then 6,000 cases for month at $ 30 per case. Mr Tlais said that there was no way that that level of support could be provided. Mr Hadkinson suggested that it might be possible if the price rose by $ 5 per case per month until the $ 90 and $ 110 levels were reached. The next day Mr Hadkinson reported that Mr Northridge had confirmed that Gallaher would provide support in the form of the free goods necessary in order to avoid a loss if sub sales were made at those prices.

107 Mr Hadkinson repeated Gallaher's willingness to provide support in the form of free goods in this way on other occasions and Mr Tlais agreed that his family would finance the purchase of goods from Gallaher at the full price notified by Mr Hadkinson and would agree for them to be sold at a fraction of their price, in order to build the business up, on the footing that Gallaher would make up the difference in free goods.

108 Gallaher had agreed to provide rebates and some free goods to Namelex. But it had not agreed to underwrite Mr Tlais' losses with free goods or to enter into any agreement with Mr Tlais, and Mr Hadkinson had no justification for saying that it had.

The Tlais family takes over Tohme and Tbeili stock and agrees to finance letters of credit

109 Mr Tlais was prevailed upon by Mr Hadkinson to purchase the balance of the unsold stocks originally supplied to Mr Tohme (Mayfair) and Tbeili (Sovereign and Sovereign Red). Mr Hadkinson had told him that Gallaher had asked Mr Tlais to help them out and that it would be a starting point to continued business and a long term exclusive distribution agreement. According to Mr Tlais Mr Hadkinson said that Gallaher would later buy the goods off him, or direct him to sell them to a particular market or provide free goods to the value of the credit.

110 Thereafter the Tlais family financed letters of credit for the purchase of further consignments of goods, becoming the principal financier of the purchase of goods from Gallaher under letters of credit. The way in which it worked was this. In 2000 and 2001 letters of credit were opened on Namelex's account. Mr Hadkinson or Mr Nammour would tell Mr Tlais what letters needed to be opened. Mr Tlais or his brother would give instructions to the bank, which would open a letter of credit which referred to Namelex as the applicant. When the letter of credit was honoured by the bank payment would be debited to Abu Ahmed's private account. The bank held security over family assets.

The Namelex Agreement

111 Mr Jack had indicated to Mr Clarke that Gallaher would enter into an exclusive distribution agreement for a number of territories in the Middle East, Africa and Asia, if Namelex showed that it was capable of selling sufficient volumes. Negotiations for such an agreement took place between Mr Jack and Mr Nammour.

112 Although discussions had proceeded upon the basis that TEL Agreement would be between Gallaher and Namelex, in the event it was agreed that it should be between Gallaher and Namelex Trading Agencies Ltd ("NTA"). Mr Tlais owned 50% of NTA. The other 50% was owned by a company (Cymanco Services Limited), which was a nominee, directly or indirectly, for Mr Hadkinson. The directors of NTA, on incorporation in April 2000, were Messrs Reynolds, Fadi Nammour and Clarke, and shortly thereafter Messrs Tlais, Abu Ahmed, and Saveriades.

113 The Namelex Agreement – between Gallaher and NTA – was signed by Mr Jack on behalf of Gallaher and Mr Clarke on behalf of NTA at the offices of H & R Distribution in Warwickshire on 5th June 2000. It became apparent to Mr Tlais at this meeting that Mr Hadkinson did not in fact have any written agreement with Gallaher giving him or his companies a right to distribute Gallaher's brands. After the signing of TEL Agreement Mr Tlais and his daughter went for lunch with Mr Clarke, who had only met Mr Tlais a couple of times before, and Mr Jack at a nearby restaurant and continued to discuss the business and its expected profitable

future. Mr Jack assured Mr Tlais that Gallaher intended to build a long term business based on the development of key brands.

114 The Namelex Agreement specified as brands Dorchester International and Dorchester International Lights "*and such other brands as may be agreed*" as the relevant Brands (clause 1(i)), and the Territories as "*the domestic duty-paid market and the duty-free market"* in a range of Territories in the Middle East, Africa, and Asia: Schedule 1. These included all the territories that were later to be included in the TEL Agreement, save Latin America, and a number of others, notably India. TEL Agreement required Namelex to comply with all laws and regulations applicable to or affecting the importation of the Brands into the Territories (clause 3(vi)); to pay all duties taxes and other imposts necessary to enable the Brands to be lawfully imported into and sold in the Territories (clause 3(xiv)); not to resell the Brands except in the Territories and to resell them only to persons or firms where there was no reasonable cause to believe that such persons or firms might sell them outside the Territories (clause 4(iv)), and to impose a like obligation on its own distributors (clause 4(v)). Brand extensions and additional territories were added by letters between Mr Jack and Mr Clarke, expressly "*conditional on goods remaining in the markets for which they are supplied*".

115 The importance of the Namelex Agreement to Mr Tlais was less than might at first appear. It was negotiated without reference to him. He regarded himself as having been made a shareholder in NTA merely as a gesture of goodwill on Mr Hadkinson's part. He played no part in the management of NTA and NTA held no board or management meetings. According to Mr Clarke NTA did not sell anything. It is doubtful whether it did anything at all.

The Namelex era

116 It is convenient to refer to the period between 5th June 2000 and 30th April 2002, when the TEL Agreement was signed, as "*the Namelex era*". The general pattern of trading during this period was as follows. Namelex, in the person of Mr Hadkinson, Mr Nammour or one of two other Hadkinson associates, would place orders on Gallaher for goods; and Gallaher would manufacture them to order. Neither Mr Tlais nor Highstreet nor any other Tlais company had any involvement in ordering, with the exception of certain orders for Latin America and Syria. Gallaher would ship the goods, at its expense, to Cyprus, and later to Dubai as well. The goods would then be stored in bonded warehouses with Gallaher retaining title to them. Namelex would be responsible for the costs of storage. The goods would be sold ex-bonded warehouse, payment being made by letter of credit (or other secure method). Upon payment being made under the letter of credit Gallaher would provide a certificate of release to the warehouse.

117 Mr Hadkinson would in many instances introduce customers to Mr Tlais, tell him that Gallaher had approved them and wanted him to supply them, and ask him to release the goods to the customer. According to Mr Tlais Mr Hadkinson controlled 75- 80% of sales. Mr Tlais took responsibility for selling to the end customer predominantly in Latin America, Syria and Lebanon.

118 In 1999 and 2000 Mr Jack dealt with Michael Clarke and Fadi Nammour at Namelex. He was unaware of Mr Hadkinson's involvement in Namelex until

October/November 2001 and only became involved in substantive discussions with Mr Tlais in March 2002.

119 During the Namelex era the Tlais family purchased about 300,000 cases from Gallaher at a cost of somewhere around $ 30,000,000, payment being made by letters of credit opened against security provided by the Tlais family. In effect the Tlais family was providing the finance for the purchase of consignments ex warehouse Cyprus/Dubai as arranged by Mr Hadkinson. Although the majority of Namelex orders were financed in this way, 80,000 cases were sold in a similar way to a Cypriot company called CT Tobacco (see paragraphs 122ff below) and there were also some Namelex sales to several smaller purchasers.

120 The commission and free goods arrangements continued during the Namelex era. Highstreet would open a letter of credit at one price, which Gallaher would receive. Gallaher would either pay a rebate or provide goods to some person or company nominated by Mr Hadkinson.

The seizure of The "Marina" in August 2000.

121 On 28th August 2000 the Greek customs authorities detained the vessel "Marina" off the coast of Crete and discovered on board substantial quantities of Sovereign and Mayfair which had been sold by Gallaher to Namelex. The cigarettes had been shipped from Cyprus to Port Said in 40' containers and then unloaded and re-loaded into 20' containers, apparently destined for Almaty in Kazakhstan. The goods were in the name of CT Tobacco Ltd ("CT Tobacco"). CT Tobacco was a company owned or controlled by Mr Christos Tornarides ("Mr Tornarides").

Highstreet's supply of goods to CT Tobacco

122 Mr Tornarides was known in the industry to have worked closely and extensively with Imperial Tobacco ("IT") in the transit business, mainly acquiring cigarettes through Frema Tobacco International ("Frema"), IT's major Cyprus distributor. The Greek authorities reported that the companies that had taken ownership of the products included Highstreet, Tlasco, and CT Tobacco. Mr Hadkinson had introduced CT Tobacco to Mr Tlais and Mr Tlais had been persuaded by Mr Hadkinson that it was safe to supply the Sovereign Classic cigarettes to CT Tobacco despite Mr Tlais' concerns about credit risk and the risk of product diversion.

Gallaher's supply of goods to CT Tobacco

123 In about June or July 2000 Mr Jack had raised with Mr Clarke the possibility of Mr Jack meeting Mr Tornarides with a view to CT Tobacco taking Gallaher brands. Mr Jack was keen to increase sales volumes, not least because he received increased remuneration from Gallaher for doing so. Mr Clarke met with Mr Tornarides and told him that Gallaher was keen to increase the volumes it sold internationally. Mr Tornarides expressed interest and suggested that he could distribute large volumes. Mr Tornarides was keen to do business with Gallaher directly because he thought that that would assist his proposed float of CT Tobacco on the Cyprus Stock Exchange.

124 In a statement dated 10th May 2002 made for the purpose of criminal proceedings against a company in the Isle of Man related to CT Tobacco Mr Jack recorded that in the first half of 2000 he had been told by Mr Clarke that Namelex had supplied Gallaher cigarettes to CT Tobacco for sale in East European markets during spring and summer of 2000, and that he understood from Mr Clarke that the destination of these products was in the Balkans. He also recorded that he was approached by Mr Clarke in around July 2000 and told by Mr Clarke that CT Tobacco had shown Mr Clarke an import licence for Albania specifying a quantity of 10 billion cigarettes and had "*raised to them a draft distribution agreement for the territory*". Pursuant to that licence Gallaher was asked to accept a Letter of Credit directly from CT Tobacco in respect of a large transaction (780 million sticks) in order to initiate business in the territory. Mr Jack was assured that exclusive import arrangements would secure a high market share and thus justify the volume and that the cigarettes were intended for Albania.

125 Mr Clarke's evidence was that he did not say that CT Tobacco had shown him an import licence and Mr Jack could not have thought that he had done so since no licence was granted until January 2001. The disclosed documents include a licence covering 10 billion cigarettes with a January 2001 date.

126 But a letter of 29th November 2001 from Namelex to Gallaher, signed in Mr Clarke's name, records that

> *"With regards to CT Tobacco they were only supplied originally once we had received assurances that the product would be sold in the territories of Yugoslavia and Albania and after we had been shown a copy of an import license for these territories"*

Since the original supply by Namelex to CT Tobacco had been in the spring or summer of 2000 it is likely that Mr Jack's statement was correct. Even so, 65,000 cases of Sovereign, which was what Gallaher supplied, was a large consignment for Albania, where Sovereign was not in demand.

127 When, on his return from his August 2000 holiday, Mr Jack learned of the seizure of cigarettes on the Marina he was assured by Mr Clarke that the seizure had been made in error and that the cigarettes were part of a shipment to the CIS markets where Gallaher was unrepresented. This is what Mr Tornarides had told Mr Clarke.

128 By September agreement had already been reached in principle that CT Tobacco would buy from Gallaher 65,000 cases of Sovereign Classic worth about $ 7 million. According to the evidence of Mr Clarke, which I accept, Mr Jack told him, when they discussed the risk of diversion in the light of Mr Tornarides' reputation, that senior members of the board, including Mr Northbridge, were very pleased with the deal which should proceed immediately.

129 The report of the "Marina" seizure reached Gallaher in early September before CT Tobacco had opened any letter of credit in favour of Gallaher. Mr Jack made some investigations in Cyprus. He was told by Mr Clarke that the sale to CT Tobacco was a legitimate sale to an upstanding Cypriot citizen. On 29th September 2000 he reported to Gallaher that Mr Tornarides was the son of a former Attorney General of

Cyprus; and that he would be challenging the seizure. He referred to Press reports of senior Customs sources saying that he was known to them as a local business man of standing. CT Tobacco was in the course of building a cigarette factory in the Larnaca duty free zone. Following this Mr Jack decided to supply the 65,000 cases to CT Tobacco against a letter of credit which was opened in October 2000.

130 The letter of credit to be opened by CT Tobacco was to be for $ 6,955,000 ($ 107 per case). But Gallaher was to rebate $ 3,055,000, which was to be used (i) to make a number of "*marketing allowances*" to Fadi Nammour, H & R Distribution, Namelex, and others; (ii) to provide free goods to CT Tobacco (13,000 cases) and Highstreet (1,250 cases in discharge of payments owing to Highstreet by Namelex) and (iii) a $ 1,000,000 payment to the opening bank. The goods were released to CT Tobacco on 31st October. All the cigarettes had global English health warnings.

Repercussions of the "Marina" seizure

131 The "Marina" incident was the first instance of what appeared to be large scale smuggling of Gallaher's brands. It caused Gallaher's Board to take a more detailed interest in Mr Jack's trading business. In September Mr Northridge and Mr Simon decided to withdraw Gallaher's more expensive brands from non-EU export in order to minimise the risk of their being illegally supplied to the UK.

132 The "Marina" seizure also attracted the attention of HMCE. A meeting took place on 15th December 2000 between HMCE (Messrs Clive Oldham, John Wales, and Greg Marcanik) and Gallaher (Mr Jeff Jeffery, the corporate affairs manager of Gallaher Ltd, and from March 2002 Gallaher Group Plc). Mr Oldham asked what steps Gallaher had taken to ensure that its customers traded securely. Mr Jeffery's response was that the pack swap survey showed that very little Namelex stock was smuggled into the UK but he would find out if there were any special measures. Mr Oldham also asked how Gallaher could satisfy HMCE that its major customers were not acting illegally; how it ensured that it knew where its products were sold; and whether it had asked Namelex who it traded with. Mr Jeffery is recorded as saying that he believed that Namelex was the sole distributor in the non-EU markets for the relevant brands, so identifying its major customers was not an issue. He would find out the relevant information and respond. It is clear from Mr Byrne's evidence that these responses were regarded by HMCE as inadequate.

133 On 23rd January 2001 Mr Jeffery wrote a lengthy reply. He referred to the appointment of NTA as distributor in territories in the Middle East, Eastern Europe and Africa; and enclosed details of Gallaher's sales with the exception of UK & Eire, Kazakhstan and Liggett-Ducat sales. He referred to the September 1999 decision that there should, with limited exceptions, be no future production for export of cigarettes in packs with UK health warnings. He also recorded that since September 2000 Gallaher had taken steps to ensure that packets manufactured for general export outside Europe were distinguishable from those on sale in the UK. He referred to the provisions of the Namelex agreement requiring Namelex to comply with all laws and regulations applicable to the importation and sale of cigarettes.

134 On 9th February 2001 Mr Oldham replied expressing the view that the Namelex issue had not been resolved satisfactorily and that the letter of 23rd January 2001:

> "*does not answer the fundamental question of how so much Namelex product came to be discovered in suspicious circumstances on the Marina and intercepted by our anti-smuggling staff, and how Gallaher could satisfy both Customs and Excise and themselves that Namelex (or their customers) were not selling to smugglers*"

135 On 20th February 2001 Mr Jeffery replied saying that his knowledge was solely derived from the Greek Customs, that he understood that the cigarettes were being held by Customs in Crete and that all the case details were with the judge. He said that, as a result of press comment[9] relating to the believed owner of the cigarettes on the "Marina", and Customs' own observations, Gallaher would not in future trade directly with CT Tobacco or Mr Tornarides until the situation was clarified; and that, following discussions with Namelex, Gallaher required those to whom it sold in Cyprus, including Namelex, not to sell Gallaher products to them. (Mr Jack had told Mr Clarke of this decision on a visit to Cyprus earlier in the year). He said that:

> "Gallaher has, in the past, repeatedly made it clear to Namelex that it would not countenance the sale of any of its products to smugglers. We have provided a copy of the relevant part of your latest letter to Namelex and taken the opportunity to, once again, restate our position so that there can be no doubt as to our attitude."

136 Mr Jeffery referred to discussions with Namelex but omitted to mention that, as Mr Jack had recorded in a memorandum to him of 16th February 2001, Namelex had approached Mr Jack and expressed concerns about continuing to supply CT Tobacco as a result of which Gallaher had agreed to accept no further orders from CT. Namelex had repurchased such goods as remained in the CT warehouse. TEL complains with some justification that this was so far as Namelex was concerned, an underplaying of their position.

137 According to Mr Tlais, Namelex did not inform him of HMCE's concerns; and he did not learn of Gallaher's instructions to Namelex until March 2002. On the contrary Mr Hadkinson told him to continue selling to CT Tobacco. He told Gallaher that he stopped providing goods in about March 2001 (see his letter of 31st May 2002 referred to at paragraph 302 below).

138 In 2001 Namelex expressed interest in CT Tobacco's plans to build a new factory in the Larnaca free zone, about which Mr Jack had on 15th January 2001 expressed hesitation. In April Mr Jack indicated to Messrs Clarke and Nammour that, although

[9] A reference to an article about Mr Tornarides in the Evening Standard of 15th January 2001 ("*The £2 billion smuggling racket behind your £ 2.40 pack of cigarettes*"). The article records a Gallaher spokesman, likely to have been Mr Jeffery or someone employed by him, saying "*We have no knowledge of him*". This was untrue.

the Cyprus factory was a very interesting opportunity, Gallaher would not be involved in any project to which Mr Tornarides or CT Tobacco was a party.

139 It is clear that in March/April 2001 Tlasco Trading was still dealing with CT Tobacco: see a delivery note of 2nd April 2001 and an invoice of 12th March, which was signed by Mr Nammour and copied to Mr Tlais. But the Statement of Account between CT Tobacco and Tlais Trading, prepared by Mr Nammour, shows product being released down to August 2001. This account was sent by Mr Hadkinson to Mr Tornarides on 4th December 2001 and to Mr Tlais on 7th December 2001 and was said to specify "*the amount owed to us*". It was, as Mr Tlais confirmed, sent to Mr Tlais in order for Mr Tlais to check it, as he did.

140 I infer from that that Mr Tlais was content to allow Mr Hadkinson to continue to arrange for goods financed by the Tlais family to be sold to CT Tobacco until well into 2001 - despite the fact that CT Tobacco was known to be in the transit business, had a reputation for smuggling IT cigarettes, and despite the "Marina" seizure.

141 Mr Tlais' evidence, which in relation to the statement of account was not always coherent, was that Mr Hadkinson was selling goods to CT Tobacco, including goods financed by Highstreet, in order to assist Mr Tornarides with floating CT Tobacco on the stock market[10], against Mr Hadkinson's oral guarantee that Mr Tornarides would pay Highstreet. In his letter of 31st May 2002 (see paragraph 302 below) Mr Tlais referred to the possibility that further supplies in addition to the 500 million to which he referred "*advanced by my partners from my stocks may also have been sold to [CT Tobacco] without my knowledge*".

142 I do not accept that goods which the Tlais family had financed were being released to CT Tobacco without Mr Tlais' knowledge. He himself accepted that the release of goods may have been effected by him on Mr Hadkinson's instructions. The account that was provided to him gave particulars in great detail of what had occurred. It is unlikely to have included details of goods whose purchase had not been financed by the Tlais family. I say that both because of the title of the account and because Mr Hadkinson's letter of 7th December 2001 contains no indication that that is so. The letter states the amount due to "*us*" as being the $ 5,097,886.97 specified in the account, sets out two proposals as to how that amount (described in each proposal as "*Amount owing to Tlasco*") shall be satisfied (involving the return of goods and a payment by CT Tobacco), each of which proposals involves a discount being given on the debt, and refers to Mr Hadkinson's responsibility for securing cover for the shortfall.

143 In February 2006 Mr Tornarides and Mr Tlais, amongst others, were convicted in Thessaloniki in Greece of smuggling related crimes committed during the Namelex era.

[10] The intention appears to have been to show an increase in turnover; some of which was artificial in that the same quantity of goods was released to CT Tobacco and then released back to Tlasco, and the cycle then repeated: see I 18/5245-7. This was plainly improper.

Spotting

144 In late 2000 Namelex reported that large quantities of the cigarettes supplied to it (Dorchester, Sovereign and Stateline) were spotted and stained. "Spotting" to the tobacco industry means the discolouration of cigarette paper which, under certain conditions, occurs when the moisture in the tobacco leaches into the cigarette paper giving it a slightly mottled or "spotted" effect. The problem, if not the solution, is well known to cigarette manufacturers. It is particularly likely to arise if cigarettes are stored at high temperatures or in poor conditions for prolonged periods. It does not necessarily affect the taste of the tobacco but it can put the consumer off.

145 Namelex suggested that the problem lay in Gallaher's inexperience in selling goods internationally, particularly in hot climates, and the use of paper outers. It claimed to have suffered huge losses and wanted financial help. Its customers complained (whether justifiably in all cases was, as Mr Clarke recognized, unclear), refused to make payment, and expected more favourable credit terms.

146 Namelex attempted to recover the offending stock from the market. It reportedly recovered in all about 250,000 cases (see Mr Hadkinson's letter of 10th September 2001) and sold some of it at a loss, in markets in which it did not operate, to mitigate its losses. It also extended further credit to many of its customers and provided additional free goods. It presented this to its customers as a fully funded Gallaher initiative: see Mr Jack's memorandum of 5th September 2001.

Credit of $ 9.8 million is extended to JL Spirits

147 Namelex explained the position to Gallaher. It indicated that it would not be seeking compensation because, so it said, of the difficulties involved in assessing the scale of the problem, which would require going through all the stock in the field, potentially involving large scale stock uplifts, and compensation for duty paid. Namelex suggested to Gallaher that it should be allowed to purchase goods already produced for it on extended credit, so that it would not have to pay until 30th June 2001. The plan – as explained by Mr Jack to Mr Mark Rolfe, Gallaher's Group Finance Director - was that Namelex would sell the spotted goods through contacts of theirs and obtain payment for them by the time that the credit expired, and in the meantime would order fresh goods on normal terms to supply existing markets. Mr Rolfe, together with Ms Jones, Mr Simon and Mr Northbridge, approved this proposal and agreed to extend credit up to $ 10 million.

148 In December 2000 Messrs Northridge, Fielden and Jack of Gallaher met Mr Clarke and Mr Reynolds in London at a dinner suggested by Namelex. Mr Clarke stressed that Namelex was not involved in smuggling and that whatever CT Tobacco had been doing, it was not with Namelex's encouragement or support. On 11th December 2000, following the dinner, Mr Jack confirmed to Mr Reynolds that Gallaher would agree to release to a company called European Consolidated goods to the value of $ 9,765,981, totalling 132,744 cases, most of which were then in either Cyprus or Dubai, such sum to be repaid by 30th June 2001. By a letter of 12th December 2000 Mr Reynolds confirmed that payment would be made by that date.

149 On 13th December 2000 Mr Nammour wrote on behalf of Namelex indicating that the company which would be responsible for the repayment was to be JL Spirits & Tobacco Ltd ("JL Spirits"), as Quickbeam Enterprises Ltd had become. He also asked for about 23,000 cases to be released to Highstreet. JL Spirits was a company owned or controlled by Mr Hadkinson, Mr Nammour, and Mr Jim Livie, a former Gallaher employee.

150 There is some doubt about the extent to which goods supplied to Namelex were in fact spotted. In June 2001, Mr Jack wrote to Mr Reynolds that "*the problem was more of perception than reality*". Mr Keevil, Gallaher's Senior and later General Counsel, was told by Mr Tlais in April 2002 that Mr Tlais had never raised any issue of spotting with Mr Hadkinson. Mr Tlais expressed the view that Mr Hadkinson had been intending to perpetrate a fraud on Gallaher and him from the outset.

2001

Relations with HMCE

151 Cooperation continued between Gallaher and HMCE during 2001 – to such an extent that HMCE came to regard Gallaher as the most cooperative of tobacco manufacturers.

152 At a meeting with Customs personnel (Clive Oldham, Paul West and Greg Marcanik) on 22nd February 2001 HMCE repeated its concerns about Namelex and asked for information about the ownership of cigarettes on the "Marina". Mr Jeffery said that he had learnt from the Greek Customs that the chain of ownership was Bank du Liban, Namelex, Highstreet, Tlasco, and CT Tobacco. Mr Jeffery asked for Mr Oldham's assistance in finding out who was being prosecuted in Greece, as the information could be useful in ensuring that Gallaher's products were sold legitimately. Mr Oldham seemed satisfied with Gallaher's actions in relation to CT Tobacco.

153 On 7th March 2001 Mr Jeffery wrote to Mr Oldham, answering a number of questions that HMCE had raised. He stated that Gallaher had no knowledge of Namelex's agreements with its customers, to which Gallaher did not have access because of Namelex's concerns that this would put Gallaher in an advantageous bargaining position; but that Namelex had indicated a willingness to discuss with HMCE its questions about Namelex's customers. He also said that Gallaher would make further inquiries of Namelex about its customers and the territories in which they operated and what steps it could take to enhance its ability to trace Gallaher products sold to its distributors.

The Policy on International Trade

154 Mr Jeffery enclosed with his letter a copy of Gallaher's Policy on International Trade (the "ITP"). The ITP had been developed in early 2001, primarily by Mr Keevil and Mr Fielden, but with input from Mr Jeffery, as a formalisation of Gallaher's existing policy on international trade, namely to build business in legitimate duty paid markets.

155 The ITP set out Gallaher's approach ("*Gallaher deplores smuggling*"), and the steps which Gallaher had taken of its own initiative to try to ensure that Gallaher products were not smuggled back into the UK. It set out that its policy "*moving forward will be to require all customers seeking to purchase Gallaher's products manufactured for international markets outside Europe, to confirm that they have read this policy and will abide by its terms*", and made clear that goods had to be destined only for duty-paid domestic markets or legitimate duty free outlets.

156 Mr Jeffery circulated his 7th March 2001 letter to HMCE to Messrs Northridge, Simon, Fielden, Birks, Keevil, Jack, Tardif and Jones, within Gallaher, to ensure that all management involved in international trade were aware of their obligations, and those of their customers. On 9th March 2001 Messrs Birks and Jeffery had a meeting with Mr Byrne and Mr Wells of HMCE. Mr Birks explained that Gallaher would provide the ITP or relevant parts of it to every employee involved in international sales and to each distributor outside the EU.

157 On 26th March 2001 the ITP was formally adopted by the board of Gallaher Ltd.

158 Gallaher gave HMCE Mr Nammour's telephone number and encouraged Mr Clarke to contact them. On 10th May 2001 Mr Oldham wrote to Mr Nammour proposing a meeting. In May or early June 2001 Mr Clarke came to Gallaher's premises in Weybridge where he met Mr Jack and, for about half an hour, Mr Keevil. Mr Clarke appeared to be willing to meet HMCE but said that all his energy was being devoted to sorting out the debt owed to Gallaher. Mr Keevil asked for more details about Namelex's customers but Mr Clarke expressed unwillingness to provide commercially sensitive information and said that he feared that Gallaher might cut Namelex out and deal with the customers themselves. Mr Keevil also asked about using more local language health warnings but was told that, because English health warnings had more cachet in the markets, local health warnings would not be used unless required by law.

159 On 5th July 2001 Mr Clarke signed a letter on behalf of Namelex agreeing that it would use its best endeavours to abide by the terms of the ITP.

Non payment of the credit extended to JL Spirits – production of a forged letter of credit

160 Two part payments were made in respect of the $ 9.7 million credit due on 30th June 2001, reducing the debt to about $ 8.9 million. Apart from those the debt was not paid, despite Mr Clarke earlier guaranteeing to pay a sum on account before that date and later stating that the payment would be made on time. The failure of either Namelex or JL Spirits to pay the amount due was a matter of increasing concern to Gallaher, not least because it could, and eventually did, mean that Gallaher would have to write the debt off.

161 Namelex blamed the non payment on a failure to complete a Russian transaction which would have produced the necessary cash. Mr Clarke understood that Mr Hadkinson was working on a Russian government related transaction which would provide the finance.

162 In late June or early July Mr Hadkinson had begun trying to make some financial arrangements which were to involve letters of credit in favour of Gallaher, one from Sobibank, a Russian bank, and one from Banque de la Mediteranée, a Lebanese bank with which Mr Nammour was associated. The plan was to raise finance through one or other of these letters of credit, and to use goods obtained pursuant to the letter of credit to supply Mr Tlais with free stock, as a result of which he would begin to open letters of credit again.

163 In early July Mr Simon and Mr Jack travelled to Cyprus in July and met Messrs Clarke and Nammour. On 6th July Mr Clarke wrote to Mr Jack saying that Namelex was moving rapidly towards finalising a letter of credit which he was confident would be closed in a week. Over the course of the summer Namelex produced regular updates promising imminent payment and proposals involved increasingly bizarre payment mechanisms.

164 On 28th August 2001 Mr Clarke provided Gallaher with a letter from Sobibank to Namelex indicating that a documentary credit for $ 30 million had been approved, the requisite collateral having been provided, and that the necessary permission from the Central Bank would soon be issued. A Russian speaking secretary at Gallaher contacted the bank who denied that the letter came from it. On Saturday 1st September Mr Jack and Mr Redshaw of Gallaher met Mr Clarke in Cyprus to confront Mr Clarke with their belief that the letter was a forgery. He was visibly shocked. Mr Nammour, to whom Mr Clarke referred the matter, expressed disbelief. Mr Jack and Mr Redshaw took these reactions to be genuine.

165 Mr Jack was given to understand by Namelex that the Chief Executive of Sobibank had given his confirmation that the transaction was in hand "*privately*", since the transaction as a whole would have breached Russian banking regulations because funds were to be moved off shore to allow the issuance of a letter of credit from a bank in which Gallaher could have confidence; and that the signatory of the letter would confirm it at a face to face meeting. He was also told that, when Gallaher sought verification, the matter was referred to the Bank's Internal Security Officer as a result of which a Central Bank investigation was launched into the affair and the bank was denying the letter.

166 On Monday 3rd September 2001 Mr Nammour met with Sobibank's lawyers in Cyprus and was told that there was "*a last minute problem*". Mr Jack appears to have been told (see his memo of 5th September 2001) that Gallaher's request for verification of the letter from Sobibank "*had caused some difficulty with the bank*"; and that the bank director stated that this would not delay the issuance of the LC "*but would cause subsequent difficulties for senior officers and shareholders of the bank*". On 4th September Sobibank confirmed to Gallaher by e-mail that they had never issued letters of any kind about financing Namelex and had never had Namelex as a client.

167 In September 2001 Mr Perks, the head of Gallaher's Group Risk Assurance ("GRA") Division, which included Gallaher's internal audit department, went, at Mr Rolfe's request, to audit the Gallaher stock in Cyprus. He found that the main Attheslis storage facility was reasonably secure. But the result of the physical stock

count there revealed 498 million sticks less stock than what appeared in Gallaher's books, which may have been attributable to exchanges of stock authorised by Mr Jack, as a result of which some of the returned stock could be in Dubai (where there was an excess of 441 million sticks).

168 He also found that there were three subcontracted facilities two of which were little more than unmanned lock ups. The third facility and one of the lock ups held significant quantities of Gallaher brands apparently owned by Namelex or CT Tobacco. The amount of stock in Cyprus belonging to Gallaher or Namelex and its customers did not appear consistent with the impression given by Namelex that stocks were moving out regularly. As a result arrangements were made to return to the UK some containers that had just arrived in Cyprus and others that were in transit. This caused Mr Clarke to claim that it would seriously affect Namelex's ability to raise the relevant funding.

169 On 10th September 2001 Mr Clarke and Mr Nammour wrote, on JL Spirits' notepaper, a long letter to Mr Northridge, outlining how much Namelex had expended in the purchase of cigarettes (said to be c $ 73 million for over 767,000 cases), and what its "*exposure*" was in the form of trade debtors and goods supplied or to be supplied free of charge, stocks in the market, and letters of credit opened for goods only partially delivered ($ 80.5. million). He outlined a number of problems (e.g. initial supplies of Mayfair, Sovereign Black and Dorchester Black in UK domestic packs at high prices, which had to be sold at a loss, and the risk of it being illegally shipped back to the UK; spotting problems, shipment delays; hard outers not supplied until late 2000, no soft packs until recently, etc).

170 The letter referred to the $ 30 million letter of credit organised by Namelex and accused Gallaher of taking the "*unethical*" step of releasing "*confidential and privileged*" documents which had caused "*our Russian partners*" to withdraw their support at a time when the letter of credit was ready to be issued. The letter expressed the hope of resolving the matter by the end of September 2001.

171 On 27th September Mr Clarke passed on to Mr Jack a message from some contact of Mr Hadkinson in Russia that the letter of credit would be issued within the week, the delay being allegedly due to the events of 9/11.

The Namelex red card

172 HMCE had in place a red and yellow card procedure. This was the means by which it alerted manufacturers in respect of customers about whom it had serious concerns, usually based on the proportion of the customer's total purchases which found their way back to the United Kingdom. In the case of a red card HMCE invited the manufacturer to consider taking action against the customer. The range of action to be considered was: cessation of supply; reduction of supply; restrictions on certain brands; delivery of product direct to intended markets; ending the practice of delivering to free ports; a review of export policy; contractual provisions regarding the behaviour of the distributors in relation to the destination of their products; conducting an audit of the distributors; and agreeing a system for tracing sales. A customer the subject of a yellow card would be one about whom HMCE had some concerns and about which it would expect the manufacturer to make further

inquiries. That was the way in which the procedure was explained to Gallaher in a letter from HMCE of 1st October 2001 which used the red and yellow card terminology.

173 The footballing metaphor was not entirely apt. It was not an expression that Mr Byrne used. HMCE had no power to order or require a manufacturer to do anything, or to penalise it for not having done so.

174 On 1st October 2001 Mr McCallum of HMCE wrote to Mr Jeffery informing him that they were issuing a red card against Namelex, stating that he was sure that as a responsible company Gallaher would want to comply with the system and take "*robust*" action against its distributors who were shown to be contributing to the tobacco smuggling problem.

175 The basis upon which HMCE issued the red card was primarily the volume of seizures of products sold to Namelex. Between August 2000 and August 2001 HMCE had seized about 100 million Sovereign cigarettes out of a total of about 2.5 billion supplied to Namelex. If a multiplier of seven were to be applied (see paragraphs 12-14 above) it would imply that nearly a quarter of the cigarettes sold to Namelex had been smuggled. The 100 million figure did not include the 100 million seized on the "Marina".

176 The red card was, not surprisingly the subject of considerable discussion at Gallaher involving Mr Jeffery, Mr Keevil, Mr Fielden and Mr Rolfe.

More letter of credit proposals from Namelex

177 On 8th October 2001 Ligget-Ducat faxed to Mr Fielden of Gallaher documents that it had obtained which detailed arrangements set out in a memorandum signed by Mr Hadkinson whereby an unnamed investor was to open a letter of credit for $ 30 million in favour of Gallaher in return for $ 45 million. The arrangement was to be that Gallaher would agree to provide 450,000 cases of product free of charge within 365 days as security for the payment of that sum, which Mr Hadkinson was to arrange. If and insofar as the investor received cash Gallaher was to be released from its obligation to supply goods free of charge. Gallaher was to have to confirm that NTA would receive a 5 year licensing agreement for Dorchester and Sovereign.

178 Mr Clarke told Mr Rolfe, who had telephoned him, that he had no knowledge of the documents, although Mr Hadkinson's memorandum had said that Mr Clarke and Mr Nammour were "*on stand by to travel*" to sign a General Agreement with the investor. Neither Mr Rolfe nor Mr Fielden had at this stage heard of Mr Hadkinson. Mr Rolfe asked Mr Jack, who had not heard of him in the context of Namelex, to find out about him. Mr Jack learnt from Mr Clarke that Mr Hadkinson had been helping Namelex to find funds.

Negotiations between Gallaher and Namelex

179 Further communications took place between Gallaher and Namelex and between Gallaher and HMCE. At a meeting in Weybridge on 15th October 2001 Mr Rolfe and Mr Jack met Mr Clarke and Mr Nammour. Namelex's purpose was to obtain further time and to ensure that, if Gallaher was paid, they did not then cut Namelex

out. Namelex sought a new 5 year contractual commitment. Namelex proposed to provide a stand by letter of credit in the sum of $ 50 million only to be drawn down after 1 year, out of which they sought a repayment of $ 12 million, together with a renegotiated five year distribution agreement and the lowest possible price levels for a year. Gallaher's representatives wanted the letter of credit to be discountable or to allow for partial drawdown. Namelex said they would explore the possibility of using the letter of credit to secure a facility which would allow Gallaher to make partial drawdowns. Gallaher was in principle prepared to allow the repayment of $ 12 million and to enter into a 5 year contract at reduced prices for a year.

180 Mr Rolfe explained HMCE's concerns and said that, if Gallaher were to continue to do business with Namelex, it would have strictly to comply with the ITP; shipments would have to go direct to local markets; and there would need to be procedures to track goods to the destination market, and pack markings appropriate to those markets. Mr Rolfe explained the need to limit the supply of packs with non-specific health warnings. Mr Clarke and Mr Nammour were, however, keen to continue to have product with a global English health warning, saying that products with an English-language health warning had greater cachet, and that to use anything else would put Gallaher brands at a competitive disadvantage. They also claimed that the smuggling of Sovereign Classic was limited to paper parcel product, and that product in hard outers would not suffer from the same problems. Mr Rolfe told Mr Clarke that Gallaher would negotiate a new agreement in good faith if the debt was paid and finance was made available for future orders.

181 On 19th October Mr Rolfe wrote to Mr Nammour referring to the fact that, if Gallaher were to continue doing business with Namelex, there would need to be a new agreement incorporating the ITP. Correspondence over the terms of a new agreement and the proposed arrangements continued in October.

Meeting with HMCE on 5th November

182 At a meeting with HMCE on 5th November Mr McCallum explained that the decision to red card Namelex was in part influenced by Mr Clarke's failure to meet with them and that it was HMCE's view that manufacturers should stop trading with red-carded customers.

183 Mr Jeffery reminded HMCE that Gallaher's export trading strategy outside the EU involved, mainly, Namelex-related companies, and discussed what could be done short of terminating the Namelex Agreement. Mr Jeffery set out the actions which Gallaher had decided to take: ensuring that Gallaher had prior notification of the final destination market of all goods; shipping the goods directly to their final destination market; identifying the supply chain; introducing a system for tracking sales of cigarettes into their final markets, using pack codes to identify destination markets and first customers; and ensuring health warnings were appropriate to the destination markets. In part, these changes were necessitated by Italian legislation of April 2001 which required tobacco manufacturers to adopt a coding system to record certain information on a cigarette packet, including intended final destination and first customer. HMCE was comfortable with the range of measures Gallaher was putting in place.

184 On 22nd November 2001 Mr Jack informed Mr Clarke of the red-carding of Namelex. He pointed out that a red card normally meant that "*We should cease to trade*" but that as a result of demonstrating that the goods seized were in the main supplied to CT Tobacco either by Namelex or Gallaher itself, he had secured "*our continuing business*". He stressed the importance of Gallaher's goods not finding their way back to Europe and that there should be no dealings with Mr Tornarides or CT Tobacco whatsoever. He also said that it was in the mutual interest of Gallaher and Namelex that Mr Clarke should give a full response to HMCE's questions, which could be expected at the meeting with Mr Clarke that was shortly to take place, about the volume of product supplied to CT Tobacco and bought back.

A disputed meeting in November 2001

185 Mr Clarke's evidence is that in November 2001 he travelled to Weybridge and met Messrs Keevil, Jeffrey and Jack of Gallaher. He explained what he knew about a deception in relation to free goods (see paragraphs 194ff below) that was being practised on Mr Tlais and that as far as he was aware Mr Tlais had no idea what Mr Hadkinson was doing and was a victim of the situation. Gallaher wanted to buy further time to consider its options and asked him to provide them with further information about the promised letters of credit. After this point he acted as an informant to Gallaher, keeping them abreast of the prospects of success of Mr Hadkinson's financing plans.

186 Both Mr Keevil and Mr Jeffery deny that any such meeting took place. Although Mr Clarke's evidence is consistent with Mr Jack's statement to HMCE in June 2002 that he did not know of Mr Hadkinson's involvement with the Namelex business until October/November 2001, I prefer their evidence to that of Mr Clarke. Their evidence struck me as convincing. Moreover there is no reference to any such meeting in Gallaher's documentation (or any documents produced by TEL).. This seems to me an unlikely omission if Mr Clarke had made a special journey to Weybridge. If Mr Clarke had begun to tell a meeting including Mr Keevil about Gallaher being implicated in a fraud being perpetrated against Mr Tlais it seems to me improbable that neither Mr Keevil nor Mr Jeffery would have made any note of it, recalled it, or done anything about it. Mr Keevil's evidence, which I accept, was that he would immediately have contacted Mr Fielden and Mr Perks and advised the suspension of Mr Jack. He did none of these things.

Mr Clarke meets HMCE

187 Mr Clarke met with HMCE in January 2002. He used the opportunity to discuss how HMCE would feel if Namelex dealt with Imperial Tobacco. His evidence was that he did not feel he could be completely open about the Sovereign brand, his true view being that Gallaher's irresponsible volume selling of stock into a transit market with global health warnings made it responsible for the seizures that occurred. As a result, so he believed (correctly) HMCE regarded him as evasive.

188 Further promises about forthcoming letters of credit were made. No letter of credit came forward and on 30th January 2002, following a high level Gallaher meeting, Namelex was given a deadline for payment of 21st February. That deadline was

influenced by the fact that 6th March was the date for the announcement of Gallaher's financial results.

189 On 20th February 2002 a meeting took place at Weybridge attended by Mr Hadkinson and Mr Clarke. Mr Hadkinson said that he had secured a letter of credit for $ 52 million from a merchant bank, the terms of which (involving various payments to Highstreet, Hadkinson and Switzerland) were set out in a letter of the following day. The letter of credit was intended (by Mr Hadkinson) to be confirmed by Deutsche Bank. Mr Rolfe raised with Namelex the possibility of a direct approach by Gallaher to Mr Tlais as a means of mitigating losses. Both Mr Hadkinson and Mr Clarke expressed concern about this, indicating that Mr Tlais was a highly volatile individual and difficult to deal with.

190 No letter of credit or other payment was forthcoming by the deadline (not least because Barclays Bank refused to undertake to pay $ 13 million out of the $ 52 million to a company called Necos Ltd). Gallaher was, therefore, forced to announce an exceptional loss of around £ 12.3 million in its 2001 results to reflect (a) the unpaid debt from JL Spirits & Tobacco and (ii) the stock produced for Namelex which was sitting in Cyprus and Dubai.

The Memorandum of Understanding

191 On 23rd April 2002 Gallaher and HMCE entered into a Memorandum of Understanding (the "MOU"). The purpose of the MOU, first mooted in September 2001, was "*to set the framework of co-operation between HMCE and the particular tobacco manufacturer in order to minimise any obstacles to legitimate trade while minimising the smuggling of exported UK manufactures cigarettes back in to the UK*".

192 The MOU recorded the existence of the ITP and stated that Gallaher only supplied product where there was a legitimate demand for the product in the intended final market; took action to identify supply routes where information indicated substantial smuggling of Gallaher's products; refused sales where the end-sale destination was in doubt; revisited its trading relationship with any distributor shown, or reasonably believed, to be behaving improperly and would terminate it immediately if it concluded that any distributor was a smuggler or was knowingly or recklessly supplying one; and that Gallaher provided HMCE with all relevant information about the destination of export sales and export sales data, including pack coding data.

193 This MOU was the first of its kind. It was publicly announced by HMCE who recognised that Gallaher had been at the forefront of cooperation by tobacco manufacturers. Gallaher was eager to benefit from this public approval.

The alleged fraud in relation to free goods

194 As appears from paragraph 92 above Mr Hadkinson encouraged Mr Tlais to offer cigarettes to other distributors at significant discounts, by representing that Gallaher had agreed to provide free goods via himself/Namelex in order to compensate Mr Tlais for his losses. It was in Mr Hadkinson's interest to get Mr Tlais to sell as much

as possible, since he or his companies or associates would earn *"marketing allowances*" on sales financed by Mr Tlais.

195 Whilst Gallaher provided a substantial quantity of free goods to Namelex, in anticipation that this benefit would be passed on in whole or in part to sub-distributors, it had made no agreement with Mr Tlais or his companies for the supply of free goods by Gallaher to them.

196 That Mr Hadkinson was deceiving Mr Tlais in this way was known to Mr Clarke. His evidence was that, although he knew that Mr Hadkinson was saying that Gallaher would provide free goods, and that that was false, he thought that Mr Hadkinson intended to make sure Mr Tlais received the goods promised. If that is what he thought, he engaged in a high degree of wishful thinking; particularly if he was – as he told me - prevented by Mr Hadkinson from speaking directly to Mr Tlais on the supposed ground that Mr Tlais disliked dealing with English people – which is, and must have been realised by him to be, untrue.

197 Mr Clarke told me, and I accept that he was not aware quite how much Mr Hadkinson had promised Mr Tlais by way of free goods. In about October 2000 he saw the free goods account between Namelex and Highstreet (which he was only rarely allowed to see) and it then stood at 42,469 cases. Mr Clarke suggested that Namelex should take steps to reduce that liability and not long afterwards a number of cases were provided to Mr Tlais free of charge. An FOC Stock Report of 13th December 2000, supplied by Mr Hadkinson to Mr Tlais, shows 42,469 cases being due (19,185 cases having been released previously), which Namelex had instructed Gallaher to release. These were part of a consignment to JL Spirits supplied on extended credit terms.

198 The next time that Mr Clarke saw the free goods account was in about August 2001 when it stood at around 300,000 cases, with a value of some $ 30 million. This was to him an unbelievable figure, representing something close to one free case for every case ordered during the Namelex era. Mr Tlais had agreed with Mr Hadkinson that, once he received $ 30 million of free goods, he would open a $ 30 million letter of credit. Mr Clarke told Mr Jack what he had found, and his belief that Mr Hadkinson was trying to defraud Gallaher. Mr Jack was deeply concerned and feared that, if Namelex collapsed, and Gallaher's business in the Middle East with it, he would be out of a job.

199 At about this time Mr Tlais was becoming increasingly concerned about whether and when Gallaher would supply the free goods he believed that Gallaher was due to be making available to him. He contacted Messrs Clarke, Nammour and Hadkinson regularly to enquire on progress, making it clear that he would not open the $ 30 million credit promised unless he got the goods. At a meeting in late July in Cyprus Mr Clarke told Mr Tlais, on Mr Hadkinson's instructions, that the free goods would be released in August, although Mr Clarke knew that this was misleading. Mr Hadkinson had told Mr Clarke that he was confident of getting the necessary finance to make this possible. In the event he did not.

200 At that meeting Mr Tlais handed Mr Jack, whom he had not met since the signing of the Namelex Agreement, a letter on NTA paper signed by him and dated 24th July

2001. This had been drafted by Mr Hadkinson, who had told him to give it to Mr Jack. That letter included the following passage:

> "*To date Gallaher have released to us about 257,000 cases free of charge and we can proudly confirm that all this quantity has already been given to our clients and more, to support the continued marketing of Gallaher business and to resolve the problem of the spotted paper outer products.*
>
> *In fact, we have to-date not only given our clients the 257,000 cases free of charge, but we have committed another 268,000 cases free of charge to this business as further support over the next few months ……*
>
> *Our commitment to this business is made with confidence since Gallaher has more than demonstrated its commitment to the business and to us by supporting the development of our cooperation with the 257,000 cases already released to us and the 268,000 cases to be released to us once manufactured and shipped as confirmed by Mike.*
>
> *We would greatly appreciate receiving the release of these free of charge goods as a matter of priority, preferably before the end of August, as confirmed by Mike, in order to assist us recover our heavy investments"*

201 Mr Jack knew that Gallaher had not released 257,000 cases free of charge, although Namelex may have done so[11]. He also knew that Gallaher was not intending to release 268,000 cases of free goods to NTA or Mr Tlais. He did not however contradict Mr Tlais' expressed understanding that Gallaher would be providing 268,000 cases of free goods. 268,000 cases at $ 100 a case, the price Mr Tlais was then paying would produce $ 26.8 million.

202 Mr Tlais knew that he, at any rate, had not received 257,000 cases free of charge. His evidence was that he had received no free goods except for about 40,000 cases to compensate him for money spent on demurrage, by which I take him to mean storage charges. He said that he believed that the 257,000 cases had been provided to Namelex or other distributors in respect of the spotting problem[12].

203 According to Mr Tlais, Mr Jack took the letter and said that he would read it later and respond, rather as if he already knew what it contained. On 26th July Mr Jack sent an e-mail to Messrs Simon, Rolfe and Jones at Gallaher which read:

> *"As I planned, I met with Abu Hameed yesterday who was, as usual, upbeat. While thanking us for our support, he expressed his concerns about our continuing support given his level of investment. He acknowledged that he had been assured of that at all times by Mike and Fadi but had felt the need to*

[11] If so, the exact way in which it did so is unclear. It may have done so by using the rebate given to it (either in cash or goods) or out of the stock ordered by JL Spirits and not paid for: see paragraph 2 (vi) (e) of Mr Keevil's letter of 14th May 2002 and page 11 of Mr Hadkinson's letter of 27th May 2002.

[12] That is consistent with Mr Hadkinson's letter of 15th April 2002 in which he said that the stock released to JL Spirits had been solely used for the resolution of the spotting problem.

> *see me face to face and to get it from the horses [sic] mouth….Fadi spoke to him privately following our meeting and also felt he was reassured. We hope to see an acceleration of his process now. They are committed to clearing the matter up in the next 2 weeks and I will keep you posted."*

The reference to "*his process*" was probably to Mr Tlais opening another letter of credit to finance the business.

204 What exactly Mr Jack said to Mr Tlais is unknown but it appears that he gave him some degree of assurance of Gallaher's continuing support in the provision of free goods. On 5th September 2001 Mr Jack sent to Mr Northridge, Mr Simon, Mr Rolfe, Mr Moxon and Ms Jones, the memorandum to which I refer in paragraph 92 above. By this stage, at the latest, Gallaher, and, in particular, Mr Jack and the recipients of the memorandum knew that Namelex had been telling Mr Tlais that Gallaher was investing heavily in the supply of free goods to support Namelex's clients.

205 Mr Rolfe's evidence was that Gallaher considered whether this state of affairs had any negative implications for Gallaher and concluded that it did not on the ground that it was largely a matter of indifference whether the free goods were coming from Gallaher or from Namelex. That would be true if, but only if, the goods kept coming. If they did not it would make a great deal of difference to Mr Tlais whether it was Gallaher or Namelex that had agreed to provide them and, if Gallaher, whether the goods were to be supplied to Namelex or to him. This was particularly so in circumstances where the Namelex group's ability to honour its obligations was in doubt. If Gallaher did not appreciate this they were shutting their eyes to the obvious.

206 In a memorandum of 6th September to the same recipients Mr Jack explained that Mr Tlais was expecting and chasing for a substantial volume of free goods (in respect of which Namelex had made a commitment to Mr Tlais) "*to support actions carried out in his markets*", which were to be supplied FOC by Namelex Holdings *"from within one of their own funding routes"* and that Mr Tlais would open his letter of credit for $ 30 million once he had got them. It was apparent to Gallaher that Mr Tlais would not provide a letter of credit unless and until he got his free goods[13].

207 From September onwards Mr Tlais was regularly calling Mr Hadkinson, pushing him to say when the free goods were going to arrive. In mid September he told Mr Hadkinson that there would be no further funding until he had had free goods or money to their value. Mr Hadkinson said he would speak to Mr Jack at a meeting they were having on 13th September and ask him to confirm matters in writing.

208 On 13th September 2001 Mr Jack wrote the following letter to Mr Tlais:

> "*Dear Abu Hameed*

[13] As is confirmed by Mr Rolfe's note of a meeting on 17th September 2003 which records that Mr Tlais is waiting for free goods to come, the provision of which will be financed by the Russian letter of credit after which he will "*endorse*" the Lebanese letter of credit for $ 30 m.

We wish to confirm to you that Mike and Fadi have presented to us the option of the US$30 million one off payment in full settlement as an alternative option to the free of charge goods.

We are currently studying the various options for the best interests of the business.

Under the current circumstances we need 3-4 weeks to reach a final decision with regards (sic) which option to take, after we have concluded the on-going discussions. The final decision will reflect the conduct of the future business.

Once a decision had been reached we shall immediately inform you of it.

Until then we would appreciate your understanding and support".

209 This letter was intended by Mr Jack to keep Mr Tlais at bay by conveying to him that Gallaher intended either to supply him with free goods or their cash equivalent and was deciding which option to take. It was written following a meeting between Messrs Clarke, Hadkinson and Nammour on 13th September. Messrs Hadkinson and Nammour assured Mr Clarke that a deal had been finalised and a letter of credit was about to be opened but said that they needed time to finalise it and needed Gallaher's help to keep Mr Tlais at bay. Mr Clarke and Mr Livy then met Mr Jack at the Secret Valley Golf club. Mr Hadkinson had produced several drafts of a letter to be sent to Mr Tlais. These were presented to Mr Jack as options by Mr Clarke and Mr Livy. Mr Jack agreed to sign the version set out in paragraph 208 above, as being the most ambiguous; drove back to Namelex's office in Larnaca, and retyped it on Mr Nammour's computer on Gallaher notepaper. Mr Nammour faxed it to Mr Tlais[14]. Mr Jack confirmed to Mr Tlais, when Mr Tlais telephoned, that he was the author.

210 Mr Jack wrote the letter because he was desperate to ensure that the Namelex debt was repaid because his job was at risk. He believed, optimistically, that Namelex would come up with the finance it was seeking which would enable the JL Spirits debt to Gallaher to be paid off, and free goods to be provided to Mr Tlais, who would then open his letter of credit and business could continue.

211 The representation as to Gallaher's intentions contained in the letter was, and was known by Mr Jack, to be untrue. Gallaher had no such intentions. The letter was a deceitful attempt (to which Mr Clarke was a party) to buy time. It was continued by Mr Jack confirming to Mr Tlais in several telephone conversations between September and December that Gallaher was getting ready to pay the money or provide the goods.

212 On 10th October 2001 Mr Jack wrote a memorandum for Gallaher's senior managers including Messrs Rolfe, Saad (head of New Business Development), Simon and Northridge in which he said:

[14] For reasons that have not been explained the version of the letter exhibited to statements of Mr Tlais and Mr Clarke in response to an application for summary judgment is attached to fax confirmation sheets purporting to show that the letter was faxed from Weybridge.

> *"In assessing the options, the other fact to be cognizant of is that [Namelex's] customers have not been fully informed of the way in which they have run the business. In particular, their key customer has been given volumes of goods by them in the belief they were supplied by Gallaher and expects further volume to be forthcoming. These goods are also the ones that Namelex expected to pay for and give free themselves."*

The memorandum referred to Namelex having promised Mr Tlais 2.5 billion additional free goods – i.e. 250,000 cases. It envisaged two possible scenarios by which Gallaher would appear to supply the free goods which TEL expected to receive. Under the first scenario Mr Tlais would pay $ 100 per case for the goods which TEL had manufactured for Namelex with the cost of the free goods coming out of Namelex's margin. In the second Gallaher would deal directly with Mr Tlais and the expected free goods would be provided out of Gallaher's margin.

213 The internal Gallaher documentation to which I have referred shows that Gallaher was aware that Mr Tlais had been promised 250,000 cases of free goods to be provided by Gallaher, and that Gallaher was intending to continue the illusion that it was they who were providing them, when in fact it would be Mr Tlais who would be financing the provision. The suggestion in Mr Rolfe's witness statement that at this stage Gallaher had no reason to believe that the provision of free goods was to be in respect of any previous commitment made to Mr Tlais and was simply an incentive to provide financing against future orders is not borne out by the documents.

214 Mr Tlais was seeking to arrange an urgent meeting with Mr Jack, who wrote to him on 6th November claiming, inaccurately, that he had been too busy with other commitments to meet him, and that he was doing all he could to meet at the earliest opportunity. On 21st December Mr Jack sent another letter expressing a wish to meet early in January 2002. In that letter Mr Jack said that he thought that the terms of a new five year term agreement had been agreed which would "*allow us to move forward, releasing the goods and building a mutual business of the size you have indicated*". When Mr Tlais received it he contacted Mr Hadkinson, furious that Mr Jack had made no mention of when the free goods issue would be resolved.

Mr Jack's second letter of 21st December 2001

215 Mr Hadkinson contacted Mr Jack, who wrote to Mr Tlais on the same day as follows:

> *"I apologise for not being more explicit in my previous note to you this morning but, as I am sure you understand, I have been rushing around in an attempt to get everything organised for our mutual best interest.*
>
> *In relation to the $ 30m issue, I am advised that the delay is only due to the increased administrative bureaucracy brought about by the recent world events.*

We understand if it is not completed before the end of the year it will definitely be finished in early January 2002. In fact, although I myself am scheduled to be on holiday with my family now until 3rd January, I will come to the office next week to push it through…"

This letter was an embellishment of a draft by Mr Hadkinson. Amongst other changes Mr Jack added the reference to his coming to the office the next week to take personal charge. The letter was intended to confirm to Mr Tlais that Gallaher would see to the provision of the $ 30 million in some shape or form.

216 On 29th January 2002 a memorandum of Mr Jack was circulated to senior executives including Mr Northridge, which under the heading "*Further Potential Solutions*" read:

"I propose to put it to [Namelex] that, if there is any doubt in their mind as to the ability to deliver on time, they should consider the following:

Make a payment to us on account of as large a sum as possible.

We will use half this sum against debt and half to release goods from stock.

These goods will go straight to Abu Hameed as evidence that the flow has started and will be used as leverage to start his direct funded orders, whereupon rebates due within the business can be used to further draw down debt and release further goods to Namelex to discharge their FOC liabilities. This route has the greatest chance of success.

If this is not acceptable, we will approach AH directly and trade with him. This will necessitate telling him the truth about what he has been told by his partners. This position will largely depend on a trade off between his greed for future business and his pride at having been misled. There is, I believe a 50:50 chance he will go for it".

217 Had the first course been adopted it would have enabled Namelex to continue the deception by representing that Gallaher was beginning to provide the free of charge goods which Namelex had led Mr Tlais to believe Gallaher was to provide. Gallaher only contemplated telling Mr Tlais the truth as the last option.

Calculation of free goods and loss

Free goods

218 Mr Tlais was expecting to receive free goods and was being told by Mr Hadkinson that it was Gallaher which was providing them. It is, however, unclear what was the basis upon which the provision of free goods was to be calculated. Mr Tlais' evidence was that he would be selling, initially, at a price that was markedly less than what he was paying and that the difference would be made up by the provision of free goods, although no agreement was made as to any value that was to be attributed to the goods supplied free for this purpose. Mr Tlais was, so he understood, to be covered by the provision of cases to make up his losses as decided

by Mr Hadkinson and Gallaher. The calculation of the free goods account referred to in paragraph 198 above suggests a figure of around $ 100 a case, which was the price that Mr Tlais was paying in the Namelex era.

Loss

219 Mr Tlais claimed to have lost $ 30 million. No calculations have been produced showing the make-up of this loss. Appendix 2 to Gallaher's final submission, to which I refer in paragraph 1180 below, contains details of apparent TEL sales figures in respect of the goods the subject of the relevant letters of credit, which show that TEL does not appear to have made a loss overall and certainly not a loss even approaching $ 30 million. This calculation has, however, to be treated with caution because the TEL sales figures are derived from the customer accounts which may well in some cases not represent the actual prices achieved.

The background to the TEL Agreement

220 By 21st February 2002 both Gallaher and Mr Tlais had serious problems. Gallaher had $ 8.7 million due and unpaid, the debt being owed by JL Spirits, which was unable to pay. Gallaher had a large quantity of stock on its hands – in Cyprus, Dubai and the UK - ordered by Namelex or JL Spirits. It knew that Mr Tlais, the major financier of letters of credit for goods ordered by Namelex, was expecting $ 30 million worth of free goods or cash in lieu.

221 Mr Hadkinson was also threatening to bring a claim against Gallaher if it terminated the Namelex Agreement. In a letter of 25th February 2002, in which he referred to a proposal for a $ 32 million irrevocable (but as yet unconfirmed) letter of credit he had said:

> *"A negative view from Gallaher will result in an unthinkable chain reaction of claims and counter claims resulting in a legal nightmare for all of us"*

222 Mr Tlais, for his part, had invested large sums in financing the purchase of cigarettes. He claimed to have suffered great losses and that the promises Mr Hadkinson had made to him about free goods had not been fulfilled. He had a sizeable quantity of goods on his hands which he had not sold. The collapse of Namelex threatened to bring his prospects as a major distributor of Gallaher's products to an end.

223 On 4th March 2002 a high level meeting took place at Weybridge. Messrs Northridge, Rolfe, Keevil, Saad, Moxon and Jack attended. The meeting considered a paper from Mr Jack which proposed direct dialogue with Mr Tlais, if a sale of Namelex's 50% of NTA (either to Mr Tlais or a Mr Sarkis Sarkis) which had been mooted for a while, did not go through. The idea was that Gallaher would disclose "*the true position as Gallaher see it*" and that Gallaher would propose supplying goods with a significant free component which would be covered "*from within his higher buying prices*". The objective was to produce a position where the free goods supplied would repay Mr Tlais' investment over time and provide Gallaher with a higher than planned unit margin which would, again over time, repay the JL Spirits

debt. The meeting decided that Mr Jack would discuss the proposal with Mr Clarke and invite Mr Tlais to Weybridge.

224 The "*true position as Gallaher see it*," which Gallaher was later to explain to Mr Tlais was that Mr Hadkinson had told him that the free goods were coming from Gallaher, when they were not; and that the provision of free goods was Mr Hadkinson's responsibility and not Gallaher's.

225 Gallaher by now recognised that Mr Jack had made errors in allowing so great a build up of stock by Namelex and that he should be closely supervised by Mr Saad. Mr Tlais himself had noticed, from the summer of 2000, that warehouse space in Limassol was becoming unusually limited with high quantities of Gallaher's products arriving including Sovereign Classic, Sovereign Black, Dorchester and Mayfair. He believed that Mr Hadkinson was selling goods to a well known Ukrainian smuggler. Mr Hadkinson professed an ability to sell all these goods.

226 Also on 4th March 2002 a long letter was received by Gallaher from Highstreet in which Mr Tlais claimed to have invested over $ 60 million in the business[15]. The letter painted a rosy picture of trade. Mr Tlais claimed to have received an order for 300,000 cases per annum at $ 30 per case for Iran. He indicated that his aim was to reach an average of 50,000 cases a month at $ 100 per case within a year – this would be over 10% of the entire Iranian market. The letter referred to the 258,000 cases already received "*from you*" free of charge and to the "*commitment of Gallaher to support us in recovering the investments we have made in the various markets to date*" exceeding $ 60 million. Mr Tlais claimed to be out of pocket for more than $ 40 million, even after receiving the 258,000 cases, and looked forward to finalising "*the outstanding amounts due to us*".

Mr Clarke spills the beans

227 By March 2002 Mr Clarke, who himself had lost out financially from Namelex's collapse, had come to the view that Mr Tlais should be told that he had been deceived. He contacted Mr Jack and told him that matters needed to be brought to a head and suggested that Mr Tlais should travel to Weybridge for a meeting. Mr Jack arranged for Mr Tlais' office to book a ticket to Milan (to put Mr Hadkinson off the scent) and for Mr Tlais to book a ticket to London on 10th March 2002. Mr Clarke arranged to be on the same flight, swapped seats with Mr Tlais' wife on the plane, and started to tell Mr Tlais what he knew.

228 He explained that the free goods Mr Tlais was expecting were not going to be delivered and that Mr Hadkinson had been deceiving him. Gallaher had known of Mr Tlais' belief that he was to get free goods from them since at least the summer of 2001 but had chosen to keep him in the dark and they were worried that they might be liable to him. He also told Mr Tlais of the commission payments that were being made to Mr Hadkinson's companies. He claimed to have been sidelined by Hadkinson and kept away from Mr Tlais. The discussion continued at their hotel.

[15] According to Mr Tlais this was the total amount of the letters of credit he had opened, including those in favour of Mr Tohme and Tbeili plus about $ 10 million of warehousing and other charges. The total is probably exaggerated.

Mr Tlais was confident that Gallaher would find a way to resolve matters and reimburse him his losses.

The meeting of 11th March 2002

229 Mr Tlais and Mr Clarke came to Weybridge the next day - 11th March 2002. Mr Clarke met Gallaher management (including Messrs Rolfe, Keevil, Saad and Jack). Mr Clarke said that he had told Mr Tlais of the deception practised upon him, and expressed the view that Mr Tlais might be willing to work with Gallaher to devise a mutually acceptable method of dealing with all the issues.

230 Mr Tlais joined the meeting. He sought to hold Gallaher liable for his losses and made it clear that, if no amicable commercial arrangement could be made, he would pursue Gallaher at law. He accused Gallaher of misleading him and said that, had he been told the truth in September, he would have rejected $ 10 million worth of goods that had been paid for by letters of credit after Gallaher's misrepresentations; that his losses in this respect were at least $ 5 million, since the goods had been sold at a loss, and that his losses in all were about $ 30 million, in respect of goods purchased and resold at a loss; which he had expected to recoup from the free goods[16].

231 Gallaher said that it regarded itself as a victim of his associates in Namelex, having suffered a £ 12.3 million write off in respect of debt and stock. Mr Keevil told him that any claim would be vigorously resisted and that his remedies were against those who had perpetrated the fraud upon him

232 The discussion then turned to consider what commercial arrangements might be reached. By now Gallaher's objective was to sever its ties with Mr Hadkinson and his business with minimal financial impact and to ensure the continuation of Gallaher's trading business. Gallaher also realised that Mr Tlais sought to recover his financial position by continued trading[17]. Mr Tlais was prepared to take a pragmatic view and work out his problems by that means.

233 A week of meetings followed at the end of which it was agreed that a delegation from Gallaher would fly to Cyprus and Beirut in the week beginning 25th March to meet with Mr Tlais and his family's banks in order to confirm his financial position, his family being said to owe the banks $ 30 million. Gallaher agreed to collateralise the stock produced for Namelex and held in-bond in Cyprus and Dubai in order to support further letters of credit. Mr Tlais agreed to accept the ITP.

[16] He repeated a claim for reimbursement in a letter of 26th March 2002, failing which he said he would have to take the necessary measures to protect his rights.

[17] The individual attitude of Gallaher's senior management differed. Mr Keevil appeared to Mr Tlais to be very constructive. Mr Saad told Mr Tlais the whole situation was his fault for trusting Mr Hadkinson and that he did not believe Gallaher owed any responsibility to him.

Further communications from Mr Hadkinson

234 In a long letter of 21st March 2002 to Mr Rolfe following the meeting between Gallaher and Mr Tlais, which Mr Hadkinson did not attend but about which he appears to have heard from Mr Tlais, Mr Hadkinson (who was still engaged in another attempt – also abortive - to obtain a letter of credit) referred to "*our contribution to the distributors of some 258,000 cases free of charge*" and to his having confirmed to Gallaher that "*a further $ 30 million was also committed to the marketing and developing of the products, a fact that was also reconfirmed by Mr Tlais*". He referred to Mr Tlais' claim to be reimbursed by Gallaher, to Gallaher's letters of 13th September, 6th November and 21st December 2001; and to the need for Mr Tlais "*to be provided with the true picture in that the 258,000 cases given to him free of charge was paid for by us (or invoiced to us) and that the US $ 30 million was also being made available by us (but supported by Gallaher)*". He also referred to 135,000 cases of Gallaher's goods then warehoused in Cyprus and Dubai, which were allegedly out of condition, which he wrongly understood Gallaher to have offered to give to Mr Tlais and which were ultimately pledged to the Bank to secure Mr Tlais' obligations (see paragraph 269(i) below).

235 Mr Hadkinson also asserted that Namelex had been encouraged to sell goods back into the UK and had knowingly supplied goods for Iraq. He referred to Mr Jack having met Uday Hussein. Mr Jack had indeed done so, to discuss the possibility of doing business once sanctions were lifted. I consider the issue of supplies to Iraq in paragraphs 538-566 below.

236 Mr Rolfe replied on 12th April 2002 stating that Gallaher had never given any indication that support of the brands, whether by free stock or otherwise would be reimbursed by it and denying any responsibility for 258,000 cases or the $ 30 million.

237 By April 2002 Mr Tlais was clearly relying on the September and December letters. A note of a meeting of 16th April records Gallaher being told that Mr Tlais' banks had seen letters which confirmed that Gallaher owed Mr Tlais $ 30 million.

Due diligence on Mr Tlais.

238 At the end of March Mr Jack, Mr Jon Moxon, Gallaher's financial controller, and Mr Stephen Perks came to Cyprus to visit the Tlais' family bankers. They met Simon Farah, the manager of the Cyprus branch of BLOM. Mr Farah said that he was under considerable pressure from head office. He saw foreclosure as a last resort but made clear that his job was on the line. If Gallaher could deposit $ 5 million as security, he thought that his head office would approve further letters of credit in the region of $ 3 million.

239 They then flew on to Lebanon, where they were shown the apparent assets of the Tlais family – two homes, three petrol stations, two coffee shops/restaurants, an unfinished hotel and parcels of land. It appeared that the Tlais were people of influence in Lebanon as well as Cyprus.

240 They met the manager of Abu Ahmed's local bank - Banque Libano-Francaise – for a token visit. Then they met Mr Jihad Bassil of the same bank. Mr Perks was impressed by him. He was told that the Tlais family was overdrawn by about $ 12 million; that that amount was well outside the bank's lending policy; and had been reviewed by head office in France. Mr Bassil said that he, himself, could not survive another audit without taking action; and that the Central Bank was monitoring the combined risk to both banks. He confirmed that the bank had security in excess of the loan apparently in the form of property but that it would be a last resort to enforce it.

241 In the event, despite some misgivings as to whether there was an element of stage management in what he was being shown, Mr Perks reported to Mr Rolfe that Mr Tlais had debts of $ 18,000,000 with BLOM in Cyprus and Abu Ahmed had a debt of $ 12,000,000 with Banque Libano-Francaise in Lebanon; and that both banks were reluctant to foreclose but were both operating outside their credit policies and could begin foreclosure within a fortnight. A forced sale would be at a significant discount, would damage the Tlais' reputation and weaken their influence particularly in respect of the collection of monies, and would have a negative impact on Gallaher's business and future development in the region, probably leaving little opportunity for the recovery of outstanding debts. But if Gallaher could provide $ 5 million in an interest bearing account in each of the two banks, they would be willing to provide credit lines totalling $ 4.3 million to Mr Tlais which would give him the liquidity needed to purchase Gallaher's goods.

242 Mr Perks expressed the view that Mr Tlais had been duped and been far too trusting of his associates in Namelex. He recorded that the Tlais family appeared genuine, open and transparent about their financial position, albeit the ownership of their assets had not been formally verified nor confirmed as free of charge.

243 Thereafter negotiation of what became the TEL Agreement took place between Messrs Keevil, Jack, and Moxon and Mr Falvey (in Gallaher's NBD) at a meeting on 16th April. The final negotiations took place between Mr Keevil and Mr Jack, for Gallaher, and Mr Saveriades and Mr Tlais for TEL on 29th and 30th April in Cyprus.

TEL Agreements made on 29th – 30th April 2002

244 At the end of April 2002, Gallaher signed with Mr Tlais:

(i) a letter dated 29th April 2002, setting out an overview of the dealings between Gallaher, TEL and Mr Tlais;

(ii) a letter agreement terminating the Namelex Agreement with immediate effect, incorporating a waiver by NTA of all claims against the Gallaher Group and its directors and employees;

(iii) a further waiver agreement, under which Gallaher, Mr Tlais, and Highstreet Enterprises irrevocably waived any claims against each other arising out of or in connection with the Namelex Agreement;

(iv) a personal guarantee from Mr Tlais, and an associated letter from Gallaher to Mr Tlais' bank, BLOM, in respect of a $ 5 million deposit to be made by Gallaher;

(v) the TEL Agreement;

(vi) Gallaher's Policy on International Trade with an agreement by Mr Tlais on behalf of TEL to be bound by its terms in all dealings with companies of the Gallaher Group.

The 29th April letter

245 The letter dated 29th April 2002 was actually signed on 30th April. It set out the arrangements which were to be, and in the event, were entered into. These included:

(i) The termination of the Namelex Agreement (Legal Matters, point (i)); the termination letter would confirm, inter alia, that Mr Tlais, Highstreet, NTA and its directors, officers, employees and shareholders had no claim against Gallaher arising in any way out of the Namelex Agreement or its termination (Legal Matters, point (ii)). Gallaher would give an equivalent confirmation to Mr Tlais, NTA and its directors. In the event NTA's waiver was included in the termination letter and a separate waiver agreement was made between Gallaher, Highstreet and Mr Tlais.

(ii) TEL Agreement of Mr Tlais to sign and observe both the ITP and the five year TEL Agreement (Legal Matters, point (iii)).

(iii) Mr Tlais' obligation to use best endeavours to procure a waiver by Mr Hadkinson of any claims against Gallaher. Gallaher would also waive any claims against him (Legal Matters, point (iv)). Such a waiver was obtained: see paragraph 295 below.

(iv) Mr Tlais was to obtain from Mr Hadkinson a letter acknowledging that promises made by him of support for the business (whether pecuniary or in kind) were made by him and his partners alone and without reference to Gallaher and that, accordingly, he and his partners "*are liable to you [Mr Tlais] for these sums at your absolute discretion*"; (Legal Matters, point (v)).

(v) Mr Tlais was to procure for Gallaher *"full transparency over the financial management of the business"*; (Legal Matters, point (vi));

(vi) Under the heading '*Banking matters'* there was a description of the arrangements made with BLOM and Banque Libano-Française, and Mr Tlais' personal guarantee. This included the provision by Gallaher of goods owned by it as collateral to be pledged to BLOM (Banking Matters, point (viii)).

(vii) Gallaher's agreement to make available to Mr Tlais 648 million cigarettes, being the stocks for Namelex held in the UK, on 365 days' credit from the bill of lading date; Mr Tlais would sell these stocks as quickly as possible

and use the cash to procure a bank guarantee in order to conduct future trade; (Commercial Matters, points (i) and (ii))

(viii) TEL's agreement to seek to sell its own stocks and Gallaher's stocks in Cyprus and Dubai as quickly as possible by inclusion in sales mixes or by parcel deals "*consistent with the International Trading Policy*" (Commercial Matters, point (iii)); in respect of Gallaher's goods payment would be made to Gallaher as soon as received but in any event after 90 days from release; and Gallaher and TEL were to agree "*on a line by line basis*" the destination of these goods, the selling price and TEL's associated expenses.

(ix) Mr Tlais' agreement to reduce his trade receivables to improve cash flow, and to reduce his reliance on the goodwill of his customers in order to secure payment (Commercial Matters, point (iv)). Mr Tlais had told Gallaher on 11th March 2002 that he traded on open credit, and so was owed significant sums by his customers, which he was unable to recover without providing them with further goods.

(x) A business plan which had been provisionally agreed coupled with an undertaking, in the light of "*our joint commitment to share the pain and gain of this business*" to give a bonus in the form of free stock if TEL succeeded in selling all Gallaher's stocks in Cyprus and Dubai and exceeded the profit generation contemplated by the plan (Commercial Matters, point (v)).

(xi) Under the heading 'Other Matters', it was agreed that a quantity of 94 million Dorchester King Size cigarettes, which had UK health warnings, held in bond in Cyprus would be immediately destroyed under the supervision of Customs: (point (i)); Mr Tlais agreed that the debt owed by JL Spirits and Tobacco Ltd to Gallaher would be assigned to TEL, and any proceeds from that debt would be shared equally between the parties (point (iv)).

The Waiver

246 The Waiver Agreement between Gallaher Group Plc, on behalf of itself and its subsidiaries and other members of the Gallaher Group, Mr Tlais and Highstreet recited that:

> *"(3) Representatives of NTA or persons associated with NTA, most notably one Charles Hadkinson has (sic) made representations to the Gallaher Group, Mr Tlais and Highstreet Enterprises which could potentially result in disputes between them*
>
> ….
>
> *(5) The parties hereto desire to acknowledge, represent and warrant to each other that there are no direct or indirect actions, claims or disputes arising out of or*

related to the Distribution Agreement [i.e. the Namelex Agreement] or otherwise between them."

247 By TEL Agreement the parties agreed, acknowledged, mutually covenanted, and represented to each other as follows:

> "1. *There are no direct or indirect actions, claims or disputes between them of whatever nature whether actual pending or prospective (a) arising out of or in connection with the Distribution Agreement or (b) any other course of trading relationships, business dealings, discussions or exchanges of correspondence between (i) GI or other members of the Gallaher Group or their respective directors or employees and (ii) NTA, Mr Tlais or Highstreet Enterprises ……*
>
> *2. If any party to this Agreement believes that it has any such claim as is described in Clause 1 of this Agreement such claim is hereby irrevocably waived."*

The $ 5 million deposit

248 The form that the arrangements with the banks ultimately took was that Gallaher was to deposit $ 5 million with BLOM in a blocked account (inaccessible by Gallaher or BLOM) as security for the banking facilities extended to Mr Tlais' brothers Fahad and Mohammed and the signatories to their accounts ("the Customers") in respect of various accounts numbered 895296, and would be credited with interest. At the end of the five years the deposit would be released to the bank for payment of any debts of the Customers and any surplus then paid to them. Mr Tlais would make annual payments of $ 1,000,000 to Gallaher.

The guarantee

249 By his personal guarantee, signed on 30th April 2002, Mr Tlais undertook that:

> *"* …..
>
> *(c) [if] I fail to make any annual payments of U.S. $ 1 million to [Gallaher] in accordance with TEL Agreement contained in the letter signed by [Gallaher} and me on 30th April 2002*
>
> *I will within six (6) months from [Gallaher's] demand to me ….reimburse to [Gallaher], without any set off, deduction, withholding or impost whatsoever ….(b) the difference between the said US $ 5 million [Gallaher] has pledged to BLOM and the value of the amount that I have repaid to [Gallaher} at the date of demand …."*

250 The $ 5 million was wired to BLOM on 2nd May 2002 for value on 6th May and Mr Tlais agreed to pay the $ 1 million due annually on 5th May in each of the years

2003 to 2007.The arrangement with the Banks was that BLOM would provide a guarantee to Banque Libano Francaise.

251 An attachment to the letter dated 29th April 2002 stated that the stock available as collateral to BLOM was as follows:

Location	**Brand & Variant**	**Packing**	**Volume (cases)**
Dubai	Dorchester International	Paper Parcel	20,000
Dubai	Dorchester International Lights	Paper Parcel	18,010
Dubai	Dorchester International Lights	Hard Outer	12,000
Dubai	Sovereign Classic Lights	Hard Outer	16,000
Dubai	Sovereign Classic (Arabic) (GCC)	Hard Outer	3,200
Dubai	Sovereign Classic Lights (Arabic) (GCC)	Hard Outer	3,200
Cyprus	Sovereign Classic Lights	Hard Outer	8,800
Cyprus	Dorchester International Lights	Hard Outer	8,800
Cyprus	State Line Lights	Hard Outer	6,400
		Total	96,410

In addition the attachment indicated that a further 29,560 cases of Gold Arrow, Gold Arrow Lights and Business Man cigarettes were, subject to a question about the ownership of trademarks, available, making a total of 125,970 cases or 1.25 billion sticks. Schedule VI envisaged that 64,400 cases of the Cyprus/Dubai stock would be sold by the end of January 2003.

The TEL Agreement

The rights granted

252 By clause 2(i) of TEL Agreement Gallaher appointed TEL as its exclusive distributor in named Territories for named Brands. The Brands were Sovereign Classic and Dorchester International (both Virginia blends), and Stateline (an American blend brand), together with Lights versions of each of these brands: clause 1(i). The Territories were defined as being the "*domestic duty-paid markets*"

listed in Schedule 1, which included 6 Middle Eastern countries (Iran, Iraq, Jordan, Lebanon, Syria. Yemen), 5 Latin American countries (Argentina[18], Brazil, Chile[19], Paraguay, Uruguay), 3 North and East African countries (Egypt[20], Libya, Sudan), together with Afghanistan and Pakistan[21].

Deliveries

253 Clause 3 (i) provided that, unless otherwise agreed, the Brands should be delivered to the port of discharge at the destination market in the Territories in accordance with Incoterms 2000. Risk of loss was to pass in accordance with those terms. Clause 3 (ii) provided that Gallaher would place identification marks on all cigarette packets. Clause 3 (iii) provided for TEL to make all the arrangements for transferring the Brands from the delivery destination in the Territories to registered warehouses and then to its customers and Clause 3 (iv) made TEL responsible for paying all excise duties imposed in the Territories on the Brands supplied by Gallaher in accordance with all applicable laws or local requirements.

254 Clause 3 (v) provided that, in the event of goods being shipped by Gallaher to an intermediate port rather than direct to the destination market,

> *"promptly after the arrival of each shipment of the Brands in the Territory, and in any event within (7) weeks of the arrival of any shipment of Brands to a territory, the Distributor shall supply to GI or Gallaher evidence of the shipment of the order to the appropriate Territory."*

Distribution

255 TEL Agreement obliged TEL to establish appropriate distribution structures in the Territories. Thus:

(i) Clause 4(ix) provided that TEL would

> *"use its best endeavours to distribute sell and promote the Brands in the Territories and ensure that its ordering and stock controls are such that the Territories and any and all parts thereof are adequately stocked to meet in full the demand for the Brands and that the Brands reach consumers in good condition."*

(ii) Clause 5(xviii) provided that TEL would

> *"provide all services necessary for the efficient distribution sale and promotion of the Brands within the Territories"*

[18] Save in relation to Dorchester International and Dorchester International Lights
[19] Save in relation to Sovereign Classic and Sovereign Classic Lights
[20] Save in relation to Sovereign Classic and Sovereign Classic Lights
[21] Mozambique was not included as one of TEL's territories under the TEL Agreement, because of concerns expressed by Mr Jack as to the reputation of Ocean Traders International ("OTI"), and its managing director Brian Nathan. Mr Jack apparently did not want TEL's reputation to be tarnished by association with OTI (because of the association of its owner with Imperial Tobacco), and so a compromise was agreed whereby Gallaher would only pay TEL a commission on sales to OTI for Mozambique. This agreement was not recorded in writing, but HMCE was informed of it on 28th June 2002. There seems however to have been only one sale to OTI on a commission basis, all other sales being invoiced by Gallaher to TEL and then by TEL to OTI.

(iii) Clause 5(x) provided that TEL would

> *"maintain directly or indirectly in the Territories a presence so as effectively to promote, distribute and sell the Brands in the Territories…"*

Sales to bona fide customers for consumption in the Territories

256 TEL Agreement made plain that the Brands were intended to end up with customers in the Territories and that TEL could only sell to customers of whose bona fides they were satisfied. Thus:

(i) Clause 2(v)(a) provided that:

> *"All Brands sold by GI to the Distributor under this Agreement are intended for final sale via distributors to consumers in the Territories. The Distributor agrees therefore to:*
>
> *(a) sell only to distributors who are legally authorised to sell tax-paid tobacco products in the Territories or in duty free zones within the Territories. (For the avoidance of doubt the duty free zones exclude traditional duty free outlets, which includes without generality to the foregoing [sic] duty free shops in airports etc);*
>
> *(b) use its best endeavours to resell the Brands under terms and conditions that are designed to ensure that the Brands are ultimately sold to distributors in such manner; and*
>
> *(c) sell the Brands in amounts commensurate with the estimated demand in the intended markets within the Territories."*

(ii) Clause 5(iv) provided that TEL

> *"shall resell [Brands] only to persons or firms where there is no reasonable cause to believe that such persons or firms will sell them outside the Territories."*

(iii) Clause 4(i)(2) of TEL Agreement provided that TEL would not[22]

> *"resell the Brands to any person, corporate or unincorporated entity, state or other governmental or quasi agency that the Distributor knows or has reason to believe to be engaged in any illegal trade in cigarettes."*

Establishing and complying with local requirements

257 Clause 4(i) required TEL to "*market and promote the Brands in strict compliance with… all applicable laws, regulations or local requirements in the Territories*" and

[22] The '*not*' is missing, but is clearly meant.

in particular to "*take no action to promote or facilitate the resale of the Brands by the Distributor's customers or subsequent purchasers in violation of any fiscal, labelling, trade or other laws*".

258 TEL was also obliged to ensure that it did not hold excessive stocks of Gallaher brands, having regard to estimated demand. Schedule III to TEL Agreement obliged TEL to

> *"use its best endeavours to limit stock in each Territory to not more than two (2) calendar months in market sales per territory.*
>
> *In the event that stocks in any Territory exceed two (2) months in market sales for whatever reason, including but without prejudice to the generality of the foregoing a reduction in sales levels and / or an inequality of shipping schedules the Distributor shall immediately notify GI in accordance with the provisions of clause 12(xi) of this Agreement[23]."*

Accounts and records

259 Clause 4 (viii) of TEL Agreement obliged TEL to:

> *" keep full, proper and accurate accounts and records showing clearly all sales transactions and inventories relating to the Brands and all services rendered by the Distributor pursuant to TEL Agreement and … produce the same to GI or its duly authorised representatives upon reasonable notice. The Distributor shall retain all such accounts and records for at least six (6) years or more if required by applicable law."*

260 By clause 6(ii) Gallaher retained the right in its absolute discretion (but where possible with prior reasonable notification) to modify the Brands or to cease supplying them. On 24th January 2003 TEL Agreement was varied with effect from 1st May 2002. As varied it provided that, in the event of cessation of brands, Gallaher would use its best endeavours to reach an agreement with TEL to introduce a substitute brand(s) with a view to putting the parties in the same position as they were prior to the cessation of the Brand(s), as soon as reasonably practicable, but without prejudice to clause 12 (iv), which provided that, without prejudice to Gallaher's rights under clause 6 (ii), the parties could amend the Brands by addition or deletion by written agreement at any time.

Prices

261 Schedule VI to TEL Agreement contained a business plan (which had been formulated by Mr Clarke and Mr Jack) specifying in considerable detail the volume of sales and sales prices contemplated for different regions, the prices to be charged by Gallaher, the credit terms and the resulting gross profit and operating profit. But by clause 7 (i) (a) Gallaher was entitled to notify TEL of price changes and TEL

[23] Clause 12(xi) sets out the formal requirements for notifications under TEL Agreement. No notification was ever made by TEL under Schedule III.

was bound to pay any altered price (whether notified or not). When TEL Agreement was amended in January 2003 clause 7 (i) (c) was added. It recognised that Gallaher might need to make "*aggressive*" price increases, particularly in the early years of TEL Agreement, and provided for maximum increases, subject to a proviso in clause 7 (i) (d) that Gallaher could seek a further price increase in the event that it could show that its costs had risen by an amount significantly ahead of the maximum increase allowed.

262 Schedule VI specified the expected volumes to be sold up to April 2004. These had been described in the 29t[h] April letter as being "*provisionally agreed*". That letter had indicated that "*early indications are that these numbers may be, as you suggested, conservative*". Gallaher contends that these numbers were in fact inflated, by a combination of Mr Jack's optimism about the prospects of the business and Mr Clarke and Mr Tlais' tendency to exaggerate the success of Gallaher brands in the Namelex territories. The figures included 20,000 rising to 30,000 cases per month to Iran.

Term and Termination

263 Clause 10 (i) of TEL Agreement provided that, subject to clauses 10 (ii) and (iii), it should continue until terminated by 3 months written notice to expire on or at any time after the fifth anniversary of the Effective Date, which was 1st May 2002.

264 However, Recital B recorded that:

> *"The Distributor …..wishes to become GI's exclusive Distributor in the Territories for the Brands for an initial period of 5 years, to be automatically renewed at the end of that period for a further 5 years subject always that [three conditions were then specified]"*

265 The words underlined were inserted in manuscript before TEL Agreement was signed. The previous typescript draft had read:

> *"for an initial period of 5 years with the option to extend that period if GI and the Distributor agree to do so and has [sic] the ability to effect the efficient and universal distribution of the Brands in the Territories subject to [the terms and conditions of TEL Agreement and the ITP]".*

266 The manuscript amendment crossed out "*with the option to extend that period if GI and the Distributor agree to do so and*"; added *"to be automatically renewed at the end of that period for a further 5 years subject always that*" and then two further conditions, lettered (a) and (b), before (c) which read "*the Distributor has the ability etc*".

267 Clause 10 (ii) gave each party the right to terminate TEL Agreement, on written notice, forthwith if the other party committed:

> *"a material breach of any of the terms or conditions of this agreement, provided that in the case only of a breach which is capable of remedy no such notice of termination shall be given unless and until a notice has first been*

given to the party in default specifying the breach and requiring it to be remedied and such last mentioned notice has not been complied with within 30 days or such longer period as may be agreed in writing between the parties…

Cooperation with HMCE

268 Clause 12 (1) provided:

> "The Distributor acknowledges and accepts that GI and Gallaher intend to co-operate with governmental or valid regulatory enquiries into any illegal importation and sale of the Brands sold pursuant to this Agreement or otherwise."

Old Stocks

269 In addition to the new goods that were to be supplied under the TEL Agreement there were 3 parcels of stock ("the Old Stocks"), totalling over 3 billion sticks, which, in the end, TEL had available to sell:

(i) Goods in Cyprus and Dubai, owned by Gallaher, which had been produced for Namelex but never released to it. Gallaher was the owner of these goods and continued to pay for their storage of these goods, but was to pledge them to BLOM as collateral. According to the evidence of Mrs Schiavetta, who is now Gallaher's Inter-Group Finance Manager the amounts concerned, (which differ from the figures in the attachment to the letter of 29th April 2002: see paragraph 251)[24] were as follows:

	Cyprus 000	**Dubai** 000
Sovereign		92,000
Sovereign Lights	88,000	192,000
Dorchester		200,000
Dorchester Lights	88,000	301,000
Dorchester Black	94,000	
Stateline Lights	67,200	
Businessman[25]	8,000	48,000
Gold Arrow	79,800	
Gold Arrow Lights	159,800	
Total	584,800	833,000
	i.e. 58,480 cases	i.e. 83,000 cases

[24] The experts have now agreed that the number of cases was 150,860.
[25] Businessman and Gold Arrow were brands for which the trademark was held by Namelex. The trademarks were subsequently transferred to TEL, however, enabling TEL to distribute these brands.

There were, therefore, a little over 1.41 billion cigarettes (141,000 cases) held in Cyprus and Dubai[26]. Schedule VI of the TEL Agreement assumed that such of these as could be sold would be sold by TEL by February 2003: It assumed that TEL would be able to sell 644 million cigarettes for $5 per 1000 ($50 per case), and would pay Gallaher $45 per case for them.

In November 2002, the unsold Stocks were released free of charge[27] to Mr Tlais[28], as part of a deal in which Gallaher also loaned him $1 million, and TEL agreed to take responsibility for the goods and destroy those which were unsaleable: see paragraphs 353-355 below. The figure agreed between the accountants for the stock transferred is 150,060 cases: see Sub-Appendix 4.5.3 to Mr Pollock's report.

(ii) Goods which one or other Tlais company owned at the beginning of the TEL era, because they had been purchased by letters of credit financed by the Tlais family. Schedule VI of the TEL Agreement identified this stock as "*Abu Hamid stock*", and assumed that it consisted of a further 1 billion sticks (100,000 cases), which would be sold at $60 per case by the end of January 2003. According to Mr Clarke's evidence this stock totalled 151,579 cases. This is supported by Mr Rolfe's notes of a meeting in September 2002 which refer to Mr Tlais' Old Stocks as being 1.2 billion, of which 300 million had already been sold. But the amount has never been established[29]. Whatever the amount was Mr Tlais managed to dispose of this stock, and thus avoid the sizeable warehouse charges on it, by the end of January 2003. Mr Tlais' evidence was that "*we sell them but we never get the money*". It is impossible to tell whether this is true.

(iii) Goods produced for Namelex which had not been shipped from the UK (or which had been returned to the UK). These goods, which were at Lisnafallan and Crewe, totalling 648 million in all (64,800 cases)[30], were the goods sold to TEL on 365 days' credit. TEL was only to pay for these after 365 days from the invoice date, although if it sold and paid for them before then, further stocks would be supplied which would not have to be paid for until the due date of the original parcel of stocks. The intention was that if TEL sold these quickly, it could use the cash generated to set up a bank guarantee to purchase further goods on 90 day terms.

The quality of the Old Stocks

Cyprus/Dubai

270 The Gallaher Old Stocks in Cyprus and Dubai were at least a year, some almost two years, old. Some of them were in poor condition. A Gallaher internal report of 2nd

[26] Mr Clarke referred to a figure of 129,815 cases.
[27] A $ 1 charge was made per case and a credit note was then issued for that price.
[28] Save that the 94,000 cases of Dorchester Black were treated as belonging to Gallaher and were due to be destroyed.
[29] One of the disclosed documents – I 10/5790 refers to 80,681 cases.
[30] The 648 million were the unpaid balance of an order from Namelex of 2 billion cigarettes in 2001.

July referred to an unacceptable yellowing of the paper on stock in Cyprus and suggested, on the basis of experiments by Gallaher's Research and Development Department ("R & D"), that goods in paper outers (as some of the Old Stock was) would deteriorate more rapidly than those in hard outers.

271 On 12th July Mr Jack wrote to the Dubai warehouse to complain that, whilst the product held in the temperature controlled area was in good condition, a significant percentage of the inventory was held in ambient condition and samples displayed distinct signs of deterioration. In May 2003 he told Mr Rolfe that the goods were in very poor condition when Gallaher passed them over and were in a much worse condition then.

272 In the negotiations which led to the release of the Gallaher Old Stocks in Cyprus and Dubai to TEL free of charge to TEL in November 2002 (see paragraphs 353-355 below) Gallaher had initially sought to make $ 20 the minimum price (a modest amount) at which the goods would be deemed to be sold, and which would be paid to them; but shortly afterwards Mr Rolfe agreed with Mr Tlais' suggestion that, if he was to bear the full risk and associated costs linked to the sale, then he should have the full benefit. In his letter of 19th November 2002 Mr Rolfe expressed the view that there remained significant value in those stocks.

273 At the same time in a letter of 22nd April 2003, in which he complained of new deteriorated Dorchester stock supplied to him, Mr Tlais said that he "*had the experience of the Old Stocks, which include Dorchester Paper Parcel which are now two and half years old that are still shining examples of your production*".

The 365 day goods

274 The condition of the 365 day goods is less apparent. On 18th December 2002 Gallaher's R & D advised that, in respect of five parcels of old stock (totalling 3,358 cartons), 4 (totalling 2,602 cartons) were unsuitable for sale on the grounds of paper yellowing. Mr Jack had said to the person responsible for dispatch that the product was being sold as "*old product*", that he did not feel the need to examine it and that it should be dispatched.

275 About 58% of the Old Stocks, excluding the 365 day goods, were Sovereign and Dorchester Lights products. The 365 day goods had a significant proportion of Lights also. Lights were popular in Teheran, although volumes were low, and in Lebanon (where Lebanese health warnings were required, which the Old Stocks lacked). The main demand in the TEL Territories was for full flavour cigarettes. Stateline had been originally supplied to Namelex for sale to the Romanian duty free market with brown filters and there was no demand for it in the Territories. Gold Arrow and Gold Arrow Lights and Businessman had been produced under a contract manufacturing agreement between Gallaher and Namelex. There was no demand for these products in TEL's territories.

276 Sovereign Full Flavour was the product for which there was the most demand. It was a popular brand in the UK and the rest of the EU. It had gold packaging similar

to Benson & Hedges. For these reasons it was attractive to smugglers. Some of the Dorchester and Sovereign cigarettes were, as I have said, in paper parcels rather than the hard outers which were preferred in the TEL territories. Dorchester Black was a premium UK brand with no market in the TEL territories but a high demand in the UK. It, together with Mayfair and Sovereign Black, had been supplied to Namelex initially but later discontinued after Namelex had protested about the control risks of selling such a product, in that its high cost and the lack of market demand for it would tend to mean that it would be smugglers who would be interested in purchasing it.

277 The Old Stocks were predominantly stocks with a global English health warning (although Businessman had Arabic as well), which meant that they could only be sold duty free in most of the TEL territories; and no pack coding showing the intended destination, having been produced before Gallaher introduced a system of country coding.

278 Mr Tlais would prefer not to have had to clear the Old Stocks. He had suggested to Gallaher that they should be destroyed and that Gallaher should provide some additional commitment to TEL to act as security to the bank in order to support trading. Gallaher did not want to destroy the goods. It hoped, initially, to recover some value for its Old Stocks in Cyprus and Dubai; and did not want to have to write off the 365 day goods which it had produced.

279 The decision not to destroy the goods left Mr Tlais with product that, to the extent that it was deteriorated, was likely to be difficult to clear. As Mr Stewart Hainsworth, who became responsible for Gallaher's AMELA division in April 2004 confirmed, the sale of such product is prejudicial to the brand, and may sour relationships with dealers (see, by way of example, OTI's letter of complaint of 29th May 2003[31]) or lead them to seek to dump it somewhere. As to the latter smugglers seek, if they can, to buy normal quality cigarettes at a cheaper price and avoid payment of duty. Poor quality cigarettes are not inherently attractive to smugglers. But, in general terms the lower the quality or condition of the product the more likely it is to find its way down the chain from legitimate distributors who do not want to keep it (at a cost), to less scrupulous ones, who may divert it and sell it to customers who are more tolerant of poor quality because they are getting the product cheap. In short low quality is a risk factor in respect of smuggling.

280 Gallaher contemplated that the Old Stocks (except for the 365 day goods) would be cleared into non-core markets and not the key markets such as Iran. On 10th July 2002 Mr Jeffery informed HMCE that, where it was possible to sell the Old Stocks (then still owned by Gallaher) in Cyprus, this was to occur in Africa over the next 12 – 15 months, although much of the stock was likely to be destroyed in Cyprus because of its condition. That was not, however, Mr Rolfe's understanding. He thought that the stock was to be sold in TEL territories (not just the African ones) over a nine month period. Mr Jeffery had referred in his letter to plans being in progress to destroy the "*first element of circa 94 millions*". These were Gallaher's Dorchester Black cigarettes with a UK health warning which were at that stage due

[31] "*I am very upset that you have seen fit to send old stock to us. The cigarettes are spotted and have obviously been sitting with you for some time. We cannot and will not sell them as regular merchandise. Please advise urgently how you wish to handle this unnecessary and unfortunate problem".*

to be destroyed because they represented a control risk[32]. Mr Jeffery may have been in error in thinking that there was at that stage any more which Gallaher thought should be destroyed. African markets were a distinctly possible place for disposal. In a memorandum of 18th July 2002 Mr Jack expressed himself particularly hopeful of clearing aged stocks in Sudan and Libya (and, also in the Yemen)..

281 TEL proposed to clear the Old Stocks by mixing them with fresh stock in the proportion 80% fresh, 20% old. In a letter of 2nd August Mr Jack expressed the hope that TEL would focus on sending the best quality stocks to "*our better partners*" whilst recognising that TEL was doing its best to clear the "*other less fresh goods*". Insofar as this mixing involved customers in receiving 20% of goods which they may not really have wanted it involved some control risk, since purchasers might try to dispose of the unwanted stock to unscrupulous sub-purchasers.

282 Schedule VI to the TEL Agreement contemplated, as I have said, that the Old Stocks would be cleared by February 2003. In fact they were not cleared, as a result of a series of problems including the fact that Sovereign had on occasion not been supplied at the levels expected for mixing and the problems thrown up by the damaged Dorchester. By June 2004 Mr Jack was referring to 512m assorted goods "*of considerable age and highly doubtful condition*" either purchased by Mr Tlais via Namelex or transferred to him by Gallaher which would have to be destroyed by Mr Tlais "*or they will represent a block to new business and a constant threat and concern with regard to diversion*".

Shipment direct to market

283 It was Gallaher's aim to have TEL's goods shipped, wherever possible, direct to their destination markets – a course which would significantly reduce the danger of smuggling. Gallaher has expressed itself to be very keen on this in a letter to Mr Tlais of 19th May 2003. On 1st October 2003 it had required it for all shipments from 1st January 2004. Save for a shipment of 8,000 cases to Port Said in June 2004 for Egypt, and some shipments to OTI and to the Lebanese monopoly, direct shipment did not happen. Mr Tlais put forward the need to mix the Old Stocks in Cyprus and Dubai with new goods, in order to clear them, as a prime reason why shipment direct to market could not take place. It is debatable whether mixing in Cyprus/Dubai, as opposed to supplying any given market with new product, shipped direct from the UK, and Old Stocks shipped from Cyprus/Dubai, was essential. Mr Tlais at one stage suggested that Gallaher should take the Old Stocks back to the UK for the mixing to take place there, prior to direct shipment to destination market; but Gallaher had turned this suggestion down. Another reason relied on for not shipping direct to market was the need to keep the goods under Mr Tlais' control and release them only against payments that would improve the customer's debit position.

[32] Gallaher later reviewed the position in respect of the Dorchester Black in the light of the difficulty of destroying them in Cyprus and the fact that there had been some changes in the UK health warning. In the end it was agreed that they should be disposed of into Iraq as quickly as possible. HMCE does not appear to have been informed of this change of mind.

The pledge

284 The Gallaher Old Stocks in Cyprus and Dubai were said by TEL to be pledged to BLOM. According to paragraph (viii) of the Banking Matters section of the letter of 29th April the stock was to be security for a guarantee by BLOM in favour of Banque Libano Francaise. Mr Richard Hill, Counsel for TEL, told me in opening that the bank allowed cigarettes to be released from the security if they were replaced with fresh stock. No pledge documentation has been produced nor any documentation evidencing the release of goods from the pledge. Mr Fawaz, who did not believe there was a pledge[33] asked for the pledge documentation at the time. Mr Clarke told me that TEL had asked the bank for it. In the light of Mr Tlais' evidence it appears that there was none.

285 Mr Tlais' evidence was that goods could not be officially pledged to the bank if they did not have a certificate of freshness and that Simon Farah, the BLOM bank manager in Cyprus, would be fired for doing so. But he had given a commitment to him that the goods which Gallaher was providing and other goods, would stand as security for $ 6 million. I accept his evidence that there was some sort of security commitment given, which was constituted or evidenced by certificates of deposit in the name of the bank or other documentation referring to the bank, examples of which appear in the disclosed papers. In respect of goods in Dubai all that had happened was that Mr Tlais had undertaken that he would not release goods without informing the bank in advance.

The ITP

286 Clause 4 (xxi) of the TEL Agreement provided that TEL would:

> *"conduct its business in accordance with the policy on International Trade of the Gallaher Group (as amended by Gallaher Group from time to time)".*

The Amended Agreement of January 2003 added to the above the words

> "*and shall procure that any sub-distributors appointed by the Distributor to undertake business within the Territories shall conduct business in accordance with the said policy on international trade*."

287 Mr Tlais and Mr Saveriades signed the ITP on behalf of TEL under a paragraph stating:

> *"I have read the above policy and confirm that I understand it and will be bound by its terms in all dealing with companies of the Gallaher Group. I*

[33] In his view: "*It's just like pledging potato chips as security*".

> *further confirm that I will obtain the same undertaking from any sub-distributors to whom I supply any products of the Gallaher Group*"

288 The ITP stated that:

> *"In the event that Gallaher discovers that any particular distributor has been shown to be behaving improperly or Gallaher has reasons for believing that they may be, Gallaher will re-visit that trading relationship with a view to discontinuing that relationship, if appropriate. In particular, if Gallaher concludes that any distributor is a smuggler it will terminate that trading relationship with immediate effect. In turn, Gallaher will expect its distributors to endorse a similar policy in respect of their customer."*

The significance of the TEL Agreement

289 The TEL Agreement and associated arrangements had benefits for both sides; probably more for Gallaher, which had a superior bargaining position, than Mr Tlais. For Gallaher they represented a clean break with Namelex and Mr Hadkinson; offered the prospect of recovery in respect of its stocks in Cyprus and Dubai (which might enable Gallaher to write back some stock previously written off); sold the 365 day goods; provided a new distributor; and tied that distributor to a contract designed to ensure the legitimacy of its business and required it to demonstrate to Gallaher the steps that it had taken, and procured others to take, to ensure that legitimacy.

290 The arrangements were also designed by Gallaher (as it told HMCE) to be terminable if significant volumes of Gallaher product were found to be coming back to Europe. This was presented to HMCE as a fulfilment of Gallaher's policy on smuggling and a compliance with what HMCE required. Mr Jeffery provided HMCE with a copy of the TEL Agreement on 10th May 2002, stating that Gallaher had tightened the control provisions that had been in the Namelex agreement. He said that Gallaher did not believe "*that Mr Tlais or Tlais Enterprises were involved in the aspect of NTA's business that has created so much difficulty for both of us*".

291 For Mr Tlais TEL Agreement provided him with relief from the prospect of imminent foreclosure by his banks; and offered the prospect of building a profitable and sustainable business and trading out of a difficult financial position. His ability to do so was dependent on Gallaher's support. But the arrangements left him vulnerable in a number of respects. He got nothing in respect of his free goods claim or his past losses. He still had his Old Stocks, which he was going to mix with new goods that he ordered[34]. He had to pay for the 365 day goods when the credit expired. He had the right to distribute the Brands, in particular Sovereign and Dorchester, but Gallaher could withdraw them. In addition TEL Agreement contained several onerous obligations and a right of termination for any material breach. In the years that followed Mr Tlais endeavoured to put himself in a better position than that which the TEL and associated agreements afforded him.

[34] But nothing in the TEL Agreement required him to dispose of his Old Stocks; much less the Stocks in Cyprus and Dubai which were to be pledged and which TEL was subsequently – see paragraph 269 (i) to acquire for free.

292 The TEL Agreement was signed at Mr Tlais' house, in Cyprus, Gallaher being insistent on it being signed by the end of April. Mr Clarke's evidence was that Mr Tlais had not been able to seek detailed advice from either Mr Saveriades or UK based lawyers; but had been comforted by Mr Jack' assurance in strong terms that TEL Agreement was fair and not unduly favourable to Gallaher and that Mr Tlais could trust him. Mr Jack pressed him to sign. I accept that Mr Jack said something to that effect.

The TEL era

293 Mr Clarke agreed to work for TEL. Mr Keevil of Gallaher and Mr Tlais had assured him that they were grateful to have his assistance, and that his past involvement with Namelex would not be a bar. It was Mr Jack's view (which he expressed to HMCE) that Mr Clarke had acted in Gallaher's best interests by staying on with Namelex after 30th April at the request of Mr Tlais (until others in Namelex became aware that he was in contact with Mr Tlais and Mr Jack[35]) and providing information about the progress of Namelex's attempts to procure a letter of credit, and by signing the letter terminating the NTA agreement. Mr Tlais regarded himself as in Mr Clarke's debt for coming clean on what had happened. Mr Clarke started work for TEL on 1st July 2002. Thereafter he had regular involvement with Gallaher and was, in the main, the drafter of letters to Gallaher from Mr Tlais.

Mr Hadkinson's admission

294 On 7th June 2002 Mr Tlais concluded a written agreement with Mr Hadkinson by which Mr Hadkinson agreed that he owed Mr Tlais $ 30 million in respect of Mr Tlais' losses and agreed to pay it by the end of the year. The recitals to TEL Agreement recorded that the business of NTA was funded exclusively by Mr Tlais or through funds obtained by him under his personal guarantee and that the funding of the business had been based on false representations by Mr Hadkinson to Mr Tlais which had caused him "*heavy personal financial losses*".

295 On 19th September 2002, Mr Tlais succeeded in obtaining waiver letters from Mr Hadkinson in which he acknowledged to Gallaher:

> *"that in respect of any assertions of impropriety that I may have made against the Gallaher Group or employees thereof, I now realise I was mistaken and I withdraw any and all such assertions in their entirety. I also irrevocably undertake to refrain from making any such allegation in future, which I acknowledge could damage the good name and/or reputation of Gallaher Group or its employees".*

[35] For a while Gallaher's strategy was to keep Mr Hadkinson in the dark as to its intention to terminate the relationship with Namelex/NTA, since that would put paid to any hope of any recovery from them. At the beginning of May Mr Clarke told Mr Jack in a telephone conversation that it was clear that Mr Hadkinson was not going to produce the $ 52 million letter of credit that he had been promising.

A letter from Mr Hadkinson of the same date records that he had signed this letter on the understanding that it would not be released until he had approved a document from Gallaher waiving any claims against him (which he did not receive), and that he had signed a document that was unacceptable to him "*solely for the best interests of the business and with the understanding that Gallaher would provide me with an identical waiver*".

Business under the TEL Agreement

296 By May 2002 Iran had recently opened its markets to importers. Dorchester International had been one of the he first duty paid imported brands. It was, however, a Virginian blend, when the predominant blend preference was for American blend cigarettes.

Coding

297 All new stock produced for TEL was coded in a manner which identified (a) the first purchaser (such as TEL) and (ii) the intended final destination market. This system had been adopted by Gallaher since late 2001 for new production.

The OLAF raid on Mr Tornarides' offices – Meeting with HMCE of 27th May 2002

298 Gallaher hoped that the problems which had led to Namelex being red carded would become a thing of the past. However, in late May 2002 OLAF raided Mr Tornarides' offices in Cyprus and seized about 11,500 documents some of which suggested a close relationship between Mr Tlais and CT Tobacco. Mr McCallum of HMCE was involved in the raid and reported on it to Mr Keevil and Mr Jeffery at a meeting on 27th May 2002. He was concerned that the relationship had continued after Customs had agreed with Gallaher that Gallaher, Namelex and its distributors would not supply CT Tobacco after February 2001. At the end of the meeting he provided Gallaher with some of the documents seized.

299 Among these documents were:

(1) a proposal on unheaded paper dated 19th June 2000 to CT Tobacco that referred to sales having been made by NTA into Iraq (which would have been in breach of sanctions);

(2) a letter dated 16th February 2001 from CT Tobacco to Mr Hadkinson at "*Tlasco (ex Tlais) Trading Ltd*" asking for confirmation to be made to auditors of "*your balance with CT Tobacco Ltd as at 31st December 2000"*;

(3) a letter of 7th May 2001 from Tlasco Trading Company Ltd, apparently signed by Mr Nammour, to Mr Tornarides, concerning the quantities of goods available in five bonded warehouses;

(4) a letter of credit raised on 21th September 2001 by CT Tobacco for the purchase of $2,500,000 worth of goods from Tlasco

Trading Company Ltd. This was long after Gallaher had decided no longer to trade with CT Tobacco, and had informed Namelex of this;

(5) a letter of 11th October 2001 from Tlasco Trading Company Ltd to CT Tobacco (IoM) Ltd, offering 125,000 cases of Sovereign Classic at a special promotional price of $78 per case, for sale in the "*specified markets that you and us have agreed upon*", together with an invoice dated 8 October 2001 from Tlasco Trading Company Ltd addressed to CT Tobacco (IoM) Ltd, for 100,000 cases of Sovereign Classic at $75 per case; and

(6) a written agreement dated 8th April 2002 under which CT Tobacco acknowledged an indebtedness to Mr Tlais of $ 5,482,000 and agreed to mortgage 9,500,00 shares in CT Tobacco as security for payment. Mr Tlais agreed to take $ 4,000,000 if a schedule of payments was complied with. Mr Tornarides agreed to transfer to Mr Tlais on signature 1,915,000 shares in CT Tobacco currently held by Mr Nammour – at no cost.

300 In the course of the meeting Mr McCallum remarked that he had been told by Mr Clarke that Namelex was owned by Hadkinson and Nammour, no mention apparently being made of Mr Tlais. He regarded himself as having been misled. It is possible that he treated what he had been told about Namelex (i.e. Namelex Holdings Ltd) as applicable to NTA (i.e. Namelex Trading Agencies Ltd) and that the distinction had never been explained to him. At any rate he had not been told of the Tlais – Namelex link.

301 Mr Jack was dispatched to Cyprus to investigate the matters raised by HMCE. He reported being told that all but two of the documents were "*created by a third party without the knowledge of Mr Tlais*". TEL Agreement for rescheduling related to an aged debt "*which has always been disclosed to us*", and the letter of credit was part of a circular transaction in which Mr Tlais was to buy Mr Tornarides' stock and sell it back to him at a different price as part of a mechanism to mitigate his debt. Mr Tlais' brother was said to have issued a letter of credit to Mr Tornarides but the one opened in favour of Tlasco, which the Customs had seized, was only issued for half the agreed value.

302 On 31st May 2002 Mr Tlais wrote to the Board of Gallaher in order to "*clarify my position as regards my business association with CT Tobacco and/or Mr Tournaritis*". What he said included the following:

(a) he had had a business relationship with Mr Tornarides and his companies during the latter part of 2000 and believed (from recollection and without reference to his records) that he had supplied him with about 500 million cigarettes; further supplies advanced to his partners from his stocks may have been sold without his knowledge.

This explanation was inadequate. The CT Tobacco account with Tlais Trading shows that considerably more than 1 billion cigarettes were supplied to CT Tobacco between May 2000 and August 2001. In his evidence Mr Tlais suggested that in his letter he was excluding cigarettes such as Mayfair and Sovereign Black and Dorchester Black which Mr Hadkinson had prevailed upon him to pay for (saying that Gallaher wanted him to take them) representing that Gallaher/he had a buyer who would purchase the goods from him at a profit of $ 15 per case. When no other sub-purchaser appeared Mr Hadkinson told him that Gallaher wanted him to sell them to Mr Tornarides. Mr Tlais' recollection was that such sale was not to be at a profit. I cannot see why, if that was the position, Mr Tlais did not say so. 500 million was the figure that was passed on to HMCE by Mr Keevil on 28th Jun 2002.

(b) the first time he was personally told not to have dealings with CT Tobacco/Mr Tornarides was when he met Gallaher in March 2002. He had, however, stopped dealing with CT Tobacco "*almost a year*" before. He only maintained contact thereafter in order to find a way to collect the very large amount of money owed to him or his trading companies; he had managed to sign an agreement with CT Tobacco providing for a schedule of payments which involved a big discount;

(c) he had been introduced to "*the specific "clients*"" i.e. CT Tobacco by "*our Namelex associates*" and convinced to supply them with goods, despite reservations because otherwise, as he was told, they would have dealt directly with Gallaher, something which happened on one occasion[36];

(d) he commented on the documents shown to him. TEL Agreement of 8th April 2002 was an arrangement for the repayment of CT Tobacco's indebtedness. The letter of 16th February 2001 "*has come to my attention for the very first time*". Mr Hadkinson, to whom it was addressed, had no authority to issue or sign any letters on behalf of Tlasco Trading Company Ltd. He had never seen the fax of 7th May 2001 from Tlasco Trading to Mr Tornarides before. No such fax had been sent by him or Tlasco Trading and he did not recognize the signature. The letter of credit of 21st September 2001 was part of a paper transaction between Tlasco and CT Tobacco with the sole aim of reducing indebtedness.

(e) He had never seen the letter of 11th October 2001 from Tlasco to CB Tobacco (IoM) Ltd. He had not seen the invoice of 8th October before, although he was aware of a request by CT Tobacco for such an invoice at the time "*in order to assist them to obtain funds to mitigate their financial obligations to me*". He did not hold the stocks referred to in the invoice which was issued without his authority.

This explanation, insofar as it suggests a total lack of familiarity with this transaction, is misleading. A credit item described as *"$ 3 x*

[36] A reference to Gallaher's direct supply to CT Tobacco in September 2000.

125,000 c/s being the difference added on to the price of $ 75 to reduce his account" appears in the CT Tobacco Account with Tlais Trading sent to Mr Tlais in December 2001.

(f) As to the 19th June 2000 proposal from CT Tobacco, which revealed breaches of sanctions in respect of Iraq he said that "*this does not originate from me. It is dated around the time I was convinced to participate in Namelex Agencies Ltd and the only thing I can say for the rest of the matters specified therein is that they are incorrect. In fact even the assertion that Namelex Trading Agencies is owned 50% personally by me is incorrect*".

This latter explanation was misleading: even though the proposal may not have originated with Mr Tlais, he was sent a copy for his records at the time; and he was involved in selling goods into Iraq at that time: see paragraphs 546-551 below.

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303 Mr Tlais also told Gallaher that he had been invited to take an equity position in NTA and nominate a director in return for making available the necessary credit lines in support of the business; but that many things had been said and done in his name without his knowledge to the detriment of his business and reputation. He expressed himself happy to give more detail in a meeting with Customs. Mr Tlais' letter as well as his indication of a willingness to meet was relayed to HMCE.

The problem with Sovereign

304 From an early stage of the TEL era Mr Tlais made clear to Gallaher his view that Sovereign was attractive to smugglers ("*the target of some of the biggest organised crime gangs in the world, for their smuggling operations*": see TEL's letter of 25th October 2002) and that what he wanted was a replacement brand. He pointed to the fact that the same problems did not arise with Dorchester cigarettes, which he alone controlled, as had arisen with Sovereign. He repeated his concerns about Sovereign and his wish for a replacement on numerous occasions. He made a number of suggestions for alternative sources of revenue including being allowed to sell duty free in Romania (part of Austria Tabak's business), an extension of his territories to include the Gulf States, or payment of the $ 30 million which he claimed to have lost from the free goods deception, to which he frequently referred.

305 There was an additional factor which made Sovereign attractive to smugglers. It was sold in low duty environments so that, even if purchased duty paid it could be profitably smuggled into a higher duty market, possibly by smugglers purchasing in small quantities and consolidating before export to the UK ("hoovering up"). Sovereign Classic had been withdrawn from the CIS market in part because of the smuggling risk (although the amount of product supplied in the CIS was relatively small – about 150 million sticks in 2000). At the same time, in default of any substitute, Mr Tlais needed supplies of new Sovereign in order to have the income to pay off his debts, and to mix with the Old Stocks that he had acquired. Of the two other brands – Dorchester and Stateline – Stateline was not established in the TEL territories and had very limited prospects.

Meetings with HMCE

28th June 2002

306 A meeting took place in early July in Cyprus between HMCE (Messrs McCallum and Marcanik), Gallaher (Messrs Keevil, Jeffery and Jack) and Mr Tlais (with Mr Saveriades in attendance at some point). On 28th June 2002 there was a preparatory meeting in England attended by all those except Mr Tlais and Mr Saveriades. At that meeting Mr Jack gave HMCE a lengthy presentation of the history leading up to the TEL Agreement. He expressed Gallaher's view that the Sovereign Classic, which was the only brand that had returned to the UK in significant quantities, was related to the introduction of CT Tobacco to Mr Tlais by Mr Hadkinson.

307 Mr Jack expressed the view that Mr Clarke had worked in Gallaher's best interests by giving Gallaher information on Namelex's proposed letter of credit, by signing the 30th April agreement terminating the Namelex agreement and staying with Namelex after 30th April. He had also acted as a whistle blower to Mr Tlais. Mr McCallum said that Mr Clarke came over as untrustworthy. He took this view because Mr Clarke had put off meeting HMCE for several months when Namelex was struggling; and, when they did meet, had been evasive, not wanting to talk about Namelex' business but only about arrangements to distribute Imperial Tobacco's products. In view of HMCE's concerns Gallaher agreed that Mr Clarke should not attend the Cyprus meeting.

308 Mr Keevil outlined Gallaher's key controls which were incorporated into the TEL Agreement: (a) regular checks on products in the markets to ensure that presence was in line with market consumption expectations; (b) marketing cigarette packets with codes that identified the final purchaser and the final destination market; (c) direct delivery to market wherever possible; (d) provision of bills of lading to identify onward shipments; (e) health warnings in local languages where applicable, not including Iran, where non Arabic health warning indicated higher quality, or duty free outlets.

309 Mr Tlais indicated at this meeting that Mr Clarke would be largely dealing with administration, book-keeping and logistics, with no responsibility for dealing with customers or raising orders.

Early July 2002

310 At the meeting in Cyprus on 3rd and 4th July Mr Tlais described the efforts that TEL would make to verify the existence of legitimate demand for Gallaher products in the Territories. He or his associates would check the markets and produce written reports. He expressed himself supportive of Gallaher's desire, and that of HMCE, for strong controls. He said that he wanted to develop the TEL markets in a slow and controlled manner. He would "*robustly adopt*" the red/yellow card system.

311 Agreement was reached as to the controls to be put in place in the form of documentation that Mr Tlais was to provide to confirm the final destination of goods supplied. These were later set out in a "*Procedural Agreement*": see paragraphs 328-333 below. Mr Tlais indicated that he understood TEL's obligation to check to see that local distributors were operating properly and to communicate

Gallaher's philosophy to them. He undertook to provide a copy of his list of distributors to Gallaher, which could be shared with HMCE. It was also agreed that HMCE would be supplied with Mr Tlais' sales data on a monthly basis, which would be incorporated into the export sales data already supplied by Gallaher monthly, and which would broken down to show quantity and final destination market. This never happened.

312 Gallaher indicated that it would whenever possible deliver product direct to the destination market and that, if this was not possible for security or other reasons, systems would be in place to obtain evidence that the product arrived at its intended market; once in the final destination market the aim would be to ensure that it remained there. Whilst this would be difficult in emerging markets, Gallaher would visit those markets and meet with major sub distributors and brief them on the ITP and the obligations it imposed upon them. Mr Tlais gave assurances that, despite the absence of formal contracts with distributors he would take all possible steps to ensure the continuation of Gallaher's export policy "*to the lowest possible denominator*"[37]. Gallaher outlined a full monitoring programme of TEL and its distributors by regular market appraisals, stock control and warehouse checks.

Provision of a list of distributors

313 On 2nd August 2002 Mr Jack wrote to TEL asking for the customer list. Mr Tlais told Mr Clarke that he was not putting anything in writing. He was prepared to give Mr Clarke a list orally but did not want to give a list direct to Customs because – so he said in evidence - he did not want anyone to think that he was working with Customs or that he was trying to damage people. He put this attitude down to the fact that he was working in the Middle East and that, if he was seen to be dealing with the Customs, and "*something, it happen, I will be killed next day*". He did not want to take the risk.

314 As a result Mr Jack put together a list based on what TEL told him, and he dictated this to HMCE in late August 2002. In November 2002 Mr Jack prepared a table, showing TEL's customers and in December 2002 (having been chased by Mr Jeffery), Mr Jack provided a revised list of customers to Mr Jeffery. In January 2003 Mr Jack advised Mr Jeffery to add two more customers to the list as he had seen their names on shipping documents. These were Virginia Trading, with an address in Damascus, and Tashapukint Al Wakhrim, a Libyan distributor.

315 At the meeting in July Mr Tlais indicated that the Old Stocks in Cyprus/Dubai would be sold out in 12 to 15 months; that as they were mainly Lights (he gave a figure of 90%) he would have to mix them with the full flavour stocks in order to sell them. He also said that it would take about a year to bring the situation under control.

[37] According to HMCE's report on the meeting.

Reorganisation at Gallaher – the arrival of Mr Fawaz

316 In May 2002 Gallaher decided to establish a new organisational structure for the New Business Development Division. That included a proposal to recruit, amongst others, a Regional Manager to oversee the AMELA region. The manager whom Gallaher selected was Mr Mounif Fawaz ("Mr Fawaz"). He had considerable experience in Middle Eastern tobacco markets having been employed by BAT for 20 years, latterly as General Manager of their Levant/Middle East business in Beirut. Part of the purpose of recruiting him was to provide closer supervision of Mr Jack. He joined Gallaher in September 2002. He knew from his past experience that Sovereign and Dorchester had no significant market share in the Middle East.

317 Mr Fawaz was suspicious of Mr Jack, whom he thought had got too close to Mr Tlais and was too confident in his view as to how much TEL could sell. He was also consistently very critical of TEL. When Mr Fawaz joined Gallaher he had heard through contacts in the Middle East that Mr Tlais was rumoured to be a smuggler. He came to regard TEL as, at best, a wholesaler rather than a distributor and, at worst, a smuggler - in the jargon "*a DNP (duty not paid) reexporter*" – a view he stated within Gallaher on a number of occasions. There was considerable personal antipathy between him and Mr Tlais. Mr Fawaz, who has, on occasion, a confrontational style, was not, in my judgment, motivated by malice. What he was motivated by was an unwillingness to tolerate someone masquerading, as he thought, as a major distributor when in reality he was something else.

318 Mr Fawaz's view was that TEL was not "*meeting the ABCs of the business*" in that Mr Tlais did not know in detail who were the distributors, what the infrastructure of each market was, what the price structure was and how to submit sales and stock statements which would show the movement in the markets.

319 Mr Tlais was mistrustful of Mr Fawaz from the start, apparently on the basis of what he had been told by contacts of his in BAT. He appeared to Gallaher to be worried that Mr Fawaz would try and steal his customers. When told of his appointment in September he said that TEL's in-market distributor in Iran (Parsian Fougan) would not want to share information about its customers with him.

320 In July 2002 HMCE expressed concern about several suspicious shipments of Sovereign in which TEL appeared to be implicated. In early August Mr Jack wrote to TEL. Mr Tlais replied with an explanation saying that such goods as had come from him were part of the Old Stocks which were committed for sale sometime ago. The details are as follows:

Goods	Circumstances	Explanation
774 cases Sovereign	Shipped ex Cyprus by Adam Trading to Gia Tauro in Italy with no declared end destination	Never shipped by Adam Trading B/L showing Metco Ltd as shipper for carriage to Bar attached.
950 cases Sovereign	Shipped ex Cyprus to Illychevsk in the Ukraine by Highstreet with a notify party in Kiev	Goods destined for Afghanistan Letter confirming destination said to be on file
480 cases Sovereign	Shipped ex Attheslis to Latvia by JT Trading Consigned to Sunfox Ltd	No direct relationship with either company. Goods could have originated from Highstreet but not directly.

Meeting with HMCE – 5th September 2002

321 In a letter of 12th August 2002 to Mr Keevil, Mr Tlais displayed some disquiet at Gallaher's inquiries about these shipments and observed that "*any movement of product especially Sovereign is being monitored to the point of paranoia*". He requested a meeting in Weybridge.

322 That meeting took place on 5th September 2002; three days after Mr Fawaz had joined Gallaher. Messrs Rolfe, Keevil, Moxon, Saad and Jack represented Gallaher, and Messrs Tlais, Saveriades and Clarke represented TEL. Mr Fawaz was not there. Mr Tlais explained that he was selling off the Old Stocks more slowly than he had envisaged, partly as a result of concerns about where Sovereign was going to and partly in order to obtain a paper trail for HMCE showing delivery to the ultimate market. He also indicated that he wanted there to be a record of what had been agreed in July with HMCE.

Dorchester Paper Parcel

323 In autumn 2002 BLOM had complained that 40,000 cases of Dorchester Paper Parcel, which formed part of the goods pledged to them, were unsaleable and required a $ 2,000,000 payment to resolve the issue. Mr Rolfe's notes of the meeting on 5th September refers to the 40,000 cases as costing money but not saleable and records the need to establish what may be saleable and consider alternative means of providing a guarantee to the bank. Gallaher was keen to save the cost of storage and, if possible, the considerable expense of destruction. By 26th September, when he wrote to Mr Rolfe, Mr Tlais had learnt that Gallaher was taking the view that the stock should simply be destroyed without replacement security, which Mr Tlais described as totally unacceptable.

324 Gallaher made a proposal to Mr Tlais that Gallaher would provide TEL with a short term loan of $ 1 million to provide security to the Bank. TEL should take over all the Old Stocks itself, sell them and remit a minimum of $ 2.9 million to Gallaher.

325 On 26th October someone at TEL (the letter is signed M.K.) wrote to Mr Moxon of Gallaher declining to give a fixed commitment as to when TEL would pay both the $ 1 million and $ 2.9 million. Three options were put forward of which the third was the destruction of the goods and an additional loan of $ 5,000,000. In the end Gallaher rejected these proposals.

326 Whether or not the Dorchester paper parcel in Dubai was unsaleable is not at all clear. About 38,100 cases were released in 2002 and 2003. These consisted of 20,000 cases of full flavour and 18,100 cases of Lights at the Modern Freight warehouse. 5,000 cases of full flavour had been released in July 2002 to Adam Trading (and so could not have been the subject of complaint by the bank in autumn 2002) and a further 3,000 cases were released in January 2003. The remaining cases of the full flavour were also released to Adam Trading or, on one occasion, Drilon over the course of 2003 and appear on the TEL customer accounts with sales figures. The Lights were transferred (with the remaining full flavour) to the Gulf Agency warehouse and then to the Thomsun warehouse. What happened to them thereafter is not known.

327 Mr Clarke pointed out in evidence that a release to Adam Trading, or Drilon, did not mean that there had been a sale for which Adam Trading paid; and said that there had been many complaints about the product and in most cases money was not collected for it. Mr Tlais' evidence was similar. In the absence of any evidence from Adam Trading it is quite unclear whether and to what extent Adam Trading had difficulty in selling these goods; and Mr Tlais' comments in a letter of 22nd April 2003 that he had "*the experience of the Old Stocks which include Dorchester Paper Parcel, which are now two and half years old and are still shining examples of your production*", without reference to any defective parcel, suggests that they were not unsaleable.

The Procedural Agreement

328 Following the meeting of 5th September Gallaher, Mr Tlais and HMCE entered into the "*Procedural Agreement*", which was finally agreed in December 2002. TEL Agreement recorded the acceptance by all parties of Mr Tlais' observations at the meeting in Cyprus in July that:

(i) the supply of Dorchester under the previous trading relationship had been within his personal control from launch and he had a high level of comfort in respect of his control of that brand;

(ii) he had serious concerns that because of a lack of control by his former business associates Sovereign Classic had a very active transit demand so that, regardless of the level of control exerted, he believed that in the short term, there would continue to be product diversion. Even in duty paid markets the economics for criminal gangs to re-export were still attractive;

(iii) It would take time to exert the same level of control over Sovereign as Dorchester. During a period of perhaps 1 – 1 ½ years he would require close cooperation with HMCE to provide him with "*the fullest details of any and all seizures of Sovereign Classic in real time*" to allow investigation as to whether the seizure was of product supplied to him and if so to cease supplies to such customers as might be required.

329 The procedure agreed was as follows:

(i) direct delivery to market was the preferred option. But it could not be fully implemented until Mr Tlais could be secure in respect of payment from his clients;

(ii) where goods were delivered to their market through intermediate destinations, TEL was to be responsible for onward shipment of goods to final destination and was to provide Gallaher with evidence of shipments by way of Bills of Lading, Customs release documents etc. This procedure was to apply to Southern Africa, South America, Iran and Syria.

(iii) in respect of the significant quantity of aged stocks held in Cyprus and Dubai, which had to be mixed with fresh stocks (which would be coded for specific markets), Mr Tlais would supply a copy of Bills of Lading where he made onward shipments. When he sold ex-warehouse he would provide details of the goods, quantities, full consignee details and the intended destination. This would apply to all other contractual markets except those in (b).

330 The Procedural Agreement recorded the fact that Mr Tlais and TEL had signed the ITP and reiterated their commitment to the building of long term international domestic business and Mr Tlais' abhorrence of smuggling "*as a destroyer of market value*". HMCE agreed to provide the fullest available details in the event of seizure in order to trace the shipment back to the culpable customer. Mr Tlais confirmed that if he found a TEL customer involved in product diversion he would terminate supply immediately without further warning.

331 In his evidence Mr Clarke accepted that, even in the case of shipments to intermediate ports or to Cyprus and Dubai for mixing, TEL still needed to have systems in place to be able to demonstrate that the goods arrived at their intended final destinations. At the meeting in July HMCE had been told that systems would be in place to obtain evidence that goods reached their intended market. Mr Tlais accepted the same point. Mr Clarke also accepted that, even in the context of the Procedural Agreement, TEL undertook a responsibility to get the product to the intended final market and to demonstrate that this had happened as well as to monitor where it went once it got there.

332 Mr Tlais' evidence was that he only ever committed to achieving 80% control of Sovereign, saying that "*if he was a hero*" and if he got the necessary cooperation he might be able to reach a position where he had 80% control of Sovereign. I do not accept this. It is inherently unlikely that Customs would have accepted a lack of control in relation to 20% of Sovereign shipments or that, if an 80% figure had been mentioned, there would have been no discussion about the balance. The suggestion that Mr Tlais' commitment extended to only 80% is noticeably absent not only from the Procedural Agreement but also from letters that Mr Tlais wrote to Gallaher in 2002 to which I refer in the next paragraph[38].

333 In his letter of 6th August Mr Tlais referred to the meeting with HMCE and said that he had advised HMCE that it would take around a year for him to discover the good and bad customers and that after about 1 year the situation would be under control. In his letter of 12th August he referred to his commitment in the short to medium term to "*bring everything under control*". Further on 15th October 2002 he wrote to Mr Keevil:

> *"I made a commitment to Customs at our joint meeting that within the region of one to one and a half years a strict level of control would be applied through vigilance and policing of the systems, including applying the red card procedures on any customer that breaches the ITP. This commitment stands …"*

Did the Procedural Agreement override the TEL Agreement?

334 Mr Clarke suggested in evidence that the Procedural Agreement was intended to replace the TEL Agreement in respect of the clearance of Old Stocks. I reject this for a number of reasons: see paragraphs 596-602 below.

Gallaher's trip to Iran

335 In October 2002 Messrs Rolfe, Fawaz and Jack on behalf of Gallaher carried out a market visit to Iran which was attended by Mr Tlais and Mr Clarke for TEL. TEL's chief sub-distributor was a company called Adam Trading, whose owner and principal director was Dr Khaled Al-Mahamid ("Dr Al-Mahamid"), whom Mr Rolfe met for the first time on this occasion. Dr Al-Mahamid and Mr Tlais had very close links. The distributor used by TEL/Adam Trading in Iran was called Parsian Fougan; although there my have been others as well. Hazem Mahmoodi Rashid ("Hazem") and Sarfaraz Mobbarraki were directors and co-owners of Parsian Fougan.

336 Mr Rolfe flew to Dubai where he met Messrs Tlais, Clarke and Al-Mahamid and the group then flew on to Iran. The market visit was arranged by TEL or its distributor. The purpose of the meeting was to get some understanding of the Iranian market and to verify the supposed market of 50,000 cases per month for Dorchester and Sovereign.

[38] It does, however, appear in his letter of 3rd February 2003.

337 The Gallaher party met with representative of the Iranian Tobacco Company ("ITC"). The ITC is the state-owned tobacco manufacturer and was responsible for the duty payment regime. They also saw the Teheran Bazaar where Dorchester cigarettes were available at wholesale level but there was very little evidence of their presence at retail level. Sovereign was not visible at all. When asked about the absence of Sovereign Hazem indicated that the demand was mainly in the rural areas and suburbs.

338 The party also went to Teheran, Isfahan and Rasht where they visited wholesalers supplied by Hazem, who was being supplied with stock by Adam Trading. They also visited some shops owned by Parsian Fougan.

339 Mr Tlais told Mr Fawaz that he was selling 20-30,000 cases into Iran per month, mainly Dorchester – a total of between 2.4 and 3.6 billion sticks per annum. If true this would have been about 5% or more of the entire Iranian cigarette market and a much higher portion of the value segment. This did not tally with what Gallaher saw in Iran or with a BAT paper on the Iranian market which Mr Fawaz had obtained from a contact there. This showed that consumption was primarily of American (i.e. non Virginian blends – no Virginian blends being in the fast moving stocks in all segments) and made no reference to sales of Dorchester or Sovereign[39]. When Mr Fawaz challenged Mr Tlais by saying that sales in Iran were inconsistent with the volume that TEL was ordering for Iran he was told that most of the Gallaher brands were sold in rural areas and along the border with Afghanistan.

340 Mr Fawaz was highly critical of the visit, which he regarded as heavily orchestrated. In an e-mail of 14th October he expressed the view to Mr Rolfe (whose evidence was that he agreed – although his letter of thanks to Mr Tlais bears no such indication) and Mr Saad that:

> *"The way the market visit was structured did not give us the opportunity to verify the information provided by a selective wholesale [sic[40]] regarding consumer demand… You did request to see a cross section of retail outlets and were not granted the opportunity.*
>
> *Our observations, however, on packs and cigarette filters on the streets, the movement of brands provided by wholesale [sic] when they were not interrupted, packs carried by consumers, and small cigarette vendors did not point to any consumption of Dorchester and Sovereign in the 3 cities visited. In addition to this, Sovereign did not exist in distribution at wholesale point.*

[39] On 6th November 2002 Firouz Homayoun, who was trying to become a Gallaher distributor, reported to Mr Fawaz that Dorchester started to be smuggled into Iran during 2001 and a sales figure of 1,500 to 2,000 cases per month was achieved; that in 2002 some had been imported officially and sales had reached 5,000 cases per month. He thought that the brand could reach substantial proportions in the right hands, and fill a market vacuum created as the result of sale and distribution problems of Magna and Montana, two blended brands. Sovereign, he said, was unknown.

[40] Presumably "*selected wholesaler*" was intended.

> *For your information, 160 million of Sovereign are ordered every month.*
>
> *It was therefore essential to strongly highlite (sic) this fact to our partner otherwise we would have emerged from the meeting agreeing with their views about a significant market demand which we cannot substantiate"*

341 On the TEL side it was suggested that Gallaher showed limited interest in the retail side; but considerable interest in buying carpets; and that Mr Fawaz refused to take internal flights which restricted what could be seen.

342 After the visit Mr Fawaz engaged a market researcher, Hicham Ezzedine, a former employee of BAT, to visit 5 Iranian cities and rank the cigarettes he found in order of popularity, based on data given by distributors as to the movement of cigarettes. When he found Dorchester it was usually low down in the rankings. At a level inconsistent with 20,000 or 30,000 a month.

Italian Seizures in October 2002

343 In October 2002 HMCE expressed concern to Gallaher on two counts. The first was a dramatic rise in the quantity of cigarettes exported to TEL. The second was a seizure of :

(a) about 2.5 million Sovereign in Venice, made, according to the batch code, for the Mozambique market; and

(b) 1,000 cases of Sovereign supplied by Gallaher to TEL in Turkey, for Syria, seized or detained in Genoa, en route to Bulgaria. The goods had been shipped to Mersin in mid July and the Turkish consignor to Bulgaria was TSS Tutun Sigara Savayi ("TSS").

344 In his letter of 15th October 2002 Mr Tlais responded to this information by repeating his commitment that, within the region of 1 – 1 ½ years a strict level of control would be applied; pointed out that the actions of removing customers from the network had to start somewhere and that the quantity of goods seized was small as a percentage of those supplied; and warned that "*large and powerful groups*" were trying to purchase product from himself and his customers[41]. He expressed the view that the Mozambique goods may not have originated from OTI and expressed himself unable to comment on the goods destined for Bulgaria and asked for full details; but said that, as a precaution, he had ceased supplying TSS *"until we have proven who is responsible for this problem"*.

[41] He repeated much the same message on 25th October 2002 ("*I told everyone to expect problems*"; "*it is clearly recognized within the procedure that seizures will occur").*

Meeting Tlais – Fawaz 31st October 2002

345 In October 2002 Mr Fawaz had been pressing Mr Jack to obtain a sales and stock statement by market and customer. Mr Jack had been pressing TEL. On 22nd October the production of the latest Sovereign order was put on hold pending its receipt.

346 On 31st October Mr Fawaz and Mr Tlais met in Cyprus. The purpose of the meeting was to address three questions (a) the collateral pledged to the bank and the warehouse payments of £ 80,000 due monthly, which Gallaher was paying; (b) the recent Customs seizures in Italy and Tlais' management of sales and orders in the Territories; and (c) the relationship with HMCE.

347 The meeting took place in Mr Tlais' office and was conducted, largely, in Arabic. Mr Clarke was there some of the time but, since he does not speak Arabic, would not have understood much of what was being said. He was present at dinner afterwards where the conversation, which addressed some of the topics considered at the meeting, was in English. At the meeting Mr Fawaz expressed the view that the stock, which belonged to Gallaher and for which it was paying storage charges – with no clear indication as to how long this would continue - should be destroyed and no replacement security provided. Mr Tlais made it clear that, if that was to happen, he wanted a replacement security.

348 Various proposals were put forward by Mr Fawaz, who made a note of the meeting to brief Mr Rolfe. I do not regard this note as involving, as was suggested, a large amount of invention.

349 As the note reveals.

(i) Mr Tlais complained about the difficulties of disposing of the Old Stocks in Cyprus and Dubai[42]. Mr Fawaz suggested that Gallaher would take custody of it and manage the issue of collateral with the bank, or provide $ 1 million as a loan and take ownership of the stock, or simply lend $ 600,000. Mr Tlais rejected this.

(ii) Mr Fawaz asked for a sales and stocks statement, following which sales of Sovereign would resume, or a detailed list of sales by country and customer detailing monthly quantities sold in each country to each customer, together, in either case, with the outstanding bills of lading[43]. Mr Tlais said that he did not have this information or documents.

[42] Schedule VI to the TEL Agreement had envisaged that all the stock mortgaged to BLOM and the Abu Hamid stock would be disposed of by the end of January 2003 and the 648 million i.e. the first parcel of the 365 day goods by the end of August 2002. A fax from Mr Khatter to Mr Fawaz of 22nd October 2002 had indicated that Mr Tlais "*intended to clear his old stock before the year end*" and put the figure at 87,000 cases.

[43] On 22nd October Mr Jack had reported that he had received documents covering 1.1 bn cigarettes as against 1.6 billion shipped. It may be that the reason he had not received the balance was that the goods had not been released by TEL to its customer on ex warehouse sales so that there was no documentation to provide.

(iii) Mr Tlais claimed that he had a 3 year agreement to operate with no restrictions, during which he would red card his customers where appropriate. If Gallaher wanted TEL to control shipments of Sovereign it would have to pay the $30.5 million that was outstanding to him from the Namelex era. He referred to the letters that Mr Jack had written which he said committed Gallaher to $ 30.5 million in free goods. He wanted the Procedural Agreement finalised as soon as possible, failing which the level of cooperation would be significantly scaled down. He also wanted $ 1 million as collateral to resolve the issue of the old stock.

(iv) Mr Tlais wanted 200 to 300 million cigarettes every month, and a business which would generate $800,000 to $1 million every month. He said that he needed Sovereign in order to sell Dorchester. He wanted ownership of the Dorchester trademark.

(v) Mr Tlais said to Mr Fawaz that he had some goods which he had bought for Iraq, with an Iraqi health warning. He threatened to say that Gallaher had known that they were intended for Iraq if Gallaher did not give him what he wanted. Mr Tlais said that he was "*burying the dirty laundry*" of Gallaher, and that "*anyone deciding to stop the business will be harmed*". As to this see paragraphs 538ff below.

(vi) Mr Tlais made some hint (which does not appear in the note) that there could be benefits for Mr Fawaz if he cooperated with him, referring to the fact that Mr Fawaz might not always be with Gallaher and might want to think of providing for himself after his employment ceased.

350 Mr Tlais' statement that, if Gallaher wanted TEL to control shipments of Sovereign it would have to pay the $30.5 million that was outstanding to him from the Namelex era, was one example of a stance regularly taken by him, to the effect that if Gallaher wanted something, in particular adequate control of stocks, then they should be paying him his $ 30 million loss. Mr Tlais treated Sovereign as a product which he could use to obtain revenue whilst it lasted, and which he needed to use if he was to satisfy his bankers, whilst seeking financial compensation for dealing with it and for its withdrawal. But the TEL Agreement did not entitle him either to the $ 30 million, or to have the Old Stocks bought out, or to be left in a position where he was not reliant on Sovereign.

November and December 2002 - meetings in Weybridge

351 In early November 2002 Mr Fawaz held a planning session for the AMELA region. Mr Clarke attended. Mr Fawaz announced that he intended to replace Sovereign Classic and Dorchester International with a new portfolio for the Middle East concentrating on American blends for Iraq, Yemen, Lebanon and Syria. Mr Clarke did not want to lose either Sovereign or Dorchester but was happy to have new additional brands.

352 Later Mr Clarke met Messrs Rolfe, Keevil, Moxon and Jack. He reported that the business was doing well (Mr Tlais' position having improved by $ 7 million since May); expressed concern at the halt in production of Sovereign (which had

happened because of late payment for some goods and lack of satisfactory documentation); but said that TEL had a large stockpile of the brand so business should not be affected. He was also concerned to find a way of releasing the stocks that had been pledged by Gallaher to BLOM. The idea had been that as TEL profited from the supply of the 365 day goods it would generate the money to redeem those goods from pledge. TEL could not afford to provide replacement security and wanted Gallaher to provide it. Mr Rolfe was not keen on increasing Gallaher's exposure.

Gallaher's proposal about the Old Stocks

353 The upshot was a proposal from Gallaher in a letter of 12th November 2002. Gallaher would lend TEL $ 1 million, secured on Mr Tlais' personal guarantee, so that TEL could free up access to the pledged stocks. In return TEL would pay an extra $ 10 a case on Sovereign up to a maximum 100,000 cases, any outstanding balance on the advance being repayable by 31st May 2004. TEL would take responsibility for storing and selling the Gallaher Old Stocks, and, if necessary, their destruction; would use its best efforts to sell them in such a way as not to prejudice existing markets; and would account to Gallaher for the proceeds at a minimum price of $ 20 a case (unless otherwise agreed) and would receive a commission of $ 5 per case. TEL would inform Gallaher of the destinations to which the goods were shipped in accordance with the terms of TEL Agreement with HMCE.

354 The variation, put forward (as one of three proposals) by Mr Tlais in his letter of 18th November 2002, was that, instead of TEL remitting the value realised on the sale of Gallaher's stock less a commission of $ 5 per case, TEL would retain the sale price in full. TEL Agreement reached is set out in Mr Jack's letter of 26th November 2002. TEL was to take over the Old Stocks in Cyprus and Dubai for free. TEL was to disclose the destination to which it dispatched these Old Stocks on the same terms as affected new supplies.

355 The Loan documentation and Mr Tlais' guarantee were executed on 22nd November 2002. The Loan was to be paid back in full by the $ 10 supplements. TEL took over the goods as from 1st December 2002. Mr Tlais also provided a further $ 1 million from his own funds to satisfy the bank.

356 A stock analysis prepared by Mr Jack at around 26th November 2002 showed that 46,515 cases in Cyprus and 83,300 cases in Dubai were was still pledged to the bank[44], although he noted his understanding that some 10,000 cases had been moved to other locations and released to customers. TEL Agreement of 26th November provided for these to be invoiced at $ 45 a case.

357 A further meeting took place at Weybridge on 11th December 2002 attended by Messrs Rolfe, Keevil and Jack and Messrs Tlais, Saveriades and Clarke. Mr Tlais said he had lost trust in Mr Fawaz who needed to build bridges with him (Mr Fawaz in turn felt that Mr Tlais had set up the meeting to bypass him because he thought he could get what he wanted more easily by dealing with Mr Rolfe and Mr Saad). Mr

[44] The product is 129,815 cases which is very close to the figure in the attachment to the letter of 29th April save that the split between Cyprus and Dubai is different.

Jack reiterated the need, and Mr Tlais agreed to provide, monthly sales and stock reports, to include the Old Stocks as well as new shipments. Mr Tlais signed the Procedural Agreement. Mr Keevil emphasised its importance and the need to keep up the flow of supporting documentation.

2003

Further HMCE concerns - Drilon Enterprises

358 In January 2003 HMCE notified Gallaher that they had in their possession documents which showed that TEL had in January supplied 3 containers of cigarettes to Alba V & C in Bulgaria, which was not a Territory, via Drilon Enterprises with an address in the Czech Republic. The cigarettes, which had not been seized, had been dispatched from Cyprus to Varna via Malta. Alba was said by HMCE to be a current customer of CT Tobacco[45] which had previously supplied them with large quantities of Sovereign. HMCE expressed concern that Alba was a distributor of TEL and that neither Drilon nor Alba appeared on the TEL customer list.

359 Mr Rolfe and Mr Jeffery took this up with Mr Tlais who replied promptly on 13th January. He complained that he was not receiving the quality of information that he had been promised, that the co-operation he had expected had not materialised and that it would take him much longer to resolve the major problems alone. Mr Tlais said that he was unaware of Alba V & C; that he had been working with Drilon for six months, as Gallaher knew from copies of letters from them that he had passed on (Mr Jack later confirmed that that was so); he had no continuing relationship with CT Tobacco (other than to be owed $ 5.5 million). Drilon had signed the ITP. Neither Drilon nor Alba had been on the list faxed to him on 12th September of customers with whom he should not deal; nor mentioned in response to his letter of 17th September asking for more information. The destination markets were as on the letters from Drilon of which Gallaher had copies and the goods supplied were marked for the final country of destination. He had now red carded Drilon.

360 Mr Tlais red carded Drilon by a letter of 14th January 2003, in which he said that TEL would have no alternative other than formally to terminate the business relationship unless Drilon was able to provide clear documentary evidence that it was "*not included in the transaction*" i.e. the diversion.

361 On 17th January Mr Jeffery replied. He indicated that "*the key to all the current issues is the need to be able to demonstrate to Customs' satisfaction that products are going to the intended destinations*". He said that further information would be needed about Drilon; expressed the belief that HMCE had provided whatever information was available "*in real time*"; and that it was "*our joint responsibility to fully investigate as far as we can*". Gallaher had not had any information about Alba and Drilon earlier in the year of which it had not informed TEL.

[45] Evidence from the criminal proceedings in Greece – see paragraph 537 below – indicates that Alba was owned by the Anthemides brothers who were parts of the smuggling ring in which Mr Tornarides and Mr Tlais were said to have been involved.

362 On 20th January 2003, Mr Jeffery wrote again to Mr Tlais, in anticipation of a meeting with HMCE planned for March, to set out the key areas that HMCE would want to review):

(i) *Evidence of shipments*: Mr Jeffery asked when the Old Stocks would be sold off, so that shipment direct to market would be possible.

(ii) *Documents:* Mr Jeffery noted that a significant number of documents were missing to show shipment to intended final destinations. He pointed out that Gallaher was required by Customs to audit the provision of documents by TEL.

(iii) *Customers:* Mr Jeffery asked Mr Tlais to agree a procedure for regular updates to Customs of TEL's customer lists in the light of the Drilon experience. (This happened but only sporadically.)

(iv) *Policy on International Trade*: Mr Jeffery asked for a complete set of ITPs signed by TEL's customers. (This was never provided.)

(v) *Market reports*: Mr Jeffery asked TEL to agree market visits for Gallaher's employees. (These happened sporadically.)

(vi) *Sales volumes and stocks*: Mr Jeffery asked TEL to provide "*a simple report of opening/closing stocks, purchases and sales on a monthly basis for each brand/customer/territory"*. (Occasional stock reports were provided. Sales reports were never provided.)

(vii) *Future steps*: Mr Jeffery emphasised the importance of proof that goods were going to final markets. "*The most comprehensive way in which this can be done is the provision of verified Customs Release documents or evidence of duty payment in the destination market*". (This never took place to any satisfactory extent.)

Gallaher's audit of TEL's shipping documentation

363 After the first reported seizures in October 2002, Mr Perks began auditing the shipping documentation that TEL had provided to Gallaher in order to see whether it evidenced the shipment of goods from intermediate ports to final destination markets. The audit reached a temporary impasse between 18th November 2002 and January 2003 because of the non provision by TEL of bills of lading from intermediate ports[46] and there was a suspension of sales which were later resumed. Mr Perks, Mr Rolfe and Mr Moxon were regularly pressing Mr Jack to obtain more documentation from TEL.

364 Mr Perks' analysis of 4th February 2003 was that, in respect of the period up to the end of November 2002, there was, at best, a 46% shortfall (about 1 billion sticks) between:

[46] The deficiency in documentation may have been in part attributable to the fact that 248 million sticks had been released to Adam Trading which were still in the warehouse and there was no end destination documentation to provide in respect of them.

(i) Gallaher's invoiced sales to TEL less TEL stock[47] (i.e. the volume apparently sold by TEL) and

(ii) documentation showing shipment to final destination.

November 2002 was selected as the end point because that would allow TEL at least seven weeks to provide shipping documentation, as contemplated by clause 3 (v) of the TEL Agreement. The 46% figure assumed that all of the documentation provided by TEL related to shipment of new stocks manufactured for TEL in the TEL era. However, TEL had taken over a large quantity of Gallaher Old Stocks and had received 365 day goods, as well as having Old Stocks of its own. Some of those goods may have been sold, especially since the idea had been that TEL would endeavour to sell off the Old Stocks as soon as it could. If so, the percentage of sales vouched by shipping documentation would have been lower. Mr Perks also assumed that manuscript annotations made on documents setting out the quantity of goods were accurate; and that photocopies were sufficient evidence, although he did not regard them as such for auditing purposes.

2003

365 During the first three months of 2003 three important developments occurred:

(i) On 21st January 2003 the amended TEL Agreement was signed;

(ii) Mr Tlais told Mr Keevil that he had stocks of Gallaher cigarettes which he had intended to sell to Iraq in breach of sanctions;

(iii) Mr Tlais notified Gallaher that Dorchester cigarettes which Gallaher had supplied to him were significantly damaged as a result of which he was in severe financial difficulties.

Complaints

366 Mr Keevil and Mr Jack were in Cyprus on 29th and 30th January 2003 and met with Mr Tlais. Mr Tlais referred to a number of ways in which he said that Gallaher had been unhelpful by not making decisions swiftly enough; his continuing concern about Sovereign due to the high level of illicit demand; and the need for a new portfolio of brands.

Goods for Iraq – "bad things in the past"

367 At a meeting in Cyprus on 30th January 2003 Mr Tlais took Mr Keevil aside and, in the presence of Mr Saveriades, but in the absence of Mr Jack, told him that during the Namelex era, when sanctions were in force, he had obtained goods with an

[47] The figures for closing stock were obtained from Mr Jack. Mr Jack's figure for stock for Dorchester Lights exceeded total invoiced sales of that product. Mr Jack explained the figure as including stock taken over from Namelex.

Arabic health warning ("the Arabic goods") which were suitable only for the Iraqi market. He said that he had "*done bad things in the past*". Mr Keevil was shocked, firstly because he regarded this news as being sprung on him without prior warning and secondly because it represented a volte face from what Mr Tlais had told him in April of the previous year, namely that he was not involved in smuggling.

368 On 5th February 2003 Mr Keevil, who had by now spoken to Mr Jack, wrote to Mr Saveriades and Mr Tlais to tell them what he had been told by Mr Jack. That was that the 33,000 cases of Dorchester, i.e. the Arabic goods, which it was agreed should be destroyed, consisted, as to 21,000 cases, of goods sold to Mr Tlais by Namelex and as to 12,000 cases were part of the Old Stock in Cyprus/Dubai which had been sold to Mr Tlais by Gallaher at the nominal price of $ 1 per case. Mr Keevil proposed to credit TEL with $ 12,000. He also proposed to credit TEL with $ 45 per case for 29,565 cases that had been invoiced in that amount, (pursuant to the original arrangement for the Gallaher Old Stocks to be sold at what Schedule VI estimated would be $ 45 per case and the proceeds remitted to Gallaher) and to re-invoice them at $ 1 per case.

369 He also reported that Namelex had told Mr Jack that all 33,000 cases had been due to be sold to a Jordanian distributor with whom Mr Tlais had no commercial relationship. Further the Jordanian health warning had changed so that the only area in the Middle East where they could now be sold was Palestine, and because of their age the goods were unsaleable.

370 In a letter of 7th February 2003 Mr Tlais explained that the 33,000 cases had been purchased by him from Gallaher by letter of credit drawn on two banks at an invoice price of $ 90 a case. The 12,000 cases referred to in the letter of 5th February 2003 were Dorchester Lights and not part of the 33,000. After the beginning of the TEL era Mr Jack had asked him not to sell these goods. But the Dubai warehouse, where the goods were kept in bond, had been approached by a customer wanting to buy the whole quantity at about $ 110 a case – a high price. Mr Tlais explained in evidence that an investigative journalist, whom he believed to be associated with the CIA, had been making enquiries of the warehouse. In his letter he expressed a desire to sell the goods "*if the sale of these goods is not a matter for you"*.

371 Mr Keevil, who consulted Mr Northridge, told Mr Tlais to destroy the Arabic goods. Eventually an agreement was reached – recorded in Gallaher's letter of 2nd April 2003 that Gallaher would reimburse TEL for the net price (after rebates) that had been received by Gallaher and 50% of the costs of destruction, but not the storage costs, such payment to be in the form of free goods, which, as Gallaher later confirmed were to be supplied during 2004. As a result of this episode Mr Keevil was left with real concerns as to Mr Tlais' intention to develop legitimate business.

Damaged Dorchester

372 On 3rd February 2003 Mr Tlais reported that there were some 800 cases of Iranian bound Dorchester in Dubai in which individual packs, but not the outer, had randomly changed to a green colour. Two weeks later, on 17th February 2003, Mr

Clarke was reporting that TEL's Iranian distributor in Iran was withholding $ 10 million (the equivalent of more than 130,000 cases)[48].

373 There is an issue between the parties as to who was legally responsible for the damage to the stock. At the time Mr Tlais took the stance that it was up to Gallaher, as manufacturer to decide what should be done with it and that he would comply with their instructions and at their risk. I address this question in paragraphs 1042-1061 below.

Further audit of documents provided by TEL

374 After his February 2003 audit Mr Perks sought further documentation relating to shipments from Dubai to Iran, and Mr Jack was instructed to seek to secure it. Further documentation in Farsi dealing with clearance and duty payments was brought back by him from Iran. These documents did not improve the position. There remained no evidence that any Sovereign cigarettes had been received in Iran despite the fact that 451 million sticks had been shipped for that market. The documents that were produced (e.g. stock movement records, banderol or duty receipts and internal bills of lading), whose quality was poor, did not, on their face, correlate to each other and some of them, such as documents recording payment to the Iranian Ministry of Economic and Financial Affairs, did not, in many cases, even show that they related to cigarettes. It was impossible in respect of any one consignment to track the goods from Dubai to the local Iranian distributor.

375 On 15th April 2003 Mr Perks reported:

(a) that the documentation supplied was unsatisfactory for the purpose of showing what cigarettes supplied by Gallaher had reached Iran as their destination market and

(b) that there was no evidence in relation to the supply of Sovereign at all.

Mr Tlais was pressed by Mr Jack and Mr Rolfe to provide more documentation.

376 In June 2003 Mr Perks made a further attempt to reconcile TEL's documents with Gallaher's supplies. As a result he identified further problems with the documentation provided. In particular:

(i) He identified some Dubai exit certificates as forgeries. There were two certificates, one with a destination of Iran, and one for the Yemen. One was an altered copy of the other. The customs stamps, the signatures crossed through the stamps and some additional Arabic handwriting were all in exactly the same place. Although the quantities were very different, the weight of the goods (which, being under the stamp, could not be

[48] This figure is not credible if it is intended to represent an amount withheld from TEL (as opposed to Adam Trading). According to TEL's customer accounts the debt owed by Parsian Fougan at the end of 2002 was $ 1,760,055.

altered) was the same. The certificate for Yemen had two different typefaces.

(ii) He identified problems with a number of other UAE documents, including 4 versions of the same document. These documents appeared to have been deliberately altered so as to give the misleading impression that they represented 4 separate shipments.

(iii) He identified one exit certificate as lacking three necessary stamps. He was also suspicious that customs stamps were absent from a number of other Customs exit certificates – while others bore more than the usual number.

(iv) He noted that customs bills were being provided as evidence of stock movement. Such bills should have been accompanied by customs exit certificates, but were not. He was unable to establish whether these bills covered the same goods as those for which exit certificates were provided, or different goods.

(v) One bill of lading showed only the approximate weight of the cigarettes, and not the number of sticks or cases.

(vi) He identified exit certificates issued by Rais Hassan Saadi Logistics, a warehouse in Dubai, as being duplicates, despite showing different details.

(vii) One document was just a letter on plain paper from a customer, requesting delivery of goods. Other documents were simply requests for delivery or confirmations of purchase and destination typed on headed or plain paper. One customer letter had been signed by a freight forwarder, rather than the Syrian customer.

377 Mr Perks' conclusion, expressed in an e-mail of 13th June 2003, was that there was, in respect of the period from May 2002 to date, a shortfall (i.e. a percentage of sales not matched by documents showing shipment to final destination) in the range of 20-36% (depending on brand and flavour). There was much debate between Mr Perks and Mr Jack about how great the shortfall really was.

378 By 8th July Mr Perkins had produced an analysis of the TEL documentation which showed that there was an overall 23% shortfall in documentation of 516 million cigarettes all or most of which appeared to consist of documents relating to:

(a) 400 million cigarettes (150m Sovereign and 250m Dorchester) purchased by Hazem which Hazem was withholding; and

(b) documents in relation to a shipment of 156 million Sovereign to TSS which had been red carded.

379 This analysis was qualified by the observation that some of the documentation had credibility issues such as those referred to in paragraph 376. On 9th July Mr Rolfe and Mr Perks agreed the 516 million and 23% figures.

380 These figures were later set out in a GRA Report on Product Shipment of 18th July 2003, which referred to the poor quality of much of the documentation and the apparent forgery of one of the exit certificates. Mr Perks was not commissioned to perform a further audit after this.

381 Mr Jack wrote to Mr Tlais on 21st July, after a visit to Cyprus, saying that the sales documentation was broadly in order (which is not how Mr Perks would have described it) but recording that "*for the future we sought to tighten up a few areas*". He set these out in another letter of 21st July 2003, and again on 28th August 2003, setting out ways in which the provision of documentation needed to be improved. The faults identified included (a) the provision of a customs duty report or an UAE exit certificate, but not both; (b) the absence of bills of lading to accompany customs documents; (c) a bill of lading which was in fact a carbon copy; (d) bills of lading and other documentation not detailing the brands and quantities; (e) one instance of two letters on different letterheads with the same signature – one on the letterhead of the customer and one on that of the freight forwarder.

382 The absence of a complete set of documents, including bill of lading, customs bill, and exit certificate meant that, in some cases, the container number and/or the brand was not apparent. Ordinarily the container would be on the bill of lading and the exit certificate and the brand often appeared on the exit certificate, if not on the bill of lading. There are some examples of two copies of the same bills of lading with different types of cigarettes specified in manuscript.

383 Gallaher made further reference to the documents outstanding from Hazem. Mr Rolfe's letter of 23rd June 2003 referred to the documents that Hazem had promised to Norman Jack in Iran and stated that if Mr Clarke "*can bring these back from his forthcoming trip, that will greatly improve the situation*". Mr Jack's subsequent letter to Mr Tlais of 21st July 2003 records an understanding that "*we await resolution of matters in Iran to secure the outstanding documents from there*". Mr Fawaz's letter to Mr Tlais of 1st October 2003 records, as one of three housekeeping points, that the missing documents from Hazem are to be provided, that Hazem's position was unacceptable and that this should be communicated to him, and that the documents "*must be supplied*" by the time of Mr Jack's visit to Iran due to take place on 12th October.

384 On 18th July 2003 Mr Jack sent Mr Tlais copies of the two forged exit certificates that TEL had provided to Gallaher - see paragraph 376 (i) above - and explained why they appeared to look similar. Mr Jack indicated that these were documents about which Gallaher had "*some doubts*". In fact Mr Perks had no doubt that they were forgeries. Mr Jack reported that Mr Tlais' initial response was "*incredulity and denial*", and that he accepted that Gallaher's suspicions were well founded and had "*advised his representative [Adam Trading] to make vigorous inquiries in his office as to who might have done this*". On 22nd July Mr Jack reported that Mr Tlais accepted that there had been "*an alteration*", was launching an investigation at Adam Trading and was a comfortable as he can be that his agent himself was not involved given the crude nature of the transaction.

385 In October 2003 Mr Tlais reported to Mr Jack that he and Dr Al-Mahamid had to accept that there had been falsification of the documents. Dr Al-Mahamid had concluded that a junior member of staff, under pressure to produce the necessary documentation, had produced a crude forgery in order to shortcut the system. The member of staff had been told that such action was not acceptable.

386 Mr Tlais' evidence to me was puzzlingly different:

> *"What he said, Khaled, is that this document, it is not belong to him, it is something belong to his brother. I do not remember exactly the story, how it happened. I told him Khaled, are you sure about it? He said, yes, I am sure, I have no involvement with these things."*

Meetings in June 2003

387 On 16th and 17th June Messrs Rolfe, Fawaz and Jack visited Lebanon where they met Messrs Tlais, Saveriades and Clarke. On 23rd June Mr Rolfe wrote summarising the matters that had been discussed. These included:

(a) *The Lebanese market*.

Gallaher had shipped a container of goods to the Régie there, and paid for various forms of merchandising, but had as yet received no payment from the Régie because of inadequate sales. In the course of the trip, Gallaher's executives visited the Régie, and obtained information as to how much had been sold. This demonstrated that TEL's information to Gallaher was wrong. TEL had said that only 200 cases remained unsold, while the Régie's records showed that 750 cases had been acquired, and 369 cases sold, leaving stocks of 381 cases. Nevertheless Mr Rolfe told Mr Tlais that his visits to the outlets gave him a very positive view of the market; and that Tlasco had clearly been effective in obtaining distribution for both Dorchester and Sovereign in the 3 main cities they visited.

(b) The Arabic goods

TEL told Gallaher that these were shortly to be destroyed. Gallaher would provide the agreed compensation in the form of free goods in the first four months of 2004.

(c) The damaged Dorchester stock in Iran

Gallaher had indicated a willingness to pay some compensation, in order to assist TEL with the problems which it claimed to be having. In his letter of 20th May 2003 Mr Tlais had asked for help in resolving the Iranian issue as the business had been on hold for five months and he was "*not in a position to fund all the parties involved in this problem*". Mr Rolfe recorded that Mr Clarke was to travel to Dubai to ensure that the stock there was handled correctly (i.e. that the goods which had been identified as capable of being resupplied to the market were so supplied). He was then to go to Iran in order to take control of the

stock Mr Tlais and his brother were to attempt to recover the duty paid on importation from the Iranian government. Once a full and final accounting was to hand, "*we could manage the settlement*".

(d) The inadequate provision of shipping documentation by TEL

Mr Rolfe indicated that Mr Jack had expressed himself broadly satisfied with the documentation[49] although Group Risk Assurance was reviewing the file. He said that that he had committed to his fellow directors that 80% of documentation would be provided as a minimum. (Mr Tlais had made reference in his letter of 20th May 2003 to his undertaking to Mr Jack that he would complete a "*full audit of what was needed to bring our paperwork up to the level agreed with customs of 80% of all shipments made by Tlais*"). TEL had blamed the inadequacies in documentation on Parsian Fougan, which was said to be refusing to provide documents until the problems with the damaged Dorchester were resolved. There was a package of documents relating to goods shipped ex Dubai to Chah Bahar and Kish which had been promised to Mr Jack in Iran.

(e) The amounts due for the 365 day goods

TEL claimed that it was unable to pay the sum due, and it was agreed that, after the $ 1 million, due to be paid off by the $10 supplement had been paid, the supplement would continue and be used to pay off the 365 day goods. Mr Rolfe put it thus:

> *"Settlement of the $ 1 m is now well advanced and you proposed that after it is complete, this $ 10 supplement should continue and be used to draw down the account in respect of the goods sold at 365 days and for which we remain unpaid.*
>
> *I advised you that I was agreeable to this but that, as part of the co-operation on this matter, we would need to receive your sales and stock report on a more regular basis (i.e. monthly) ."*

388 Mr Fawaz again regarded the trip as stage-managed by TEL. Gallaher's representatives had been taken to 12-15 outlets where there was some Dorchester and Sovereign, but when he visited other outlets on his own there was nothing there. Furthermore, following the meeting with the Régie, the General Manager had spoken to him by telephone, and expressed surprise at Gallaher's choice of distributor. He felt that Mr Tlais was unprofessional, and his choice of Virginia brands a mistake as the market was predominantly American blend.

[49] He had said that he had about 80% of documentation needed and that he had evidence that there were further documents in Iran and Dubai which would take it up to about 95%.

Meetings on July 30th and 31st 2003

389 On 30th July Mr Keevil and Mr Jack met Mr Tlais and Mr Clarke at the Langham Hilton. This was in part to discuss the meeting with HMCE the next day, and in part to explore the possibility of revising the commercial arrangements between Gallaher and TEL, on which Mr Saad and Mr Fawaz had been working.

390 The meeting with HMCE on 31st July was attended by Mr Keevil, Mr Jeffery and Mr Jack on behalf of Gallaher, Mr Tlais on behalf of TEL, and Mr McCallum on behalf of HMCE. Once again, HMCE did not permit Mr Clarke to attend. There was a general discussion on the progress apparently being made by TEL in building legitimate business, and the levels of seizures of Sovereign. Mr Jack made a presentation on behalf of TEL, from a speaking note which was handed to the Customs at the meeting. I am satisfied that this approach had been agreed the previous day because Mr Tlais was uncomfortable presenting in English – as Mr Tlais himself explained to the HMCE officers – and was not an attempt by Gallaher to gag him.

Mr Jack's presentation

391 Mr Jack's notes show that he presented matters in as favourable a light as possible. They record that "*Mr Tlais has exercised due diligence over customer selection to our satisfaction*"; and that he "*ensures all his customers are fully conversant with the provisions of our policy and, to the extent he enters into written agreements with them reflects its terms*"[50]; and "*the red and yellow card system has demonstrably been implemented by Mr Tlais*"; and his belief that the measures he described "*have been effective since the incidence of seizure of TEL products are limited and, anecdotally I have heard that Sovereign is very difficult to secure on the open market nowadays*".

392 Mr Jack told HMCE, who had received a copy of Gallaher's audit of the first year of operation under TEL Agreement, that documents were not in Gallaher's hands in respect of delivery to ultimate destination in respect of two customers, one who had been red carded by Mr Tlais (i.e. TSS – see paragraph 914 below) and in respect of a quantity of goods supplied for the Iranian market ex- warehouse Dubai for which the Iranian distributor (i.e. Hazem) was keeping the documents because he was in dispute with TEL.

393 Mr Jack also referred to a consignment of 24,800 cases of Sovereign, coded for Iran, which had been ordered in January and were to provide additional security to the bank in order to secure the release of old stock, about whose age the bank was concerned. These cases had been produced by Gallaher and shipped but due to a number of problems relating to the letter of credit, (which had to be replaced), for which TEL was not responsible, the documents were not presented until May. BLOM had insisted on having the goods surveyed and declined to accept them as security[51] due to the time that they had been in port as a result of which Mr Tlais wanted to order the same quantity again. Mr Tlais wanted to explore the possibility

[50] This was unduly favourable to TEL. There are no written agreements between TEL and its distributors.
[51] There was an issue as to whether they were acceptable. Mr Jack asserted that they were. Mr Clarke claimed that they were not because they were beginning to spot.

of selling the first consignment with a secondary code to be put on the packs for tracking and tracing purposes.

394 Reference was made to the fact that Sovereign continued to be high on the seizure list. This was represented as attributable to two main factors; (a) residual stocks supplied to Namelex and CT Tobacco remaining in the market and (b) a degree of sweeping up of product on account of the high demand from the transit segment. It was no longer necessary to suspend Sovereign production.

395 HMCE were told by Mr Tlais at the end of the meeting about the damaged Iranian Dorchester stock. He explained that he had stock coded for Iran which he did not want to sell there, not because it was unfit for human consumption, but because it was not of top standard and he did not wish to damage Dorchester's reputation by putting it in the market. He asked what HMCE's attitude to his selling it elsewhere was. HMCE said that they had no objection in principle provided that due control was exercised over where the goods were sold and it was possible to track and trace them.

396 Mr Tlais agreed with Mr Rolfe that he would take the goods which the bank had rejected anyway and pay for them by cheque. In January 2004 he was to complain that customers were returning them due to their condition.

Meetings with Mr Fawaz

397 Mr Clarke's evidence was that in late July or early August 2003 at dinner one night Mr Fawaz asked for TEL's help in removing Mr Jack from the business and said that in return he would assist Mr Tlais obtain regular supplies of Sovereign. Mr Fawaz denied that any such conversation took place. I am not satisfied that a conversation in those terms took place. It seems to me implausible that Mr Fawaz would think that he could obtain such assistance from TEL or that he would see the need to seek it. I accept Mr Fawaz's evidence that he had a discussion with Mr Clarke in which he pointed out that not all decisions were taken by Mr Jack, and that decisions within Gallaher were usually taken by consultation and as a team and that in the end Mr Jack had to defer to Mr Fawaz himself or to Mr Rolfe. I also do not accept that Mr Fawaz said that Mr Saad, who was his superior, was "*my man*" in the sense that he could exercise control over him.

Attempts to renegotiate the TEL Agreement

398 After his discovery that Mr Tlais had been involved in selling goods into Iraq in breach of sanctions Mr Keevil began to have doubts about Mr Tlais' desire to develop a legitimate business. He came to take the view that the best long term solution would be to renegotiate the arrangements made with Tlais in such a way as to give Gallaher direct responsibility for the control and management of the brands, whilst utilising Mr Tlais' contacts to develop the business.

399 In June 2003 Mr Fawaz put forward a presentation for changing the relationship between Gallaher and TEL. Under "*Current Key Issues*" he noted:

"• *Lack of distribution expertise and infrastructures by sub-distributors*

• *Lack of disciplines in the areas of stock control / inventory management*

• *Current activities based on limited market know-how*

• *Gallaher / customs requirements re corporate governance*

…

• *Lack of Supply Chain fundamentals"*

400 He proposed a new Business Model involving the following headline points "*Change from a trading to a strategic platform"*, "*Agree a commission format for [TEL] for the whole of Gallaher portfolio across Tlais Contract markets*"; "*Sell direct to national distributors – one per country*" with a "*Hands-on Modus operandi*" including "*Tight management of sales, stocks and credit for all customers*". These proposals were to be discussed at a meeting with Mr Tlais in Lebanon in August 2003. In an e-mail to Mr Saad and Mr Rolfe of 24th June Mr Fawaz envisaged that Mr Tlais would cease to have an active role in the business and would not hold stock, but would retain a consultancy role and be involved in strategic decisions, and would be paid a commission on all sales to the Territories, for the period of the original contract. In an e-mail to them of 26th June he expressed the view that TEL "*have no potential whatsoever as a distributor and have been proven to have no expertise in the area of distribution*" and, whilst proposing TEL as sole distributor for Lebanon and Syria and a sharing of net profits on the Gallaher portfolio, which was to include new brands, he provided for other distributors in all other Middle Eastern markets.

Meetings in Lebanon

401 On the evening of 18th August Messrs Rolfe, Keevil, Saad, Fawaz, and Jack had dinner with Messrs Tlais, Saveriades, and Clarke and Abu Ahmed, Mr Tlais' secretary and other Tlais family members.

402 On 19th August Mr Jack began the meeting with a substantial presentation of Gallaher's plans for the AMELA region. At some stage a blazing row began in Arabic between Mr Saad and Mr Fawaz on the one hand and Mr Tlais and his brother on the other about who should have control over distribution. Mr Saad referred to Mr Tlais as wanting to strip Gallaher naked. Mr Fawaz probably used a coarser expression. In the end the argument subsided. Mr Keevil concluded that, in the light of the hostility displayed, neither Mr Saad nor Mr Fawaz could any longer be responsible for managing TEL.

403 Before the Gallaher party left Lebanon Mr Fawaz told Mr Saad that on the evening (as Mr Saad understood) of Tuesday 19th Mr Tlais' brother had threatened him and Mr Saad on the telephone ("*It is us or you*"). He had said that the Tlais family would deal with them if they hurt their interests; harm them, if they harmed the Tlais (i.e. members of the Tlais family); and that there would be no limits to what

they were prepared to do to "*you and yours*". I think that something to that effect was said, but probably on 20th August.

404 Mr Clarke's evidence was that at about lunchtime on 20th August, when he and Abu Ahmed were in Tripoli Abu Ahmed made quite a long call in Arabic on a mobile telephone to Mr Fawaz, who was probably in Beirut. This involved a lot of shouting. The conversation took place because Mr Tlais and his brother had learnt that Mr Fawaz had asked for a copy of the TEL Agreement and thought that Mr Fawaz was trying to terminate it. After he learnt of the call Mr Saad hired some security to protect him and his family. A few days after the incident Mr Tlais called Mr Rolfe and said that neither he nor his brother had meant to threaten any physical harm.

405 Mr Griffiths of Gallaher carried out an investigation and made a report on what had happened. He was told, I assume by Mr Fawaz, that the threat to Mr Fawaz and Mr Saad had occurred at lunchtime on 20th August in an hour long telephone conversation; and that Mr Fawaz thought that Abu Ahmed had spoken in the heat of the moment. Mr Fawaz went out to dinner with Mr Tlais and his brother the same evening and matters appear to have been amicably resolved.

406 Whatever happened in Lebanon between 18th and 20th August, on 25th August Mr Tlais wrote Mr Rolfe a warm letter of thanks, and described the plan presented as "*clearly very well thought out and extremely professional in its content*". He looked forward to receiving the revised set of budgets showing how the plan could deliver the level of profit which Mr Saad had suggested. As a result Mr Fawaz travelled to Cyprus on 8th September 2003 for discussions with Messrs Tlais and Clarke.

407 After this meeting Messrs Rolfe and Keevil decided that a substantial TEL order for Sovereign to be supplied for Iraq, Iran, Yemen and Syria, should not be fulfilled until at least the following issues had been resolved:

(a) Ensuring that the order was commensurate with market demand.

(b) Assurances that the goods would be going to the market for which they had been ordered. Messrs Rolfe and Keevil wanted details of TEL's customers and routes to market; and required provision of evidence of shipment to market within 7 weeks of TEL receiving goods from Gallaher;

(c) Further details of the letter of credit financing the order;

(d) A commitment from Mr Tlais to obtain before shipment production of the missing documentation from Hazem; a certificate of destruction of 33,505 cartons of damaged Dorchester in Dubai (which was later obtained); the resolution of the duty position on damaged Dorchester and an agreed plan for shipping direct to market.

408 On 18th September Mr Fawaz visited TEL in Cyprus for a further meeting to explain these requirements and others. A meeting between Mr Fawaz, Mr Tlais, and Mr Clarke was secretly recorded by TEL. A 30 minute tape was disclosed in July 2006.

This was a section of a much longer tape which was only provided in April 2007 following an "unless" order. According to Mr Clarke the failure to provide the full tape was because he could not remember where it was. I found this explanation unconvincing. Much of the transcript of the tape is difficult to follow but parts of it confirm Mr Fawaz' evidence that, on this, as on other occasions, there was discussion about the withdrawal of Sovereign in which Mr Tlais made reference to various different sums that he needed to have covered if Sovereign was to go, his principal concern being to ensure that he was put in a position where he could pay off the bank – for which he said he needed something in the order of $ 30 million.

409 In a fax of 1st October 2003 Mr Fawaz set out what he understood to be an agreement reached in principle at the meeting in September 2003 as to the fulfilment of Gallaher's requirements if it was to continue shipping product:

(i) Orders were to be commensurate with market demand;

(ii) Messrs Jack and Fawaz were to conduct a review of documents in Gallaher's files relating to previous shipments, followed by a programme of market visits to determine whether orders were commensurate with demand;

(iii) Final in-market distributors were to provide monthly sales and stock statements;

(iv) Assurances in writing were to be provided with each future order that the specific volumes requested were intended for their stated destination;

(v) TEL was to provide a list of customers by market with, in the event of direct shipments, full consignee details by order. In the case of shipments to intermediate destinations details of the final customer were to be supplied with order and not retrospectively;

(vi) Shipping documents were to be provided within 7 weeks of receipt; Mr Fawaz was to seek agreement from Gallaher for a variation of this time scale to 10 weeks,

(vii) Letters of credit were to be submitted in draft first. Orders for shipment to intermediate ports were to be accepted but only up to the end of the year.

(viii) Future shipments were to be made direct to market and to carry appropriate market labelling as required by local legislation.

There were three further housekeeping requirements: (a) missing documents from Hazem were to be supplied no later than Mr Jack's visit to Iran scheduled for October; (b) a destruction certificate for the goods in Dubai was to be provided by end of September; (c) Mr Tlais was to advise by the end of September if recovery of the Iranian duty on the damaged Dorchester could not be achieved.

410 On 3rd October 2003 Mr Tlais wrote to Mr Fawaz. He did not deal with the requirements that Mr Fawaz had outlined, saying that no formal agreement had been reached and that he had requested a formal meeting with Mr Rolfe to finalise a way forward for both parties. His letter of 2nd October to Mr Rolfe had asked for a formal meeting, to be attended by Messrs Northridge, Rolfe and Keevil only, to produce "*clear decisions from your side as to our future*". Mr Rolfe agreed that such a meeting should take place but asked for a detailed response to Mr Fawaz's fax of 1st October in advance. This did not come.

411 Mr Fawaz viewed what he regarded as Mr Tlais' attempt to exclude him and Mr Saad from the meeting as indicating a wish to avoid making the new arrangements work; and Mr Tlais' overriding objective as the retention of Sovereign; and that the more Gallaher gave, the more Mr Tlais would demand. He favoured exploring the termination route.

412 In November 2003 Mr Tlais telephoned Mr Keevil said that he had secretly recorded meetings with Mr Fawaz, in audio and video, in which Mr Fawaz had made improper suggestions as to the conduct of future business¸ involving a suggestion that Mr Tlais and Mr Fawaz should work together against Gallaher's interests. Any such recordings have not been produced.

Meeting in Weybridge – 8th December 2003

413 Mr Tlais' meeting with senior management eventually took place on 8th December 2003 in Weybridge. On 20th November 2003 Mr Fawaz sent Mr Keevil an e-mail in which he complained of the exclusion of him and Mr Saad from the discussion, complained that the Tlais affair was being badly managed, and referred to a

> *"reluctance to acknowledge that [TEL] is a DNP reexporter, primarily to the UK, not a distributor. Their interest lies in continuing to receive stocks for reexports and credit for goods already received".*

414 By the time of the meeting the increasing level of seizures of goods supplied to TEL underscored the need for some change of arrangement which would give Gallaher more control. The problems with production of adequate documentation and up to date sales and stock reports (about which Mr Jack had corresponded with Mr Tlais on 22nd September and 4th December) had continued, although a stock report in a letter faxed on 3rd December 2003 was received by Mr Jack after he had written, but not dispatched, his letter of 4th December.

415 At the meeting Mr Tlais made an attack on Mr Fawaz, whom he said was trying to damage his relationship with Gallaher. He referred again to recorded conversations with him after the row in Beirut in August. He claimed to have stock levels of 190,000 cases of various different brands with a further 24,800 cases about to arrive. By the end of January the stock would be mainly Dorchester. The main Sovereign markets were Iran, Afghanistan, Pakistan and Yemen. Direct shipment could not begin because it was still necessary to mix Lights from the Old Stocks

with the full flavour ones in order to sell them. By this time Dorchester intended for Libya, one of TEL's territories, had started arriving in Nigeria, which was not a TEL territory and was an important market for Gallaher. TEL had been shipping goods for Libya to Cotonou in Benin, for overland transport via Niger and the Sahara to southern Libya. Mr Tlais blamed the diversion on spotting.

416 The Cotonou – Niger/Chad – Sahara Desert to Libya route is the so called "*tribal route*", which was, according to Mr Jack, an established "*semi-legitimate*" route by which it was possible to sell to tribes that supported Colonel Gaddafi. That is what he assured Mr Rolfe and Mr Fielden. TEL produced evidence to Gallaher of shipment by Adam Trading to Cotonou without any demur from Gallaher.

417 It was agreed that Mr Jack and Mr Clarke would meet in January 2004 to agree a new draft business plan, intended to cover the next 3 years, providing for transition to direct to market sales as soon as possible.

418 The upshot of the 8th December meeting was to confirm Gallaher in its view that it was necessary to change the business structure and that the relationship between Mr Fawaz and Mr Fawaz had irretrievably broken down. In January 2004 Mr Fawaz was removed from the reporting line to concentrate on Africa and Latin America; Mr Jack was thereafter to report directly to Mr Rolfe and to have day to day responsibility for the Middle East.

2004

The Jack/Clarke plan

419 Mr Jack and Mr Clarke met early in January 2004 to discuss a detailed business plan for 2004-6 a draft of which Mr Jack circulated within Gallaher. It included a number of proposed control measures. The draft was not acceptable to Gallaher for a number of reasons including:

(i) The plan envisaged a dozen territories continuing to require a 'global English' health warning.

(ii) Sovereign was to continue to form a large part of TEL's business (55% of sales).

(iii) Parts of the plan were factually questionable – such as the assertion that Parsian Fougan controlled "*a large part of the imported cigarette marke*t" in Iran. This was contrary to the experience of Mr Rolfe when he had visited Iran, and contrary to Mr Fawaz's information.

(iv) The plan suggested a contract manufacturing agreement with TEL which would mean that TEL's own brands would be in competition with those of Gallaher. The plan also continued to use marginal costing.

The arrival of Mr Hainsworth

420 Mr Hainsworth, a man with forthright opinions but no previous relationship with TEL, had been responsible for Gallaher's business in the CIS, and was based in Moscow. On 5th April 2004 he took over responsibility for the AMELA region[52]. He was somewhat reluctant to do so. Mr Rolfe asked Mr Hainsworth to review the plan. Mr Northridge, at whose insistence he had agreed to take up the position, told him to have a look at the proposed plan to see whether it was any good and then reformulate how Gallaher could do business in the region.

421 Mr Hainsworth's comments on the plan were scathing. He described it to Mr Perks as "*truly the worst sales plan I have seen in my life*", involving Gallaher "*selling product to Iran at NEGATIVE contribution while Tlais make a guaranteed 8% and the importer (normally a Tlais subsidiary) makes 20%*". He pointed out in an e-mail to Mr Perks, Mr Rolfe and Mr Keevil, that the P/L information showed that Gallaher were selling at negative margins before marketing; and that the idea of brand launches of Sobranie Classic ("*only worked in Kaz*") and a "*completely unknown*" Gallaher Red were laughable. He noted "*I do not see any economic argument to continue Sovereign Classic sales, especially as it is evidently impossible to track, it exposes the company to great legal risks in the EU, far beyond any debt owed or potential contractual dispute*". He also noted that the proposal involved "*selling to some countries that are very difficult if not impossible legally due to monopoly status like Egypt and Libya! You have to question where the real intended location is*". He was critical of the lack of reference to the sales mix and the absence of a brand strategy (i.e. an analysis of what segment was being aimed at, what were the unique selling points etc). He was also critical of the continued use of marginal costing for certain new markets, and what he saw as a failure to provide for proper marketing and brand support.

422 Mr Hainsworth asked Mr Jack to revise his calculations and prepare an adjusted plan with substantially less Sovereign, a reduced number of countries, a lower number of brand and SKU (stock keeping unit) launches and an assumption of manufacture in Poland rather than the UK.

423 Mr Hainsworth's view was that Gallaher should extricate itself from its involvement with Tlais, that Mr Jack and Mr Fawaz should take no future part in the AMELA business and that Sovereign Classic business should cease because it was a transit band. He thought that some form of settlement would be the best solution because of the breakdown of trust that had occurred between Mr Tlais and Mr Fawaz.

424 From this time onwards Mr Hainsworth dealt with plans for the future and Mr Rolfe and Mr Keevil were responsible for dealing with the problems from the past.

HMCE's concerns

425 On 28th January 2004 Messrs Jeffery and Jack met HMCE (Mike Barrett). HMCE reported that for the current fiscal year Sovereign represented the most seized brand of non-counterfeit cigarettes. Of the seizures in excess of 500,000 sticks, Sovereign cigarettes supplied to TEL represented 22 million; those supplied to Namelex (and

[52] This division, with the addition of India, was then renamed "*Developing Markets*" and restructured. Mr Fawaz was made redundant shortly afterwards. Mr Fawaz and Mr Hainsworth plainly did not get on.

possibly, therefore, part of the Old Stocks) 7 million. 14 million Russian Sovereign packs (not supplied to Namelex or TEL) had also been seized.

426 On 4th March Mr Jeffery and Mr Keevil met Mr Byrne and Mr Wells for their normal six monthly review. HMCE reported its concern that Sovereign was likely to be the most seized of all brands in the UK in 2003-4 as it had been in 2002-3. Namelex seizures appeared to be on the decline but seizures of Sovereign sales to TEL coded for Iran, Yemen and Sudan were on the increase. The fact that seizures were not limited to goods supplied to one country suggested to HMCE either a widespread problem amongst TEL's distributors and lack of due diligence on the part of TEL or TEL involvement.

427 HMCE felt that the use of global English health warnings increased the risk of diversion. It referred to the fact that Gallaher was the first company to sign an MOU; and indicated that, were it not for that relationship and the steps that Gallaher had taken to control the business, HMCE might already have taken a more aggressive approach. Matters were left on the basis that if Gallaher wished to avoid a red card being issued (either against the whole business or in respect of sales of Sovereign to Tlais) immediate action need to be taken to stop Sovereign sales to Tlais and to use local health warnings in future. HMCE recognised that some time would be needed to discuss things with Mr Tlais. It was agreed that Gallaher would report back by the end of May. Customs would stop short of issuing a red card meanwhile against Gallaher's undertaking to accept no new orders for Sovereign pending discussions with TEL and Gallaher reporting back to HMCE.

428 On 11th March Mr Jack notified Mr Tlais that Gallaher would accept no new orders for Sovereign pending a review and further discussion.

429 On 24th March Mr Wells of HMCE wrote to Mr Jeffery stating that HMCE would want to assess the efficacy of the measures taken (the removal of Sovereign and the use of local only health warnings) and to discuss the impact on seizures in about two months.

Mr Keevil and Mr Jack's visit to Cyprus

430 On 24th and 25th March Messrs Keevil and Jack met TEL in Cyprus. The meeting began with a litany of complaints against Mr Fawaz. Mr Tlais maintained that it would take two years to phase in any replacement for Sovereign. He wanted a further 1 billion sticks to enable him to collect outstanding receivables and honour commitments. Mr Tlais and Mr Clarke said that TEL had debts of over $ 40 million and stocks worth about $ 8 million. Mr Keevil and Mr Jack then proposed an arrangement (which they said would require Board and HMCE approval) whereby TEL should become an agency (not a distributorship). This was put forward as a means of meeting HMCE's concerns and as something that might well also permit a continuation of sales of Sovereign, which would be largely under Gallaher's control. Mr Tlais agreed that Gallaher should develop this proposal as a way forward, whilst expressing the need for money outstanding from the destruction process, i.e. compensation in relation to the destruction of the Arabic goods, to be given to him: see his letter of 7th April.

The second Jack/Clarke plan

431 By the end of April Mr Jack had compiled, in consultation with Mr Clarke, a further planning document entitled '*Tlais Enterprises – Proposed Structural Revisions*'. It included forecasts of 4.5 billion sales in 2005[53] generating $ 13.3 million net margin for Gallaher (before advertising and selling costs) and $ 6.9 million of commission for Tlais. It also proposed an income guarantee of $ 5,000,000 for 10 years[54], upon the footing that the agency agreement would greatly reduce TEL's earning potential. Mr Rolfe thought that the volumes looked highly optimistic and the size of the commission unworkable. He asked for Mr Hainsworth's views.

432 Mr Hainsworth was unimpressed. In particular he objected to (a) the excessive quantity of Sovereign which Mr Jack envisaged TEL selling – 42% of sales compared with 55% in the January plan; (b) the fact that the expected sales of Dorchester were not supported by any research or backing in terms of size of market; (c) the inclusion in the plan of sales to countries such as Libya and Egypt where legitimate importation could only take place through the existing monopolies; (d) what he regarded as unrealistic expectations of sales of Sobranie. If, as he suggested, sales of Sovereign and sales to Libya and Egypt were removed, Dorchester and Sobranie expectations were reduced, and marketing costs taken into account, there was no resultant profit.

433 He was also concerned that under the plan Gallaher would make direct deliveries so that TEL could disclaim responsibility to HMCE and would not be subject to red carding but would retain a degree of control of what the distributors did - so that Gallaher might be at greater risk than before.

434 Mr Hainsworth revised these calculations further. In one version he removed all Sovereign sales on the ground that it was no longer appropriate to supply the brand, reduced the Dorchester level to one that he regarded as more in keeping with a Virginia cigarette, removed all sales to countries where importation to the domestic market was in practice impossible and altered the targets for Sobranie. This produced a total of about $ 2 million gross profit with $ 750,000 commission for Mr Tlais. But to do that would, he estimated, require $ 2 million in marketing costs. So in the first year there would be no profit at all. An alternative calculation which involved focusing on Iran, Iraq and Lebanon, would produce profits of less than $ 450,000 after deduction of marketing costs of $ 1 million and before deduction of TEL commission.

435 Mr Hainsworth's instructions from Mr Northridge around this time were that he was to take a fresh perspective on the business and to use his best endeavours to try to make matters work.

[53] Sales in 2002 had been 4.5 billion and in 2003 0.6 billion

[54] Gallaher had never given a distributor any income guarantee. The proposal of a $ 5 million income guarantee may well have been made by Mr Tlais at the March meeting.

The follow up meeting with HMCE

436 On 28th May 2004 Mr Keevil and Mr Jack met Mr Byrne, Mr Wells and another HMCE representative. In advance of the meeting Mr Jack had sent to Mr McCallum a list of the sanctions that TEL had applied to its customers such as red carding TSS, putting supplies to Drilon on hold, and ceasing to deal with certain distributors etc. Mr Keevil had written to HMCE in advance identifying as areas for discussion (i) TEL's perspective on the Sovereign issue and the importance to it of continued supply; (ii) HMCE's attitude to a "run off" period if Sovereign were removed from the brand mix; (iii) HMCE's attitude to Gallaher supplying Sovereign to distributors direct in the current TEL territories if TEL became an agent.

437 Mr Byrne did all the talking. He left Gallaher in no doubt that HMCE regarded the level of seizure of Sovereign in the UK as very serious. Between April 2003 and March 2004 Sovereign accounted for 56% of all seizures (in excess of 500,000 cigarettes) of genuine product. Between January and April 2004 it accounted for 65%. HMCE's concern was increasing and the trend was damaging UK revenue. He said that this conversation with HMCE was to be taken as a second serious warning. HMCE was being pressured from several quarters. Comments about whether Gallaher was genuinely committed to its MOU had been made by the Treasury and the Public Accounts Committee. Gallaher was invited to sort the position out and meet again in 2-3 months. It was made plain that any decision to be taken was a commercial matter for Gallaher to decide. HMCE also expressed concern at the level of stocks that TEL had; and expressed the view that, if Sovereign was removed, it did not want to see the position repeat itself with Dorchester.

Sovereign is deleted as a brand and Gold Bond proposed instead

438 In the light of that meeting Gallaher decided to delete Sovereign from the brands available to TEL under the TEL Agreement. On 8th June Mr Keevil informed TEL, and HMCE of this decision, which was expressed as an exercise of Gallaher's entitlement under clause 6 (ii) of the TEL Agreement. Gallaher proposed Gold Bond as a replacement brand. Gold Bond was not widely known outside the Middle East and Africa; and therefore presented a lesser risk of smuggling.

Counter proposals

439 Mr Jack met Mr Tlais shortly thereafter. The upshot of their discussions was a recommendation from Mr Jack that, instead of amending TEL Agreement to substitute Gold Bond for Sovereign, and in recognition of the pressures on TEL's business as a result of the withdrawal of Sovereign, TEL should become an agent, with a $ 5 million a year profit guaranteed for three years. This proposal was contained in a document, favourable to TEL, entitled "*TEL Response to Gallaher Proposal in Respect of Gold Bond and his detailed Counter Proposals*". In the course of the document Mr Jack expressed the view that in considering whether the Sovereign seizures represented a lack of control and a matter of concern going forward consideration must be given to the fact that Mr Tlais had continually pressed for a replacement; had been open about the fact that complete control over Sovereign was not possible because of the demand for it by smugglers against

which background he suggested that seizures were "*minor*" in the context of the volume shipped.

440 This was not acceptable to Gallaher, not least because of the demands that it might generate from other distributors. Gallaher offered – by Mr Jack's letter of 15th June – to add LD (an American blend) as a brand, in addition to Gold Bond. LD is Gallaher's biggest seller by volume.

Mr Tlais writes to Mr Northridge

441 Mr Tlais' response was to write, on 16th June 2004, to Mr Northridge. He referred to the fact that he had been asking for a replacement for Sovereign since the beginning of the relationship; accepted that Gold Bond and LD had a good future with time and investment; but said that Gallaher had put him in a position where he had neither the time nor the resources to build these brands. He claimed that all of the mistakes of the previous two years in relation to Sovereign were down to Gallaher and not him and that he was not prepared to pay the price for them. He referred to:

> "*specific problems involving Gallaher staff who were encouraging the smuggling of the brand and making sales behind my back to my own customer and to individuals who were fronting for people who were on the customs blacklist*", and to
>
> "*many other things that have come to light that you may or may not be aware of and before we go down a road from which we cannot return I believe it is my duty to inform you fully of everything that has taken place…*"

442 In an e-mail of 20th June 2004 to Mr Rolfe Mr Hainsworth recorded that it seemed that "*we are not going or unable to close the Tlais contract*". He asked to take over full control of the contract negotiations and pay Mr Tlais an agency fee. Mr Rolfe agreed that he should.

443 In the same e-mail Mr Hainsworth expressed his view of Mr Jack:

> *"We need to urgently draw the line with Norman who is loose cannon at best. He is not reporting to me or anyone else by the way he is operating."*

In September Mr Jack was seconded to Gallaher's group security and brand protection team.

The meeting with Mr Northridge on 23rd June 2004

444 A meeting was arranged for 23rd June in Weybridge. In a letter of 18th June to Mr Keevil, who had written to him the previous day to set out certain key points, Mr Tlais claimed that Sovereign produced a profit of $9 million during the first trading year. He also complained about Mr Fawaz *("I am still living with his legacy and am paying the price daily for your errors in judgment*"). In respect of his contention

that Sovereign should have been withdrawn sooner coupled with a continued desire for Sovereign, he observed:

> *"It is true that the new business plan produced by Mike and Norman in January contained significant quantities of Sovereign, but I would point out that Stateline had been withdrawn, Dorchester was building back year on year as the market cleared through the damaged product. Without any new brands available to Tlais what do you expect? As I have to produce a minimum of $5 million a year to survive."*

445 The meeting was attended by Messrs Northridge, Rolfe, Keevil, and Jack for Gallaher and Messrs Tlais, Clarke and Saveriades for TEL. Mr Northridge said that HMCE's concerns about Sovereign were now such that continuation of the brand was impossible. Mr Tlais spent considerable time expressing the several dissatisfactions that he had expressed in the past. He said that he had with him a lawyer representing Dr Al-Mahamid who was planning legal action against him as a result of the removal of Sovereign and other matters. The lawyer would remain in London awaiting advice on the settlement of matters with Gallaher.

446 Mr Rolfe outlined Gallaher's offer (as an alternative to continuing with the existing distribution agreement) which Mr Jack later set out in a letter of 25th June. It involved:

(i) the introduction of LD and Gold Bond as brands.

(ii) the replacement of the distributorship agreement by an agency agreement with a minimum term of five years under which there would be an equal sharing of the net profit after deduction of marketing and selling costs

(iii) Gallaher would give guarantees of income. In respect of year 1 that would be the balance of the blocked deposit (i.e. $ 3 million after allowing for the $ 1 million repayment in respect of each of years 1-2), less an amount to be used to offset outstanding stock destruction costs. In respect of years 2 and 3 there would be a guarantee of minimum earnings of $ 2,500,000 for each year.

447 On 24th June Mr Tlais told Mr Jack that he could accept $5 million per year in years 1 and 2 and $ 2.5 million in year 3; on the basis that his bank, who had not received anything for the last five months, required him to provide $ 15 million over three years. On 7th July Mr Rolfe told him that before Gallaher could commit to that proposal or make any counter-proposal it would be necessary to resolve the stock destruction claims and estimate the likely level of sales and profits under any agency arrangement.

Gallaher's attitude to Tlais

448 TEL contends that certain key individuals at Gallaher were intent on extracting Gallaher from the TEL Agreement; and that the negotiations in 2004 to replace the TEL Agreement were conducted in bad faith and broke down because those individuals had taken against TEL and not, as HMCE were told, because of concerns about TEL's control of goods.

449 There is no doubt that Mr Fawaz had a very low opinion of Mr Tlais and would have been glad to see the back of him. An AMELA plan drawn up at the end of 2002 by Mr Fawaz and Mr Saad expressed a need to negotiate an immediate exit from the TEL Agreement. Mr Fawaz was not concerned in the negotiations for a new agreement in 2004.

450 In June 2003 Mr Northridge had indicated that he wanted a presentation to the Board to consider the current strategy and options for AMELA including "*Tlais exit, cooperation, or our own organic business"* although "*Tlais exit*" does not seem to have been given much serious consideration. In October 2003 Mr Fawaz had recommended further exploration of the termination option: see paragraph 411 above. At an Audit Committee meeting of Gallaher Group Plc on 4th December 2003 the Committee noted that management aimed to review matters in 2004 to consider "*whether exit opportunities existed*".

451 Mr Hainsworth was not impressed with Mr Tlais either and thought that Gallaher should seek to extricate itself from the TEL Agreement: see paragraphs 420-424 above. In his e-mail of 20th February 2004 to Mr Perks he said *"I am not going to let this drop. There would be no Tlais and no Norman and no Sovereign Classic business, otherwise they can get someone else to do the job*". He thought that Mr Keevil and Mr Rolfe were "*all on the same page*" as him.

452 In those circumstances, and in the light of the difficulties that Gallaher was having in its relationship with TEL, the possibility of Gallaher buying out the TEL Agreement or terminating it was, from at least the middle of 2004, in Gallaher's collective mind. When Mr Hainsworth sounded Mr Jack out on the former the numbers suggested were too large. Mr Tlais was prepared to be bought out if his liability to the bank was covered.

Heads of Agreement

453 The fact that Mr Hainsworth held the views that he did does not mean that Gallaher was acting in bad faith or failed to negotiate. His evidence, which I accept, was that in July his aim was "*to avoid litigation, to allow Gallaher to make a profit where it had been making losses and of course to minimise the risk of our products being smuggled*".

454 By 23rd July 2004 Heads of Agreement had been agreed, subject to contract. On that date there was a difficult meeting attended by Messrs Hainsworth, Rolfe, Keevil, Murden and Jack for Gallaher and Mr Tlais and Mr Clarke. At one point, when an impasse had been reached, Mr Hainsworth telephoned Mr Northridge who told him to try to do everything possible to reach a settlement which Gallaher could live with.

Mr Northridge was aiming to achieve a settlement of all the issues: an arrangement for the future that would give Gallaher more control, the Old Stocks, the 365 day goods, Mr Tlais' guarantee and destruction of the damaged Dorchester.

455 The Heads of Agreement proposed the termination of the TEL Agreement; its replacement with a new arrangement covering at least Iran, Iraq, Syria, Jordan and Lebanon with Dorchester, Gold Bond, LD and Ronson as brands. Key decisions were to be discussed jointly but final decisions on all advertising, pricing and selling matters, in addition to the structure of the portfolios for the territories, would lie with Gallaher. The actual agreement was to incorporate provisions to ensure that neither party should seek to impose unreasonable conditions upon the other. The goods for the new business would be produced in Poland. Indicative ex factory prices were $ 60 per case[55]. The business would be based initially on TEL's existing distributors in respect of whom TEL would take the credit risk. New distributors would be determined jointly. Sales volumes would be commensurate with the duty paid demand in each of the specific markets, or, where specifically agreed, duty free outlets, and all sales would be in accordance with the ITP. TEL would be guaranteed minimum profits of $2.5 million for 2005 and 2006, any profit between $ 2.5 and $ 5 million would be for TEL, and any profits in excess of $ 5 million would be split equally.

456 Profit was to be defined as revenue less cost of sales and also less an indicative sales and marketing budget of $ 3 million per year. Mr Hainsworth considered that this figure, for a number of new brands i.e. Sobranie, Ronson and LD, to be launched across several territories, in addition to the marketing needed for Dorchester, was barely adequate.

457 Following the meeting Gallaher examined the production costs for making the brands that would be sold to TEL. TEL thought Gallaher could do better than $ 60 per case. Mr Hainsworth believed that, once the details were gone into, it would become apparent, and TEL would realise, that the volumes needed to make the business profitable would be very difficult to achieve if TEL was to comply with the ITP. Mr Jack seemed to believe that huge volumes were achievable.

458 On 29th July Mr Hainsworth reported to Messrs Keevil and Rolfe:

> *"You are aware that at the price of $60 per case for Dorchester, LD, Ronson and Gold Bond we effectively make nothing after all our costs.*
>
> *If they sell at $70 which I guess is the most likely price for Iraq, then they would have to sell 3BN a year to cover the marketing costs ($3m).*
>
> *To reach the min guaranteed profit he would have to sell another 2.5BN.*

[55] This was the lowest price that Mr Hainsworth thought achievable assuming Polish production. No one was getting a better one. The final cost worked out was about $ 60.

> *This is highly unlikely, with the exception of Dorchester which has had spotted success, these brands are new to the market and I do not think they have the infrastructure to handle such business. I could only conclude they intend to concentrate on non-Duty paid transit markets which is why Dorchester / Ronson may be a major problem for Gallaher. I did change the design of the LD to ensure that CIS is reduced risk.*
>
> *I hope by conclusion that Tlais will realise that he is unable to make this work within the terms of the Int Trading Policy.*
>
> *I also note that the sales of Sobranie Family are highly subjective and for reference if we sell 100m in Israel in one year I would consider this a good result.*
>
> *I also seriously doubt that Tlais has the banking issues that he makes out, although they are his issues he seems to use them as a leverage against Gallaher".*

459 Mr Rolfe responded:

> *"I agree that it looks difficult to make a business case to deliver his supposed $ 5m+ per annum requirement from the cost and overhead that we have indicated to him, and that does lead to suspicions that he is looking to focus on duty-free activity. I think our approach should be to be seen to be working cooperatively to develop the business options (to continue to make it difficult for him to fallback to a legal challenge route); whilst ensuring that this will be [a] properly controlled and managed operation….*
>
> *I am sure that there will be more twists and turns here and Tlais may well conclude that he can't make it work, but in the meantime, we are buying time and building a fact trail that helps us. In the meantime, despite several requests to improve our offer, we have held the line – as you say, his banking problems (if genuine) are his concern"*

460 TEL submits that the reference to "*buying time and building a fact trail that helps us*" shows that Gallaher hoped that, if it strung things along for long enough, Mr Tlais would slide into insolvency, and was putting together a sequence of correspondence which would give the appearance of trying to support TEL, when Gallaher had no such intention. I take a less cynical view. Mr Rolfe no doubt thought that it would stand Gallaher in good stead, in the event of any legal dispute, to show that it had tried to make things work. He also realised that any arrangements that were made would come under intense scrutiny by the Board, particularly if Gallaher was to give an income guarantee; and time was needed to work out a properly constructed plan with numbers in which he and a sceptical Mr Hainsworth could have some confidence when making any recommendation. He also did not want to improve Gallaher's offer. He did not regard Mr Tlais as verging on insolvency. Indeed he and Mr Hainsworth had doubts as to the extent of Mr Tlais' problems with the banks.

461 Mr Hainsworth's reply was as follows:

> *"He is going to dance around all he can but the fact remains those markets cannot absorb this level of new product overnight.*
>
> *Our competitors have been there for some time with recognised brands.*
>
> *We have all made the best efforts to move it forward but reality is that in emerging markets margins are low and to build volume takes time.*
>
> *His profit expectations are optimistic to say the least, Norman seems convinced that Dorchester will sell very well, I really think he has lost touch of reality."*

"*Neutralising the business*"

462 On 2nd August 2004 in an e-mail to Mr Perks, Mr Hainsworth said:

> *"I hoped that by insisting on Gallaher having $ 3m of marketing p.a. before any profit split we would effectively neutralise the business if shipments are to Duty Paid Market because the volumes become very unlikely i.e. 3 BN p.a. just to cover marketing on $ 10 margins"*

463 Mr Hainsworth had some difficulty in explaining the meaning of the words "*we would effectively neutralise the business*" when he was first asked about it at the end of his evidence on Tuesday 10th June 2007. He appeared to be saying that he was concerned to neutralise the risk to the business; but, if so, his answers did not make much sense. TEL submits that this was because what he revealingly meant was that his hope was to kill off the business. On Wednesday 11th June 2007 he told me that what he meant was that the result of that level of marketing expenditure (covering both advertising and selling) would be that the business would be profit neutral.

464 In my judgment Mr Hainsworth was genuinely perplexed on the Tuesday as to what he had meant. He had used a form of management-speak, which (as often) obscures meaning, that was intended to indicate that at a mooted $ 10 margin the volume of duty paid sales would not support the level of marketing expenditure budgeted for and would thus show the impracticability of the proposal. It was not suggested that this level of marketing expenditure was unreasonable or artificial. I accept his evidence that he took a figure of $ 2.6 million for advertising from an earlier Jack plan and added some more to cover the cost of Gallaher having people on the ground to control the business. This was not unreasonable. The $ 3 million figure was specifically referred to in the Heads of Agreement.

465 Nor do I regard Mr Hainsworth's e-mail as indicating that he had given up on negotiations. After this exchange the parties continued to negotiate and Gallaher made further concessions e.g. by the addition of territories to those specified in the original Heads of Agreement.

466 Mr Paul Murden, who in April 2004 became Gallaher's Vice President, Developing Markets, considered how the new business structure could operate. In late August (by which time Gallaher had added Afghanistan, Pakistan, and Egypt to the list of proposed territories) he went to TEL's head office in Cyprus (which he found surprisingly lacking in facilities and employees for a business of the size that Mr Tlais claimed to have built). He arranged to meet with TEL's distributors – see paragraph 469 below. He became concerned that TEL was seeking to engage in transit business, having regard to Mr Tlais' expressed desire to include markets such as Sudan, Mozambique, Chile, Paraguay, and Libya via Benin, rather than focusing on a few key markets.

467 On 9th September 2004 a meeting took place in Lausanne attended by Messrs Hainsworth, Murden, Jack and Whale for Gallaher and Mr Tlais and Clarke for TEL. When Mr Tlais talked about a guarantee of income, Mr Hainsworth told him that, if he expected Mr Northridge to write him a cheque he could go to Court now. During the course of this meeting Mr Northridge repeated his instruction to Mr Hainsworth to try to make the best deal and to make it work. The meeting ended constructively. In his letter to Mr Tlais of 10th September confirming the upshot of the meeting Mr Hainsworth described it as "*most productive*".

468 Agreement was reached on a number of matters including the following: (i) that a number of territories (Yemen, Sudan and the Gulf States) should be added to those previously decided on; (ii) Gallaher agreed to consider whether an agency structure could be introduced in respect of the Cyprus domestic market (which would be of benefit to Mr Tlais in relation to his refinancing operations); or, if it could not (the decision not being for Mr Hainsworth) Gallaher would introduce Mr Tlais to its bankers with a view to helping him to refinance his borrowings; (iii) the brand range would be extended to include a number of Sobranie variants (in addition to LD, Gold Bond, Dorchester, and Robson), subject to trademark restrictions for particular territories and subject to Gallaher having a right of veto over the precise brand mix for each market; (iv) all products would be subject to double wrapping which would limit the risk of spotting.

469 Later in September Mr Murden and Mr Richard Johnson ("Mr Johnson"), who had recently taken over responsibility for the Middle East, met representatives of TEL's distributors at Adam Trading's offices in Dubai. These were (i) Dr Al-Mahamid; (ii) Hafeezulah and an associate (in respect of Afghanistan and Pakistan); (iii) Wahib Tabra of Jode and Sara General Trading (in respect of Iraq); (iv) Mobbaraki and Hazem of Parsian Fougan (in respect of Iran); and also (v) Jamal Mahmoud of Saman General Trading (in respect of Iraq). Mr Tlais had written to the first four in advance asking them to provide in writing a wide range of detailed information in English covering matters relating to their areas. As he put it:

> *"As we are dealing with a British Company with a limited mentality it is important that you prepare the … information in a manner that caters for this type of individual. A good professional western presentation is essential...."*

470 In the event Mr Murden was not impressed. He did not regard the distributors as having prepared a proper professional presentation with information about their

operations, the tobacco market in their proposed regions and their proposals for developing a market share. At best he thought they were amateurish. He could not see, in the light of the meeting, what value TEL could add to Gallaher's distribution in the Middle East.

471 On 20th September Mr Jack wrote to Mr Tlais a letter saying that he knew that overall Mr Murden and Mr Johnson were, after a modicum of "*culture shock*", impressed with the meetings and the quality of the distributors in the context of the markets. It was suggested to Mr Murden, whose evidence was that he did not see that letter at the time, that his supposedly poor impression was something recently thought up by him or put into his head by another. I accept his evidence that it was not.

Further negotiations

472 On 13th October 2004 a meeting took place between TEL and Gallaher at Weybridge for the purpose of dealing with the issues arising from the Old Stocks and the destruction of the damaged Dorchester. The matters agreed subject to contract were set out in a letter from Mr Rolfe of 15th October 2004. Mr Rolfe expressly reserved Gallaher's position in relation to all of the points in the letter pending resolution of all outstanding issues. It was clear at the meeting that Gallaher would make no cash settlement in relation to the damaged Dorchester until the proposed new agreements had been signed. But Gallaher offered to provide a letter to the bank explaining the position negotiations had reached and that, when the new agreements were entered into, a sum of $ 3,218,501 would be released to TEL.

473 Mr Tlais responded by writing to Mr Northridge on 26th October claiming that the letter of 15th October did not accurately reflect the details of the meeting on 13th, making a number of unflattering remarks about Mr Rolfe, and also reserving his position on all the points mentioned in the letter pending resolution of all outstanding points.

474 On 4th and 5th November 2004 Messrs Keevil, Moxon and Jack met Mr Tlais in Cyprus and reached a subject to contract agreement of principal terms in relation to past dealings with TEL. That they had done so was recorded in a document of 6th November.

The impasse

475 In November 2004 negotiations between the parties in relation to the new agreement reached an impasse. On 10th November 2004 TEL produced comments on a draft Term Sheet that had been produced by Gallaher and sent to Herbert Smith, who were then acting for TEL. Some of these appeared to Mr Hainsworth to be going back on points that Gallaher thought had been agreed. The sticking points were these:

(i) TEL wanted compensation for the removal of any brand from the joint venture company (with 50/50 TEL/Gallaher ownership) which was to be established to sell a portfolio of Gallaher brands through in-market distributors. Gallaher thought that, in practice, this could mean

compensating TEL for TEL's failure to control a brand, thus reducing TEL's incentive to do so. TEL thought this meant that it would suffer even if the reason for the removal of the brand was not its fault;

(ii) TEL wanted Gallaher not to be allowed to appoint another agent or distributor for the territories for brands outside the initial portfolio of distributors. Gallaher thought this would mean that TEL might be able to try and discourage Gallaher from ceasing distribution of the brands, even if they were being smuggled.

(iii) Gallaher wanted the right to remove from the territories of the joint venture any territory for which the business plan target volumes were not achieved in any two consecutive years of a three year plan. Further, if the business plan profits were missed in any one year by a significant factor (to be agreed) either party could terminate the joint venture. TEL regarded this as completely unacceptable since in the rest of TEL Agreement Gallaher "*appears to be seeking control over distributors pricing, marketing and other currently undefined areas*"[56].

476 TEL claims that the negotiations, which (because of a family illness) Mr Hainsworth had now left largely to Jonathan Wale and Suzanne Wise, broke down predominantly as a result of Gallaher's insistence on having the right to remove territories or terminate the joint venture without compensation on account of underperformance by distributors whilst retaining the right to have the final say in respect of the appointment of such distributors. It wanted such a right, TEL submits, because it would afford an easy way for Gallaher to extract itself from the new arrangements in the future. Mr Hainsworth regarded such a provision as standard commercial term in a manufacturer's contract for the distribution of its own products; and thought that no agreement was reached was because there was an issue as to who should be in control of the business.

477 Disputed term (iii) (see paragraph 475 (iii) above) was very much in Gallaher's favour. I do not regard it as unreasonable, from Gallaher's point of view, to have required it, particularly because the issue of control (and the financial consequences thereof) was not at this stage fully resolved as appears from paragraph 6 of TEL's comments on the term sheet which records that "*further discussion will be required to agree the level of responsibility that the Gallaher entity wishes to take, including the financial impact of all decisions taken while in a controlling position*". Mr Hainsworth's recollection was that in the latter part of the year there were disputes over who would have control of the brands, what brands would be sold and in the event of a brand getting into trouble what mechanism would deal with that.

478 In mid November Gallaher receive a letter from a Jordanian lawyer on behalf of Mr Nabil Karam seeking to arrange a meeting "*to discuss the legal aspect arisen [sic] as a result of the supplies of your brands made to my client through your distributor, Tlais Trading Ltd, for importation into the territory of Iraq during the period of 2000 -2001*". Mr Karam had been placed on a blacklist by the US

[56] Under the terms a Gallaher entity was to control the board of the joint venture for the first two years and thereafter was to have a casting vote in relation to advertising, pricing, selling (including the right to appoint a new distributor) and the structure of the portfolios for the Territory.

Treasury as someone playing a key role in Uday Hussein's cigarettes smuggling and racketeering activities[57]. Mr Tlais was aware (because Fadi Nammour told him) that a proposal for doing business in Iraq whilst sanctions were in force – see paragraph 547 below – was to be sent by Namelex to Mr Karam; and he had himself met with a representative of Trading and Transport Service Co, Mr Karam's company, to discuss business for Jordan duty free shops. Gallaher suspected, probably rightly, that this was a tactic employed by Mr Tlais to indicate that he could embarrass Gallaher if Gallaher did not sign up to a commercial deal.

The TEL red card

479 Gallaher had hoped that, with Sovereign deleted from the brand mix, the quantity of goods supplied to TEL that were seized would reduce. What happened was that seizures of Dorchester began significantly to rise.

480 On 2nd September 2004 Mr Jeffery wrote to Mr Tlais reminding him that until such time as new arrangements were entered into the TEL Agreement remained binding on TEL and Gallaher. He reminded him that:

> *"Under that agreement, in respect of all sales made by Tlais Enterprises Limited you have various obligations, including:*
>
> *a. To comply with our Policy on International Trade;*
>
> *b. To ensure that sales are intended for final sale to consumers within your territories;*
>
> *c. To supply us within 7 weeks of any shipments with evidence of the shipment of the order to the appropriate territory;*
>
> *d. To keep paper records showing clearly all sales made by you; and*
>
> *e. To ensure that anybody to whom you sell goods complies with our Policy on International Trade"*

481 Mr Jeffery told Mr Tlais that it was critical that he was able to explain to HMCE why there had been seizures of Dorchester. He referred to (a) a seizure in Poland involving 2 million Dorchester and 6 million Sovereign destined for Iran and Sudan and another seizure of an unspecified quantity of Dorchester and Sovereign; and (b) two recent seizures in Spain consisting of 3 containers (30 million) of Dorchester supplied to Namelex/Highstreet and 1 container of 9 million Dorchester supplied to TEL. In addition HMCE had so far notified Gallaher of UK seizures of some 56 million Dorchester supplied to TEL. He recalled that, when Mr Tlais had met HMCE in Cyprus in 2002, he had made clear that he believed there was no issue with Dorchester supplied to Highstreet as Highstreet was fully under his control.

[57] He appears also to be the subject of a Notice issued by the Bank of England on 7th June 2004 giving directions under the *Iraq (United Nations Measures) Order 2000*, whose effect was to require all UK financial institutions to freeze any accounts held for him and forward them to the Development Fund for Iraq.

482 He added:

> *"I am very concerned at their potential reaction if I simply supply them with your current explanation[58]. In the circumstances, I must ask you to provide me with details of:*
>
> *i. The parties to whom you have supplied Iranian and other Dorchester product in Libya, Afghanistan, Iraq and elsewhere;*
>
> *ii. The countries within Latin America and parties to whom you have supplied Dorchester;*
>
> *iii. The volumes of Dorchester that were mixed with Sovereign and the parties to whom you supplied these goods;*
>
> *iv. Given your obligations to ensure that sub-distributors to whom you sell product comply with our Policy on International Trade, the steps that you took to ensure that your customers exercised proper control and management over goods that you supplied."*

483 On Friday 15th September Mr Jeffery met Mr Byrne. Mr Byrne told him that Sovereign remained the most seized non counterfeit brand. On 24th September Mr Jeffery, having had no response to his letter of 2nd September 2004, wrote to Mr Tlais again saying that it was absolutely essential for Gallaher to demonstrate that TEL was adhering to its responsibilities under the TEL Agreement. He expressed the view that there was a real risk of HMCE "*extending the red card*"; and asked for a full response to his questions by Friday 1st October prior to the meeting with HMCE in 4th October.

484 Mr Tlais' response came on 1st October 2004. He complained that the bulk of information that had been passed to him about seizures was of little or no use as it only dealt with quantities of goods forming part of a larger production batch In reply to the letter of 2nd September 2004 he said that it was in fact agreed that:

> *"I would TRY and control up to 80% of the business during the one and a half years initial period. I also requested a replacement for Sovereign that had previously been in the hands of smugglers"*

485 He said that he had relied on Gallaher to present HMCE with an accurate and detailed narrative of the problems he had encountered and the level of cooperation that had been extended from his side to support the business. He referred to the verbal information covering a wide range of issues to prevent smuggling that he had provided to Mr Jack at each meeting with him. He acknowledged that "*until such time as the new arrangements are agreed the existing agreement is binding on both parties"*, that he was fully aware of his obligations under (a) – (e) and had complied with them. As to Dorchester he referred to the spotting problem, the fact that he had halted sales at the beginning of 2003; that he had been told to sell the damaged Dorchester for "*best value*" and had proceeded to ship them primarily to Iraq, but that most customers would not pay.

[58] Which was that the problems had arisen because TEL had supplied damaged Dorchester to various territories mostly on an FOC basis.

486 In essence his response to the questions posed of him was:

(i) These details had been provided to Mr Jack

(ii) TEL only had one distributor for Latin America and the individual destinations appeared on the bills of lading supplied to Gallaher;

(iii) This information was on the bills of lading passed to Norman Jack

(iv) All sub-distributors had signed the ITP.

487 Attached to the letter were a number of bills of lading and other shipping documents, some of which contained no reference to TEL or Adam Trading, and which for the most part referred only to volumes of cigarettes and not the brands. A number of Dubai customs bills were unstamped. The bills of lading for Latin America added up to only 4,870 cases (not 6,000 as had been referred to by Mr Tlais in a letter of 29th January 2004[59]). None of them related to Libya. Mr Clarke said that Mr Jack had seen documents relating to Libya of which Gallaher did not keep copies, but there is no means of knowing whether that is so. These documents did not meet the standards expressed in Mr Jack's letter of 21st July 2003 (in particular items (a) (b) and (d)): see paragraph 381. Mr Clarke's view was that, given the problems with the product, Gallaher was lucky to get anything at all.

488 On the same day Mr Tlais faxed to HMCE a letter, wrongly dated 1st September, which he attached to his letter to Gallaher, saying that TEL had sent Gallaher all the documents requested by Gallaher and reiterating TEL's strong commitment to combating smuggling. The letter expressed TEL's happiness to supply any further documentation required and encouraged a dialogue between the parties "*to ensure that as clear a picture as possible is gained with respect to the situation with the Dorchester brand*".

489 On 4th October 2004 Mr Jeffery met Mr McCallum and updated him on negotiations with TEL. He told him what brands and territories the new arrangements would cover. He also discussed Mr Tlais' offer to meet with HMCE which Mr McCallum said he would consider once the new agreement had been signed. On 24th November 2004 Mr Jeffery, who now regarded a red card as highly likely, met him again. He explained that outline terms had been agreed regarding the old stock (about the disposal of which in an uncontrolled manner HMCE was concerned) and that everyone at Gallaher was aware of the importance of seeking to ensure that such cigarettes did not form part of an illicit trade. Mr McCallum expressed serious concern at the level of seizures of Sovereign and Dorchester cigarettes supplied to TEL. He expressed a personal view that the level of seizures of Sovereign and

[59] TEL's customer account for Latin America only refers to the release of 2,000 and 3,000 cases in July and September 2003 and the release instructions show that these releases were of M (July) and N (September) production..

Dorchester warranted a red card but said that he intended to discuss the matter further within HMCE.

490 On 30th November 2004 Mr Jeffery telephoned Mr McCallum. His note to himself, from which he spoke, included the following:

> *"As you know we have been trying over the last six months to find a way to reengineer the business model with TEL to make the controls and management as watertight as possible. We are not there yet and we have increasing concerns that we will ever achieve this with TEL. The commercial discussions are ongoing and could well break down – we will know in the next few weeks …If they do break down then we would understand why you want to issue a red card given that between us we have done everything possible to make things watertight. As you mentioned, we agreed protocols with TEL in 2003 and despite the assurances given about Dorchester there have been ongoing seizures.*
>
> *If you do issue a red card, then under the contract we would have to formalise the suspension of our distribution agreement which would ensure no further sales."*

Mr McCallum said that HMCE had to date recorded for 2004 seizures of 126 million Sovereign and 62 million Dorchester cigarettes, which on the assumption that about 10% of smuggled goods were seized, suggested that over 1 billion Sovereign, and over 500 million Dorchester had been smuggled.

491 On 2nd December 2004 HMCE published its paper "*Measuring and Tackling Indirect Tax Losses – 2004"*: see paragraph 12 above. The paper estimated losses to the Treasury from smuggling in 2003 - 4 at £ 1.9 billion. It showed that, in respect of seizures of over 500,000 sticks, genuine UK brands accounted for 28% of seizures by HMCE. Of that 28%, 58% were Sovereign and 16% Dorchester. In other words 74% of all genuine UK brand seizures of over 500,000 sticks were of Gallaher products. The proportion of all genuine brands seized was about 45%.

The Meeting with HMCE on 7th December 2004

492 On Tuesday 7th December 2004 Mr Jeffery and Mr Keevil met Mr Wells and Richard Las of HMCE. Mr Jeffrey had prepared a note to himself, which he must have started as a note for a telephone conversation ahead of the meeting[60], which included the following:

> *"Ahead of the meeting [i.e. the Treasury Select Committee Meeting on 12th January 2005] you may want to issue a red card and … given the level of seizures of both Dorch + Sov, we would understand*
>
> *TK [Mr Keevil] would be happy to join the discussion if you have not decided*

[60] See the crossed out words "*Putting together agenda*" and the first paragraph cited in this paragraph.

Our perception under the MOU that it is both Gall + Customs interest for you to issue Red Card before + not after Select Committee. TK has briefed our Chairman who supports this viewpoint

If no red card we cannot under distribution contract fail to supply + we now know that we will be unable to have control + management that we both require.

There is now pressure to supply TEL with stock. As we have not supplied whilst negotiating new agreement we are now being threatened with legal action for not trading.

If there are others in C & E who do not want to progress this, then we would be happy to meet whoever."

493 At the meeting Mr Wells produced some slightly different figures for seizures of genuine cigarettes so far recorded: 115 million Sovereign and 71 million Dorchester. (Namelex had been red carded after seizures of about 100 million cigarettes). Mr Wells noted that, while some smuggled brands came from a variety of distributors and locations, Gallaher brands seemed confined to a particular distributor (Namelex then TEL) and limited locations. Dorchester seizures had now increased to 60% of the level of Sovereign seizures.

494 Mr Wells told Gallaher that HMCE found it difficult to square the level of seizures with the MOU and that it believed that, given the high level of seizures, TEL should be treated as a red card customer. He said he would write to Gallaher.

495 Gallaher's brief note of the meeting does not indicate the extent to which Mr Jeffery used the phraseology of his note. But four features of the meeting seem to me clear. Firstly, HMCE was very close to issuing a red card. Secondly, Gallaher, as HMCE knew, appreciated that that was so. (Mr Jeffery and Mr Keevil thought a red card was extremely likely). Thirdly, Gallaher indicated (i) that, if a red card was to be issued, it would be better if it was done before rather than after the Treasury Select Committee (to avoid the suggestion that nothing had been done by HMCE or Gallaher until the Committee acted)[61] and (ii) that that was in the interests both of Gallaher and HMCE (the Gallaher note records: "*Achieve we both want*").

496 Gallaher's purpose by now was to push HMCE towards issuing the likely red card before rather than after the meeting. Mr Keevil told Mr Wells at the meeting that Gallaher had worries about the contractual position with Tlais, and he gained the impression, probably correctly, that Gallaher felt that the further HMCE went in terms of pushing Gallaher, the more that would help. As will be seen (see paragraph 510 below), when what looked to be a red card was shown, Mr Jeffery asked for clarification that that was indeed what he had received.

[61] All were aware that Imperial Tobacco had been aggressively questioned by the Public Accounts Committee in 2002.

The Gallaher Group Board meets

497 The Board of Gallaher Group Plc met on Thursday 9th December 2004 and discussed the state of the negotiations with TEL. Mr Hainsworth, who was now a main board director, said, as the minutes record, that:

> "*Most importantly, [he] was not satisfied that what was currently proposed by Mr Tlais would ensure that we could exercise satisfactory control and management over the Gallaher brands which were proposed to be supplied to the new business if the arrangements were finalised"*

Mr Hill suggested to Mr Hainsworth that, in saying this, he was now toeing a Gallaher party line. Mr Hainsworth told me that he did not toe party lines. Having heard him I am sure that that is so. Mr Tlais accurately described him to Mr Northridge (in an e-mail of 27th December 2004) as a "*straight and clever businessman*". Mr Clarke regarded him as a bright guy for whom he had a lot of time.

498 Mr Keevil pointed out that the recent HMCE Report - "*Measuring and Tackling Indirect Tax Losses – 2004*" – showed that 74% of the HMCE seizures of legitimately produced but illegally imported product was Sovereign and Dorchester. This was a misreading of the HMCE paper (see paragraph 491 above). The 74% figure related to all genuine *UK* brand seizures over 500,000 sticks.

499 The Board regarded it as critical, if the proposed arrangement was to go ahead, that Gallaher could effectively control and manage products supplied to the joint venture. It agreed to form a committee to review any proposed new arrangements before they were executed. In the event the members of the committee were Mr John Gildersleeve, Gallaher's non-executive Chairman, Mr Northridge, Mr Rolfe and Mr Keevil.

500 On 15th December 2004 Mr Hainsworth wrote to TEL setting out the three fundamental issues that remained unresolved namely:

(i) Gallaher's right to withdraw brands. Gallaher wanted the seizure in any EU country of in excess of 5 million sticks (500 cases) in any one calendar year automatically to trigger a removal of the relevant brand; and a right to terminate any distribution agreement if to continue to trade in the particular country concerned would materially impact Gallaher's reputation.

(ii) Mutually agreed targets for distribution and market share (as distinct from total volume) with a right for Gallaher to implement an independent and alternative method of distribution outside the joint venture if the targets were not met.

(iii) Gallaher management to have the final say in relation to strategic decisions concerning the brands

501 On 24th December 2004 Mr Tlais responded by e-mailing Mr Northridge to the effect that negotiations had reached an impasse; that it was unacceptable for TEL to

be subject to sanction for failures which were the responsibility of the distributors of the joint venture, and inconsistent with TEL Agreement made in July which stated that neither party should seek to impose unreasonable conditions on the other. Unless an amicable settlement could be reached it would be necessary to consider how to bring the relationship to a close.

502 The requirement under (i) was certainly very tough. Whether or not it should be characterized as unreasonable is not an issue that I need decide. The provision in the subject to contract Heads of Agreement that neither party should seek to impose unreasonable terms gave rise to no legally enforceable obligation.

Was HMCE misled?

503 TEL contends that HMCE was not given the full picture. Firstly they were not fully informed, as they should have been, of the problems that that had arisen in respect of Iranian Dorchester, which TEL had been instructed to dispose of in non-core markets (as to which see paragraphs 1063ff below), no doubt, TEL submits, because that would cast Gallaher in an unflattering light. Secondly, they were given to understand that Gallaher had ongoing concerns about the control of brands under the proposed new agreement, when Gallaher's real concern was about being able to terminate the distribution of brands which were under its control.

504 At the end of the meeting in July 2003 it was Mr Tlais himself who explained the problems with the damaged Dorchester: see paragraph 395. HMCE does not, however, appear to have been told about the full scale of the damaged Dorchester or that seizures of that product might be attributable to its sale in non core areas, much less that Gallaher did not consider TEL at fault. If HMCE had been told that Gallaher did not consider that TEL was at fault, it might have altered its view as to fault, but it was unlikely to have altered its approach. HMCE's procedure is to deal with the manufacturer in the light of the quantity of seizures over time. By now the quantity of seizures was simply unacceptable (whatever the reason or excuse). HMCE regarded TEL as the link between Gallaher's Sovereign and Dorchester and the smuggling of both that had taken place over an extended period. HMCE looks to the manufacturer to take the steps it thinks necessary to sort out the problem.

505 I do not regard Gallaher's failure to exonerate TEL in respect of Dorchester before HMCE in those terms as culpable, not least because legal responsibility for the damaged Dorchester and the causal effect of its sale, so far as smuggling was concerned, was highly debatable.

506 On 30th November HMCE was told that Gallaher had been:

> *"… trying over the last six months to find a way to reengineer the business model with TEL to make the controls and management as watertight as possible. We are not there yet and we have increasing concerns that we will ever achieve this with TEL ….*

507 On 7th December 2004 Mr Wells of HMCE was told by Mr Jeffery and Mr Keevil that they could not be sure that future supplies of product from Gallaher to Tlais would remain in their intended market. That was their opinion. Mr Wells regarded

that remark as very important. He thought that, if he had been told that Gallaher did not have doubts about future supplies remaining in their intended market, things might have turned out differently in terms of what HMCE expected to be done.

508 HMCE was not told that the principal reason for the impasse was Gallaher's wish to be able to remove Territories and or terminate in the event of underperformance, in circumstances where Gallaher was intended to control the joint venture company and shipment was to be made direct to the in-market distributor. If it had been told something like that, it is likely that it would have regarded that as a matter for commercial negotiation, and not as altering the approach that it needed to take.

The red card

509 Meanwhile on 23rd December 2004 Mr Wells had written to Mr Jeffrey giving updated figures: 2003-4 - Sovereign seizures were 58%, Dorchester seizures were 19% of all seizures of genuine cigarettes; 2004-5 to date - Sovereign seizures were 55%, Dorchester 14%, with approximately 90 million cigarettes awaiting the results of tracking and tracing. He summarised the relevant provisions of the MOU and said:

> *"In view of Gallaher's concerns about whether future supplies of cigarette would remain in their intended destination and the level of seizures already established, and in keeping with the terms of our MOU, Customs request that Gallaher take action in respect of the risks of further product supplied to TEL contributing to the tobacco smuggling problem in the UK. We will want to review this action with you at our next meeting in the New Year."*

510 On 6th January 2005 Mr Jeffery wrote to Mr Willis saying:

> "I *understand that the "red card procedure" … is now encapsulated within the [MOU].. Nevertheless, so that Gallaher and TEL are absolutely clear as (sic) the position, I need your confirmation as a matter of urgency that TEL should now be treated as being subject to the "red card procedure, I should stress that in seeking this clarification, I also understand that the action that needs to be taken is solely our responsibility"*

511 On 7th January Mr Wells replied:

> "*I can confirm that Customs feels that the concerns arising with Tlais Enterprises are sufficiently serious to require action under the terms of our MoU as set out in my letter of 23rd December and commensurate to the red card procedure subsumed within that process and accordingly we invite Gallaher to consider the position".*

512 The somewhat stilted language of this letter is probably attributable to the fact that HMCE, at least in the upper echelons, regarded the "red card" metaphor as inapposite (since HMCE had no powers of coercion and it was for the manufacturer to decide what to do) and in part a result of the fact that the MOU could be said to have overtaken the red car procedure anyway.

513 Mr Wells' concern, as an officer of HMCE, was to reduce the amount of brands smuggled into the U.K. It was the renewed presence of a different Gallaher brand in the illicit market, notwithstanding that there had been a period of time to deal with the problems of the Namelex period, that most exercised his mind. His approach would probably not have been any different if Gallaher had impressed on HMCE that they did not consider that TEL was to blame for the level of Sovereign seizures and said that they had given instructions for large quantities of damaged Dorchester to be sold into non core markets. By now he would probably have regarded that as an explanation or excuse which could not hide the fact that whatever steps were being taken to prevent illicit trade, they were inadequate. The position might have been different if he had grounds which satisfied him that there were unlikely to be significant seizures of goods the subject of future shipments. But it seems unlikely that he would have reached that view before seeing a concluded new arrangement with TEL which so satisfied him.

The end game

Suspension of supplies

514 On 10th January 2005 the Gallaher Group Board committee met from 10.15 to 10.30. The minutes record that:

> *"In the light of the letter from [HMCE] requiring us to take action, having regard to the steps that we had already taken to date, Mr Keevil advised the Committee that under the terms of our [MOU] and our [ITP] the Company had no alternative but to suspend supplies.*
>
> *After due and careful consideration it was agreed that it was in the best interests of the Company to suspend supplies to TEL and given Mr Tlais' proposal that we should seek to bring the business relationship to an end Mr Keevil should write to him, notifying TEL of the decision to suspend supplies and inviting Mr Tlais to set out his thoughts on discontinuance of the current business relationship".*

515 On 11th January 2005 Mr Keevil wrote to Mr Tlais to inform him that *"we have now received a letter from HM Customs requiring us to take action in respect of our business relationship with TEL*", and that Gallaher's committee overseeing the relationship with TEL "*met yesterday and concluded that, in light of the requirement from HM Customs to take action in respect of TEL, we obviously cannot, as you will appreciate, make any further supplies at this time*". This constituted a formal suspension of all supplies to TEL. The letter invited Mr Tlais' thoughts on bringing a formal end to the business relationship.

The Adam Trading Schedules

516 In January 2005 Mr Espin made a trip to Dubai. On what was probably 12th January 2005 he was told by Mr Jack in the evening, before he and Mr Jack went to dinner with Dr Al-Mahamid, that the latter had, until 18 months previously, been a smuggler but that he had had to stop because he had established a business

developing a product called Mecca Cola and was now a respected businessman. Mr Jack said that Mr Tlais was not a smuggler.

517 On 13th January 2005, prior to a relatively informal meeting with Dr Al-Mahamid, Mr Espin and Mr Jack were shown some schedules on a laptop computer which had been obtained by private investigators called Ask International while investigating a separate matter. The information contained in them, which Mr Espin and Mr Jack did not examine in detail, suggested that there had been widespread and serious breaches of the TEL Agreement throughout the period of its operation in that goods had been sent all over the world without going to their intended markets. Dr Al-Mahamid was not then asked about the Schedules or whether he had been diverting goods. He was asked about two containers of Dorchester Menthol which had ended up in Lomé. Dr Al-Mahamid acknowledged that he had sent the containers there and said that they were on the way back. He did not say, nor was he asked, why he had sent them there[62]. The meeting was affable.

518 On their return to England Mr Jack, who also saw the Schedules, expressed the view that Dr Al-Mahamid might become Gallaher's main distributor if the planned agency relationship with Gallaher went ahead because he was no longer a smuggler and had only smuggled for Imperial Tobacco. Mr Espin did not discuss the Schedules with Mr Jack any further. Having discussed the matter with Mr Keevil he asked Ask to send over the schedules. The documents appear to have arrived in e–form and hard copy on 4th and 22nd February but their order appears to be misplaced in the trial bundles.

519 According to an initial summary of the Schedules made by Gallaher in February goods had gone in 2004 to ports of discharge in Holland, Romania, Ukraine, Pakistan, Slovenia, Montenegro, USA, Malaysia, Togo and Singapore. The totals of such goods in respect of 2004 were 115,400,000 Sovereign cigarettes and 253,430,000 Dorchester out of total supplies of 412,580,000 and 454,240,000. The Schedules also indicated destinations such as Riga (Latvia), Varna (Bulgaria), Cotonou (Benin), Iraq (during sanctions), Thessaloniki, and Tenerife.

520 In view of the quantity of goods concerned and the close relationship between TEL and Adam Trading Gallaher regarded this information as evidence of, at best, a reckless failure to take proper steps to control the goods. On 14th February 2005 Mr Clarke told Mr Jack that Mr Tlais accepted that there was "*a serious case to answer*" but said that the issue was with his partner and should be dealt with under the normal agreed procedure by the provision to Mr Tlais of evidence, followed by an investigation, which, if the matter was proven, would lead to a red card being issued.

521 On 16th February Mr Tlais told Dr Al-Mahamid that he was ceasing supplies of Gallaher products to him or any of his companies. He invited any explanation of the summary referred to in paragraph 519 above, which he attached. Adam Trading's letter of 24th February to Mr Tlais expressed Dr Al-Mahamid's shock at the allegations; informed Mr Tlais that he was making a chart for Gallaher to show

[62] It is possible they were en route to Libya.

clearly how and where Gallaher smuggled and who was involved (he said it included Mr Fawaz); but did not condescend to any details about the contents of the Schedules. So far as the evidence shows, no further attempt was made by TEL to investigate the shipments the subject of those schedules. Dr Al-Mahamid also wrote to Gallaher on the same day denying the charge of smuggling and claiming that Mr Fawaz had supplied cigarettes for a smuggling operation in Egypt and that Austria Tabak had run a large scale smuggling operation in Romania through duty free shops. He complained that his actions against counterfeiters had not been adequately supported and that he had been damaged by having to dispose of the damaged Dorchester. He did not, however, provide a response to the Schedules

Termination

522 The Board Committee met on 4th March 2005. Mr Keevil outlined the investigation carried out by Mr Espin and himself, including the Adam Trading Schedules, and the serious concerns that arose from it. The Committee resolved to terminate TEL Agreement and to commence proceedings.

523 On the same day Slaughter & May on behalf of Gallaher :

(i) dispatched letters terminating the TEL Agreement with immediate effect and demanding payment within 14 days of $ 3,266,650 being the amount remaining due in respect of the 365 day goods after allowing for $ 160,000 paid by way of the $ 10 supplement (see paragraphs 1090ff below); and

(ii) issued these proceedings seeking a declaration that Gallaher had lawfully terminated the TEL Agreement.

Events post termination

Stock

524 On 5th January 2005, following a request from Mr McCallum of HMCE, Mr Jeffery asked Mr Jack for information on TEL's stock levels. On the same day Mr Jack provided his understanding of the position as at September, with the caveat that he had not dealt with TEL for some time.

525 On 19th January 2005, Mr Wells of HMCE wrote to Mr Jeffery seeking further information. He asked for the results of the stock reconciliation that he understood Gallaher was about to carry out and asked about "*Gallaher's plans to safeguard this stock and prevent its entry into the illicit market, and if appropriate to invoke the 'buy-back' clause in your contract with TEL*".

526 On 26th January 2005, Mr Jeffery wrote to Mr Tlais asking for a summary report of TEL's stock holding, setting out "*a) Stocks by brand and location at the time of last reconciliation; b) Sales by brand since the reconciliation identifying your customer and market destination; c) Current stocks by brand and location; d) Status of the stock i.e. whether or not they have been pledged to BLOM bank*".

527 On 3rd February 2005 Mr Tlais responded, stating that the stock details provided by Mr Clarke of TEL in a letter of 8th October 2004 were still correct save that 5000 cases of Sovereign had been released as had 1000 fresh Dorchester and the full balance of Businessman. The letter of 8th October 2004 had referred to a number of storage places but had not allocated specific quantities to specific locations, although manuscript notations on the letter suggest that Mr Jack was told those details. Mr Jack turned this into a report which allocated the different brands/flavours to different locations. It did not provide the level of detail requested by Mr Jeffery in his letter of 26th January 2005.

528 On 14th March 2005, Slaughter and May wrote to TEL seeking an inventory of TEL's stocks so as to enable Gallaher to decide whether or not to invoke clause 10(vi) of the TEL Agreement. This clause provides:

> *"If on termination of TEL Agreement the Distributor has on hand any stocks of the Brands… GI shall be entitled (but not bound) to purchase all or part of such stocks from the Distributor or require the Distributor to sell all or part of such stocks to a third party nominated by GI at (in respect of stocks of the Brands) their 'in warehouse cost price' to the Distributor (unless such stocks shall not be in a sound and saleable condition in which case at their lesser value)…. The price payable by GI to the Distributor on any such purchase as aforesaid may be set-off by GI against the amount of any monies then owing to GI by the Distributor but without affecting the right of GI to recover any balance of such monies owing to it."*

529 Slaughter and May's letter asked for the location of all stock, whether title in such stock had passed to a distributor, and if so which, and to know "*what your intentions in relation to the stock are*". They also sought clarification whether goods were pledged, and if so that "*the documents which contain the terms upon which the stock had been pledged*" be provided.

530 On 31st March 2005, Rosenblatt (TEL's then solicitors) responded to this request. They stated that all stocks were pledged to the bank, that "*the 'unsaleable' stock has been inspected by GIL on a variety of occasions, thus this information is within your client's possession*", and that "*On 3 February 2005 you client was delivered an inventory*" i.e. Mr Tlais' letter of 3rd February. On 6th April 2005 Slaughter and May pointed out that this was inadequate.

531 On 27th April 2005, Slaughter and May also wrote to BLOM informing it of Gallaher's interest in the goods apparently pledged to it. On 26th May 2005 Slaughter and May chased Rosenblatt for a response to the 6th April letter.

532 On 27th May 2005, Rosenblatt wrote purporting to accept an alleged repudiatory breach by Gallaher of the TEL Agreement. That letter claimed that, as a result of the alleged repudiation:

> *"So far as unsold Stocks are concerned, your clients are obliged and TEL hereby requires them to cancel [invoices outstanding] and collect the unsold lights on payment in full of*

> *the costs incurred in the storage of these goods and the settlement of the destruction account; TEL will look to GIL for (amongst other things) payment in full of the costs and demurrages surrounding the storage of these goods for the full period that they have been in the possession of TEL…"*

533 The letter did not explain how the goods could be taken up despite the pledge to which they were supposedly subject or where exactly they were. By a letter of 7th June 2005, Gallaher exercised its right to purchase, free from any encumbrances, all stocks of the brands of which Gallaher was the trademark owner which TEL was claiming were not in a sound and saleable condition. Gallaher agreed to bear the responsibility for the goods, relieving TEL of future liabilities for their storage and destruction. Slaughter and May asked for "*TEL's immediate proposals to enable the transfer of title in the relevant stocks and their delivery to our client free from any encumbrances and charges prior to the date of the passing of title"*.

534 No response was received from Rosenblatt – whether as to the identity and location of stocks held by TEL, or as to the arrangements for the transfer of title and delivery: see the letter from Slaughter and May dated 22nd June 2005. On 9th August 2005, however, Rosenblatt wrote again proposing that TEL would seek to sell the stocks into the market and thereby establish which of them were unsaleable. It would then transfer the latter to Gallaher – but would sell off the remainder. Rosenblatt said that the sales would be in compliance with the Procedural Agreement. No record of these sales was provided to Gallaher, and none has been disclosed.

535 Slaughter and May wrote on 17th August 2005 repeating Gallaher's wish to purchase all unsaleable stock, bemoaning the absence of any accurate inventory, and disputing the need to seek to sell the goods in order to decide which were unsaleable. noting what it characterised as a change of tack by TEL, in claiming that some of the goods which it held were in fact saleable. Rosenblatt responded on 16th September 2005, stating

> *"We have confirmed that our client is prepared to transfer to your client those stocks that are of no value in the market at all, in accordance with the election that your client has made. However, in order to establish which stocks fall into this category, our client will need to ascertain whether any value can be realised in respect of the stocks that it holds. To the extent that any value can be realised, your client has made no offer at all to purchase stocks from our clients, and selling the relevant goods into the market is the only course open to our client to mitigate its losses."*

536 Thus, even by September 2005, TEL did not apparently know, without a sale, which of the stocks that it held were saleable. Slaughter and May pointed this out in its letter of 20th September 2005 – and noted the curiosity of the supposed pledge not inhibiting any sale.

Mr Tlais' conviction

537 On 10th February 2006 Mr Tlais was convicted by the Thessaloniki Appeals Court (sitting as a Court of First Instance) for his part in a smuggling ring which had evaded Greek taxes payable on cigarettes valued at € 11 million. He was held to have provided material and moral assistance before and during the commission of acts of smuggling by his co-conspirators – Georgios and Heracles Anthemides and Christos Papkoulas. Mr Tlais was represented in the proceedings; but not physically present. He was sentenced to 4 years of imprisonment for the act of direct complicity in smuggling. He has exercised his automatic right of appeal.

Supplying Iraq

538 After the Gulf war in 1991 shortfalls in Iraqi cigarette production were made up by illegal imports. In 2000 something like 10.9 billion sticks are reported to have been imported illegally. A considerable amount of evidence was adduced as to whether or not Gallaher or Mr Tlais supplied goods to Iraq for sale there whilst UN sanctions were in force. Each side has sought to criticise the other in this respect; but the issue seems to me to have limited relevance to the case.

539 Mr Tlais' written evidence was that during the Namelex era Gallaher had been producing cigarettes for the Iraq market, which were identifiable as such because they bore a unique Iraqi health warning so that they could only legally be sold in Iraq. He said that Gallaher had supplied, firstly, a company called FREMA with Gold Bond. Mr Clarke's evidence was that Mr Jack had told him on some later occasion that these goods were for the Iraqi market.

540 In a memorandum to Mr Keevil of 6th June 2002 Mr Jack said that he had supplied Freddie John Paul of FREMA with goods for Libya, Jordan and the Balkans and refuted what he described as the "*scurrilous and defamatory allegation*" that he conspired in sanctions breaking in respect of the Iraqi market.

Iraqi and Jordanian regulations

541 The Iraq regulations in force at the time required all packs to have in English and Arabic a Health Warning clause ("*Smoking is a main cause of lung cancer, lung diseases and of heart and arteries diseases*") and the Tar and Nicotine contents of not more than 12 mg and 0.8 mg respectively.

542 In Jordan the health warning was required to be in Arabic and was slightly different ("*Smoking is a major cause of cancer, diseases of the lung and diseases of the heart and arteries*"). The pack had to have in English or Arabic the trade mark, name of the manufacturer, number of cigarettes in the pack and, country of origin and a batch or consignment number. The maximum tar and nicotine limits were in January 2001 12 mg and 1 mg and are unlikely to have been less in 2000. The maximum possible limit for carbon monoxide has been 15 mg since January 1998. The nicotine, tar and carbon monoxide content had to be displayed in Arabic on the pack.

Gold Bond.

543 A mock up of a Gold Bond pack that was supplied by Gallaher to Mr Nammour for approval in April 2000 (as to which see paragraph 552 below) contained the Iraqi health warning in Arabic and English together with the Iraqi tar and nicotine figures in both languages. It did not contain the carbon monoxide content or any of the other matters specified by the Jordanian regulations. The AMELA spreadsheet shows that 4,000 cases of Gold Bond "ME" with Arabic health warnings were supplied to "FREMA – Jordan" in May 2000. In July 2003 Gold Bond with the same bar code as on the mock up was reported to Gallaher by a distributor named Rahal Group as being in the market in Iraq.

Sovereign and Dorchester

544 Mr Tlais also claimed – in his written evidence - that Gallaher supplied Sovereign and Dorchester to Namelex and had delivered them to Dubai with instructions to him to release them in transit to Aqaba in Jordan, where they could be and were collected by a distributor named Trading and Transport Service Co. Much of the stock apparently turned green (it is impossible to tell whether that is so) and the balance of the goods - some 33,500 cases of Dorchester - remained in the warehouse in Dubai until it was destroyed in 2003 on Mr Northridge's instructions.

545 In his oral evidence, however, Mr Tlais corrected this to say that he had been instructed by Charles Hadkinson, not Gallaher, to ship the goods to Aqaba and that Mr Hadkinson had told him that Gallaher knew about it and had put the Iraqi health warning on. He claimed that he had simply shipped to Jordan as instructed and had no further involvement.

Documentary evidence of Mr Tlais' involvement in supplies to Iraq

546 Mr Tlais' involvement in sales to Iraq goes further than that. On 13th October 1999 Mr Nammour of Namelex wrote to Mr Tlais following an earlier meeting. In the course of the letter Mr Nammour pointed out that various Gallaher cigarettes had an English or a European health warning and that Sovereign Gold was currently sold in the CIS and in UAE, Iran and Iraq. As Mr Clarke accepted, the goods were thereby being offered to Mr Tlais with a selling point that they were suitable for smuggling into the UK or for sanctions busting in Iraq.

547 On 19th June 2000 Mr Nammour wrote to Mr Tlais with a copy of a Namelex proposal for CT Tobacco. This referred to Gallaher brands having been launched in Iraq. On the same day he sent Mr Tlais a 5 page document outlining the Iraq/Gallaher business which Namelex intended to send to Transport and Trading Co, Mr Karam's company: (see paragraphs 478 above). The attachment which was headed "*Iraq Gallaher Business*" began with the following words:

> *"After consultation with Abou Hameed, the only way for this business to be successful is for us to do it ourselves, with no intermediary assistance. This is too important a business to place in the hands of a trader who would not give it due care. Therefore, at the insistence of our Protector, we have decided to conduct the sale and distribution in Iraq ourselves".*

Mr Tlais accepted that he may have given some advice but did not explain what the reference to "*our Protector*" meant. From the rest of the document it appears to be Mr Karam who was to provide protection and security for all Namelex's staff and operations. The document states that "*our contribution*" is to include securing the supply of Gallaher cigarettes and paying the costs of delivery to Aqaba.

548 On 31st July 2000 Mr Nammour sent a letter to Mr Tlais headed "*Re: Jordan Local Domestic Market*" which enclosed a letter of credit for the purchase of 400 cases of Sovereign and Dorchester all sold at $ 99 per case, CIF Aqaba, "*for sale and distribution in the local market in Jordan*". The letter recorded that Mr Tlais should open a letter of credit in favour of Gallaher at a price of $ 82.50 per case :

> *"which is a special price agreed by Gallaher for local domestic distribution in Jordan"*

and added:

> "*Gallaher are very pleased with this order because it is official distribution. This is also good for us since we will be doing the Iraqi business".*

549 On 10th November 2000 Mr Hadkinson wrote a letter to Mr Tlais headed *"Re Iraq business*" which began "*As you know Andreas is already in Baghdad and has inspected the goods*". Andreas was a man who worked for Namelex. It also recorded that the goods were spotted; that Namelex had blamed Gallaher and that Mr Clarke was said to be leaving on Monday to discuss the matter with Gallaher

550 It is plain from this correspondence that Mr Tlais was well aware that cigarettes for which he had paid were to be shipped to Iraq for consumption there. That explains why in January 2003 Mr Tlais told Mr Keevil that he had "*done bad things in the past*": see paragraph 367 above.

551 The letter of 31st July appears to indicate that so far as Gallaher was concerned they were being told that the business was official business in Jordan.

Communications between Namelex and Gallaher

Sovereign and Dorchester

552 On 29th March 2000 Gallaher confirmed to Namelex (in an exchange of correspondence) that they agreed to put in hand an order for some Sovereign Gold with a Tar/Nicotine content of 12mg/0.8mg and an Arabic Global health clause. An initial order for 5 containers was to be produced "*on receipt of materials 5 x containers*". On the same day Namelex confirmed that Gallaher had got the details correct but that the health clause should be in English and Arabic. They enclosed a specimen (which complied with Iraqi requirements). The Gold Blend mock up sent to Namelex in April 2000 had the same content.

553 On 2nd August 2000 Mr Nammour wrote to Ms James (as Mrs Schiavetta then was) enclosing a letter of credit for $ 33,000 covering 1 container with 400 cases of

Sovereign and Dorchester. These were the goods the subject of Mr Nammour's letter of 31st July. The letter said that all packs were to be printed with the English/Arabic Health Warning clause ("*Smoking is a main cause of lung cancer, lung diseases and of heart and arteries diseases*") and that the Tar and Nicotine contents of Tar 12 mg and Nicotine 0.8 mg were "*exactly as per the Iraqi specification*"[63]. The letter of credit covered goods CIF Aqaba Port Jordan in transit.

554 The Sovereign and Dorchester the subject of the 2nd August letter did not, therefore, comply with Jordanian, but did comply with Iraqi, requirements. The health warning on the pack, which was in English and Arabic and not just Arabic contained the slightly different Iraqi language, and there does not seem to have been a statement of the carbon monoxide content.

555 A separate letter, also of 2nd August 2000, from Mr Nammour to Mr Jack headed "*Re: Iraq*" asked him to arrange a certificate attesting inter alia that Gallaher owned the trademarks in Dorchester and Dorchester International and that Dorchester International could be imported into the Iraq local domestic market. The letter included the sentence "*It will be pertinent also to mention that we are your official distributors of this market*". Mr Jack wrote to Mr Nammour on the same day asking for information about an "*alleged registration for Dorchester*" including details of the name of the applicant. Someone must have been claiming the right to use the mark in Iraq and Mr Jack and Mr Nammour were considering how to defeat this.

556 Mr Clarke accepted that he had knowingly ordered goods for Iraq during the Namelex era which he said he thought were covered by a DTI licence. He thought that Mr Jack thought the same.

557 In September 2000 Mr Jack visited Iraq. During that trip he met Uday Hussein for about half an hour and discussed the possibility of post sanctions dealings. At this time there was a prospect that sanctions might lifted. There was nothing improper in this meeting. He also saw Gallaher product in the market and met someone who purported to be a Gallaher distributor. He challenged Namelex with this. It is not clear what this product was.

558 On 27th September 2000 Mr Jack confirmed in his letter to Mr Clarke of that date that Mr Clarke had supplied him at a meeting shortly before then with a letter of comfort from the DTI and had "*agreed to forward Fadi's initial enquiry as well to complete the step*". The letter provided was a letter from the DTI of 10th December 1999 to Mr Nammour, apparently responding to an enquiry of his of 29th November 1999. It stated that it appeared to the DTI that cigarettes did not require an export licence unless the end-use of the intended export was as described in an attached supplementary notice.

559 Mr Clarke's evidence was that it was Mr Nammour, and not he, who gave Mr Jack the letter, although he was present at the meeting when the letter was handed over. He only saw the letter at the meeting which he said took place in Weybridge in

[63] Mr Espin indicated in his evidence that Mr Jack had said that the comment about Iraqi specifications should have been a reference to Jordan. This is unlikely to be right. It is an account Mr Espin must have learnt years after the event; and is inconsistent with the correspondence at the time and the purported DTI confirmation provided to Gallaher: see paragraph 560 below.

November 2001. I do not accept this for two reasons – firstly I do not accept that the November 2001 meeting took place; secondly I regard it as implausible that Mr Jack would have written to confirm receipt from Mr Clarke of a letter that Mr Clarke had not then seen, without any reply from Mr Clarke disputing that.

560 Thereafter Mr Jack was provided with a letter to the DTI on H & R Distribution Ltd notepaper dated 29th November 1999 which stated that H & R had been approached by a trader for the supply of branded cigarettes to the Iraqi market. In fact, as it turned out, the request to which the DTI replied on 10th December 1999 was a request in respect of Libya. Mr Jack then required Namelex to stop any supply to Iraq.

561 The AMELA spreadsheet shows that the Sovereign and Dorchester the subject of the letter of 2nd August were supplied to "*Namelex – Jordan*" in October 2000.

562 An internal Gallaher document of 26th April 2001 has under the heading "*Current BD opportunities & Status*" the cryptic sentence "*Irak [sic]: confirm happy not to pursue outside of existing arrangement"*. It is not clear to what that is a reference to. It may be to the discussions with Uday Hussein. The same document describes Iraq as "*Believed to be 'out of reach' (sanctions*)".

563 It will be recalled that in his letter of 7th February 2003, following his meeting with Mr Keevil (see paragraph 370 above), Mr Tlais had explained, in relation to the Arabic goods, that 33,000 cases of Dorchester had been purchased by him from Gallaher by letter of credit drawn on two banks at an invoice price of $ 90 a case and that after the beginning of the TEL era Mr Jack had asked him not to sell these goods.

564 The picture that emerges from this jigsaw is, so far as I can discern it, as follows:

(a) In May 2000 Gallaher shipped 4,000 cases of Gold Blend to FREMA in Jordan and some or all of it ended up in Iraq;

(b) In October 2000 Gallaher shipped 400 cases of Dorchester & Sovereign to Dubai, which Mr Tlais then shipped from Dubai to Aqaba. These goods were then taken to Iraq. Mr Jack was told that these goods were for the Iraq market[64];

(c) In September 2000 Namelex had provided a letter which appeared to confirm that the export to Iraq was legitimate; and then produced what was supposed to be, but was not, the letter to which the DTI letter was a reply;

(d) Mr Jack then told Namelex not to supply Iraq anymore;

[64] This is what the letter of 2nd August 2000 implies. Mr Jack denied to Mr Keevil that the goods had been sold with the intention of going into Iraq but Mr Keevil suspected, having gone through the disclosure, that Mr Jack may not have been entirely candid with him. I do not think that he was. Mr Jack also told Mr Keevil that he had not told TEL to cease supply; but it is apparent from Mr Tlais' letter of 7th February 2003 that he had.

(e) It is not clear whether Mr Jack had received not only the DTI letter but also the letter to which it was supposed to be a response by the time that the Sovereign and Dorchester were dispatched in October 2000. Nor is it clear when he learnt that the request related to Libya; but that is likely to have been after the goods had reached Iraq;

(f) The pack for both the Gold Blend and the Dorchester and Sovereign complied with the Iraqi but not the Jordanian packaging requirements;

(g) The health warning on the Sovereign and Dorchester was specifically required by Namelex: see the exchange on 29th March 2000. The specification used on the Gold Blend pack and supplied in proof copy to Namelex in April 2000 had the same content;

(h) It is not wholly clear whether, when the Gold Blend was dispatched Mr Jack, who at the time would have been responsible for signing off health warnings in consultation with distributors, knew that the pack of which Gallaher had provided a proof copy did not comply with Jordanian regulations;

(i) The likelihood is that he did. The Jordanian and Iraqi regulations are different. Namelex had made a specific request for a particular pack marking, which meant that the packs would comply with the Iranian regulations. The same pack marking was used for the Sovereign and Dorchester which, as the 2nd August 2000 correspondence shows, was for Iraq. I regard it as unlikely that Mr Jack was unaware of the significance of this. In February 2003 he claimed that the health warning for Jordan had changed so that the goods could no longer be sold there. This claim does not seem to be true. Neither the Tobacco County Profiles Report nor the ERC report indicates that any such change took place. It may be that the erroneous suggestion was put forward in order to support the contention that the goods were originally intended for Jordan and could be sold there; but I am unable to reach a conclusion as to whether that is so;

(j) In those circumstances it seems to me that the likelihood is that Mr Jack was aware that the Gold Blend cigarettes for FREMA would go to Iraq. Whether he was told anything about the absence of any need for an export licence is unclear;

(k) In addition to the above Gallaher shipped to Namelex Dorchester with an Iraqi health warning – these being the goods the subject of Mr Tlais' letter of 7th February 2003. It is not clear when these goods were shipped but it looks from the 1999 AMELA spreadsheet, which refers to Dorchester with an Arabic health warning shipped to JL Spirits as if it was in December 1999.

565 Mr Jeffery looked into the question of whether Gallaher's goods had got into Iraq in early 2001. Either as part of, or at the same time as, that process he discovered Mr

Nammour's first letter of 2nd August. He did not believe that he saw the second. He also discovered the bill of lading that showed that the goods had gone to Aqaba in transit. He does not seem to have discovered that any of the goods went to Iraq.

566 If and insofar as Gallaher placed reliance on the DTI letter of 10th December 1999 it was misplaced. The attached supplementary notice referred to UN sanctions on Iraq and directed the reader for information to the Sanctions Licensing Unit.

The Issues

567 Looking at the matter in broad terms the issues for determination are as follows:

A Gallaher's claims against TEL

(i) Was Gallaher entitled to terminate the TEL Agreement when it did for all or any of the reasons upon which it relies?

(ii) Is Gallaher entitled to recover $ 3,239,450 together with interest being the sum said to be due in respect of the 365 day goods?

B TEL's claims against Gallaher

Loss of Profits and other claims in respect of termination

(iii) If Gallaher was not entitled to terminate the TEL Agreement what damages, if any, is TEL entitled to recover for the wrongful termination?

(iv) Was Gallaher in breach of the TEL Agreement in any of the following respects:

a. failing to use its best endeavours to reach an agreement for a replacement brand as soon as reasonably practicable after Sovereign was removed; clause 6 (ii);

b. failing to cooperate with TEL to assist TEL to conduct its business in accordance with the ITP;

c. failing to act in good faith towards TEL in dealing with HMCE;

d. failing to ensure that TEL was the exclusive distributor in the Yemen.

(v) If Gallaher was in breach in respect of the matters set out at (iv) to what damages is TEL entitled?

Damaged stock

(vi) To what damages or payment is TEL entitled in respect of the damaged Dorchester cigarettes?'

C TEL's claim against Mr Tlais personally

(vii) Is Gallaher entitled to $ 4 million plus interest pursuant to Mr Tlais' guarantee?

The witnesses of fact

568 Before I turn to address those issues I must make some observations about some of the witnesses of fact. I was satisfied that Gallaher's employees were endeavouring to give me their honest recollection of the facts, although that does not mean that I accept all their analysis without reservation. In particular there appeared to me to be some downplaying of the increased risk of smuggling of old or damaged product, and of the steer given to HMCE to wield a red card. Mr Byrne and Mr Wells of HMCE were plainly honest and independent witnesses.

Mr Jack

569 Gallaher's most significant absentee was Mr Jack, from whom a very long statement was taken. Gallaher made a final decision not to call him during the course of the trial. I have not read that statement nor seen its contents save to the extent that paragraphs were used in cross examination of Gallaher witnesses or referred to in opening. Gallaher regarded Mr Jack, who is no longer their employee, as having got far too close to Mr Tlais[65] and as being a highly unreliable assessor of the strength of the markets in the territories[66]. It is noticeable that his reports were often markedly pro-Tlais and optimistic about prospects. He sent the letters of 13th September and 21st December 2001 which were designed to be misleading. I was not surprised that Gallaher decided not to call him. That lack of surprise does not cause me to forget (i) that he was the principal day to day contact between Gallaher and Namelex and Gallaher and TEL and could, ordinarily, be expected to be called, and (ii) that, the fact of his absence when coupled with the evidence adduced might justify drawing conclusions adverse to Gallaher. I do not, however, infer that he was not called because, had he been called, Gallaher's case would have collapsed.

570 TEL could have called him. But they did not have access to him before the trial. Mr Jack left Gallaher's employment in 2005. An undisclosed compromise agreement with him of 30th May 2005 included a provision to the effect that "*except as required by law, he must not divulge to any person any information concerning the*

[65] As Mr Fawaz put it: "*as far as I was concerned, when I worked with Norman Jack, I just considered him a Tlais employee at Gallaher's offices and that is it*".

[66] Exemplified by his preparedness to report in March 2003 that State Line was, according to an agent, doing modest business in Iran and that it had good gutter presence in a small sample when, as is common ground, there is practically no market for State Line there.

business or affairs of the company or any associate company that came into his possession while he was an employee." Slaughter and May asserted to TEL's solicitors that approaching Mr Jack would be an attempted inducement of breach of contract, a breach of the Solicitors Conduct Rules and would infringe Gallaher's rights in confidence. Gallaher failed to confirm to Mr Jack or his lawyers or to TEL that they consented to TEL contacting Mr Jack and his speaking with them. I draw no adverse inferences against TEL because it did not call him. I was told by TEL that much of his statement was helpful to its case but I do not propose to speculate on what he may have said.

Mr Clarke

571 The principal witnesses for TEL were Mr Clarke and Mr Tlais. Mr Clarke gave a very lengthy statement and was TEL's principal witness, although he was neither a director nor a shareholder in TEL and had no authority to deal with customers. He described himself as "*not a decision-maker in any way, shape or form*". His principal role was to communicate with Gallaher because of his command of English. It became apparent in the course of his evidence that there were a number of matters of which he gave evidence of which he did not have direct knowledge [e.g. Namelex's and Mr Tlais' intentions in the Namelex era).

572 His evidence indicated a preparedness to be part of a business without understanding important aspects of it and a willingness to accept something at face value even if told it by someone he distrusted.

573 As to the former, the Namelex business was, according to his evidence, run by Mr Nammour and himself. Mr Nammour dealt with the financial side, with which Mr Clarke was not involved, although it is apparent that he was involved trying to obtain finance to honour the $ 9 million credit extended to JL Spirits and Tobacco and he explained the delay in his failure to contact HMCE until February 2002, some 11 months after he was first asked to do so, as a period in which he was predominantly involved in financing. He was a director of Namelex Holdings Ltd but was unaware who exactly were the beneficial owners and financiers of that company[67]. He was also a director of JL Spirits & Tobacco, which failed to pay its $ 9m debt. He had himself lent money to Namelex when it was trying to get a letter of credit in 2002, trusting in Mr Hadkinson, and lost it, which was one of the reasons he ended up working for Mr Tlais.

574 As to the latter, towards the end of 2001 he signed a letter to Gallaher dated 22nd October 2001 which said that Namelex was "*taking forward [its] exposure to in excess of $ 100 million*" on the basis that that was what he was being told by people in Namelex; and a letter to Gallaher of 9th November 2001 which referred to extensive research trials with existing customers in the Iranian market claiming success for the hard box Stateline, which he had later learnt was untrue (the product

[67] He knew that Mr Nammour was a shareholder, was told that Mr Reynolds was one and understood that Mr Hadkinson's trust was an indirect shareholder. But there were others, who were providing finance.

being then still in a warehouse in Dubai), and which he had simply accepted at face value from others in Namelex.

575 Mr Clarke was an active participant in the plan to mislead Mr Tlais in September and December 2001. In March 2002 he told Mr Tlais that he had not been allowed to know the true situation with the free goods and had been kept away from Mr Tlais because of Mr Tlais' supposed dislike of English people, when, on his evidence he knew of the state of the free goods account in late Summer 2001.

576 Some of his evidence gave a misleading impression. Thus he stated in his witness statement that on 1st September 2001 he reassured Gallaher that a Russian letter of credit would be issued but on 3rd September the bank's lawyers notified Mr Nammour of a last minute problem. What he did not indicate was that a comfort letter apparently provided by the bank on 28th August 2001, a copy of which was sent by him to Gallaher on that day, was said by the bank to be a forgery (as he knew in 2001). He also referred to discussions in early 2001 concerning the possibility of Gallaher investing in a factory associated with CT Tobacco, thereby implying a continuation of Gallaher's involvement with CT Tobacco. He did not refer to the fact that Mr Jack had made it plain that he would not countenance such an investment given Mr Tornarides' involvement. He suggested that Gallaher and Namelex were colluding to ensure that the price per case paid by Highstreet was higher than Gallaher's "list price" for the cigarettes when, as he accepted, Gallaher was not aware that Namelex was not using the rebates given to it in order to provide Mr Tlais with free goods.

Mr Tlais

577 Mr Tlais' command of English is quite good, but not perfect. He had, however, the advantage of an Arabic interpreter of which he availed himself whenever he needed to. On a number of occasions he displayed a marked inability to answer the question rather than engage in speeches or the repetition of points. Some of his evidence was given in terms of considerable generality where a degree of specificity was reasonably to be expected, such as his oft repeated refrain that everything had been approved by Norman Jack. Some of it was not at all easy to follow in a way which is not sufficiently explicable by language difficulties.

578 Mr Tlais, too, was prepared to state or sign up to what he must have realised was inaccurate or as to the truth of which he had no knowledge. For instance:

(a) He signed the letter of 24th July 2001 on NTA paper (see paragraph 200 above), drafted by Hadkinson, which represented that Gallaher had released to NTA 257,000 cases free of charge "*and we can proudly confirm that all this quantity has already been given to our clients*" when, save for 40,000 cases, he had received none of them. The letter also said that "*until today we are still owed about $ 16 million from clients*" but, as he told me, he was unable to tell if this was correct and from the documents disclosed it looks as if the figure was much less;

(b) In his letter of 4th March 2002 he referred to having invested and

committed over $ 60 million to the business. But the letters of credit disclosed total less than $ 30 million; and, even allowing for purchases from Mr Tohme and Tbeili, and expenses, this looks to be an exaggeration;

(c) In his letter of 30th May 2002 he claimed to have started dealing with Mr Tornarides in the *latter* part of 2000 when the account with CT Tobacco shows it to be May 2000. He said that from his recollection and without reference to his records he had supplied Mr Tornarides with some 500 million sticks. In fact the number was over twice that. I did not find his explanation for the discrepancy – namely that he had only been referring to the cigarettes that he wanted, and not to the Mayfair, Sovereign Black and Sovereign Red that Mr Hadkinson had told him to buy to supply to Mr Tornarides - satisfactory. The same letter asserted that a letter of 19th June 2000 (see paragraph 547 below) referring to launching Gallaher brands in Iraq, which was sent to him by Mr Nammour, was "*incorrect*" and that it was even incorrect to say that NTA was owned 50% by him. He was in fact the beneficial owner of 50% of Namelex and, as he admitted, he knew that Namelex had dealt with Iraq, although he said he had nothing to do with it.

(d) In a letter to Gallaher of 22nd April 2003 he said that he had not been able to collect money during the previous four months. But the customer accounts show that over $ 2 million had been received over that period;

(e) On 18th September 2006 in connection with an application for security for costs Mr Clarke stated that since March 2005 TEL had been unable to collect receivables. Mr Clarke's information about TEL's financial position came from Mr Tlais. In fact the Adam Trading customer account shows receipts of over $ 1.8 million since March 2005.

579 Even allowing for Mr Tlais' somewhat voluble nature and a sense of grievance, I did not regard Mr Tlais' evidence as something upon which, in relation to disputed matters, I could readily rely.

Dr Al-Mahamid

580 TEL's most significant absentee was Dr Al-Mahamid, described by Mr Tlais as his "*key partner and master distributor*" from whom a statement was taken, which I have also not read. No reason was given as to why he was not called and I do not propose to speculate about it. The result is that I have no evidence from him as to the controls, if any, which, between them, TEL and Adam Trading had in place. Nor do I have any explanation from him as to how goods came to be shipped to the destinations set out in the Adam Trading Schedules and payments for goods supplied by Adam Trading made to Highstreet. According to Mr Tlais' evidence it was Adam Trading which carried out mixing of the goods; received returns; obtained signed ITPs; kept sales records to in-market distributors and might, therefore, have had a record of the intended final destination of the goods. It was, according to Mr Tlais, Adam Trading's task to carry out due diligence on his

customers and to secure compliance with the ITP. No evidence has been given by Dr Al-Mahamid as to whether, how, and to what extent he did this.

Joseph Khatter

581 Also noticeably absent was Joseph Khatter, the TEL employee who was said to be "*responsible for banking matters, payments, invoices, dealing with stock releases, typing up the releases, dealing with the warehouses*" and as "*holding the account, buying, stock position and dealing with warehouses*". He was said to be the source of the stock figures provided by Mr Clarke to Mr Jack and of the information collated by Mr Clarke so as to form the customer accounts (see paragraph 677 below). It was he who instructed warehouses to release goods and checked the source of funds transferred to TEL. He instructed Agathocleous to prepare the misleading financial accounts to which I refer in paragraph 670 below.

Sarafaz Mobaraki

582 Mr Mobaraki gave TEL a witness statement but he was not called. He could have given evidence of the extent of the build-up of the Dorchester business in Iran; the circumstances surrounding the damage to the product; the loss of the business and the expenses of destruction.

The presentation of TEL's claim

583 The claim put forward by Mr Tlais and TEL is extremely large, even by the standards of this Court. Some of it e.g. the $ 30 million claim arising out of events in the Namelex era was obviously problematic, not only because of the waiver agreement but also on account of the want of detail of its composition. The damages claim is, on any view, grossly exaggerated. Large portions of it were wholly unsupported by any evidence. The calculations of damages set out in Schedule I to the Amended Defence and Counterclaim were, so far as factual evidence is concerned, supported by a single paragraph of Mr Clarke's statement. The question of expert evidence in support seems to have been left until very late in the day.

584 There has been an imbalance (which I have endeavoured to ensure had no unfair effect) between the legal firepower available to the two sides. Gallaher has been represented by Slaughter & May and one Leading and two Junior Counsel – a level of representation which is not surprising in view of the size of the claim. Executives from Gallaher have been present throughout the trial. TEL has been represented by Picton Howell and, originally, two junior counsel, with assistance from a third. Over the long vacation TEL lost the services of Mr Hill, its leading junior, who had presented their case with great skill for the first 47 days, presumably for want of funds. Mr Alastair Tomson had to shoulder the burden of continuing in his place, which he has done with marked ability. TEL was unable to call its expert accountant because, so I was told, he had not been paid a balance of £ 137,000 that was due to him. Despite my allowance of a short adjournment to enable him to be put in funds to the extent that he required (£ 40,000) in order to give evidence, and which I was told were on their way, that sum was not provided, and he was not called.

585 I record these matters because I have gained from them the impression that these proceedings were launched by Mr Tlais upon the basis that, if everything was thrown at Gallaher, including allegations about which Gallaher would be sensitive, there was a good chance that Gallaher would settle in order to avoid embarrassment[68]; and without any measured consideration by TEL of what could be established and how, and the focused marshalling of resources for that purpose. Whilst that does not of itself mean that TEL's claims are ill founded it does mean that I approach them with a degree of circumspection.

586 On 29th December 2006 Gallaher, through Slaughter & May, gave notice that it challenged the authenticity of a large number of TEL's disclosed documents and required TEL to prove them. Mr Tomson submitted that the authenticity of these documents had been proved by paragraph 869 of Mr Clarke's witness statement in which he states that, after a detailed review of the sales documentation disclosed, he considered that it satisfactorily accounted for TEL's releases of the good supplied by Gallaher to TEL. Whilst this covers some of the documents not admitted, such as sales invoices, it does not extend to others – such as the signed ITPs. Its usefulness in relation to sales documentation is however much reduced by his evidence that Mr Khatter was responsible for payments, invoices, and dealing with stock releases, and that until after the termination of TEL Agreement, when he summarized them, he had nothing to do with the customer accounts.

A Gallaher's claims against TEL

Issue (i)

Was Gallaher entitled to terminate the TEL Agreement when it did for all or any of the reasons upon which it relies?

587 Gallaher claims that it was entitled, pursuant to clause 10 (ii) of the TEL Agreement to terminate it because, at the time when it purported to do so, TEL was in material breach of several clauses of the TEL Agreement which were incapable of remedy in that TEL had failed:

(a) to comply with the ITP: clause 4 (xxi);

(b) to keep full, proper and accurate accounts and records: clause 4(viii);

(c) to obtain evidence of shipment of goods into domestic duty-paid markets: clause 3(v);

(d) to sell goods only in quantities commensurate with legitimate demand in the relevant territories: clause 2(v) (c);

[68] This impression was not dispelled by the initiation of proceedings in the Lebanon on 12th April 2007 by Abu Ahmed, on behalf of 'Tlasco Company for General Trading, Import and Export' against Gallaher, Mr Rolfe, Mr Keevil, and Mr Fawaz personally, making allegations of fraud of a criminal nature, and claiming $ 20 million in compensation.

(e) to deal only with customers in respect of whom there was no reason to believe that they would be involved in smuggling: clauses 2(v) (a), 4(i) (2) and 5(iv) of the TEL Agreement;

(f) to have in place proper structures for the marketing, distribution and sales in the territories: clauses 3(iii), 4(ix), 5(x) and 5(xviii) of the TEL Agreement.

(g) to secure compliance by its customers with the ITP: clauses 4(xxi) and 5(v) of the TEL Agreement.

588 Clause 10 (ii) provides that if a breach is capable of remedy no notice of termination can be given unless and until a notice has been given requiring it to be remedied "*within 30 days or such longer period as may be agreed upon in writing between the parties*". It is apparent from this that the parties envisaged that a breach should be regarded as remediable, for the purposes of clause 10, only if that could be done within 30 days or any longer period which Gallaher agreed. Gallaher never agreed a longer period.

589 In addition Gallaher claims an entitlement to terminate because it had reason to consider that TEL was complicit in smuggling and that, in those circumstances the ITP itself entitled it to terminate the relationship.

Ground 1: Compliance with the ITP.

590 Clause 4 (xxi) of the TEL Agreement provided:

> *"The Distributor will…*
>
> *Conduct its business in accordance with the policy on International Trade of the Gallaher Group (as amended by Gallaher Group from time to time) and shall procure that any distributors within the Territories shall conduct business in accordance with the said policy on international trade".*

591 The ITP (as signed on behalf of TEL) contained a number of provisions designed to limit the risk of smuggling of Gallaher brands. In particular, it provided:

> *"Subject always to applicable laws and regulations, sales of Gallaher cigarettes (and other products) will only be made available to distributors, joint venture partners, licensees etc who are prepared to provide the following commitments to Gallaher that:*
>
> - *They share Gallaher's vision to build business in legitimate markets and are prepared to devote the necessary resources to develop trade in those countries;*
> - *They will only sell products supplied to Gallaher into countries where duty will be paid (excluding duty free outlets) and that they will comply with all applicable laws and local*

requirements relating to the importation of cigarettes into those countries;

- *They will take no action to promote or facilitate the resale of products to their customers in violation of applicable laws and regulations;*
- *They will not sell products supplied by Gallaher into countries where Gallaher has other distribution arrangements in place for such products or infringe Gallaher's trademarks;*
- *They will not trade with those that they know are or have reason to believe are involved in smuggling cigarettes. Indeed, they will make the necessary enquiries to satisfy themselves that their customers in turn will behave responsibly; and*
- *They will co-operate with Gallaher in allowing Gallaher representatives to visit emerging markets for the purpose of auditing the supply chain to those markets and to inspect stocks in the possession of distributors, wholesalers and retailers."*

592 The ITP, as signed, required TEL to impose the same obligation on its own customers. Mr Tlais stated:

> *"I further confirm that I will obtain the same undertaking from any sub-distributors to whom I supply any products of the Gallaher Group"*

The effect that the TEL Agreement gives to the ITP

593 TEL submits that the ITP is a Gallaher policy statement, which the TEL Agreement does not, either by its express terms or by necessary implication, incorporate. Some of its provisions, such as a commitment to share Gallaher's "*vision"* to build business in legitimate markets, are inapt to create any enforceable legal obligation. Neither the TEL Agreement nor the ITP creates legal obligations in the terms of the ITP. Alternatively, the most that clause 4 (xxi) does is to require TEL to conduct its business in accordance with the ITP. To the extent that there are parts of the ITP which set out with reasonable clarity how the distributor should conduct its business they should be given effect. But the clause deals only with what TEL is required to do under the ITP and does not extend beyond action required of TEL itself.

594 The obligation to share Gallaher's vision is insufficiently precise to give rise to any enforceable legal obligation. But much of the ITP is not of that character. The policy makes clear that sales will only be made to distributors who are prepared to provide *"commitments*" to Gallaher and that expression, together with the content of the required commitments, is couched in the language of legal obligation. TEL's contractual agreement to conduct its business in accordance with the policy was an undertaking to make the commitments which the policy specified.

595 I reject the submission that the clause does not extend beyond action required of TEL if that submission is intended to mean that TEL cannot be responsible for the actions of others. The obligation in clause 4 (xxi) to procure that distributors within

the Territory conducted business in accordance with the policy obliged TEL to see to it that those distributors fulfilled those commitments or, to put it another way, to secure that result: *Re Royal Victoria Pavilion, Ramsgate* [1961] 1 Ch 561; *Barnicoat v Knight* [2004] EWHC 330 (Ch); *Nearfield Ltd v Lincoln Nominees Ltd* [2006] EWHC 2421 (Ch). This was an onerous obligation.

Did the Procedural Agreement of November 2002 override the ITP?

596 Mr Clarke suggested in his evidence that TEL's obligation to comply with the ITP applied to domestic duty paid goods i.e. goods shipped direct to their destination market where duty was to be paid; and did not apply to the clearance of Old Stocks in Cyprus and Dubai or the 365 day stocks dispatched to Cyprus and Dubai for the purpose of mixing (at any rate insofar as it was mixed); or to sales of damaged Dorchester supplied by TEL for the Iranian market, upon the basis that compliance with the ITP in respect of those goods was impossible, or at best very difficult, because they were old or damaged goods without banderols with English health warnings.

597 Since almost all of Gallaher's sales to TEL were not shipped direct to market, the effect would be that the ITP was inapplicable to almost all of Gallaher's sales to TEL.

598 I do not accept this suggestion for a number of reasons. Firstly, the Procedural Agreement, which refers to the fact that Mr Tlais and TEL had signed the ITP without suggesting that it was to be inapplicable to any of the sales specified, was not expressed to override or modify the TEL Agreement; nor must it necessarily do so.

599 Secondly, the TEL Agreement was amended in January 2003 without any indication that it was inapplicable to the Old Stocks. On 30th August 2002 Mr Tlais had sent an agenda for the meeting in London of 5th September 2002, item 6 of which was "*Contract amendments*". A note attached to the agenda suggested that the then existing draft of an amended distribution agreement "*had been overridden in principal [sic] by the new working procedure agreed between the parties and the customs*" and that that procedure should be incorporated in the amended agreement. That suggestion was removed when Mr Jack re-wrote the agenda and attached a note on the distribution agreement which contained no reference to any overriding. On 4th October 2002 Mr Jack sent Mr Clarke a paper setting out the tripartite agreement that was to become the Procedural Agreement. On 15th October 2002 he wrote to Mr Tlais dealing with amendments to the TEL Agreement and the draft procedural agreement. In neither case was there any suggestion that the latter would replace or override the former. The Amended TEL Agreement was signed soon after the Procedural Agreement without any suggestion that its provisions were in part superseded by the Procedural Agreement.

600 Thirdly, in his letter of 1st October 2004 (see paragraphs 484-487 above), which Mr Clarke drafted, Mr Tlais confirmed his awareness of his obligation to comply with the ITP and to procure that his distributors did so without suggesting that that obligation applied otherwise than in respect of "*all sales*" as Mr Jeffery had stated. No suggestion was made in the pleadings that the ITP was not applicable to all

sales. Mr Tlais accepted in evidence that it did, that he was bound to procure that TEL's sub-distributors complied with it, and that that was the confirmation that he intended to give Mr Jeffery in his letter.

601 Fourthly, there is no inconsistency between the TEL Agreement and the Procedural Agreement. Clause 3 (i) of the TEL Agreement provides that "*Unless otherwise agreed (for instance, for logistical or security reasons) all brands shall be delivered by Gallaher to the destination markets in the Territories*". Clause 3 (v) obliges TEL to supply evidence of the shipment of the order to the relevant Territory where it is necessary for the distributor to make deliveries to destination markets via an intermediary port. The Procedural Agreement sets out agreements as to delivery by Gallaher otherwise than to destination markets and additional details as to what types of documentation are to be provided where deliveries are not made directly to those markets.

602 In the light, however, of Mr Clarke's evidence that he did not regard TEL as bound by the ITP in respect of most of the goods supplied to it, it would not be surprising to find that TEL had not done so.

Was there a breach?

603 Gallaher relies in support of its allegation that TEL failed to comply with the ITP on a number of matters. Firstly it relies on the sheer number of goods supplied by Gallaher to TEL that were seized by HMCE and other customs authorities. The numbers themselves are large but they have a significance beyond themselves. As I set out in paragraphs 12-14 above most smuggling is not detected, HMCE's estimate being that the amount smuggled is about seven times the amount seized.

604 HMCE notifies Gallaher of seizures of cigarettes made by it (and overseas Customs authorities). Gallaher also receives notifications from overseas Customs authorities and others. Gallaher is able to discover whether the product seized, of which it is given samples, is genuine or counterfeit and usually, at any rate in the case of UK manufactured stock, to trace the person to whom the product was first supplied.

605 Gallaher has an enormous database of seizures. The reliability of that database and the inferences validly to be drawn from it have been the subject of much debate. TEL disputes the reliability of Gallaher's attribution to the category of goods supplied to TEL of goods not specifically manufactured for it. (The goods manufactured for it -coded in such a way as to identify TEL as the customer - are referred to as the "TEL coded stock").

606 The key figures on which Gallaher relies are set out in the table contained in paragraph 11 which, for ease of reference, I repeat.

Notifier	TEL coded stock	Stock only ever sold to TEL
HMCE	447 million	491 million
Overseas	243 million	264 million
Total	690 million	755 million
Total TEL coded Stock ever sold	2,176,660,000 Sovereign Classic 1,428,000,000 Dorchester International 3,604,660,000 (of which 690 million is 19.14%)	

607 I consider in Appendix A to this judgment the method by which these figures have been arrived at. My conclusion is that the figures derived by Gallaher both as regards "TEL Coded Stock" and "Stock only ever sold to TEL" are a fairly reliable estimate (and certainly the best obtainable) of the amount of stock supplied by Gallaher to TEL that was seized.

608 I approach with a little caution the proposition that because HMCE estimates that the authorities only seize about one seventh of all smuggled goods and because the amount of TEL coded stock seized was about a fifth of total production of that stock, the likelihood is that virtually all of the TEL coded stock, other than such as was destroyed, was smuggled. Ratios applicable to the entire population of produced and smuggled cigarettes may not necessarily be applicable to individual sections. It does however seem to me likely that a considerable amount, probably amounting to well over half of the goods supplied by Gallaher to TEL will have been smuggled. If the amount seized is looked at alone, the quantity is very substantial – nearly 70,000 cases of TEL coded stock and 75,500 cases if the non coded stock is included. Even if these figures are out by a third the picture of substantial seizures and much more undetected is not radically altered.

609 Seizures of product supplied to TEL took place over the entire period of the TEL Agreement. When supplies of Sovereign ceased seizures of it reduced and Dorchester became, in its turn, the subject of very sizeable seizures. The size of these figures suggests that TEL had not taken adequate steps to sell only into countries where duty would be paid (excluding duty free outlets) and to customers whom they had no reason to believe were involved in smuggling and which, having made the necessary inquiries, they could be satisfied would behave responsibly, and to procure that its sub distributors did likewise.

610 Secondly, Gallaher relies on the Adam Trading Schedules. Mr Tlais accepted that these schedules were very likely to record actual shipments made by Adam Trading and that, at least in the main, the shipments made by Adam Trading were of stock

received from TEL[69]. They reveal that Adam Trading was exporting large quantities of goods to destinations outside the Territories.

611 The question arises as to whether those destinations identified in the Schedule which are not in the Territories were, or may have been, legitimate intermediate ports i.e. ports to which the goods were carried en route between Cyprus/Dubai and one of the Territories. Some ports on the Schedules e.g. Bar in Montenegro, Illychevsk in the Ukraine, Rotterdam in Holland, Koper in Slovenia, Thessaloniki and Trieste, are hubs for legitimate, but also for illegitimate, trading. Malaysia could, it is said, have been on a route including Pakistan; Loendersloot in Rotterdam on a route to South America. But there seems no possible warrant for shipping from Cyprus or Dubai to Rotterdam or elsewhere in Europe, or to Singapore or Malaysia, goods intended for the Middle East.

612 Suspicion that these destinations are not true intermediate ports in a legitimate trade is heightened by what is known to have happened in one case where the goods arrived in Malaysia. A number of the entries on the schedules showing Malaysia or Singapore as the port of discharge identify M'Exim International Limited ("M'Exim") of Singapore as the shipper. On 5th January 2004 - a date before the relevant entries in the Schedule – Gallaher had provided TEL with a report of a raid by the Royal Malaysian Customs at Pelapas, Johor. That revealed that master cases of Sovereign and Dorchester shipped by M'Exim had been repacked into a larger carton used to pack loose furniture and that the cartons were to be declared to Customs as furniture for export (according to an informant, export to the UK). Either TEL failed to inform Adam Trading of this information or Adam Trading ignored it and continued using or supplying M'Exim as shipper.

613 The evidence also reveals that some of the goods were sold ex warehouse in Rotterdam e.g. a sale by Adam Trading in July 2003 of 950 cases of Sovereign in Rotterdam to Pearlion Overseas Trading Ltd, and a sale of 1,000 cases of Sovereign Classic and 150 cases of Sovereign Classic Lights to Metco, ex Loendersloot with the full flavour goods then being shipped by Metco to Montenegro, payment being made to Highstreet. In March 2002 Highstreet received a transfer of $ 69,090 under a note "*1010 Dorchester for Pearlion less USD 16760 for our costs*")' There is also evidence of 2,900 cases (which appear on the Adam Trading customer account) being sold by Adam Trading C & F Rotterdam, again with payment to Highstreet.

614 Both of these types of sale are inconsistent with the ITP, which calls for goods not to be sold into countries where Gallaher has other distribution arrangements. If goods are sold by Adam Trading ex warehouse Rotterdam or are sold by Adam Trading to a customer C & F Rotterdam, they will have been sold into Holland, whether or not they have become subject to duty. Their ultimate destination will then depend on the terms of a subsequent sale. In addition the goods were not being sold to a distributor in a duty free zone but delivered to a bonded warehouse.

[69] The likelihood that in 2003 and 2004 Adam Trading was still shipping goods purchased by it in the Namelex period is slim.

615 The Schedules also show a number of shipments of Gallaher cigarettes made by Adam Trading to Iraq during the period when UN sanctions were in place (i.e. until 22nd May 2003), although it is not possible to establish whether these are TEL goods. The fact, however, that Adam Trading was making shipments in breach of sanctions show Adam Trading's preparedness to make unlawful shipments.

616 If Dr Al-Mahamid had been called, it may be that he could have shown that some or all of the destinations on the Adam Trading Schedules that are not in the Territories were true intermediate destinations for final destinations within the Territories. But he was not, even though I was told during the trial that he was to be called. Nor was documentary evidence produced which established that the shipments shown on the Adam Trading Schedules were sales to some legitimate final destination via a true intermediate port.

617 In the light of (i) TEL Agreement between the experts that it is normal for a master distributor to ship CIF to the end market; (ii) the unlikelihood, as it seems to me, that ports of discharge in as diverse places as Malaysia, Singapore, Montenegro, Bulgaria, Latvia, Ukraine and Miami as well as Rotterdam were all intermediate ports to which the goods were taken en route to one of the Territories; (iii) the absence of any explanation for the relevant destinations on the schedules from Dr Al-Mahamid (or Mr Tlais or Mr Clarke); and (iv) the cases of Midwinter, Metco and Alsharq referred to in paragraphs 622-631 below, I infer that Adam Trading was engaged in making very substantial shipments of goods to territories outside those specified in the TEL Agreement without regard to any of the restrictions under the ITP and that, in respect of some of these shipments Adam Trading was selling into countries where Gallaher had other distribution arrangements or had reason to believe that the recipients were engaged in smuggling, and that it failed to make the necessary inquiries to satisfy itself that its customers would behave responsibly.

618 I further infer that Mr Tlais must have known that such shipments were being made (even though he may not have been aware of each one) and that they were inconsistent with his obligations under the TEL Agreement and Adam Trading's obligations under the ITP. He and Dr Al-Mahamid were very close and their fortunes interdependent[70]. As Mr Tlais put it:

> *"I used to talk to Khaled in daily basis, daily basis, maybe two or three or four or five times per day, sometimes. And sometimes in the night, to tell me exactly where it is going and what he is making and what he is doing. The shipment and everything"*

619 In a number of cases Highstreet was receiving payment into its bank account from Adam Trading's customer. I regard it as unlikely that Mr Tlais was unaware, even if only in broad terms, of the shipments that Adam Trading was making or that he was simply told that payments would be made to Highstreet by Adam Trading's customers without being aware that what were being paid for were goods that TEL had supplied.

[70] Mr Barakat of Midwinter (see paragraph 623 below) seems to have regarded Mr Tlais, TEL, Highstreet and Adam Trading as one and the same.

620 If I am wrong on that and Mr Tlais was in fact in ignorance of the shipments by Adam Trading to destinations outside the Territories, TEL nevertheless failed to procure Adam Trading to conduct business in accordance with the ITP. Even if TEL's obligation had been only to use best endeavours to see that Adam Trading complied with the ITP it is apparent that TEL failed to do so. Mr Tlais' evidence appeared to indicate that he regarded it as sufficient for him to require Adam Trading to sign the ITP and to tell Dr Al-Mahamid to check what its distributors were doing. As he put it:

> *"I have done my duty. Adam Trading has sign the ITP, I have given my order, and my instruction also he has to follow the customer. I cannot follow everything myself."*
>
> *"I told you, all the time, my instruction to Mr Adam Trading to be sure about his distributor. I cannot tell you more than that."*

621 That was not sufficient. TEL needed to have arrangements in place with Adam Trading whereby Adam Trading could and would (a) demonstrate to which customers they were selling and with what ultimate destination; and (b) produce documentation to vouch for it. In the case of an intermediate destination that would involve documents showing not only the arrival of the goods at, but also their onward passage through the intermediate to the final destination. Without doing any of that TEL could not procure (except by chance) Adam Trading's compliance with the ITP, or fulfils its own obligation under the ITP to make the necessary inquiries to satisfy itself that its customer would behave responsibly.

Midwinter (Mr Barakat), Metco and Andalus Alsharq

622 Thirdly Gallaher rely on what happened (as it learnt after March 2005) in the case of certain specific consignments of cigarettes to entities known as Midwinter, Metco and Andalus Alsharq. What happened in relation to those goods is, it is suggested, indicative of a pattern of conduct or inaction by TEL and Adam Trading.

Midwinter Intercomercio Internacional Ltd ("Midwinter")

623 Midwinter is a company based in Madeira, owned or controlled by Mr Pascal Barakat. Midwinter purchased 7,000 cases of Dorchester from Adam Trading in June and July 2004. Adam Trading shipped the goods from Jebel Ali, Dubai to Rotterdam. The goods were stored in the Loendersloot bonded warehouse in Roosendaal, The Netherlands. Payment for the goods was made partly to Adam Trading and partly to Highstreet via an escrow account at the Loendersloot warehouse[71]. Mr Barakat was not asked to sign the ITP and no restrictions were placed on the final destination of the goods: as he confirmed to Mr Espin, and as his solicitor confirmed in a letter to Slaughter & May of 30th August 2005. Mr Barakat was not called at trial but that does not cause me to reject what he and his solicitor have said. His letter to Mr Espin of 27th April 2005 complains that the goods were spotted. But that would not justify a sale to him without restriction.

[71] A credit advice dated 26th July 2004 shows that Highstreet received payment from Loendersloot Finance in respect of a sale of 3,000 cases of Dorchester to Midwinter.

Metco Ltd ("Metco")

624 Metco is a company based in Cyprus. In October 2005 Gallaher obtained a file of documents relating to sales to it. The file included Bills of Lading, Adam Trading invoices and payment advices. Those documents evidence 15 separate transactions involving shipments of over 20,000 cases of cigarettes over an 18 month period from May 2002 to November 2003. The goods were shipped by Adam Trading to Belgium (Antwerp and Hawe), Montenegro, The Netherlands (Loendersloot), Singapore, Slovenia and Tenerife. None of these were TEL territories. Metco made payment for some of the goods to Highstreet via its Loendersloot escrow account[72]. Mr Edwin Cotran of Asmar Holdings, the owner of Metco, confirmed to Mr Espin that no restriction had been imposed upon Metco as to the final destination of the goods. It was suggested to Mr Espin that Mr Cotran had never said that, not least because there was no note of the conversation and no reference to it in his witness statements. I am satisfied that Mr Cotran did say that; and that Mr Espin obliquely referred to it when he said, at paragraph 68 of his first statement that "*it is also apparent that Adam Trading imposed no restrictions on where Metco could sell the goods"*.

625 Cigarettes sold by Metco have been seized in the UK. On 15th December 2005 at the Maidstone Crown Court five men were convicted of smuggling offences. According to press coverage, and information derived from attendance at court by a Gallaher representative, on at least one occasion the men had purchased Gallaher brand cigarettes from Metco. From the markings on the pack it was found that the goods had originally been sold by Gallaher to TEL[73]. The goods had been imported into the UK under duty suspension for re-export to Dubai and Togo. When the containers arrived in the UK the cigarettes were unloaded and replaced with photocopying paper which was what was then sent to those destinations. The cigarettes, or some of them, were later found on a lorry in Kent. Given the shipping documents showing sales by Adam Trading to Metco via Loendersloot it seems likely that Metco bought these cigarettes from Adam Trading.

626 I shall assume that Metco had nothing to do with the criminality. Even so, the sale by Metco of what ended up being smuggled arose as a result of Adam Trading's failure to place any restriction on the sale of the goods. The fact that Metco appears on a customer list provided by Gallaher to HMCE in February 2003 and on another such list in April 2004[74] does not reduce the significance of that lack of restriction.

627 In August 2002, in response to an inquiry from Gallaher about a shipment of 778 cases ex Cyprus by Adam Trading to Gia Tauro with no declared end destination, Mr Tlais pointed out that the goods were never shipped by Adam Trading and produced a bill of lading showing Metco to be the shipper and Bar as the port of discharge. This appeared to distance Metco from Adam Trading. As is now

[72] The disclosed documents include (i) a BLOM credit advice dated 29 July 2003 which shows that Highstreet received a payment of US$147,750 from Loendersloot Finance in respect of 1150 cases of Sovereign, 1000 of which were full flavour and (ii) an invoice for US $ 147,750 from Adam Trading to Metco. The full flavour goods were shipped to Bar in Montenegro.

[73] This information was derived by Gallaher from the judge's summing up. The information was derived in this indirect way because when Gallaher gives a witness statement about markings on goods it has no ready means of relating the written statement to a trial it later learns of in a newspaper.

[74] Gallaher did business with Metco and manufactured tobacco for GB Tobacco, which is in the same group.

apparent, these goods had been sold to Metco by Adam Trading, the price including the ocean freight. According to the Adam Trading invoice payment was to be made to Highstreet. The application for a shipping order made by Atteshlis Bonded Stores indicated that Bar was a transit port.

628 Mr Tlais' evidence was that he had carried out an investigation which concluded that Adam Trading was not the shipper. That was true as far as it went. But it seems to me likely that he discovered, or could without difficulty have discovered, the sale from Adam Trading (from whom he must have obtained the bill of lading) to Metco, that Bar was a transit port and the ultimate destination. In either event he should have provided a fuller explanation. That he did not do so shows a lack of engagement with the process of tracking seizures and a failure to satisfy himself that Adam Trading was behaving responsibly..

Andalus Alsharq

629 Andalus Alsharq General Trading LLC ("Alsharq"), a Dubai based company, purchased more than 30,000 cases of Gallaher brand cigarettes from Adam Trading between 2003 and 2005 for Iraq. In a letter of 9th October 2005 Alsharq confirmed to Gallaher that it had not been asked at any stage to sign the ITP and no restrictions had been imposed on it in respect of the onward sale of the products. I regard this as likely to be so (and of a pattern with the position in respect of Midwinter and Metco). I do not regard what Alsharq said as unreliable because it approached Gallaher with a view to becoming a potential distributor for Iraq. It is right to records that the same letter states that Alsharq's market was "*very much prevalent in Iraq*".

630 TEL has produced what purports to be the second page (undated) of the ITP stamped by Alsharq, in which no market is specified. The stamp is similar to a letter from Alsharq to Gallaher of 4th August 2005. This is one of the documents the authenticity of which has been challenged. I do not regard its authenticity as either proved or disproved.

631 Gallaher submits that TEL and Mr Tlais must have been aware of these three sets of sales by Adam Trading in the light of the closeness between Mr Tlais and Dr Al-Mahamid and the fact that, in the case of the Midwinter and Metco sales, payment was made to Highstreet. I accept that submission. TEL was in breach of its obligation to procure that Adam Trading complied with the ITP - by *not* selling products into countries where duty would not be paid or where Gallaher had other distribution arrangements and by making the necessary inquiries to satisfy itself that its customers would behave responsibly. If TEL was not aware of these sales, it was also in breach of its own obligation to make such inquiries in respect of Adam Trading. Further clause 5 (iv) requires TEL to resell the Brands only where there is no reasonable cause to believe that the purchasers will sell them outside the Territories. A sale without restrictions would, where the destination intended by the purchaser was not known to be within the Territories, be likely to afford reasonable cause to believe that a sale would take place outside them.

TEL's submissions

632 TEL points out that it red carded a number of customers during the currency of the TEL Agreement (e.g. TSS Tutun Sigari, Drilon, Houmouz Marine, and a Yemeni and Saudi distributor), and voluntarily changed a Libyan distributor because of concerns about him. It also points out that efforts to track down smuggling routes were hampered by the following:

(i) most of the seizures of which TEL was notified by Gallaher were of seizures by foreign Customs authorities, which are very difficult to follow up, and on the basis of which it would often be unsafe to red card anyone;

(ii) the information that Gallaher got from HMCE and supplied to TEL (usually in a fax from Mr Jack, Jeffery or Keevil) was limited and did not include shipping documentation (typically it would include date and place of seizure, brand and quantity seized, and intended final market);

(iii) such information might come forward 3-4 months, and never less than 2 weeks, after the seizure, with the sample on occasion taking up to 7 months;

(iv) Gallaher would often not provide the date of invoice and manufacture and total quantity supplied to TEL. Had it done so it might have been easier to spot where in the chain any diversion is likely to have taken place;

(v) Gallaher's notification of seizures to TEL contained (as they did) a considerable number of errors e.g. as to date of manufacture, or where the goods were coded for, or the location of seizure.

633 TEL submits that the proper inference to be drawn from the quantity and volume of seizures of a customer's product depends on the circumstances in which the customer in question is required to trade. In the present case the most important circumstances, they submit, are :

(a) TEL was required to clear the Old Stocks which were generally unsuitable for TEL's needs having regard to their age, condition and/or brand mix. It was not common, as Mrs Schiavetta confirmed, for customers of Gallaher to be supplied with stock older than 6 months to sell or stock that did not comply with Gallaher's quality standards;

(b) Sovereign was already a heavily smuggled brand at the start of the TEL Agreement, to such an extent that smugglers would buy it duty paid and smuggle it into another market and still make a profit. Smugglers will get hold of duty paid product whatever the controls placed on the brand by the distributor. Further, as Mrs Schiavetta also confirmed, the vast bulk of sales of Sovereign Classic with a global

English health warning went to Namelex in the Namelex era and to TEL in the TEL era;

(i) There were no seizures of TEL coded Dorchester or Dorchester only ever supplied to TEL in either 2002 or 2003. In 2004 all the product seized had been coded for Iran. This shows that it was only when the impact of the damaged Dorchester began to be felt that seizures began. The increase is fairly attributable to the problems created by that damage.

Discussion

634 In deciding what inferences are to be drawn from seizure volumes it is necessary to pay proper regard to factors which may explain those seizures consistently with fulfilment by TEL of its contractual obligations. Damaged or poor quality goods (as some of the Old Stock and Dorchester was) represent more of a control risk than goods in pristine condition. A brand which is already attractive to smugglers is likely to remain so if the factors that make it attractive (e.g. English get up and global English health warning) remain, as with Sovereign they did. The Procedural Agreement recorded agreement with Mr Tlais' observation that he believed that, in the short term, there would continue to be product diversion of Sovereign.

635 These considerations do not, however, sufficiently account for the very high incidence of seizures both of Sovereign and Dorchester and its continuation over the whole length of the TEL Agreement and across the Territories. The fact that a product has become attractive to smugglers does not mean that it must stay smuggled in large quantities. Much depends on the degree of control exercised by Mr Tlais and his sub-distributors, whose compliance with the ITP he agreed to procure, and the selection by them of the persons with whom they dealt. Smuggling is, in large measure, a function of availability. One likely reason for the incidence of smuggling in the Namelex era was the laxity of control exercised by Namelex. If control is exercised properly e.g. by getting distributors to sign the ITP and monitoring what they are doing with the product, smuggling of the brand will decline[75]. Mr Tlais told Gallaher that he would be able to bring Sovereign under control in a period of 12-18 months.

636 Nor does the fact that product is sub-standard (which may make it something that a distributor wishes to dispose of but will also make it less attractive to many consumers in a high duty area), or sold into non-core markets, mean that it will be smuggled. Again much will depend on the degree of control. It is noticeable that Mr Tlais' position in October 2002 was that all of his sales, including those into core markets, were ITP compliant and made to distributors who had signed the ITP.

[75] One example of what appears to be such a lack of control is the seizure of a container with 827 cases of Sovereign in Piraeus in December 2004. According to Mr Jack's report the goods had been produced by Gallaher for TEL for the Iranian market (save for 14 cases of counterfeit) and shipped to Dubai; they had then apparently been sold by TEL to Intercargo (not on the TEL customer list). Intercargo took delivery in Port Said and the goods then went to Alexandria, Varna, Limassol, Burgas and then to Piraeus apparently, according to Intercargo, en route to Iran.

TEL's submissions on the figures

637 TEL also submits that the figures for seizures of product supplied to TEL should be reduced or certain seizures discounted. So far as reduction is concerned TEL suggests that little weight should be attached to the overseas notifications because they were not supplemented by the track and trace procedure and they may be less reliable. TEL then observes that, if you take the seizures notified by HMRC only, then, on Gallaher's figures, the HMRC seizures represented 11.2% of all goods said only ever to have been supplied to TEL. Sovereign seizures represented 12% of Sovereign supplied to TEL. Dorchester seizures represented 9.1% of Dorchester supplied to TEL. These figures should then be reduced to take account of the fact that the termination at the beginning of 2005 exacerbated already high control risks so that only seizures up to 2004 are relevant. In that case the relevant percentages are 7.4%, 8.4% and 5.2%. If reliance is placed only on goods pack coded for TEL (i.e. no account is taken of the 365 day goods) then the relevant percentages up to the end of 2004 are 6.3%. 7.2% and 5.2%. The figures are reduced even further if you ignore 25% of seized volumes on the ground that they are volumes to which Gallaher has applied assumptions about attribution, which TEL claims are unjustified.

638 I do not accept this approach. The information obtained from overseas' notifications was put into the database when received and I see no reason to regard its quality as being significantly less reliable than that supplied by HMCE. Nor do I see any good reason to leave the 365 day goods out of account. Termination of the TEL Agreement may reduce the diligence with which distributors in the chain control it but I do not regard that as a reason for ignoring seizures after 2004 altogether.

639 TEL also submitted that seizures of goods bound for Mozambique are attributable to OTI or Gallaher because Gallaher decided to supply OTI in Durban as the South African distributor directly. Gallaher did its own market visits and decided what orders should be accepted, paying TEL only a commission on sales.

640 The disclosed documents contain only one invoice from TEL to Gallaher for commission in respect of 3,080 cases. All the other sales were from Gallaher to TEL and then from TEL to OTI. In other words, OTI was TEL's customer (although in some instances Gallaher shipped the goods to Durban direct) and was invoiced by TEL. Since OTI was TEL's customer, TEL was obliged by the TEL Agreement to procure that OTI complied with the ITP (as with any other customer). This is borne out by a letter from OTI to Tlais Trading of 3rd December 2003 in which Mr Nathan, OTI's chairman, warns Mr Tlais that Gallaher is seeking to do business with OTI direct, rather than indirectly via Cyprus. The letter refers to more than two years of dealing with Sovereign at Tlais' request and OTI having gone the extra mile in all its dealings with Tlais Trading in an attempt to create the kind of relationship "*that we enjoy with all our Major International Principals*".

641 TEL also submits that no account should be taken of seizures of goods manufactured for the Syrian market in June and August 2002. TEL red carded TSS Tutun Sigari and, having acted diligently, should not – TEL submits - have any such seizures held against them. Again, it was TEL's obligation to procure that its

distributor complied with the ITP[76]. Even if these seizures are ignored on account of the fact that TEL red carded the customer the quantity involved does not affect the overall picture.

642 In short, I regard the important figures as those set out in paragraphs 11 and 606 above. Taking into account (a) the very high level of seizures; (b) the likelihood, in the light of those seizures, that well over 50% of the cigarettes supplied to TEL ended up being smuggled; (c) the evidence of the Adam Trading Schedules; and (d) the specific instances of Midwinter, Metco and Andalus, I am satisfied that TEL was in serious and continued breach of its obligation to conduct its business in accordance with the ITP and to procure that any distributors within the Territory did likewise. TEL's failure to produce adequate documentary records of its sales/dealings and Mr Tlais' conviction only serve to confirm that view. If TEL had fulfilled its obligations in this respect the likelihood is that there would have been a much lower level of goods smuggled and of goods seized and there would not have been the wholesale distribution of Gallaher's cigarettes to destinations outside the Territories exemplified by the Adam Trading Schedules.

643 Because what occurred in the distribution chain below TEL is not patent, it is not possible to identify TEL's individual breaches, particularly insofar as they consist of a failure to procure that Adam Trading and others of its distributors conducted business in accordance with the ITP. Essentially there was a failure of control of the distribution either by TEL or Adam Trading (or other distributors) as a result of which Gallaher products could with relative ease be resold into countries where duty would not be paid and to countries outside the Territories or to persons whom there was reason to believe were smugglers. Neither TEL nor Adam Trading can have made the necessary enquiries and taken the necessary steps to satisfy themselves that their customers would be behaving responsibly. In particular there was no sufficient record from which it was possible to discover at any given time where the stocks supplied to Adam Trading were, where they were intended to go, and where they had gone.

644 TEL's breaches were highly material. Securing compliance with the ITP and preventing smuggling was of prime importance to Gallaher and, professedly, to TEL. The provisions of the TEL Agreement had been crafted with a view to stamping out smuggling. TEL's breaches occurred over a long period with significant adverse consequences for the reputation of Gallaher and TEL with HMCE and others. They also had a severe negative effect on the trust and confidence that Gallaher could place in TEL.

645 The breaches were irremediable within 30 days or, indeed, longer. There was, in my judgment, no way in which TEL would have been able to restore the position. The smuggling which was the result of TEL's breaches, and which it was the object of the ITP to prevent, could not be undone, nor could its effect on Gallaher and HMCE's confidence in TEL's ability to control its customers. It is also unrealistic

[76] The red carding does not seem to have been efficacious. It occurred in about October 2002. About 57 million sticks were seized which had been produced in Lisnafallan by the end of August 2002, all or most of which would have arrived in Syria before the red card. But about 39.7 million sticks were seized that had been produced in or after September 2002 and did not, therefore, arrive in Syria until after the red card.

to suppose that TEL would or could within that time scale bring about a situation where only or predominantly ITP compliant trade would continue.

Ground 2: Gallaher's belief in TEL's breach of the ITP

646 The penultimate paragraph of the ITP reads as follows:

> *"In the event that Gallaher discovers that any particular distributor has been shown to be behaving improperly or Gallaher has reasons for believing that they may be, Gallaher will re-visit that trading relationship with a view to discontinuing that relationship, if appropriate. In particular, if Gallaher concludes that any distributor is a smuggler it will terminate that trading relationship with immediate effect. In turn, Gallaher will expect its distributors to endorse a similar policy in respect of their customers."*

Gallaher's case

647 Gallaher contends that it had very good reason for believing, and did believe, that TEL was behaving improperly, those reasons including the following:

(i) the level of seizures by HMCE notified to Gallaher;

(ii) TEL's closeness to Adam Trading which was directly implicated in smuggling;

(iii) TEL's failure to provide sales and stock reports;

(iv) TEL's failure to investigate seizures.

648 In the light of that belief Gallaher re-visited the trading relationship, when on 4th March 2005 the relevant Group Board Committee met and considered TEL's failure to control the goods supplied to it and Gallaher's suspicions of TEL's involvement in smuggling and its breaches of contract. The Committee resolved to discontinue the relationship.

TEL's submissions

649 TEL contends that the provision of the ITP set out in paragraph 646 above do not confer on Gallaher any right to terminate the TEL Agreement. Any such right must be found in that agreement alone. Gallaher's statement of its intentions ("*Gallaher will re-visit that trading relationship*") does not absolve it from the consequences of a termination that turns out not to be justified.

650 The parties, cannot, as commercial concerns, have intended to confer on Gallaher a right to terminate a long term distributorship agreement without compensation simply because Gallaher had reason to believe that TEL might be acting improperly and Gallaher considered it appropriate to do so; nor that TEL's fate should be determined by the application of so wide and uncertain a criterion as impropriety; nor that Gallaher should be the sole judge of what was appropriate. The ITP is not

incorporated into the TEL Agreement – see paragraph 593 above, and, in any event the ITP does not provide that, if Gallaher terminates the TEL Agreement, it can do so without liability.

My conclusion

651 The ITP was not incorporated into the TEL Agreement. But the ITP, taken with Mr Tlais' subscription on TEL's behalf, to it in the statement - "*I have read the above policy and confirm that I understand it and will be bound by its terms in all dealings with companies of the Gallaher Group*" - entitled Gallaher to terminate the TEL Agreement if:

(a) TEL was shown to be behaving improperly; or

(b) Gallaher had reason to believe, and did believe, that TEL might be behaving improperly; and

(c) in case (a) or (b), Gallaher thought it appropriate to terminate; or

(d) Gallaher concluded that TEL was a smuggler.

In order to come within (a) Gallaher would have to establish that the facts showed that TEL was behaving improperly. In order to come within (b) Gallaher would have to show belief, and reasons for belief in possible impropriety. In order to come within (d) Gallaher would have to show that it concluded (and had reason to conclude) that TEL was a smuggler. Gallaher's decision to terminate the trading relationship could be impugned if it had acted in some arbitrary, capricious or irrational way.

652 I do not regard the concept of impropriety, or the proposition that Gallaher should be entitled to act, if it had reason to believe that TEL might be guilty of impropriety and if it thought it appropriate, as so startling that the parties cannot have intended it. This is particularly so given that the TEL Agreement was drafted in circumstances where Gallaher was, and was known to be, eager to stamp out smuggling and to be in a position to part company with a distributor who might be a smuggler. Nor do I accept that the ITP did no more than state that Gallaher would consider termination if it had reason to believe that TEL was behaving improperly but would have no right to do so (save that given in TEL Agreement) if, having reason to hold that belief, it discontinued the relationship.

Gallaher's belief

653 Gallaher believed that TEL either was complicit in smuggling or had at least shown a reckless lack of control which was improper. As Mr Keevil put it:

> *"As a result of the …[Adam Trading Schedules] it was clear by mid-February that the reason for the extremely high level of seizures ….could only be explained by the lack of control exercised by TEL over its customers and, in*

> *particular ….Adam Trading. While the lack of control and management was the obvious inference to draw from the seizures [the Adam Trading Schedules] provided confirmation that the inference was correct and indeed showed that the failings by TEL were not merely the result of a lack of care, but most probably the result of deliberate complicity in smuggling.."*

See also Mr Rolfe's statement to similar effect:

> "[*The Adam Schedules were] clear evidence ..not just that [TEL] had failed to take proper steps to control the goods, but .. they had been at least reckless in the way they sold, and potentially complicit with smugglers".*

As was his oral evidence:

> "*What we were seeing on the face of it was evidence of shipments to a whole variety of ports where we had not received any documentation to support any rationale as to why [they*] *were going there. On the face of it, they were wholly incompatible with shipping to the markets in question and we believed they were evidence of malpractice by Adam Trading at least and given the close relationship with Adam Trading and Tlais, cast grave concerns about Tlais' complicity in those arrangements.*"

654 The first three matters set out in paragraph 647 above gave Gallaher reason to think that TEL had behaved improperly. So far as the level of seizures is concerned Gallaher thought – erroneously – that the level of seizures was 74% of all genuine seizures by HMCE in 2003-4. That is what Mr Keevil told the Board on 9th December 2004, citing "*Measuring and Tackling Indirect Tax Losses – 2004*". In fact, as I have said, the seizures represented 74% of all genuine UK brands seized: see Figure 3.1.

655 TEL submits that the internal processes by which Gallaher generated seizure statistics have been shown to be so poor that Gallaher had no reason to believe that they pointed to impropriety. Importantly, the figures which Gallaher had in March 2005 were greater than those upon which they now rely. But even the lesser figures relied on at trial give rise to an inference of complete lack of control. Those figures, when taken with the evidence of the Adam Trading Schedules, of which no satisfactory explanation has been given, are sufficient to justify such a belief. The reasonableness of that belief is not displaced by the fact that Sovereign had become a much smuggled brand, that there had been damaged Dorchester sold off in non core markets and that Mr Tlais had been engaged in the clearance of the Old Stocks.

656 I deal with TEL's failure to provide sales reports in paragraph 739 below. In other circumstances these might be treated as just a failure and no more. In the light of the level of seizures and the Schedules, the failure to account for sales made supported, or, at the least, did nothing to dispel, the inference of a lack of control.

657 The matters upon which Gallaher relied under head (iv) as justifying its belief do not take the matter much further and I do not propose to address them.

Conclusion on ground 2

658 Accordingly I conclude that Gallaher was entitled to terminate the TEL Agreement pursuant to the ITP and TEL's subscription to it.

Ground 3 Failure to keep and produce accounts and records

659 The third breach relied upon is a breach of clause 4 (viii) by which TEL agreed that it would keep:

> *"full, proper and accurate accounts and records showing clearly all sales transactions and inventories relating to the Brands and all services rendered by the Distributor pursuant to this agreement and will produce the same to GI or its duly authorised representatives upon reasonable notice. The Distributor shall retain all such accounts and records for at least six (6) years or more if required by applicable law"*

660 There is an issue as to whether the clause requires one or two forms of documentation i.e. whether the obligation is to keep a form of documentation which can be compendiously described as "accounts and records" or whether it is to keep (a) accounts and (b) records. In the latter case the question is whether the adjectives "*full, proper and accurate*" apply only to the accounts and the obligation to "*show clearly all sales transactions and inventories relating to the brands*" applies only to records, or whether the adjectives and the obligation apply to both.

661 In my judgment TEL is bound to keep both accounts and records, each of which are required to be full, proper and accurate and which, between them, show clearly all sales transactions and inventories. Accounts and the records from which accounts are prepared are recognisably distinct things. That is so as a matter of ordinary language. The distinction also appears in the English *Companies Act 1985*, which by section 221 requires every company to keep "*accounting records which are sufficient to … enable the directors to ensure that any balance sheet and profit and account*" prepared under the relevant Part complies with the requirements of the Act. It also appears in the *Cypriot Companies Law*, section 141 (1) of which requires the directors to ensure that "*proper books of account are kept that are deemed necessary for financial accounts"* in accordance with the Law.

662 I see no reason to depart from that construction in favour of a composite form of documentation that can be described as "accounts and records", the ambit of which is not clear, or to limit the application of the adjectives or the "*show clearly*" phrase to the accounts. This is particularly so given the context in which the TEL Agreement was made namely that Mr Tlais would:

> "*procure for Gallaher full transparency over the financial management of the business, including without limitation, the management of your banking facilities in order that Gallaher might gain comfort that your position is improving in line with the agreed plan*": paragraph (vi) under 'Banking Matters' of the letter of 29th April 2002.

663 That does not mean that the accounts and records will involve duplication. By their nature they will contain different things.

664 In order for the accounts and records to be "*full and proper*" and to show "*clearly*" all sales transactions and inventories, they would need, in my judgment, to be such as would make it possible to identify in respect of the Brands:

(i) what orders had been given;

(ii) which goods had been sold, to which customer, at which price (or on what terms as to price);

(ii) the territory for which those goods were destined;

(iii) the opening stock; and the warehouses at which it was stored;

(iv) all additions to that stock, with the date of receipt;

(v) all releases of stock; including the date of release and either the identity of the person to whom the goods were released, the place of release and the intended final destination or the place to which the goods were shipped and the consignee, with details, if different, of the final destination and the ultimate recipient;

(vi) the warehouses into which additions of stock had been made and from which releases had been effected;

(vii) the current balance due in respect of purchases;

(ix) the amount in stock at any given time at every location where stock was kept;

(x) the cost of the stock and information from which its value could be derived e.g. a record of whether it had deteriorated;

(xi) in all the above cases the mix between brands and flavours.

665 I reach that conclusion for a number of reasons. Firstly, some of the information set out above would be essential for any form of record and account of sale transactions and inventories. Secondly, the parties clearly showed by the language that they used that they did not intend TEL's obligations to be restrictively construed. The accounts and records were to be "*full, proper and accurate*". They were to show sales transactions and inventories, not just sales and stock figures.

666 Thirdly, TEL Agreement imposes on TEL a number of obligations the fulfilment of which would require it to monitor sales and inventories in considerable detail. Thus, TEL was obliged to ensure that its ordering and stock controls were such that the Territories were adequately stocked to meet in full the demand for the brands:

clause 4 (ix); to agree sales targets for the ensuing 12 months on a quarterly basis: clause 4 (xi) (a); to maintain minimum stock levels for the brands: clause 4 (xv); to provide all services necessary for the efficient distribution, sale and promotion of the Brands: clause 4 (xviii); and to comply with the obligations contained in the ITP to sell only into countries where duty will be paid and the goods would comply with all applicable laws; and to make necessary inquiries to satisfy themselves that their customers would behave responsibly. Accounts and records which had the characteristics that I have mentioned would be needed to comply with those obligations.

667 Fourthly, as I have said, the parties contemplated that TEL's records would have a high degree of transparency.

668 Fifthly, so far as stock is concerned, in the absence of information from which the value of stock can be derived it is not possible to calculate opening and closing stock values; without which it is not possible to prepare annual accounts.

ACCOUNTS

669 Both Mr Tlais and Mr Clarke accepted that TEL did not during the TEL era keep accounts which showed the financial position of TEL. The reason, according to Mr Tlais, was that all the money received went to Highstreet.

670 There are no relevant audited financial statements for TEL. There is a document which purports to be an audited financial statement for the period from 1st November 2002 to 31st December 2003, prepared by C. Agathocleous & Co ("Agathocleous") on, according to Mr Tlais, the instructions of Mr Joseph Khatter, TEL's administrator/accountant. It plainly does not reflect the true size of TEL's business.

671 As Gloster J put it in a judgment of 20th September 2006:

> *"The only accounts disclosed by TEL to GIL as part of the disclosure process are for the period 1 November 2002 to 31 December 2003. These show negative working capital as at 31 December 2003 and total assets of only about $ 12,800. However, what is particularly significant is that the accounts do not appear to reflect the business of the company; they show only some modest fee income when they should, on TEL's own case, reveal millions of dollars' worth of cigarette sales resulting in about $9 million profit for the 2002-03 period. However these sales and alleged profits are not recorded anywhere in the accounts. It is clear to me that the accounts as presented to this court do not appear to show anything like a true and fair view of TEL's financial position, if indeed it was the entity that was carrying on the business referred to in the defence and counterclaim. The absence of other accounts or financial information to support TEL's trading position is also a matter for concern in view of its extensive claims for alleged loss of profits and other business losses."*

672 The account refers to "*fees receivable*" of C £ 85,435 and to administration and finance expenses of C £ 84.134. What these fees are is wholly unclear. It may perhaps be that these accounts were drawn up on the footing that Highstreet had received all the money and TEL was only retaining a fee.

673 There is a set of unaudited accounts for the period from 25th April 2002 to 31st December 2005 prepared by Agathocleous but unsigned by the directors. These accounts, which are irreconcilable with the accounts referred to in paragraph 670 above, reveal a loss over the period of US $ 32,082,221 on sales of US$ 32,895,359. No opening stock is specified. The notes show an inventory of zero, a figure of $ 8 million as "*provision for impairment of stocks*" having been written off against a figure of the same amount for "*Finished goods*". The $ 8 million is said to represent 160,000 cases purchased at $ 50 per case. Mr Clarke's evidence was that this information was (a) inaccurate and (b) supplied by Mr Tlais. Another note to the accounts writes off $ 15,435,935 of trade receivables.

674 These accounts are undated but were, as I understand it, produced together with their accompanying workings in 2006 and early 2007. They were prepared at least in part on the basis of information supplied by Mr Clarke the nature of which has not been revealed. The experts are agreed that these accounts are not prepared from TEL's books and records as disclosed and should not be relied upon as a record of TEL's historic trading performance.

675 There have been disclosed no overall summaries of account balances derived from any accounting system, or books of prime entry. There has been disclosed what has been described as a "cashbook". This is not what an accountant would describe as a cashbook, i.e. a record of cash receipts and payments which can be reconciled with banking documents. It is a list of expenses that TEL alleges it incurred covering most of the overhead expense categories that TEL would be expected to incur.

676 In the light of the above TEL was in breach of its obligation to keep full proper and accurate accounts.

RECORDS OF SALES TRANSACTIONS

677 TEL has produced a number of customer account statements. These list sales made and cash received from individual customers. They are not primary accounting documents[77]. They are summaries prepared by Mr Clarke after the TEL Agreement was terminated and after Mr Khatter had left TEL. They detail for each customer to which they relate, the date, volume, price and brand of cigarettes sold; and record cash receipts from customers[78]. They do not show the final destination of the goods sold (information which TEL did not have) nor do they provide a link to the shipping documents. Goods released to Adam Trading, which account for 385,781

[77] An accountant would call them a memorandum account.

[78] Mr Pollock found that 452,873 cases detailed in the statements could be matched to stock release and delivery documents. 9,400 cases could be matched to bills of lading and 49,985 cases to sub-distributors' letters. These figures cannot reliably be aggregated because it is not clear to what extent different documentation belongs to the same shipment.

out of the 550,000 cases on the customer accounts, could, as Mr Tlais accepted, have gone to any one of a dozen or more territories.

678 The underlying documents from which the customer accounts were created had been compiled and kept by Mr Khatter. The documents from which Mr Clarke made his summaries included print outs from a desk top PC. The contents of that PC have not been disclosed. Mr Khatter printed these documents out almost every day. They apparently gave details of the last three or four transactions (with date, product, number of cases, price and total), details of payments received and the balance for each customer (so that a lot of duplication was involved). In the absence of the underlying material it is impossible to tell whether the contents of the customer accounts are complete or accurate, or whether, for instance, any apparent sales have been reversed. Nor can their accuracy as a summary of all relevant sales be verified by reference to other documents. TEL's' own expert identified numerous instances in which he could not match entries in the customer accounts to any documents.

679 Once he had compiled the summaries Mr Clarke threw the underlying documents away. This occurred after the commencement of these proceedings. I accept Mr Clarke's evidence that he did this because he thought that the documents were duplications and did not need to be retained. But he should not have done so. The destruction of the documents has meant that it is not possible to check whether his summary accurately reflected the contents of the base material from which it was compiled.

680 Even if the customer accounts are accurately derived from the underlying material, they are not records that clearly show all sales transactions, nor are they full and proper. Mr Tlais' evidence was that the customer accounts showed the release of the goods and that the price recorded in them was not the final price, which was agreed only when the customer had sold the goods on. The customer would then "*take his expenses and very small profit for him and then [TEL] receives the balance*". Mr Clarke's evidence was that the price that was to go in as a debit entry in the books was agreed at the point of release. The evidence of both Mr Clarke and Mr Tlais was that payment would become due when the goods were sold by the customer.

681 The customer accounts have odd features. For instance, the Parsian Fougan account stops in August 2002 although Parsian Fougan remained the principal Iranian distributor long after that. The total of the goods supplied to Iran is said to be the product of sales to Parsian Fougan recorded in its customer account (60,000 cases) and such of the sales to Adam Trading as were destined for Iran. But it is impossible to identify which of the sales in the Adam Trading customer account were destined for Iran; and the only figure identified in Mr Clarke's witness statement as sales by Adam Trading to Parsian Fougan (5,631 cases of Dorchester) is too small.

682 Adam Trading was said by Mr Clarke to have kept records of sales, to which TEL had access, and I am prepared to accept that it did. The form and content of those records (save insofar as they are contained in the Adam Trading Schedules) are unknown. TEL did not have copies and had not asked Adam Trading for them.

683 There are no sales and purchase ledgers and there is no nominal ledger. An invoice appears to have been prepared if needed for a letter of credit; but otherwise the amount due was simply added to the customer account. As a result there are very few TEL or TEL related invoices. The invoices disclosed total about $ 4.66 million and represent less than 10% of the sales recorded in the customer accounts. A number of those are from Highstreet or Tlais Trading Company Ltd or are invoices to unknown customers. The TEL invoices raised to identified TEL customers for Gallaher brands the subject of the TEL Agreement total $ 2,074,700.

684 Such invoices as were disclosed were the subject of the notice of challenge to which I referred in paragraph 586. One set of invoices on the paper of Tlais Trading Company Limited shows the price due as $ 30 per case. That is the price used in the letter of credit for the relevant goods but the customer account statement refers to $ 60 as the price per case. Either the customer account statement is wrong or the price was not wholly paid by the letter of credit. In that event the certificate of authenticity stating that the amount invoiced is the full price is misleading.

Release documents

685 At one point in his evidence Mr Clarke stated that TEL's compliance with its obligation to keep records of all sales transaction was constituted by "*the warehouse releases, and the fact that the customers were being charged*". The disclosed release instructions to the several warehouses (the authenticity of which was disputed and not proved) do not identify the goods being released other than by the brand (so that there is no way in which the age or codes of the goods can be known), and hardly ever provide any indication of the intended final destination of the goods.

686 Mr Clarke's evidence was that he was not involved in releases but he believed that either Mr Tlais or Mr Khatter would telephone the warehouse and give them details of the destination of the goods to be released, or the code of the goods to be released (which would relate to a particular destination), and the written instruction would follow, but without those details. Mr Tlais' evidence was that it was not he who did this. He would tell Mr Khatter that he wanted goods to be released to a particular destination and Mr Khatter would tell the warehouse that the goods were for that destination, or would give instruction for goods of a particular code to be released.

687 I have considerable doubt as to the extent to which Mr Khatter told the warehouse of the destination of the goods. If the warehouse was to be given the destination information I see no reason why it should not have been included on the written release instructions. Mr Tlais said that his instructions were that the release instructions specifying the destination should always be given in writing. I doubt that too. Even if it was so, Mr Khaterr did not comply with those instructions. Further, releases in respect of 7,850 cases cannot be matched to any record of sales, whether on an invoice or a customer account.

Bills of Lading

688 TEL has disclosed a number of bills of lading (the authenticity of a number of which has been challenged). Some do, but most do not, contain an indication of the

final destination of the goods shipped, if different from the port of discharge. The bills often failed to record the brand shipped.

689 In the light of the matters set out above it is plain that TEL failed to keep records showing clearly all sales transactions let alone full, proper and accurate ones. The records Mr Khatter kept did not show clearly all transactions. On the contrary they showed a notional price, not in fact due until a sub sale had taken place, and then in all probability not in the amount specified. Wholly inadequate records were kept of the intended destination of the goods sold to purchasers from TEL.

INVENTORIES

690 So far as stock records are concerned, TEL stored cigarettes in seven different warehouses during the TEL period. There were three principal ones (i) A Georgiades Bonded Stores Ltd – in Cyprus; (ii) Thomsun Mercantile Marine LLC – in Dubai; and (iii) Atteshlis Bonded Stores – in Cyprus. TEL's documents do not reveal anything which an accountant would recognise as an accounting system in respect of stock nor any summary records derived therefrom.

691 There are six letters ("stock reports") from Mr Clarke to Mr Jack reporting the balance of the stocks that TEL held on specific dates: see the second and third columns of the following table:

Table 4.8.1

Summary of stock reconciliation

Disclosure reference	Date of stock report	Stock Balance	Calculated Stock balance	Difference	Difference %
07393	28/05/2003	266,505	n/a	n/a	n/a
07870	28/07/2003	224,892	223,335	1,557	1%
08320	30/09/2003	175,936	157,287	18,649	11%
08771	30/11/2003	194,936	159,401	35,535	18%
08979	31/12/2003	153,559	194,936	(41,377)	-27%
10638	08/10/2004	168,151	105,652	62,499	37%

692 The letters do not identify the brand of the goods or which goods were TEL coded. Nor do they identify the date of production of any of the stocks, their destination codes, whether they were pledged, or their value.

693 Gallaher's expert accountant was Mr Angus Pollock. I found him a highly competent and impressive witness, in whose evidence I could, once I had mastered it, place considerable confidence. He was unable to reconcile the data in the stock reports with the movements in stocks apparent from Gallaher stock shipment records and TEL's disclosed documents showing stock releases. His attempt to effect the reconciliation required the making of certain assumptions as to when

goods would have been received into or released from the warehouse[79]. The "*Calculated stock balance*" in the above table is the balance that Mr Pollock derived from the data in those documents[80]. (Mr Clarke thought that some of his reports included some old stocks owned by Adam Trading)

694 There are also in the disclosed documents some stock reports from individual warehouses. TEL does not seem to have had or kept a complete set of stock certificates from all of the warehouses that it used in Cyprus and Dubai; nor any set of documents from all those warehouses as of the same date. The data contained in Mr Clarke's stock reports does not reconcile with the data derived from the stock reports from the warehouses: see Sub-Appendix 4.8.2 to Mr Pollock's report. The Clarke stock reports record stock greater than that reported in the warehouse letters of between 48,573 and 183,166 cases[81]. Mr Pollock's calculated end position – taking the period from 28th May 2003 to 8th October 2004 and all stock movements – produced 66,853 cases less than the amount of cases recorded in the stock report of 8th October 2004: see Sub Appendix 4.8.3.

Opening stock

695 TEL pleaded that its opening stock was 151,579 cases, originally ordered by Namelex but paid for by the Tlais family. But TEL has never, despite requests, identified the make-up of these cases by brand, nor any documentary evidence that establishes that TEL owned this amount. (If the figure is correct, it is agreed that, on the basis of the volumes of purchases, sales and destroyed stock in the historic trading account (see paragraphs 710ff below) the closing stock would be 77,192 cases). Nor is it possible to value the opening stock. It is possible that the value of the opening stock for which TEL seems never to have paid, is nil. But this is unlikely, not least because TEL appears to have realised some value from it.

696 Mr Clarke's evidence ("*It is very complicated and I am not the best person to explain it")* was, in effect[82] that the 151,579 cases consisted of (a) goods in Cyprus that were owned by Mr Tlais, Highstreet, or one of the Tlais family, "*whoever opened the LC*", and (b) goods in Dubai that had been owned by Mr Tlais or Highstreet or the bank or whoever purchased the goods[83] but had been released to Adam Trading (since until around Christmas 2002 goods in a warehouse had to be consigned to a resident company), but not paid for and were goods which Mr Tlais could claim back. They had been entered on the Adam Trading customer accounts.

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[79] Set out at paragraph 8.25 of Appendix 4 to Mr Pollock's report.

[80] In relation to some brands on some of the dates Mr Pollock's calculations produced - see sub-appendix 4.8.3 - a negative stock balance; suggesting that the documentation on which he based his analysis was either inaccurate or incomplete.

[81] The stock letter of 30th November 2003 shows a figure of 194,936. But there is no warehouse report with which to compare it.

[82] The evidence was somewhat confused not least, I suspect, because Messrs Tlais and Clarke did not distinguish much between Highstreet, TEL, Mr Tlais and other family members/companies nor pause long to consider the precise ownership position or the basis upon which any stock was to be regarded as belonging to TEL or Mr Tlais.

[83] Mr Clarke's evidence embraced all three of these.

According to a document prepared by Mr Clarke after the termination of TEL Agreement, as explained by him in evidence, there were 80,681 cases of goods transferred to TEL from Highstreet in Cyprus, and 70,000 cases under the ownership of Adam Trading, in Dubai, which Adam Trading released to their customers during TEL Agreement and for which TEL received payment during the TEL era.

697 There are no records to show the level of goods returned, although there were said to be many returns.

Closing stock

698 There is no complete set of stock records to confirm the closing volume or value of stock at the termination of the TEL Agreement or any date thereafter. It is possible that it had no realisable value.

699 Agathocleous appears to have been instructed, not by Mr Clarke and presumably by Mr Tlais, that TEL owned 160,000 cases as at 31st December 2005. Mr Mathew-Jones was instructed some time before his report of March 2007 that there remained 16,000 cases in Dubai and 4,920 cases in Cyprus.

700 In the light of the above it is clear that TEL failed to keep accounts and records clearly showing its inventories relating to the brands, let alone full proper and accurate ones. It is not possible to tell, even now, what TEL's opening stock was nor its value, nor is there any full and accurate TEL record of additions and releases and of outstanding balances of stock at all the warehouses at which stock was kept.

General

701 The obligation to keep full, proper and accurate accounts and records requires the keeping of records to a standard that a competently managed company in TEL's position could reasonably be expected to achieve. Different companies may keep records in different forms and still comply with that standard.

702 Paragraphs 702-705 and 709 below reflect matters upon which Mr Mathew-Jones and Mr Pollock, the experts for the parties, were agreed or which are accepted by Mr Tlais.

703 TEL's business involved the purchase, receipt, storage, sale and shipping of billions of cigarettes across several jurisdictions and in several different currencies. Its activities were, however, essentially simple. It bought, kept and sold cigarettes.

704 TEL's transactions could have been accounted for and adequately recorded in a basic set of accounting records. It could be expected to maintain books and records in accordance with relevant laws and accounting guidance which would record the actual financial performance of the business. These would include the books and records necessary for the preparation of financial accounts including a profit and loss account and a balance sheet. Underlying those financial accounts there should be books of account, typically, but not necessarily, maintained on a double entry bookkeeping system, which recorded the individual transactions.

705 TEL could be expected to have kept the following documents:

(i) audited financial statements;

(ii) tax returns and assessments;

(iii) stock reports;

(iv) books of account e.g. sales and purchase ledgers, a nominal ledger, and a cash book;

(v) sales and purchase invoices for cigarettes;

(vi) invoices for direct and indirect selling costs (e.g. shipping and storage costs – direct; and promotional costs – indirect;

(vii) invoices for overheads and administrative costs (e.g. insurance and telephone) ;

(viii) payroll information;

(ix) banking records;

(x) to the extent that the directors of TEL required them for the management of their business (i) management accounts and (ii) budgets and forecasts.

706 Compliance with TEL's obligation under clause 4 (viii) would, in my judgment, require the keeping, in addition to financial statements (not necessarily audited), of at least the following records or their equivalent: (a) sales and purchase ledgers; (b) sales and purchase invoices; (c) stock records; (d) a nominal ledger; (e) a cash book, properly so called ; (f) invoices for direct and indirect selling costs; (g) some record of overhead and administrative costs; (h) information as to payroll costs; and (i) banking records relevant to the business.

707 TEL failed even to come close to compliance with these requirements. It kept no financial statements which were even half reliable. Its stock and sales records, such as they were, were defective in the manner that I have described. The "sales" figures in the customer accounts were probably overstatements. It had no sales and purchase ledgers or nominal ledger (and Highstreet does not appear to have had any either). Nor did it have any cash book in the normal accounting sense of that term. Only a small proportion of goods sold were covered by invoices. TEL has disclosed bank statements for 20 different accounts. But there are significant gaps in the statements produced, which, despite requests, have never been filled. There were, in addition, accounts at other banks through which TEL business was conducted and the statements for these accounts have never been produced.

708 Full, proper, and accurate accounts and records of TEL would have given some explanation and record of how the price actually received on the sale of goods that TEL had bought from Gallaher was handled. Mr Tlais' evidence was that all the

money that Tlais was to receive for the sale of the Brands went to Highstreet, and not to TEL.

709 A critical test as to the adequacy of TEL's records is whether they were sufficient to prepare a complete record of TEL's historic trading performance. It is agreed by the experts (and Mr Tlais) that the financial information disclosed by TEL is

> "*incomplete and, in the absence of other information, is insufficient to prepare a complete record of TEL's historic trading performance*".

TEL Agreement as to a historic trading account.

710 Subject to that qualification Mr Pollock and Mr Mathew-Jones reached a substantial measure of agreement as to figures for an historic trading account reflecting TEL's trading during the TEL era. They have however been unable to test its accuracy in the absence of any reliable financial accounts or summary of account balance.

711 They agreed a net trading result of US $ 12,041,480 reflecting total sales revenue of $ 42.1 million (derived from customer account statements and sales invoices[84]); less:

(a) total purchases of $ 22.2 million;

(b) other income of $ 0.257 million[85];

(c) operational expenses (from 1st May 2002 down to November 2006) of $ 3,500,000[86] and

(d) bank /financial charges of $ 4.6 million.

The latter figure may be incomplete since the banking records, particularly for the period May to December 2002 are incomplete.

712 The experts have also agreed that TEL had purchased the 365 day stock for $ 3.4 million and new stock for $ 18.8 million, as well as receiving the Dubai/Cyprus stock.

713 The only difference between the two accountants was that Mr Mathew-Jones would deduct $ 2,579,967 for stock destruction costs and $ 12,902,231 for a write off of irrecoverable debtors. He would write off the debtors on the basis that this is what should be done in the absence of evidence to the contrary, particularly since there is evidence that some customers are preparing their own claims. Mr Pollock takes the

[84] Assumed to represent legitimate sales, including sales by TEL, Highstreet and, also, Tlais Trading Co Ltd. A number of stock release document which agree to sales in the customer account statements show the latter as the party instructing release.
[85] This includes a figure of $ 77,000 which is a receipt into Mr Tlais' personal bank account and may not represent TEL income.
[86] Including an assumed figure for salary and other sundry office costs of $ 548,000.

view that whilst some of TEL's debts may have been irrecoverable it is impossible to determine a reliable figure for what that amount might be.

714 The $ 42.1 million figure is likely to be overstated. As is now apparent the figures in the customer accounts do not always represent the prices which the sub-distributors were bound to pay and were liable to be discounted according to whatever price the sub-distributor managed to obtain. That will mean that the net trading result is overstated. The net trading result would also fall to be reduced by the value, if any, of the stock remaining at the end of the period.

715 The experts agree:

(i) that out of 553,408 cases identified as sold on the customer account statements and invoices, 461,923 cases could be matched to stock release documents;

(ii) that the customer account statements indicated total receipts of $ 27.8 million (compared with overall sales revenue of $ 42.1 million). Of this $ 19.4 million could be matched to the banking records disclosed, on the basis of the criteria set out in Appendix 4 of the Joint Statement[87]. They agreed that this amount may be an understatement on the basis that there are other bank accounts which had not been analysed in full and there were gaps in the banking documentation that had been analysed;

(iii) that there were about $ 34.7 million of third party receipts (i.e. all credits on bank statements less internal transfers, receipts from Gallaher and interest from the bank) in the disclosed documentation analysed.

716 The effect of the above is that (a) $ 8.4 million ($ 27.8 – 19.4m) of receipts on the customer accounts could not be matched to the banking documentation; and (b) about $ 15.3 million ($ 34.7 - $ 19.4m), i.e. about 40% of receipts by TEL, could not be linked to receipts recorded on the customer accounts. These are major defects in record keeping.

717 As to $ 15.3. million the experts agreed the following:

> *"4.12 The US$15.3 million unmatched third party bank receipts (i.e. approximately US$34.7 million less US$19.4 million) can be split into the following four categories:*
>
> • *US$1.8 million which appear to relate to known customers (or persons / entities identified as the payer of an amount already matched) but which we are unable to match to specific entries in the customer account statements;*

[87] The agreed criteria are wider than initially used by the accountants. The wider the criteria the greater is the uncertainty of the match.

> • *US$3.1 million from named third parties but which are not a known customer (i.e. a party identified as the payer of an amount which we have been able to match another receipt from)*
>
> • *US$1.4 million of receipts from OTI which are matched against sales invoices identified separately; and*
>
> • *US$9.0 million of other receipts for which we have seen no further information*"

US $ 9 million is over 25% of total receipts.

718 The experts also made this observation:

> *"4.13 We do not know what these unmatched receipts relate to, however we agree that there are a number of possible explanations. These include:*
>
> • *receipts from customers as listed in the customer accounts, for which we do not have sufficient information to make a match;*
>
> • *receipts from sales which have not been included within the accounting records disclosed;*
>
> • *receipts from old debts due from sales made in the Namelex era;*
>
> • *receipts from Mr Tlais, or members of his family to provide additional working capital to finance the business;*
>
> • *receipts for business carried out by Mr Tlais which is unrelated to that of TEL".*

The utility of the historic trading account.

719 In Mr Pollock's view, with which I agree, it is not possible to create a historic profit and loss account that provides a reliable record of TEL's past financial performance, even on the basis of the reconstructed historic trading account[88].

720 Firstly, the documents disclosed are incomplete and unreliable. For example, Mr Pollock was only able to match three sales invoices to entries on the customer accounts. He found credit advices with descriptions including reference to an invoice number but has not seen the corresponding invoice. He was unable to

[88] The experts are agreed that it is not possible to test the accuracy of that account against any reliable financial accounts of TEL or any summary of account balances.

reconcile some 27 cash receipts in the banking documentation having descriptions which suggest that they were receipts from customers, with receipts shown on the customer account statements. These amounts total $ 3,575,526[89]. There are gaps in the banking documentation particularly in relation to the period May 2002 to December 2002.

721 Secondly, it is not possible to calculate the gross profit. Gross profit is sales revenue less cost of sales. The cost of sales is calculated as the value of the opening stock plus purchases less closing stock. By calculating gross profit in this manner the sales made in any given period are matched by the costs appropriate to those sales. Without such a calculation costs will appear in the account in one year (e.g. the very large costs of initial purchases in 2002/3 which represented 86% of total purchases over the whole period of the account) which may be far more than the costs properly attributable to sales in the same year; or one year (e.g. 2003/4 and 2005/6 in the historic trading account) may have sales with no apparent related cost.

722 In the present case the only figure for opening stock is the pleaded but unsupported figure of 151,579 cases of stock transferred from Namelex to TEL. There is insufficient information available to value that stock, whose make up and age are unknown. Nor is it possible to derive opening and closing balances for each year by using the purchase information (in the form of Gallaher invoices) and sales information gathered by Mr Pollock from the documents disclosed.

723 The brand of stock sold is apparent from the documentation but it is not possible to tell whether and to what extent the sales made were sales of (a) cigarettes transferred from Namelex, (b) new purchases from Gallaher or (c) Gallaher stock held in Dubai and Cyprus transferred to TEL at nil value. TEL mixed old stock with new, in what is said to have been the proportion 80% (new) and 20% (old). It is impossible to determine from the documents which sales were of mixed goods and of what each particular sale consisted. It is thus not possible reliably to calculate the cost of sales of mixed product or the value of stock left behind. On the assumption that the opening stock was 151,579 cases it is possible to calculate a closing stock of 77,592 cases, but neither its make up nor its value[90].

724 Since it is impossible to derive from the documents a figure for opening and closing stock, any attempt to derive a profit and loss account would require the making of assumptions as to:

(i) the opening stock balance and its constituent brands;

(ii) the value(s) to be attributed to such stock/brands;

[89] In addition Mr Pollock was unable to reconcile the sales indicated in the customer account statements and sales invoices with the shipping documents disclosed. It is thus not possible to verify the destination of the sales shown in the statements.

[90] It is possible that the proper opening figure for stock was zero (if, for instance, it is to be regarded as acquired for no value) and the proper closing figure also zero (on the ground that the stock was valueless). If that was so it would be possible to calculate a profit/loss account spanning the whole period (subject to the other inadequacies in the material) but not one for any given financial year.

(iii) how the different categories of stock (old, new or transferred from Gallaher at nil value) are reduced in volumes by sales; and

(iv) the method of valuation.

725 As to (iii), Mr Pollock performed a calculation which assumed that the opening stock was 151,579 cases of existing stock and that all the stock sold was mixed in an 80:20 proportion of new to old in respect of all brands as pleaded. The effect of making that assumption was that there was (see Sub-appendix 6.5.2) a shortage of new stock at the end of the period resulting in a negative new stock balance of 80,740 cases. This exercise showed that it was not possible to calculate a reliable stock movement schedule by category of stock using the 80:20 ratio. It may be that whilst in general a ratio of 80:20 did apply, there were some shipments of unmixed old stock or different permutations of old and new stock in the sales transactions. But, if so, the documentation did not enable Mr Pollock to make an appropriate adjustment.

726 As to (iv), normal accounting convention is to take the lowest of cost and net realisable value. That requires you to be able to identify what was sold and what remains and the original cost of the latter. This cannot be done.

727 Mr Pollock concluded that there were too many unsupported assumptions that needed to be made in order to prepare a stock movement schedule to enable a reliable value for stock to be determined at any time in the TEL trading period. Accordingly he did not regard it as possible to prepare a reliable historic profit and loss account for TEL. I agree with this analysis.

Breach

728 The matters to which I have referred in paragraphs 704-727 above establish that TEL was in breach of its duty to keep full proper and accurate records showing clearly all sales transactions and inventories in relation to the Brands. It kept no accounts; had no full and proper records of sales or stocks, nor did it keep the accounting records that it could reasonably have been expected to keep.

Estoppel and Waiver

729 Paragraph 112 of the Defence reads as follows:

> *"Further, or alternatively, if (which is denied), any conduct on the part of TEL was strictly contrary to the terms of TEL Agreement, or any of them, GIL is estopped and/or otherwise precluded from relying on the same by reason of:*
>
> *112.1 its consent and/or instructions given to TEL in relation to the relevant conduct and/or its acquiescence in the same; and/or*

112.2 the fact that any infringement of the strict terms resulted from GIL's conduct (as pleaded at paragraph 51 above) and/or GIL's own breaches of its obligations under TEL Agreement as pleaded at paragraph 122 below".

730 The breaches alleged in paragraph 122 were the removal of Sovereign and a failure to cooperate with TEL in the exercise of its best endeavours under clause 2 (v) (b) of TEL Agreement or in conducting its business under the ITP.

731 TEL was asked for further information about its case on estoppel. Its response was that its case was clear. It then referred to certain paragraphs in its existing pleading by way of example. These examples did not relate to any breach by TEL of the ITP, or any failure by TEL to keep records, to sell brands commensurate with demand or to appropriate customers, to take proper steps for the distribution, sale and promotion of the brands, or to secure proper business conduct by its customers, or in respect of the breach of the ITP by TEL's customers.

732 The evidence given in TEL's witness statements in support of the plea of acquiescence was of the highest degree of generality. It consisted of paragraph 904 of Mr Clarke's witness statement which read:

"Even if there were any respects in which it could be considered that TEL fell down in any way on the strict letter of the requirements of the distribution agreement, any defaults could in no sense be considered serious or irremediable (as I have described in this witness statement). TEL's conduct at all times was agreed to or acquiesced in by Gallaher itself and/or was entirely reasonable and appropriate given the situation in which TEL was dealing and in which it was placed by Gallaher."

733 In the course of being cross examined Mr Clarke and Mr Tlais from time to time stated, particularly when any question of possible breach was involved, that Mr Jack knew about what was going on at TEL and made no objection to it. Reliance was placed by Mr Tlais on the fact, which I do not doubt, that Mr Jack would come to Cyprus about once a month, receive information from TEL and make a long note of it. Mr Jack had a catch phrase "*fair enough*" when given information.

734 Mr Jack knew a lot about TEL's business. He was a regular visitor and sought information on a number of topics including stock (he had access to the warehouses) and sales. He participated in the production of business plans. But it is not at all clear to me what he knew about the deficiencies of TEL's accounts and records, or that he was able to conduct any sort of review of them, much less that he clearly indicated to TEL an acceptance of, or indifference to, the major deficiencies in them.

735 Mr Clarke gave evidence of how, in March 2004 when Mr Keevil visited Cyprus, he went through TEL's financial position with Mr Jack. It was apparent from his description that, whilst they went through the latest bank statements, customer accounts showing the latest transaction and end balance for each customer, stock figures and sundry other things, there were a number of matters that were not gone through - such as earlier bank statements, the cash book which had a file of invoices and earlier versions of the customer accounts - and that Mr Jack was not signing off

on whether TEL had complied with its obligations under the TEL Agreement in respect of books and records. I have no reason to conclude that Mr Jack was doing so on any other occasion.

736 Nor do I accept that Mr Jack had actual or apparent authority to waive compliance with clause 4 (viii). Mr Fawaz gave evidence of a discussion he had with Mr Tlais where he told him that "*normally, decisions within Gallaher are taken by consultations and as a team and Norman Jack is not the, you know, the decision – the only decision-maker within Gallaher*". Mr Clarke accepted that "*we were working with a company and decisions would be made by a group of people within that company. Mr Jack, we know, was not the ultimate decision-maker for key decisions*". If TEL was to be relieved of the obligation to keep proper accounts it was not, in my judgment, for Mr Jack to do so; nor does the evidence support a claim that TEL thought that it was.

737 Further, the exchange of correspondence on 2nd September and 1st October 2004 – see paragraphs 480-486 – made plain, in a somewhat formal manner, that the terms of the TEL Agreement remained binding. The letter of 2nd September 2004 said as much and identified a number of specific obligations, *including* the obligations (a) to comply with the ITP, (b) to ensure that sales were intended for final sale to consumers within the TEL territories, (c) to supply within 7 weeks of any shipment evidence of the shipment of the order to the appropriate territory, (d) to keep paper records showing clearly all sales made and (e) to ensure that anybody to whom TEL sold complied with the ITP. Mr Tlais' response of 1st October 2004 accepted that, until the new arrangements were agreed and formalised the TEL Agreement was binding on both parties and confirmed Mr Tlais' full awareness of the obligations identified. This exchange of correspondence does not support the notion that TEL thought that there had been any relaxation of its obligations under the TEL Agreement and, if there had been, brought any such relaxation to an end.

Failure to produce records

738 TEL also failed to produce on request records showing sales transactions and inventories. Gallaher made a number of requests for stocks and sales reports. In particular in letters of 15th October, 18th and 29th December 2002, and 3rd January and 22nd September 2003 Gallaher requested and TEL agreed to provide monthly sales and stock reports. At the meeting with HMCE in July 2002 it was agreed that HMCE would be supplied with Mr Tlais' sales data on a monthly basis, such data to be incorporated in the export sales data supplied by Gallaher monthly. The data would be broken down to show quantity and final destination market.

739 Six stock reports were produced by TEL at irregular intervals, the last in October 2004: see paragraphs 527 and 691 above; but written sales reports were not. The stock reports did not identify which goods were TEL coded and which were not (let alone what the destination code of the goods was); or for the most part where the stock was. As is apparent from paragraphs 693-694 above the figures in the stock reports do not reconcile to the warehouse stock summaries or to the figures for goods shipped by Gallaher and the releases recorded on the customer accounts. Sales reports were not produced.

740 Mr Jack himself obtained information from time to time about TEL's inventory position. The documents reveal that in November 2002 he performed his own analysis of the Old Stocks. In January 2003 he was able, with the assistance of Mr Clarke and Joseph Khatter, who provided details of the closing stocks, to carry out a reconciliation of stocks and sales for 2002. In October 2003 he carried out a full stock count in Dubai, distinguishing between goods purchased under the TEL Agreement, Old Stocks and Dorchester awaiting destruction. He verified that his count of Dubai stock matched the records he had been provided with. In May 2004 he provided information on TEL's stock levels to the HMCE. In October 2004 he faxed a stock report from Cyprus.

741 On 14th January 2005, Mr Keevil wrote to Mr Tlais acknowledging the failure of negotiations in 2004 and inviting Mr Tlais' "*considered proposals concerning a potential discontinuance of our business relationship*". Mr Keevil reminded Mr Tlais that :

> *"Under our contract you are, of course, required, amongst other matters, to notify us of the final destination markets and provide the documents necessary to demonstrate that the goods have gone to the final destination markets. HM Customs will undoubtedly ask Jeff for this information in the near future. Could you please arrange for Mike to provide him with this information? At the same time can you let Jeff have a full stock reconciliation and your proposals for liquidation of your stocks, as he will need this information for HM Customs? If you could provide this information next week it would be very helpful."*

742 On 26th January 2005, as I have already recorded, Mr Jeffery wrote to Mr Tlais seeking

> *"at this time, a summary report, showing:*
>
> *a) Stocks by brand and location at the time of last reconciliation*
>
> *b) Sales by brand since the reconciliation identifying your customer and market destination*
>
> *c) Current stocks by brand and location*
>
> *d) Status of the stock i.e. whether or not they have been pledged to Blom bank."*

743 On 3rd February 2005 Mr Tlais replied. He referred back to Mr Clarke's 8th October 2004 stock report and said:

> *"Since that point 5000 cases of Sovereign have been released, 1600 fresh Dorchester full flavour and the full balance of Businessman. All other stocks remain the same. The location of the goods also remains the same."*

744 This was an inadequate response. The customer accounts in respect of the period from October 2004 to February 2005 show releases of Sovereign well in excess of

5000. More than 17,000 cases are recorded as having been released to Adam Trading. The accounts do not show any releases of Dorchester. The 8th October 2004 letter did not provide any detailed location of the stocks. It stated that the goods were "*held in several locations including the Republic of Cyprus, the occupied territories, Dubai, North Africa, Latin America and Iraq*".

745 In short TEL did not provide full, proper and accurate records of sales transactions and inventories.

Materiality and irremediability

746 TEL's breaches of its obligations of clause 4 (viii) were material. They have deprived TEL, Gallaher, and the Court of the ability to have a reliable view of the success or otherwise of TEL's trading activities or a proper foundation upon which to assess TEL's claim to damages. The absence of such accounts and records has led to enormous efforts having to be made to construct from inadequate raw data the means of establishing or refuting a huge claim for loss of profits. That is, is itself, an indication of the materiality of TEL's breach. One of the reasons for having proper accounts and records is to avoid the sort of protracted and expensive reconstruction exercise that has had to be undertaken in this case[91]. Another reason is to enable Gallaher to monitor what has happened to and in respect of its goods, to whom they have been sold and with what intended destination; and to facilitate the investigation of Customs' seizures of goods, for which purpose TEL's accounts and records were inadequate.

747 TEL submits that, to the extent that there were any breaches, they were remediable. Had a notice to remedy, rather than a notice of termination, been given, TEL and its accountants could and would have obtained the necessary information from distributors, customers, banks, and warehouses.

748 I regard this submission as wholly unrealistic. By March 2005 TEL's breaches were not remediable within 30 days. Its failure to keep proper accounts or records was extensive, deep seated and of long standing. It was not able, even at a trial in which it claims very large sums, properly to establish its sales, stock and accounting position. No doubt it would have been a better position to obtain data from third parties if Gallaher had not terminated the TEL Agreement; but it is most unlikely to have been able to have remedied the sizeable gaps in accounts and records within 30 days or even a more extended period.

Conclusion on ground 3

749 Accordingly, Gallaher was, in my judgment entitles to terminate the TEL Agreement on the ground of TEL's breach of clause 4 (viii).

[91] Mr Pollock informed me that he and his firm had spent over 8,000 hours in compiling his expert report. Whilst this breathtaking total was by no means entirely devoted to constructing an historic trading account it is obvious that a substantial part of it was devoted to that and an examination of the deficiencies of TEL's papers.

Ground 4 Failure to supply documents evidencing shipments to the appropriate Territory

750 Clause 3 (v) of the TEL Agreement provided that, in the event of TEL having to make deliveries to destination markets via an intermediate port:

> *"promptly after the arrival of each shipment of the Brands in the Territory, and in any event within (7) weeks of the arrival of any shipment of Brands to a territory, [TEL] shall supply to GI or Gallaher evidence of the shipment of each such order to the appropriate Territory."*

751 The reference to "*arrival*" in the Territory, and the obligation to supply evidence of shipment to the Territory within at most seven weeks of that arrival, shows that the clause required TEL to produce evidence of the shipment arriving in the Territory, not simply its shipment from the place of dispatch.

752 There are a number of ways in which TEL could evidence the shipment of cigarettes to their ultimate destinations. These would or might (depending on their content) include one or more of: (a) orders from, invoices to, and records of payment from TEL's customers; (b) records of releases from warehouses; (c) bills of lading or freight forwarding instructions; (d) exit/export certificates stamped by Customs and customs bills for administrative charges; (e) documents showing that the shipper had discharged containers at the intended destination; or (f) in the case of sales ex warehouse details of the consignee and the intended destination.

Documentation for the first year of the contract – 2002-3

753 In October 2002 Mr Perks began an audit of the shipping documentation provided by TEL. This was an ongoing process in the course of which TEL was asked for further documentation. The progress and upshot of that audit and his findings relating to the first year of TEL Agreement are set out in paragraphs 363-364 and 374 – 379.

754 As appears from those paragraphs the documentation provided by TEL in relation to the first year was defective and incomplete. In particular TEL failed to provide documents relating to shipments to Parsian Fougan and to TSS Tutun Sigara Savayi. These documents appear never to have been handed over to Adam Trading or to TEL. Between these two the missing documentation covered about 556 million cigarettes. Some of the cigarettes supplied may have been Old Stocks.

755 Parsian Fougan refused to co-operate in the provision of documents because of the problems with the damaged Dorchester. Hazem was seen by TEL in Iran shaking a set of documents, which he said he was going to give to Mr Jack - but not before his problems were solved. TSS was, I assume, unwilling to cooperate because it had been red carded.

756 Clause 3 (v) does not provide for exceptions, nor for TEL to be released from its obligation because of any reluctance on the part of a sub-distributor to provide the necessary evidence. It was, therefore, incumbent on it to make such arrangement with its sub-distributors as would ensure that it could produce the documents needed.

757 In relation to documents in respect of Iran Mr Clarke suggested that TEL had, under the Procedural Agreement, only limited obligations for ex warehouse sales. According to his evidence Parsian Fougan purchased from Adam Trading ex warehouse as did Adam Trading from TEL. But goods for Iran fall into the second category under that agreement, in respect of which TEL was to be "*responsible for onward shipments of goods to final destination*" and subsequently was "*to provide Gallaher with evidence of shipments by way of Bills of Lading, Customs release documents etc*". The fact, if it be such, that TEL did not in practice control shipments to Iran cannot absolve it from compliance with clause 3 (v). Moreover it was open to Adam Trading to ensure that any ex warehouse buyer provided copies of the shipping documents for supply to TEL/Gallaher.

758 In any event, not all sales to Hazem were made ex-warehouse. The disclosed documents reveal that there were some direct shipments from TEL to Hazem in the summer of 2002 including 48,000 cases of Dorchester full flavour and 12,000 cases of Dorchester Lights.

759 TEL also placed reliance, in relation to Iran, on the facts (i) that Gallaher representatives had had discussions with Firouz Homayoun as a prospective distributor in place of Hazem, about which Hazem had learnt; (ii) that Ligett-Ducat had sold some LD to a company called Platinum Leaf for Iran; and (iii) that Gallaher had delayed in the production of a marketing plan. None of these were breaches of contract by Gallaher. Gallaher was entitled to have discussions, which were only tentative and came to nothing, with Homayoun. The sale to Ligett-Ducat was soon discontinued. The delays in production of a marketing plan, which in November 2002 Mr Rolfe had said his team would look into preparing, was no justification for the non production of documents.

760 In relation to non Iranian markets, reliance was placed by TEL on the difficulties faced by TEL because the goods being sold where old or damaged. That is not, however, a justification for non production of evidence as to where they have gone.

761 TEL says that it only had an obligation to procure documents in respect of 80% of shipments: see the letters of 20th May and 2nd October 2003. For the reasons given in paragraphs 332 above I do not accept that TEL and HMCE agreed on Mr Tlais exercising only 80% control over Sovereign. I also do not accept that it was agreed that Mr Tlais need only produce documentation for 80% of shipments in the first year of business, an agreement that Mr Tlais characterised in his letter of 20th May 2003 as an agreement with HMCE.

762 What Mr Rolfe did tell Mr Tlais, in a letter of 23rd June 2003, was that "*based on our previous discussions I have committed to my fellow directors that we will be able to account for 80% of all documents as a minimum*". This was a reference to the fact that Mr Jack had told him that he believed that he had documents showing

end destination, covering around 80% of shipments. Mr Jack had previously produced a memorandum showing that, on receipt of a further parcel of documentation held in Iran and with Adam Trading in Dubai, this figure would rise to around 95%. On the strength of this Mr Rolfe had felt able to commit to his directors that 80% could already be accounted for. On 27th June he confirmed in an e-mail that he was holding up approval for the manufacture of a new order for Sovereign pending clearance from GRA that the documentation in respect of earlier shipments was at a satisfactory level which he put at least 80% of volume. The sequence of events thereafter appears at paragraphs 378ff.

763 The documents that were produced were incomplete, and some of them unsatisfactory. The inadequacies of the documentation were set out in Mr Jack's letter of 21st July 2003.

Materiality

764 I do not regard these breaches as material. Materiality has to be assessed in the context in which the question arises which, here, is the possible termination of a five year agreement. In order for a breach to be material it does not have to be repudiatory: *Dalkia Utilities Services Plc v Celtech International Ltd* [2006] EWHC 63 (Comm). In *Phoenix Media Limited v Cobweb Information*, Unreported, 16th May 2000, Neuberger, J, as he then was, said:

> "*Materiality involves considering the following: the actual breaches, the consequence of the breaches to [the innocent party]; [the guilty party's] explanation for the breaches; the breaches in the context of TEL Agreement; the consequences of holding TEL Agreement determined and the consequences of holding TEL Agreement continues*".

I respectfully regard that as a helpful check list.

765 The essential character of the breach was a failure to prove evidence of arrival in the relevant Territory of over 500 million cigarettes. It arose in circumstances where the likelihood was that the goods had in fact arrived in Iran and Syria. Proof of arrival was withheld because one recipient was in dispute with TEL or Adam Trading and the other had been red carded. Documentation had been produced in respect of over 80% of shipments and Gallaher had been prepared to continue to manufacture on that basis. In December 2003 Hazem showed Mr Jack documents which, as far as he could tell (they were in Farsi), proved arrival of the goods in Iran. TEL Agreement was a long term agreement covering many hundreds of millions of cigarettes. Termination would have been acutely prejudicial to TEL. The effect of the breach, if TEL Agreement continued would have very limited prejudicial consequences for Gallaher.

766 In any event Gallaher waived this breach as a ground for termination. It plainly decided not to terminate TEL Agreement on the ground that insufficient documentation had been provided in respect of the first year but to continue with TEL Agreement, and communicated that decision both by Mr Jack indicating on 21st July 2003 that the documents were broadly in order and by Gallaher's conduct

in not terminating despite the deficiencies in the documents. In March 2005 it was too late for Gallaher to terminate on this ground.

Documentation for the second year of the contract - 2003-4

767 In October 2003 Mr Jack reviewed the TEL documentation for the year to date. He reported that he found documentation in respect of 97.4% of sales to be complete.

768 In September 2005 i.e. after the termination of TEL Agreement Mr Perks carried out a review of the 2003-4 documentation from Mr Jack's office. He did so again for the purposes of his witness statement. Mr Perks would regard as an acceptable set of documents: (i) a customer invoice, (ii) an exit certificate bearing customs stamps, (iii) a stamped customs bill showing the payment of administration charges, (iv) a bill of lading and (v) freight forwarding instructions. In respect of no shipments was there a customer invoice. In respect of some there were various combinations of the other four documents: see Appendix 2 to Mr Perks' statement. The fact that, in relation to these shipments, there was not what Mr Perks would regard as a complete set of documents does not necessarily mean that the one or more documents that were produced were insufficient to show delivery to the ultimate destination. His five category list is something of a counsel of perfection. I proceed on the assumption that in cases in which there was a combination of documents there was sufficient material to vouch arrival.

769 The remainder of the documentation appeared to be single items relating to individual shipments. These documents had the following deficiencies:

(i) Bills of lading often failed to show the brand of cigarettes shipped; and, instead, had "Dorch", "Sov" or "Businessman"/"B'man" added in manuscript – whether accurately or not it is impossible to tell;

(ii) Several of the bills did not name TEL or Adam Trading as the shipper; so that the involvement of TEL in the chain of supply was not apparent;

(iii) One "bill of lading" in which Adam Trading was the shipper was a carbon copy of what had been typed on the common form printed bill;

(iv) There were three shipments identified as being to Constanza in Romania, and two to Benin, both outside the TEL territories;

(v) Some of the exit certificates had containers and/or seal numbers and/or customs stamps missing;

(vi) Some of the documents were customs bills which, although showing a destination (in one case Benin) did not show that the goods had left port;

(vii) In two instances the document was a letter from Drilon Enterprises Ltd. In one of them the document was a request to TEL to arrange shipment to Egypt of 1,000 cases of Dorchester. In the other there was a request for the release of 2,250 cases of Dorchester full flavour with a statement that they were believed to be destined for Syria. These documents were inadequate, in the absence of a bill of lading.

770 Mr Perks did not produce a figure for the percentage of shipments not covered by adequate documentation because he had not seen what he regarded as accurate sales records from TEL for this period.

False documents

771 In at least two instances the documentation produced by TEL was false. In the first example Iran was specified in the Customs exit certificates as the destination for 1,950 and 960 cases of Sovereign going from Dubai (Jebel Ali). The goods, some of which were coded for Yemen and some for Iran, were in fact shipped by Adam Trading to Rotterdam, with Loendersloot as the notify party, (although there are also copy bills of lading naming Metco Ltd as the shipper). This is apparent from a comparison of the container and seal numbers on the exit certificates which also appear on shipping documentation obtained by Gallaher from Metco pursuant to a letter of request in Holland. The goods had been sold to Metco C & F Rotterdam. Metco paid Highstreet for the account of Adam Trading.

772 In the second example the Yemen was specified in the customs bill as the destination for 4,000 cases of Sovereign cigarettes; whereas, again, the goods, coded for Iran, were shipped by Adam Trading and Metco to Holland with Loendersloot as the notify party and sold to Metco by Adam Trading C & F Rotterdam. It is unlikely in the extreme that these two sets of goods were sent to Rotterdam in transit to Iran or the Yemen.

773 Mr Tlais was aware that funds were being paid to Highstreet to be credited to Adam Trading because Dr Al-Mahamid would tell him that funds were coming in. His evidence was that this did not mean that he knew that the money came from Metco. He denied any knowledge of the false exit certificates.

774 Mr Tlais is not shown to have been aware of what Adam Trading was doing in relation to the documentation. But it is unlikely that he was unaware of what Adam Trading was doing with the goods, at least in general terms: see paragraph 618 above.

775 Even if, contrary to my view, Mr Tlais was not aware of the destinations to which Adam Trading was sending the goods (including Yemen and Rotterdam), TEL was in breach of its obligation to produce evidence of the shipment of the orders to the appropriate Territory. It could not rely, in respect of Iran on the provisions in the Procedural Agreement relating to the third category – deliveries to Cyprus/Dubai - because that category applied to "*all other contractual markets except those dealt with above*" and Iran is dealt with in the second category. In respect of the Yemen, which did fall within the third category he was still obliged to provide details of "*the goods, quantities, full consignee details and the intended destinations*". In fact TEL

produced documentation which purported to evidence shipment to Yemen and Iran when that evidence was false. TEL was also in breach of its obligation to procure compliance by its sub-distributors with the ITP. TEL did not comply with its obligations under TEL Agreement simply by selling to Adam Trading and leaving Adam Trading to it. Insofar as it relied on Adam Trading to comply with its obligations and to produce verifying documentation it did so at its risk.

776 On Mr Tlais' evidence he took no effective steps to audit Adam Trading or to monitor its records to see where goods were going. As he put it:

> "*I cannot be the accounting, I cannot be the salesman, I cannot be everyone in the office. He has a duty. I was getting a telephone call. He was informing me about money…the money has been received, this is what I used to know. Now, the details of who sent it, who does this and that, I have no idea".*

Materiality

777 These breaches were material. The provision of evidence that goods had reached an ultimate destination within the Territories was important to Gallaher as a weapon in the fight against smuggling. The breaches were neither sporadic nor isolated nor the result of accidental errors.

778 It seems to me, however, that Gallaher must be regarded as having waived any entitlement to rely upon these breaches as breaches sufficiently material to entitle termination. Mr Perks was not asked, prior to March 2005 to carry out any further review of the documentation produced by TEL. After TEL had been told that the documentation for the first year was broadly satisfactory, but also told how it could be improved, no further complaint was made about the quality of documentation that was being provided to Gallaher nor was any opportunity given to remedy any deficiencies.

779 Such inactivity must, in the circumstances, have indicated to TEL that no complaint was being made that the documentation being produced to Gallaher (of the quality of which it was necessarily aware) was materially defective. It also deprived TEL of the opportunity to remedy any defect. In continuing with the contract without complaint Gallaher must be taken to have elected not to rely on defects in the documents for the second year as giving rise to a right to determine TEL Agreement or, at the least, so to have conducted itself as to make it inequitable for it to rely, post termination, on such defects as a ground for termination.

Conclusion on ground 4

780 Accordingly I do not regard Gallaher as having been entitled to terminate TEL Agreement on ground 4.

Ground 5 Failure to sell brands commensurate with estimated demand

781 Clause 2(v)(c) of the TEL Agreement provides:

> *"All Brands sold by GI to the Distributor under this Agreement are intended for final sale via distributors to consumers in the Territories. The Distributor agrees therefore to… (c) sell the Brands in amounts commensurate with the estimated demand in the intended markets within the Territories."*

782 This is a reflection of the ITP which recorded that "*Gallaher will only supply products where there is a legitimate demand for the product in the intended final market*".

783 Gallaher contends that TEL (a) failed to make any reasonable estimate of the demand as the clause required; and (b) that the volumes actually sold were inconsistent with any reasonable estimate of market demand. Before addressing those contentions it is necessary to consider what demand TEL was permitted to satisfy.

"Estimated demand"

Gallaher's submissions

784 TEL was undoubtedly permitted to sell to distributors in domestic markets in the countries listed in Schedule 1 to TEL Agreement cigarettes for consumption in those markets following payment of all applicable taxes and duties.

785 The area of dispute relates to duty free sales. In this respect Gallaher's case underwent something of a sea change. Its original position was that TEL was not entitled to sell goods which were to be purchased by the ultimate consumer duty free.

786 Gallaher's case remains that that was the contractual position under the TEL Agreement, under which, it submits, TEL was only entitled to sell cigarettes to distributors in duty free zones for import into domestic markets in the relevant country and consumption there following payment of all applicable taxes and duties

787 That position is said to derive from the fact that "*the Territories*" in clause 1 (1) are defined as "*the domestic duty paid markets in those countries listed in schedule 1 to this Agreement*" and from Clause 2 (v). Clause 2 (v) (a) provides that:

> *"All Brands sold by GI to the Distributor under this Agreement are intended for final sale via distributors to consumers in the Territories. The Distributor agrees therefore to (a) sell only to distributors who are legally authorised to sell tax paid tobacco products in the Territories or in duty-free zones within the Territories. (For the avoidance of doubt the duty free zones exclude traditional duty free outlets, which include without generality [sic] to the foregoing duty free shops in airports etc").*
>
> Underlining added

Gallaher contends that, by reason of the definition of "*the Territories*", the brands must be sold to consumers in the domestic duty paid markets.

788 The words underlined were added in manuscript to an earlier typed copy prior to the signing of the original TEL Agreement. They were then incorporated in typescript when TEL Agreement was amended in January 2003.

789 However, Gallaher accepts that during the TEL era it understood that in certain markets TEL was selling product to distributors for sale in duty free zones and that it allowed this to happen. When that occurred, although Gallaher waived compliance with TEL's obligation to sell only for domestic duty paid consumption, Gallaher did not waive compliance with any other provisions of TEL Agreement, such as the obligation to sell only in accordance with the estimated demand and to comply with all applicable laws in relation to such sales.

790 Gallaher's waiver was of no greater effect because (a) Gallaher did nothing which amounted to a more extensive waiver; and (b) clause 12 (ix) of the TEL Agreement provides:

> *"The failure or omission of GI at any time to require the Distributor's performance of any obligation or duty under this Agreement shall not affect the right to require performance of that obligation or duty in the future. Any waiver by GI of any breach of any provision hereof shall not be construed as a waiver of any continuing or succeeding breach of such provision a waiver or modification of the provision itself or a waiver or modification of any other right under this Agreement…"*

791 Accordingly the legitimate demand that TEL was entitled to satisfy included such demand as there was for cigarettes that had been lawfully imported into a duty free zone and then lawfully imported into the relevant country on a duty free basis. The quantity of goods falling into the latter category was, it is submitted, very limited.

TEL's Submissions

792 TEL contends that under TEL Agreement it was entitled to sell cigarettes into duty free zones for duty free consumption. So the question of waiver does not arise.

793 Since TEL does not contend that the obligation to sell only in accordance with the estimated demand and to comply with all applicable laws in relation to sales is inapplicable to sales for duty free consumption, the difference between the parties is moot. It is not suggested that TEL could sell quantities for duty free consumption which it knew exceeded the possible legitimate uptake of duty free goods.

The meaning of the clause

794 In my judgment, TEL's contention is correct. When the words were added in manuscript shortly before the TEL Agreement was signed the parties' intention must have been to allow TEL to sell in duty free zones cigarettes intended for sale to the consumer without payment of duty. It is inherently unlikely that the purpose of the amendment was to allow duty paid sales to take place via duty free zones; and doubtful whether an amendment was needed to allow that in any event. Whilst it is possible to construe TEL Agreement in its final form in the way contended for by Gallaher by reference to the definition of "*Territories*", that involves accepting that

the "*duty-free zones within the Territories*" means the duty free zones within *"the domestic duty paid markets*" in the countries listed in Schedule 1. That is contradictory. Much more likely is that the parties intended to allow for sales in duty free zones in the Territories, meaning thereby the countries listed in the Schedule without the additional reference to duty paid markets of which a duty free zone is not a part.

795 The parties must also have intended that TEL should be permitted to supply cigarettes for sale from shops in duty free zones. They did not intend TEL to supply traditional outlets, such as duty free shops at airports or on ferries. But they obviously did intend TEL to supply distributors who sold in duty free zones and they cannot have intended that TEL should be disentitled to do so because the distributor had a shop in the zone.

796 Gallaher certainly knew that a significant volume of cigarettes were being supplied for sales on a duty free basis during the TEL era. The Old Stocks had predominantly global English health warnings. So did most of the new stocks. TEL was, as Gallaher knew, expecting to mix new stock with Old Stock. As Gallaher was aware, during the TEL era the only countries that did not have specific local labelling requirements - so that duty paid cigarettes for the domestic market could have a global English health warning - were (i) Afghanistan, and (ii) Iran - until June 2003 when a warning was required in Farsi as well. Cigarettes with Global English health warnings could also lawfully be sold in Iraq after the lifting of UN Sanctions (on 23rd May 2003) but there was no duty payable immediately after the war. In other countries global English health warnings, if permissible, were only permissible for duty free stock[92].

797 Gallaher was aware that cigarettes were being supplied for sales on a duty free basis to Latin America[93]; Pakistan; Egypt; Syria; Yemen; Sudan, Iraq, and Iran. It also knew that, save for Egypt where 8,000 cases were produced to be shipped to MISR Foreign Trade, an Egyptian state owned corporation, with an Egyptian health warning in Arabic, and some goods for South America with a "Latin American health warning" the product supplied bore global English health warnings. In respect of Iran, Gallaher produced 342,000 cases of Iran coded Sovereign with global English health warnings after June 2003, when global English health warnings, if permissible at all, were only permissible for sales in the duty free market. In October 2003 Parsian Fougan, to Gallaher's knowledge, was going to try to clear damaged Dorchester in Iran – an exercise that could not have been done with domestic duty paid sales.

798 Iran has two duty free zones – Kish and Chah Bahar. Kish is an island with a resident population of about 21,000. The island enjoys tax exemptions and reduced

[92] It is not clear whether after June 2003 global English was still permissible for goods shipped direct to the Iranian duty free zones: cp Mr Jack's letter of 22nd December 2003 and paragraph 22 of Mr Goel's second report. When Mr Jack visited the ITC in March 2003 he was told that the Farsi health warning would be needed after June 2003 for all imports. Hazem expressed the view that the date would not be universally applied and that that there would be some flexibility. The likelihood is that new imports for duty free shops did require a Farsi warning because duty free and duty paid labelling requirements had previously been the same.

[93] As HMCE was informed on 28th June 2002.

customs duties. Neither Iranians nor foreign nationals require a visa to enter it. About 1 million tourists do so every year. Gallaher was aware that cigarettes were being supplied for these duty free zones. There was a Gallaher show room in Chah Bahar.

The process of estimating demand

799 There was a measure of agreement between Mr Clarke, Mr Goel and Mr Gough. This was to the effect that, in order to assess demand, it is necessary to take account, so far as it is possible to do so, of the following : (i) blend preferences; (ii) price segments; (iii) competitor activity across price and blend segments; (iv) applicable laws; and (v) in respect of duty-free zones (a) their location, (b) the number, nationality, smoking incidence and blend preference of those passing through and (c) the applicable laws affecting duty free purchase.

Estimation by Mr Tlais

800 Gallaher contends that the evidence does not indicate that TEL made any proper assessment of the demand in the Territories.

801 Mr Tlais was responsible for market assessments. His witness statement made no reference to such assessments save that it referred to the October 2002 trip to Iran – his only trip to Iran in the TEL era. He compiled no report on that visit. When questioned about it he claimed not to have been reliant, as was suggested to him, entirely on those who had a commercial interest in inflating demand. Asked whether he had received any detailed analysis of the market by price segment and blend and brand preference, he said that he had got all the information and given it to Gallaher. In respect of a number of the other markets (Afghanistan, Egypt, Iran duty-free, Iraq, Latin America, Libya, Pakistan, Syria, Sudan, and Yemen) he indicated in very general terms that he had made the necessary inquiries, knew the market well, and that Mr Jack had all the information.

802 In support of its contention that there was inadequate market assessment Gallaher refers to the remarkably different figures that Mr Tlais gave about sales in Iran. In his letter to Mr Jack of 4th March 2002 he referred to having received an official order for 300,000 cases per annum (i.e. 25,000 per month). The same letter referred to Tlais having slowly achieved regular volumes over the past two years. But a report of a market visit by Gallaher employees in June 2001 said nothing about Sovereign or Dorchester being in the market at all. On 29th April 2002 Hazem told Mr Keevil that there was a ready market for Gallaher's products of 50,000 cases per month. On 26th September 2002 Mr Tlais told Mr Rolfe that TEL had established a network that was wholesaling and retailing 50,000 cases per month. In April 2003 Mr Tlais referred to average monthly sales of 18,000 cases per month.

803 I do not doubt that Mr Tlais had experience of the Middle East and was in regular telephonic communication with contacts in the markets, including but not limited to his distributors or sub-distributors, some of whom he had dealt with for a number of years. I accept that a reasonable assessment of demand does not have to be made

in elaborate detail or recorded in any particular form, much less in the form that a would-be distributor or a paid research organisation would present it to a client. An experienced operator may be able to carry much of the information in his head. I also accept that the assessment of an emerging market can be a difficult exercise, there being, as Mr Jack put it in a memorandum of 4th July 2002 "*limited or non-existent research tools available*". Nevertheless the absence of any written assessment by TEL and the vagueness of Mr Tlais' evidence cause me to conclude that little focused examination was made by him or communicated to Gallaher, of the true levels of demand.

804 Mr Clarke claimed that Parsian Fougan had carried out market assessments for Iran and that information on price segmentation, blend preferences and brand preferences was readily available in Parsian Fougan's office; that he had asked Mr Mobaraki to provide these documents; and that he had refused because he had a claim for money. Mr Clarke had obviously never seen these documents since he was unable to say whether they were in English or Farsi (he assumed the latter). No such documents were produced to TEL or disclosed.

Gallaher's role

805 On 3rd July 2002 Gallaher indicated to HMCE, at the meeting in Cyprus, that, when Gallaher believed that there was a market opportunity, it would in the first instance carry out a desk study to establish market size and structure and identify target volumes for Gallaher's brands. It would supply HMCE with market appraisals for Mr Tlais' territories. In a memorandum to Mr Rolfe of 4th July 2002 Mr Jack set out a system of checks that were to be carried out. After initial market studies Gallaher would carry out market visits in order further to assess potential and gather intelligence on the market. There was then to be a system of monitoring, including meeting distributors/sub-distributors and briefing them on the ITP; a written system requiring the head distributor to produce formal reports on the markets at least every eight weeks; and further visits to markets on a regular basis in order to assess consumption in market.

806 At a meeting with TEL shortly before the Iran visit in October 2002 Mr Rolfe recorded that :

> *"We will be preparing portfolio strategy for this and other AMELA markets including customer research identifying preferred distribution profile for brands and regions. We want to have ability to approach, sanction choice of distributor (sic)"*

807 At the meeting with HMCE in July 2003 Mr Jack recorded that detailed visits and reports had been prepared in respect of Mozambique, Iran and Lebanon and copies of these reports had been provided to HMCE; and that in addition Mr Jack had had prepared reports on each market detailing market size to assist him in policing of volumes to ensure that they were consistent with demand. He also recorded that sales data was being provided monthly and destination markets were being identified.

808 TEL relies on what happened in 2002 as showing that the parties did not intend that the estimation of demand referred to in TEL Agreement should be done by Gallaher alone. Neither the TEL Agreement nor the ITP so provide. It also submits that, since Mr Jack had full access to all aspects of the TEL business, including the markets and distributors (particularly the Iranian distributor), Gallaher was aware of and consented to or acquiesced in whatever supplies were made by TEL.

809 The evidence of Mr Rolfe and Mr Jeffery, which I accept, was to the following effect. In 2002 Gallaher indicated to HMCE that it was being provided with necessary data and that it would be monitoring markets to ensure that the presence of goods in the markets was in line with market expectations. The commercial department would estimate what level of sales could be achieved in markets. On occasion, when Mr Jack met with Customs, he would explain the scale of the market, and what proportion of Gallaher products he thought could be delivered to those markets.

810 All production orders had to be signed off by two persons other than Mr Jack. Mr Rolfe and Mr Jeffery relied on Gallaher's commercial people to agree, as they did, that it was proper to do so; and Mr Jack regularly expressed the view that it was fine to do so. But it became difficult to verify that sales were being made in accordance with market demand without information as to exactly what sales were being made by TEL and as to where the cigarettes were being shipped to and consumed.

811 The fact that Gallaher, having its mind on the question of demand, was supplying TEL with the goods that it ordered, believing that the supply was consistent with demand, is evidence that TEL's sales of the goods ordered were consistent with demand. But it is not conclusive evidence - not least because Gallaher was entitled to make the prima facie assumption that TEL would not be ordering (and thus paying for) goods for which it estimated there to be no sufficient demand - and did not absolve TEL from its obligation under the clause. TEL was responsible for its sales in its Territories. If it sold in excess of any reasonable estimate of demand it would be in breach.

Were the volumes sold consistent with a reasonable estimate of market demand?

812 As I have indicated Gallaher's industry and market expert was Mr Rajiv Goel and TEL's expert was Mr Alan Gough. Mr Goel is an employee of Gallaher. My assessment of these two witnesses and a discussion of their evidence may be found in Appendix B.

813 Mr Goel considered whether the volumes ordered by TEL (which are detailed in Mrs Schiavetta's statement) were commensurate with demand. His conclusion was that the following volumes of goods ordered by TEL[94] were not commensurate with demand:

[94] Mr Pollock has what appear to be different figures in Sub-Appendix 4.5.4. I have not been able to reconcile his figures with those of Mr Goel.
[95] Erroneously referred to in the report as 4,000 cases.

Territory	Brand	Year	Volume supplied	Reason
Iran	Dorchester	2002	138,800 cases	No consumer preference for Virginia blend
Iran	Sovereign	2002	39,800 cases	Ditto
Iran	Sovereign	2003	64,801 cases	Ditto
Iran	Sovereign	2004	9,600 cases	Ditto
Latin America	Sovereign	2002	40,000cases[95]	Ditto
Syria	Sovereign	2002	25,200 cases	Ditto Supply only possible through GOTA
Syria	Sovereign	2004	4,800 cases	As above
Sudan	Sovereign	2002	4,800 cases	In excess of reasonable estimate
Sudan	Sovereign	2003	4,800 cases	Ditto
Pakistan	Sovereign	2004	1,600 cases	In excess of reasonable estimate

Sales to Iran

Duty paid

814 As appears from the above table, Mr Goel's view on Iran, which is traditionally an American blend market, was that there was no data to support a Virginia segment and, therefore, all the stock ordered was in excess of any reasonable estimate of demand. That view was based on (a) personal experience and (b) retail audits. As to the former, between 1999 and 2002 he had visited Iran about 40 times spending about a third of his time in rural areas and driving all the way around the country. In addition as he put it:

> "*I probably met with the ITC every six weeks and at no point did they say to me that Dorchester had a 3 or 4 per cent market share… I did not ask them what the Dorchester market share was but I do recall that we were assessing the launch of a Virginia brand and apart from – well, to be honest, they laughed at us and they said: what is the point of doing that? There is no one here who smokes those kinds of cigarettes. So we asked for the listing of what they had imported, which they gave to us. This would have been 2002, and nowhere did we see Dorchester on that or indeed Sovereign.*"

815 As to the latter, a retail audit is an exercise in which an independent company goes round to a number of outlets chosen so as to be representative of the volume and type of outlets that sell cigarettes. Its representatives obtain information on how much is being sold of different brands; and check invoices or take physical stock checks. Two audits have been relied on. One such audit was an MEMRB audit

covering Tehran only over the period 1995 to 2001 i.e. before the TEL era. Between 1995 (before which imports were not permitted) and 1999 (when there was a general relaxation) imports were only permitted by those who had been registered for that purpose. The second audit was an RAI Iran audit covering 2004 and 2005.

816 Each audit identified only American or local blends as being available in retail outlets. The reports are compiled in very considerable detail and have details of even a 0.01% market share. This evidence is consistent with the report of a Gallaher visit to Iran in June 2001 which made no mention of Gallaher brands; and a report of Mr Fawaz in October 2002 in which none of the 17 fast moving brands identified were Virginian.

TEL's position

817 TEL contends that this analysis is a misrepresentation of the true state of affairs. Before the problem of the damaged Dorchester, which undid all the good work, Iran was a successful and growing market for TEL. It had the advantage of being the "first mover" after the market was opened up in 1999[96]. Parsian Fougan was an effective and successful in-market distributor. TEL and Parsian Fougan's progress in developing the Iranian market was apparent on the two Gallaher visits to Iran in October 2002 (Rolfe, Fawaz, and Jack) and March 2003 (Jack).

818 In June 2002 Mr Clarke described the Iranian business as the cornerstone of Mr Tlais' business and Mr Jack expressed the view that Iran would represent between 60% and 70% of volume in the region, of which 66% would be Dorchester. It is common ground that on the first market visit in October 2002 there was no evidence of Gallaher product in retail distribution. But Gallaher confirmed the presence of Dorchester with in-market wholesalers who reported (with what degree of accuracy is unknown) a brisk trade, and also confirmed with the monopoly that the stock in the market was duty paid. In the course of the visit Mr Rolfe was minded to extend the portfolio by introducing Dorchester Slims (he was subsequently persuaded - by Mr Fawaz - that it was inappropriate to do so in the absence of any market analysis).

819 At the end of the visit Mr Rolfe told Hazem that he had been impressed with what he saw in respect of Dorchester distribution and indicated that Gallaher prepare a marketing plan which should be available by the end of November. In December Mr Rolfe told Mr Tlais that Mr Jack would present the brand support plans for Sovereign and Dorchester in January. In the event he was persuaded by Mr Fawaz that it was impractical to commit marketing investment until Gallaher had a better idea of consumer (not wholesaler) demand and the pattern of it, which would be after Mr Jack had made a further visit. In January 2003 Mr Jack calculated (by deducting Tlais closing stock from Gallaher sales) that TEL (not Parsian Fougan) had sold 1.6 billion Dorchester full flavour (160,000 cases) and 20 million Lights (2,000 cases) the previous year.

820 There are some other indicia of a Virginia market in Iran. In Autumn 2002 Mr Homayoun produced a report on the Iranian market for Mr Fawaz which said that at

[96] The accuracy of this claim is debatable. Mr Goel recalls that the first international company to conclude a deal with IRITC was Reynolds, selling Winston and Magna, some time in 2001, followed by BAT in the same year, selling Montana, Kent and Dunhill Lights.

November 2002 sales of Dorchester had reached up to 5,000 master cases per month. Sovereign was unknown. He suggested that in correct hands (by which he no doubt meant himself) the product could fill a market vacuum created by the sale and distribution problems of Magna and Montana – two blended products. Mr Goel regarded this as unreliable not least because Montana, which he was handling, was selling 20,000 a month - about 12% of the market.

821 At some time in 2002 or 2003 a survey of 168 outlets showed that 37% of them stocked Dorchester. This was not a very revealing statistic - many of them had Dorchester low down the list of stock or sales (it is not clear which). An e-mail from Mr Fawaz in January 2003 attached a table which referred to Iran having a 20% blend preference. I do not regard this figure as reliable. It is inconsistent with much other evidence and I note that the document does not indicate any Virginia brand on sale in Iran (although it does do so for other territories).

822 In March 2003 Mr Jack made an eleven day visit to Iran. He went to six cities and subsequently produced a long report. In it he said there was good distribution in the wholesale bazaars with various degrees of stock cover. He visited 130 retail outlets with overall distribution of 51.5% full flavour and 59.2% Lights. All stockists reported good sales for the brand. He described Hazem Mahmoudi and Sarafaz Mobaraki as experienced dealers with a history of trading in Winston and Montana, who were highly committed and had spent at least $ 250k on trade incentives. They had agents in all but 6 of the 28 provinces responsible for developing a network of wholesalers. Overall sales were said to be +/- 20,000 cases a month – down 8-10,000 cases because of the damage problem. Out of condition stocks were being brought to Tehran for assessment. On the basis of observations and the importers' sales records Dorchester was commanding somewhere in the region of 3% nationally.

823 At his meeting with the ITC in March 2003 Mr Jack, according to his note, expressed the view that Dorchester's current market share was 3-4% and ITC agreed broadly with that estimate. Mr Jack explained that Gallaher saw the need to enter the mid-price and premium segments. Mr Jack also reported to Gallaher that Parsian Fougan's historic method of ordering in large batches "*together with ambitious forecasting from the market*" had led to relatively volatile stock levels.

824 Mr Jack made a further visit in autumn 2003. He reported that Parsian Fougan remained committed to Dorchester and Gallaher despite effectively having no product to sell because of the damage problem.

825 Gallaher's plan for Iran, approved by Mr Rolfe by the end of May 2003, proposed a "*restoration"* of a 3% market share, after the problem of the damaged Dorchester had been resolved, by the end of year 1, and 5% by the end of year 2. The Iranian market is agreed to be about 50 billion sticks per year. 3% would be 1.5 billion i.e. 150,000 cases or 12,500 cases a month.

826 The version of the Gallaher business plan originally drafted by Mr Jack and then amended by Mr Hainsworth and Mr Murden forecast substantial sales in Iran for the remainder of 2004 and for 2005 and 2006. The figure for Iran for 2005 was 150,000 cases of Dorchester full flavour and 75,000 cases of lights. Mr Hainsworth's

evidence based on information from distributors was that the Virginia value segment in Iran was 2-3% of the market - maximum. The report from ERC[97] on the Iranian market referred to a move away from oriental flavours to American blends. Mr Goel drew attention to the fact that the report did not refer to any Virginian brand in Iran and thought that the report had confused Dunhill, which may be Virginian, and Dunhill Lights which was an American blend. It is impossible to tell whether this is so.

827 In the light of that material it seems to me the contention that there was practically no Virginia demand in Iran 2003 is too extreme and that an estimate of a 3 – 4 % share would not be unreasonable as an estimate of what an optimistic new entrant might hope to achieve if the price was right.

Duty free sales to Iran

828 So far as duty free sales in Iran are concerned, under TEL Agreement they were not to include sales in traditional duty free outlets such as airports, airlines and ferries. Sales to diplomatic and military stores and ship's chandlers would be negligible. Diplomatic stores might absorb 100 cases a year. Sales to the military are usually handled by tobacco manufacturers direct. Sales to ship's chandlers would not amount to much.

829 So far as duty free zones are concerned, Mr Goel's evidence, which I accept, is that Iranian nationals are not permitted, as non nationals are, to purchase cigarettes duty free (although they are permitted to purchase other items) unless they are leaving the country[98]. I have no reliable information as to the quantity of sales that the Iranian duty free zones could be expected to generate.

830 Mr Goel's experience was that prior to 2000 the Iranian Government had appointed a company called Shaheed to be the exclusive duty free operator in Iran, including the operation of licensed outlets in Duty free zones. In the light of the fact that Gallaher's cigarettes were being openly sold in the two duty free zones during the TEL era, and not through Shaheed, it seems to me likely that this arrangement was inapplicable to such sales.

Duty paid sales other than to Iran

831 In relation to *Latin America* (encompassing for this purpose Argentina, Brazil, Chile Paraguay and Uruguay, the destinations in respect of which TEL makes a claim) Mr Goel found no data to support a Virginia segment and therefore concluded that the 4,000 cases of Sovereign ordered exceeded any reasonably estimated demand.

832 He, also, made an assessment in relation to American Blend cigarettes, of which Stateline was one. His methodology was to assume that, at the sale prices implicit in

[97] i.e. ERC Group Ltd, a market research company with a particular expertise in the tobacco industry which provides annual reports to clients, and on whose World Cigarettes I & II reports Mr Goel relied.

[98] His informant was the Deputy Managing Director of the ITC who told him this when BAT invited him as a guest to Dublin for the Ireland v Iran 2002 World Cup qualifying game on 10th November 2001.

the Schedule to TEL's Amended Defence and Counterclaim, TEL brands would be saleable at the appropriate price segment. He then took the ERC figures in 2004/5 and 2005/6 for the whole imported market. If major manufacturers occupied an identified percentage of that market he assumed (i) that all other potential competitors had the potential to occupy the remainder and then, favourably to TEL, (ii) that the contestants for the remaining share (or the whole of the imported market if no clear share was attributable to a specific manufacturer) would participate equally in the remainder. He then discounted the total market available to TEL by factors that took account of the distribution of cigarettes in the market. Thus if the total accessible market was 200 cases and the market was 82.7% King Size and 27.8% hard pack (these being the characteristics of TEL's products) he would assume a figure of 200 x 82.2% x 27.8%.

833 In the case of *Argentina* the whole imported market in 2004 and 2004 was miniscule (200-300 cases) and TEL's potential share on the above basis (which assumed no other competitors) even smaller (c 46%). In the case of *Brazil* the figure calculated on the above basis was 3,799 cases for 2004 and 2005; in the case of *Chile* 93 cases; for *Paraguay* 150 cases and for *Uruguay* 730 cases in 2004/5 and zero in 2005/6. These are all negligible volumes.

834 In the case of *Syria* (a) Mr Goel again found no data to support a Virginia segment and (b) in any event only Gallaher, as manufacturer, could supply GOTA, the Government monopoly.

835 *Sudan* is 99% Virginia. In 2002 and 2003 according to ERC only 3,000 cases were not accounted for by local manufacturers' sales and those of BAT. Mr Goel estimated that it was theoretically possible for TEL to access the market with Sovereign and gain 6% of the import market, being the estimated size of the smallest established Virginia blend, making 2,600 cases annually, which was not viable.

836 *Pakistan* is divided between Virginia and local blend. It has a very low imported segment (just over 2,100 cases in 2004/5 and 2005/6). Even if TEL captured the whole of that the trade would not be viable. Mr Goel estimated that, between them, Sovereign and Dorchester might sell just over 350 cases.

Duty free sales other than to Iran

837 Mr Goel estimated that the legitimate demand for cigarettes for duty free zones was minimal in relation to countries other than Iran for reasons set out in paragraph 828 above. The researches of local lawyers have showed that, in respect of *Argentina*, but not *Brazil*, *Chile* (probably), *Egypt, Paraguay*, and *Uruguay*, sales in duty free outlets required health warnings in accordance with local law, although no sanction for non-compliance was known to have been imposed in Uruguay. Gallaher supplied some goods with specific Egyptian duty free packaging. It also supplied 40,000 cases in 2002 with a Latin American health clause[99]. Mr Goel's recollection was that in *Sudan* and *Syria* duty free sales required the same pack markings as domestic product.

[99] As is recorded in the 2002 AMELA spreadsheet.

Conclusion

838 TEL's *purchases* from Gallaher are known. But TEL's failed to keep adequate records of what was being *sold* to each market. Thus, according to the customer accounts, only 60,000 cases (of Dorchester) were sold to Parsian Fougan. The rest must have been sold to Adam Trading, which then made sales to Parsian Fougan. It is not, however, possible to tell from the customer accounts in relation to Adam Trading what volumes of goods it *sold* to each market, so as to test whether those sales (and *TEL's sales to it* for that purpose) were consistent with legitimate demand. The quantity of goods ordered by TEL for a particular market in any one year is obviously an indication of the quantity sold. But some of the goods purchased will have remained unreleased for a while.

Iran – duty paid/free

839 It does not seem to me to be established that the orders for 138,800 cases of Dorchester for Iran in 2002 were in excess of any reasonable estimate. If that was to be treated as a year's sales it would work out at about 11,500 cases a month.

840 The RAI audit appears to show an almost total absence of Virginia blend sales in 2004 and 2005. But in April/March 2003 the reports from Mr Jack and Mr Tlais were of sales of the order of 18 – 20,000 cases a month. Mr Jack's estimate of Dorchester's current market share at 3-4% does not appear to me wholly unreasonable; it appears to have been accepted by the ITC and it tallied with the plan approved by Mr Rolfe in May 2003 and Mr Hainsworth in 2004. These figures, coupled with the observation in the ERC report, suggest that there was, or could reasonably be expected to be, a greater call, actual and potential, for Virginia cigarettes than there had been prior to the TEL era, or was found by the RAI audit.

841 In assessing whether the orders made exceeded the bounds of reasonable estimation account must be taken of a number of factors. Firstly, Gallaher and TEL obviously sought to tap into emerging markets. Estimating the level of a new entrant's future sales in such a market is not easy; and should not be unduly constrained by assumptions that the new entrant will have little or no impact on existing market shares. Some degree of optimism may be entertained. Secondly, Gallaher did not think at the time that it was supplying goods in volumes that were not commensurate with demand. Thirdly, account must be taken of the fact that the Dorchester supplied by Gallaher in 2002 was, on Mr Goel's figures, the total supply of TEL coded Dorchester during the TEL era. In addition Gallaher supplied 114,201 cases of Sovereign between 2002 and 2004 but that was, as Gallaher was aware, to go predominantly to Afghanistan (as was some of the Dorchester). Fourthly, orders in the opening year may legitimately involve an element of stockpiling.

Latin America

842 Mr Goel's conclusion that on any reasonable estimate there was no demand for Virginia cigarettes in Latin America is founded on the absence of any reference to Virginia cigarettes in the ERC reports. I am not convinced that such absence of reference means that any reasonable estimate of the demand for Virginia cigarettes

whether in the duty paid or duty free market, TEL's supplies being for the latter, was nil, especially since one of the potential markets was Brazil. Most[100] of the cigarettes supplied for Latin America had "Latin American health warnings", as was required in some markets even for duty free sales. It would seem unlikely that anyone would place such an order unless he believed that there would be a demand for it[101]. The distributor in Latin America was Mr Tlais' brother who may well have had a reasonable basis upon which to estimate this sort of level of demand.

Syria – duty free

843 In respect of Syria Mr Goel's view that 25,220 cases was beyond any reasonable estimate of demand is based on (a) the fact that the imported market is American blend with established brands such as Marlboro, Kent, Lucky Strike etc making up 90% of the market.; and (b) his understanding from market sources that GOTA had never imported Virginia cigarettes. Further he understood that any shipment would need to be made direct to GOTA by the manufacturer.

844 That is undoubtedly so in respect of the duty paid market. In the document "*Tlais Enterprises – Proposed structural revisions*" of 2004 Mr Jack recorded in respect of Syria:

> "*It is not possible to import value brands into the Syrian duty paid market as GOTA seeks to protect its domestic franchise. There is a limited opportunity in duty free (border shops) for Dorchester as an extension of the Iraqi market".*
>
> Underlining added

845 As Gallaher was aware, through Mr Jack and others, goods for Syria were supplied to TEL, with English global health warnings, and not the Arabic warning required for domestic consumption, and were delivered to Mersin in Turkey en route for Syria. Gallaher was, on Mr Keevil's evidence, aware of the health warning requirements for the duty paid markets. It must therefore have been apparent to Gallaher that it was supplying TEL, and not GOTA, with cigarettes which could not be sold in the duty paid market.

846 The Mersin route (described as "unofficial") was, according to a portion of Mr Jack's statement that was put to Mr Perks and with which I understood him to agree, adopted in order to avoid the Syrian monopoly. It is not clear to me whether this avoidance was legitimate or illegitimate. Whatever the answer is, it does not seem to me that Gallaher, which supplied a further 4,800 cases in 2004 after those supplied in 2002, can complain of its use as a material breach. Mr Jack was well aware that this route was being used and there is no evidence that he ever objected to it. Mr Perks' evidence was that Gallaher shut down this route but it is not apparent that that was ever communicated to TEL.

[100] The Latin America customer account shows a supply of 49,968 cases in all.
[101] The same applies in respect of Dorchester in Iran where, as the KPMG report reveals, a substantial proportion of the cigarettes destroyed in Iran were duty paid.

847 So far as the volumes supplied are concerned the amount for 2002 appears high, given that in Summer 2004 Adam Trading produced an estimate of the Virginia market of 4,800 cases annually, which tallies with the amount of goods supplied to TEL in that year. But none was supplied in 2003. In the absence of a better understanding of the unofficial route I do not regard it as established that TEL made sales in excess of any reasonable estimate of duty free demand. Even if it had been excessive sales for the Syrian market would not be a material and irremediable breach.

848 In respect of *Sudan* the market is said by ERC to be 99% Virginia. Mr Goel's view - that the 4,800 cases ordered in 2002 and 2003 exceeded any reasonable estimate - is based on the fact that in respect of both of those years ERC state that only 3,000 cases were not accounted for by the sales of local manufacturers and BAT, the dominant player in the market; and his expectation that a new entrant could not take more than the unaccounted for demand. I am not convinced that any reasonable person would be bound to make that assumption (and so assume that a new entrant would make no impact at all on BAT's share), or that 4,800 cases are beyond any reasonable estimation. I do not regard it as established that TEL made sales in excess of any reasonable estimate of demand.

849 *Pakistan* has a Virginian or local blend preference. In 2004 the total import market as identified by ERC was 2,130 cases. On Mr Goel's methodology (factoring blend preference – 50%; King size – 80%; and hard pack format – 81%) a total potential volume of 690 cases is produced and this ignores all competition. For that reason he regards the 1,600 cases as in excess of any reasonable estimate of demand. That is one method of calculating demand. But I do not regard the 2,130 cases (the only supply to Pakistan) as outside any reasonable range; and I do not regard it as established that TEL made sales in excess of any reasonable estimate of demand.

Conclusion on ground 5

850 Accordingly, I do not accept that Gallaher was entitled to terminate the TEL Agreement on ground 5.

Ground 6: Failure to sell to appropriate customers and distributors

851 Under clause 2(v)(a) of the TEL Agreement it was agreed that TEL may sell

> *"only to distributors who are legally authorised to sell tax-paid tobacco products in the Territories or in duty free zones within the Territories. (For the avoidance of doubt the duty free zones exclude traditional duty free outlets, which includes without generality to the foregoing [sic] duty free shops in airports etc)".*

852 Clause 4(i)(2) of the TEL Agreement provides that TEL will not:[102]

[102] The 'not' is missing but is clearly implicit. The wording reads: "*the Distributor will (1) take no action to promote or facilitate…., or (2) resell the Brands…".*

> *"resell the Brands to any person, corporate or unincorporated entity, state or other governmental or quasi agency that the Distributor knows or has reason to believe to be engaged in any illegal trade in cigarettes."*

853 Clause 5 (iv) provides that TEL

> *"shall resell [the Brands] only to persons or firms where there is no reasonable cause to believe that such persons or firms will sell them outside the Territories."*

854 The parties cannot have intended that TEL would be innocent of any breach of clause 4 (i) (2), if there was reason to believe that a person to whom TEL was supplying was engaged in smuggling but, because TEL had failed to make any appropriate inquiries, it was unaware of it. That would be inconsistent with TEL's obligation under the ITP "*to make the necessary enquiries to satisfy themselves that their customers will behave responsibly*". Nor can they have intended that TEL would be in breach of clause 5 (iv) if there were facts which, if known, would give reason to believe that a person was someone who would sell the goods outside the Territories, but TEL was not, and could not reasonably be expected, to have known of them. It is TEL who has to have reason to hold the belief.

855 TEL would, however, be in breach of the TEL Agreement if the facts were such as to give it reason to believe that the person to whom it was supplying goods was a smuggler or someone who would sell outside the Territories, and TEL was either aware of such facts, or would have become aware of them if it had made such inquiries as could reasonably be expected of it. To establish a breach of clause 4 (i) (2) or 5 (iv) it would be necessary to establish both the facts giving reason to hold the relevant belief and also that TEL was aware of those facts, or would have been if it had carried out such inquiries. A failure to make due inquiry would not, of itself, be such a breach.

856 TEL would, however, be in breach of its obligations under the ITP, and thus under the TEL Agreement, if it failed to make the necessary enquiries to satisfy itself that its customers would behave responsibly, although, if those enquiries would have led nowhere because there was nothing to discover, the breach would be unlikely to be material. Such inquiries would involve TEL satisfying itself that Adam Trading, for instance, would not be selling to companies which were likely to be smugglers or to sell outside the Territories. Exactly what inquiries were needed would depend on the circumstances. Further TEL was, in the light of its obligation to procure that its sub-distributors complied with the ITP, obliged to procure that its sub-distributors made the necessary inquiries to satisfy themselves that their customers would behave responsibly.

857 TEL was not required to act as a private detective in relation to its sub-distributors' business nor did compliance with the TEL Agreement require a formalised set of arrangements. But, if TEL was to comply with its obligations, it would need (i) to know to whom Adam Trading (and others of TEL's distributors) was supplying goods; (ii) to satisfy itself that the distributors were satisfying a legitimate demand;

and (iii) to investigate any suspicions of smuggling or exporting beyond the Territories and take steps to stop it. It would also need some understanding of the infrastructure of the distributors' businesses and the level of their expertise.

858 By the wording by which TEL subscribed to the ITP ("*I have read the above policy* ….") TEL was required to obtain a written undertaking from its sub-distributors to be bound by the ITP. That provision did not require TEL's sub-distributors to procure the signing of an ITP by their own sub-distributors. But TEL's obligation was to procure that its sub-distributors made the necessary inquiries to satisfy themselves that their customers would behave responsibly. The absence of an ITP from a sub-sub distributor would be some indication that they had not done so.

The parties' cases

859 TEL's case is that its distributors, with whom Mr Tlais was familiar and in regular communication, were:

> "*the best available in their respective markets and had many years of experience in the cigarette business. Each of them was a substantial commercial entity, involved with other markets, manufacturers and brands. Certain of them were the largest distributors in their individual countries and controlled the bulk of the cigarette business (of a number of manufacturers) in their respective markets*".

See paragraph 45.1 of the Re-Amended Defence.

860 The picture of TEL painted by Mr Fawaz was that TEL was not in the business of exercising careful selection of its distributors with a view to building a long term business; but was prepared to sell to anyone who was willing to pay for goods, exercising either no or minimal control over what was to happen to them. As a result goods were sold to people who were likely to re-export them back into the UK or into a chain of supply that ended up in the UK, there being no or no adequate market in the Territories in which to build brands.

Analysis

861 In order to determine whether TEL had reason to believe that its distributors and customers were smugglers or likely to sell outside the Territory, and whether it made appropriately diligent inquiries about them, it is first necessary to identify who those customers were. This is not a straightforward task. Mr Tlais declined to write down for Gallaher a list of his distributors: see paragraph 313 above. The reason he gave – that he did not want anyone to think that he had done something to harm anyone, as a result of which he might be killed – suggests that he realised that some of those with whom he was dealing might turn out to be smugglers or persons who would sell outside the Territory.

862 Mr Jack was in touch with Mr Tlais about provision of a list in August 2002. As appears from paragraph 314 above a version with 24 names was produced by Mr Jack in November 2002 and an additional name – Alphatrans Limited - added in December ("the December List"). Of these only 11 were said to be active. Two

names were added later. Additional sources of information as to the identity of distributors are the signed ITPs disclosed in the course of these proceedings, whose authenticity is disputed (and not satisfactorily proved), together with (i) companies identified in Mr Clarke's and Mr Tlais' statements, (ii) customers identified in the customer accounts, and (iii) other companies who can be identified from other documentation such as letters of release or payment records.

863 I consider in the paragraphs that follow such evidence as there is as to the carrying out of inquiries by Mr Tlais or anyone else in respect of known TEL customers and the extent to which there may have been cause to believe that they were smugglers or likely to sell outside the Territory, and as to the signature of ITPs.

864 Before doing so I recall that in July 2003 Mr Jack told HMCE that Mr Tlais had exercised due diligence over customer selection to Gallaher's satisfaction; and, also, that Mr Tlais had told Gallaher at about this time that he was happy to sit down and discuss alternative distributors.

Adam Trading

865 The December list describes Adam Trading's market as "*Yemen, Sudan, Libya*". The undated ITP purportedly signed by Adam Trading specifies the markets as "*As listed in the Tlais contract*". Adam Trading was the largest of TEL's distributors.

866 Mr Tlais had dealt with Dr Al-Mahamid, the principal of Adam Trading, since the 1990s when he was one of his customers for Philip Morris. He had been supplied with goods by Mr Hadkinson in the Namelex era and Highstreet had supplied him as well.

867 Mr Tlais' evidence was that Dr Al-Mahamid was a bona fide legitimate distributor who had established a successful business through hard work, with whom he had no difficulties, and whose activities he never had reason to question. There was no suggestion that he was involved in any illicit business. Mr Tlais had had no hesitation in appointing him as a master distributor. He had an excellent network of sub-distributors, built up over several years, in which he had confidence.

868 Entries in the Adam Trading Schedules reveal that in December 2002, when sanctions were in force, Adam Trading was selling to Iraq (1655 cases of Businessman). TEL's disclosure reveals Customs certificates relating to these cases. In March 2003 Mr Keevil e-mailed Mr Saveriades to tell him that Mr Jack had raised some concerns about Dr Al-Mahamid – in essence the level of unpaid debts due to Mr Tlais - and also that Mr Jack had had "*a loose discussion with our friends in London* [sc. HMCE] *who have different concerns about this gentleman's previous relationships and some of the causes to which he may be connected*". Mr Tlais and Mr Clarke did not recall what those concerns were.

869 In November 2003 Greek Customs reported that 245,000 packs of Sovereign Red (a product produced in the CIS and UK for export only to the Horn of Africa) were being offered in Greece having been sold to a Greek company by Adam Trading. The Greek company had asked for permission to keep the product in a duty free warehouse for a short time and, when that was refused, had sold it to a Cypriot

company. Mr Jack was given to understand by TEL that Adam Trading's name had been used falsely. Mr Tlais was unable to remember anything about this when he came to give evidence and it is not apparent that any investigation was carried out

870 Adam Trading shipped goods as set out in the Adam Trading Schedules. As I have indicated I do not accept that Mr Tlais was wholly unaware that shipments were being made by Adam Trading to non TEL territories in sizeable quantities in breach of the ITP: see paragraph 618. The number and range of the different transactions was sufficient to give reason to believe that Adam Trading was engaged in an illegal trade or, at the lowest that it was selling outside the Territories. The likelihood is that Mr Tlais knew that that was happening or, at the least, turned a blind eye to it. The relationship between him and Dr Al- Mahamid was close. His evidence was that the two of them were in daily contact and that their discussions covered the destinations of the goods. TEL's business was increasingly dependent on Adam Trading, which obtained goods on credit in ever larger amounts. There is no evidence from Dr Al-Mahamid to explain the transactions in those schedules, the extent to which Mr Tlais was kept in ignorance of them, or as to what checks, if any, Mr Tlais made on Adam Trading's business. I infer that his evidence in this respect would not have been helpful.

871 Even if Mr Tlais was unaware of the destinations to which shipments were being made, TEL failed to make the necessary enquiries to satisfy itself that Adam Trading was behaving responsibly; and there were matters, of which the contents of the Adam Trading Schedules are the most signal example, which reasonable inquiry would have revealed, which afforded cause to believe that Adam Trading was selling outside the Territories and engaged in an illegal trade. There is no evidence that TEL took any steps to investigate the Adam Trading Schedules and I infer that it did not. TEL cannot have carried out any proper audit of Adam Trading's activities and properly satisfied itself as to the appropriateness of the persons with whom Adam Trading was dealing. Nor can Adam Trading itself have made the necessary inquiries.

Afghan Watan Wal/Fisher Tobacco

872 Afghan Watan Wal purchased Dorchester and Sovereign from Adam Trading and TEL for the Afghanistan market. It is part of a group of companies owned by Hafeezullah Mohammed and his brothers. Mr Jack wrote a short report on them in 2003 which described Hafeezullah's experience of working with Gallaher in the 1990s. Hafeezullah himself gave written evidence for Gallaher which gives details of the group and records that the brothers have been in business since the 1990s and their father ran the business before them from at least the 1980s.

Algemene Panama

873 This company has a customer account. But nothing more is known about it.

Alphatrans Limited

874 This company is on the December list with Afghanistan as its market. It appears to be a Ukrainian company supplying cigarettes for local consumption in Afghanistan.

Neither Mr Clarke nor Mr Tlais could recall it. There is no evidence that it signed an ITP.

Auto Trans Shipping

875 The name of this company appears in a customer account as having been sold a quantity of Gold Arrow (not covered by TEL Agreement) and Stateline on 4th March 2005 (the day before termination) and quantities of Sovereign and Dorchester after termination. It appears (from the fax header of the Hormuz Shipping ITP on which its name appears) to be an associate of Hormuz Marine, which was said to have been red carded in 2003. TEL was thus shipping goods to a company which had not signed the ITP and was associated with a company which TEL had reason to believe was behaving improperly. There is no evidence that TEL made any necessary inquiries to satisfy itself that it would behave responsibly and I infer that it did not.

Aziz Poor Trading

876 This company has a customer account. But nothing more is known about it.

Drilon Enterprises LLC ("Drilon")

877 The ITP for Drilon, which was not a customer on Mr Jack's December list, specified Syria and Libya as markets. Drilon was based in Cyprus. Mr Tlais was unable to say who its directors were. He dealt with someone called Takis. Letters from Drilon refer to sales to Iran as well as Syria and Libya. Mr Tlais' evidence was that he had cleared this with Mr Jack. A further Drilon letter refers to selling to Illychevsk in transit with Alphatrans as the Notify Party, and so, presumably, for Afghanistan. Ten bills of lading of 25th June 2003 show 10 containers of Sovereign and Dorchester being shipped from Limassol to Port Said in transit for Tartous. Eight of the containers were released to Misr Transit in Port Said. Misr Transit was named in the OLAF report of July 2003 as being suspected of involvement in smuggling.

878 Mr Tlais' evidence was that he was introduced to Drilon through a connection with a close friend of his. He made inquiries to confirm that Drilon was genuinely going to supply market demand in Syria and of a number of other contacts in Cyprus to confirm that they were serious and trustworthy people. As with all of Mr Tlais' evidence in relation to inquiries as to distributors, this evidence was of a very general character, without any detail, e.g. as to the persons of whom inquiry had been made.

879 TEL threatened to terminate its business relationship with Drilon on account of HMCE's finding that goods supplied to Drilon were destined for Bulgaria (see paragraph 360 above. – unless Drilon could show that it was not in fact involved in the diversion).

880 Mr Tlais claimed that there was a later letter from Mr Jack accepting that it was alright to continue supplying Drilon and that there had been some sort of mistake. No such letter has been produced or disclosed and I do not accept that it ever existed. On 17th January 2003 Gallaher replied to Mr Tlais' letter of 13th January

2003 – see paragraph 361 above - saying that the information that had been provided was helpful but that Gallaher would need to establish the names/addresses etc of the principals of Drilon and to outline to Customs the steps taken by TEL prior to the engagement of Drilon as distributor to assure itself that Drilon was a bona fide distributor to Syria and Libya, and how the performance of Drilon in respect of sales into Syria was assessed. Mr Tlais' evidence was that he gave all the information to Mr Jack, but it is entirely unclear what (if anything) he said on this topic.

881 On 4th February 2003 Mr Tlais told Gallaher that he had been advised that the goods were shipped to Bulgaria for onward shipment to Syria, via Turkey, because a bond of around $ 1 million per container had to be lodged with Cyprus customs for direct shipments to this market; and that the goods were, at the time of Gallaher's letter of 17th January 2003 still under Drilon's control, located at the warehouses of Alba, which was an international forwarding company[103]. The paperwork concerning Drilon had, he said, been passed to Mr Jack. Despite the fact that Mr Tlais told me that he had evidence which showed that there was such a law (still in force) and that he would bring it to Court, he did not do so. I do not accept that there was such a law or provision.

882 The Drilon customer account shows that from May 2003 Drilon was supplied with nearly $ 1.9 million of goods.

883 Mr Tlais said that he told Mr Jack all about his investigations into Drilon and he said "*fair enough*". In this, as in many other instances, his evidence was of the most general kind, unsupported by any contemporary documentation, either from Mr Jack or from Mr Tlais, even though his correspondence with Gallaher was often very lengthy. I do not know what he may have told about Mr Jack his investigations but, on the evidence before me, it is unlikely to have gone beyond what is set out in paragraph 359 above.

884 I am satisfied that the inquiries made by TEL to establish that Drilon would behave responsibly were inadequate, both before and, particularly, after the detention of goods bound for Bulgaria. Mr Tlais lacked satisfactory information as to who the directors/principals of Drilon were or as to how Drilon came to be involved in goods destined for Bulgaria. In the absence of the latter there remained reason to believe that Drilon would sell Gallaher's goods outside the Territories.

El Gizera

885 There is an ITP in the name of El Gizera, which does not state any market. The relevant market must be Egypt, on account both of the name and the Port Said contact address, and possibly Sudan, since Mr Jack is said to have visited El Gizera in Sudan. There is no evidence as to what due diligence was carried out other than

[103] But it was also a trading company. In June 2004 Alba expressed interest in purchasing, inter alia, 4 containers of Sovereign Classic monthly. Mr Clarke sent the fax to Mr Jack telling him that TEL would not be replying, as was normal procedure in respect of unsolicited requests. Alba had in January 2004 made payments of $ 62,375 to Highstreet Enterprises. Mr Tlais said that this was in satisfaction of amounts owed by Alba to Adam Trading. But the relevant payments do not appear on the Adam Trading customer account.

Mr Tlais' repetition of his evidence ("*You come back to the same question, I will replay the same*") that everything had been given to Norman Jack.

Hormuz Marine

886 In the section of his witness statement headed "*TEL's distributors*" Mr Tlais described how he and Mr Jack had selected Hormuz Marine and Truebell (see paragraph 908 below) as distributors for Pakistan on the basis that they would see which of the two was the most effective and whether there were any control risks in using either of them. When Hormuz Marine failed to provide the shipping documentation that was required they were placed on stop despite the absence of any actual seizures.

887 In October 2003 four containers of Sovereign Classic shipped by Hormuz from Bandar Abbas in Iran consigned to Loendersloot were detained in Holland. The destination codes were for Iran (DD). In addition eight containers shipped from Bandar Abbas consigned to territories of the former Yugoslavia, Ukraine and Bulgaria were detained in Gia Tauro in Italy. The goods in the 8 containers had destination codes for Iran (DD) and, in one sample, Sudan (EG). The detention had been on suspicion that the goods were counterfeit, which they were not.

888 The ITP signed by Hormuz specified Iran as the relevant market. Mr Jack appears to have been told by Mr Tlais – see Mr Jack's letter of 4th December 2003 – that the detained goods were supplied to Hormuz with a declared end market of Afghanistan. (Mr Tlais said that Hormuz Marine were distributors for Pakistan but goods went from Iran to Afghanistan, for which there was no separate destination code, and then to Pakistan.)

889 In his oral evidence, however, Mr Tlais claimed that Hormuz was one of Adam Trading's customers. This is difficult to square with his written statement and the fact that the customer was eventually red carded, albeit Mr Tlais said everything was done through Adam Trading. I am, however, prepared to accept that Hormuz was Adam Trading's customer, not least because there appears to have been no customer account with Hormuz and, according to Mr Clarke, there was no communication between TEL and Hormuz. In circumstances where Adam Trading was given extended credit and TEL's price to it was or could be dependent on the price that it received from its customer, the distinction between being a customer of TEL and being a customer of Adam Trading was less marked than would otherwise be the case – the customer was a customer of the joint business. This may partly explain the discrepancies between Mr Tlais' written and oral evidence on whether a number of customers were customers of TEL or Adam Trading. Not surprisingly some customers regarded Adam Trading and TEL as one and the same.

890 But TEL would have been in breach if it sold stocks to Adam Trading when it ought to have known that there was reason to believe that Hormuz, to whom Adam Trading was to supply the goods, would smuggle them or sell them outside the Territories. TEL was bound to make the necessary inquiries to satisfy itself that

Adam Trading would behave responsibly and to procure that Adam Trading made the necessary inquiries to satisfy itself that Hormuz would act responsibly. In the absence of any evidence that Adam Trading had an effective system for appraising and monitoring the activities of its distributors and that that such a system had revealed nothing of concern, and in circumstances where TEL was party, with Mr Jack, to the selection of Hormuz, it was necessary for TEL to carry out a proper investigation in respect of that company ("due diligence").

891 That due diligence consisted, on Mr Tlais' evidence, of Mr Tlais being told by a number of people that Hormuz was an honest and good company. But his evidence revealed that he did not know who the personnel involved in Hormuz were and he was not even sure whether it was, as he thought, an Iranian company. This was, in my judgment, inadequate. It is not, however, apparent that further inquiry would have revealed that they were likely to sell goods outside the Territories.

892 The red carding of the company occurred after the October detentions, when Hormuz failed to produced the paperwork required to show that the goods were going to the agreed destination (presumably Pakistan).

Kiurdu

893 An ITP for this company, which was not one of those originally supplied by TEL's former solicitors on 1st August 2005, does not refer to any Territory; and nothing more is known about it.

Megamar Denizcilik Trading

894 Mr Tlais' evidence was that Megamar distributed no more than two containers of cigarettes at the beginning of the TEL era for distribution into Syria. He knew the company from his Philip Morris days and they had a good reputation. In his oral evidence he said that they were a shipping company with an office in Mersin and another in the Turkish area of Cyprus, which also dealt in cigarettes.

895 There is no ITP for this company and, although Mr Tlais' evidence was that he checked on it and found that it was a shipping company, there no evidence of what those checks were. Megamar's name does not appear on the December list. Nor does it appear in the customer accounts. Mr Tlais did not know why that was so.

896 TEL's disclosure contains releases in October 2002 of 8 containers to Mersin. A Megamar document certified that 4 of the containers were destined for Iran, although, as appears form Mrs Schiavetta's evidence, they were coded for Syria[104]. Mr Tlais suggested that in respect of these goods TEL might have been using Megamar as a shipping company, or that he had cleared the dispatch with Mr Jack.

897 The OLAF report of July 2003 noted that there had been a significant seizure of smuggled cigarettes in Greek waters in November 2000, in relation to which Megamar had been the agent: see paragraph 1002 below.

[104] Of the other four containers, 3 were coded for Syria and one container came from the 365 day goods.

Mira Limited

898 This company appears on Mr Jack's list as based in the Ukraine with Afghanistan as its specified market. No ITP for this company has been disclosed. Mr Tlais did not recall having dealt with Mira. There is only one sale record (on a document headed 8th July 2002 but with a fax header of November 2001) in the form of a request from the company for goods for Ukraine (Illychevsk) in transit with the statement "*NB The final destination of the goods will be Afghanistan*". There is no record of any due diligence.

Misr Foreign Trade Limited

899 This company appears on the December list. It also has a customer account. There is no ITP for it. Mr Tlais' evidence was that it was a well known and well run Egyptian duty free company with a big shop on the Egypt/Libya border. He and Dr Al-Mahamid met with them before commencing supply and were impressed. Gallaher shipped cigarettes with an Arabic health warning for duty free outlets. In the light of that evidence, which I accept, I do not regard it as established that TEL failed to make the necessary inquiries or that TEL had reason to believe that goods supplied to this company would go astray.

Ocean Traders International

900 This company appears on the December list. Gallaher contend that TEL carried out no due diligence on OTI. However, Gallaher themselves intended originally to supply direct notwithstanding that there was a question mark over the propriety of Mr Nathan: and such direct supply was discussed at a meeting with HMCE on 28th June 2003. I am not satisfied that TEL has been shown to have failed to make the necessary inquiries in relation to OTI; or that there was reason to believe that it would smuggle or re-export cigarettes. Gallaher appears to have been content for TEL to supply notwithstanding concerns about Mr Nathan.

901 The original arrangement was for TEL to receive a commission on Gallaher sales. It received such a commission in respect of a sale of 3,080 cases in November 2002. Otherwise, all sales were from Gallaher to TEL and then from TEL to OTI.

Parsian Fougan

902 Parsian Fougan was TEL's distributor in Iran. It appears on the December list. Mr Tlais' evidence was that, as soon as TEL commenced trading with Gallaher, he asked Dr Al-Mahamid to identify a distributor in Iran and after contacting several people in the market for recommendations and meeting several potential distributors they chose Parsian Fougan on the basis that, although not the largest, Hazem, the co-owner, was hard working and very keen to make a go of the domestic business, and would therefore present few control risks. Dr Al-Mahamid had done business with him in the Namelex era and had had no problems with control issues. Mr Tlais impressed upon Hazem that he wanted all business to be official business, duty paid

through the monopoly. All goods were supplied on that basis[105]. Initial stocks of about 2,400 cases were sent by air at the end of May 2002 to Adam Trading for release to Parsian Fougan. In July and August 48,000 cases of Dorchester were paid for by Parsian Fougan by letter of credit. Mr Tlais said that he was in almost daily contact with Hazem, who spoke Arabic.

903 It has not been shown that TEL failed to make the necessary inquiries in relation to Parsian Fougan; nor that there was reason to believe that it would smuggle or re-export cigarettes. Mr Jack's report on Parsian Fougan in 2003 gave details of their business which included representing Japan Tobacco and, indirectly, BAT. He recommended them strongly to represent the new Gallaher portfolio. Parsian Fougan is the current distributor for Iran for Japan Tobacco, Gallaher's now parent, and has achieved market dominance for Winston. Hazem was, however, overconfident in respect of sales. In April 2002 he had told Gallaher that there was a ready market for Gallaher's products at a volume of approximately 50,000 a month

Pioneer Trading Corporation

904 Mr Clarke's written evidence was that Gallaher had agreed with TEL and Adam Trading that Adam Trading should appoint a sub-distributor in the Yemeni market. Dr Al-Mahamid identified Pioneer Trading. However, by a letter of 22nd January Mr Jack of Gallaher wrote to Pioneer Trading to confirm that TEL had appointed them as TEL's official distributor in the Yemen. This was for the domestic market. There is no ITP and no evidence of any due diligence by TEL or Adam Trading. As to the position in the Yemen, see also paragraphs 1026ff below.
Prestige

905 An ITP for this company specifies "*America Central*" as the market. Mr Tlais said that Dr Al-Mahamid's brother dealt with Latin America. There is no documentary evidence of any due diligence on this company.

Skywards SA

906 The ITP refers to Chile Peru, and Bolivia. The latter two are not TEL Territories. This company appears on the December list but nothing else is known. There is no evidence of any due diligence.

Tasharakiat/Tashapukint Al Wakhrim

907 According to Mr Tlais this company was Adam Trading's distributor in Libya. Mr Jack, Mr Clarke and Dr Al-Mahamid visited the market in 2003 and were satisfied that product was in the market and that the distributor was doing good business. On 17th January 2003 Mr Jack had recorded that Tashapukint Al Wakhrim was an addition to the TEL customer list. No ITP appears to have been signed. There is no evidence of what due diligence was performed.

[105] This cannot literally be true, given that some of the supplies were for duty free sale.

Truebell

908 Truebell, which was based in Sharjah in the U.A.E., was identified by Mr Tlais in his statement as the other of the two distributors selected for Pakistan. As with Hormuz, he claimed in his oral evidence that Truebell was a customer of Adam Trading. This would be consistent with the fact that it is not referred to on the December list; and that there is no customer account for it; but inconsistent with advice to Mr Jack recorded in his letter to Mr Tlais of 4th December 2003 that TEL "*intended to commence supply to Pakistan using Truebell as your distributor*".

909 As with Hormuz I accept that Truebell was Adam Trading's customer, but regard it as incumbent upon TEL to have carried out due diligence in respect of it. The evidence in relation to this amounted to Mr Tlais saying that they had a good name because he had dealt with them in his Philip Morris days. This does not seem to me adequate. According to Mr Jack's e-mail of 2nd January 2004 at some stage in the "*distant*" past they had been used by Gallaher to distribute Sovereign in Fujairah and he was not aware that any problems had been experienced. In addition there was no ITP for Truebell.

910 One container of goods released to Truebell, produced for TEL in October 2002, coded for Iran, was the subject of the raid by the Royal Malaysian Customs on 9th December 2003 at Pelapas, Johor: see paragraph 612 above. After this Truebell were red carded. According to Mr Clarke this was because their statement that they had a particular route to Pakistan was regarded as unacceptable.

911 The evidence does not establish that proper inquiry before supplies to Truebell began would have given cause to believe that it was likely to smuggle or to export outside the Territories; but the fact that Truebell appears to have done just that underscores the importance of proper inquiries in the first place.

TSS Tutun Sigara Savayi

912 This was described as a customer in Mr Tlais' December List (although one that had been red carded). In his written evidence Mr Tlais described how he had selected TSS as a distributor for Syria, after speaking to some friends of his, in particular Megamar. These enquiries told him that TSS had been in business a long time and had a good name. This seems to me inadequate. It is not, for instance, clear who the principals were. In his oral evidence Mr Tlais claimed that TSS was a customer of Adam Trading; which is consistent with the absence of a customer account.

913 The ITP apparently signed by TSS specifies its market as Syria. However, a letter from TSS to Highstreet of 2nd September 2002 refers to TSS as having purchased goods for the Iranian market. Mr Tlais said that he would have got authority from Gallaher for that; but there is no documentary evidence of this and, as appears from the next paragraph, Mr Jack was given to understand that the goods were going to Syria.

914 In October 2002 10 million sticks of Sovereign Classic which had been shipped to TSS in Mersin in July 2002 were seized in Genoa. The goods were in transit from Turkey, where the consignor was TSS, to Bulgaria. Mr Tlais promised an

investigation and a full report and ceased to supply TSS. His evidence was that he went through different channels trying to find out what had happened (Mr Jack's letter of 25th October 2002 shows that Mr Tlais had expressed the view to Mr Jack that there had been a change of documents en route from Mersin to Syria and that he had given Mr Jack details of the person he believed was behind the transaction – on what basis is unknown).

915 On 20th June 2003 Mr Tlais told Mr Jack that he had concluded that "*while the customer had acted correctly we were not in a position to continue supply for the long term protection of Gallaher and the reputation of Tlais*". There seems to have been no basis for drawing the conclusion that the customer had acted correctly since, as Mr Tlais told me, he did not ask TSS directly how goods supplied to them had ended up in Genoa destined for Bulgaria "*because maybe they will lie to me*".

916 TEL's ceasing to deal with TSS led to TSS refusing to provide the paperwork to show the correct importation of goods into Syria. But, after they were said to have been red carded they did continue to pay sums totalling more than $ 700,000 to Tlasco, which then paid Highstreet. These sums were credited to the Adam Trading customer account. TSS was, according to Mr Tlais' evidence, continuing to trade with Adam Trading but not in cigarettes, and paying Adam Trading by this route. Whilst the suspicion must be that TSS was still obtaining cigarettes from Adam Trading, there is insufficient evidence to justify such a conclusion.

United Trade

917 The ITP for this company makes no reference to the intended market. Mr Tlais' written evidence was that it was Adam Trading's distributor for Sudan and that sales were to be made through the tobacco monopoly so that there would be no significant control risk. He, Mr Jack, Mr Clarke, and Dr Al-Mahamid met with United Trade in Sudan and Gallaher agreed to provide Sovereign in 10s and 20s and agreed pricing. But Gallaher delayed production and shipment. An initial consignment of Sovereign was provided for Sudan and either sold at a discount or given away for promotional purposes. Gallaher refused to provide any follow up stock.

918 The documents reveal a somewhat different picture. Between October 2002 and February 2003 Adam Trading instructed Misr Transit on four occasions to release 9,600 cases of Sovereign Classic to United Trade with English health warnings for duty free sales i.e. not via the monopoly. The discussion about providing 10s and 20s, with Arabic health warning, via the monopoly, came later.

919 Although the fact that goods were being supplied for the duty free market undermines the suggestion that supplies to United Trade were without significant risk because they went through the monopoly, I decline to find that there was inadequate due diligence in relation to this company, which appears to have been the subject of investigation by Gallaher and TEL.

Virginia Trading

920 Virginia Trading was a distributor for the Syrian market, as was specified in the ITP. According to its customer account trading took place between July 2002 and January 2003. Mr Tlais' evidence was that he assured himself of their background by asking contacts in the marketplace. In his oral evidence he said that he had once met their representative – someone called Faris - for about 20 minutes when he came to TEL's office; and that he would speak to them about twice a week to discuss how business was going. Again this appears to me inadequate. I note that Virginia Trading is one of the entities mentioned in the OLAF report as being suspected of involvement in smuggling.

Miscellaneous companies

921 There are a number of companies which either appear to have signed an ITP or are on Mr Jack's list but about whom practically nothing is known save that they were believed by Mr Tlais to be an Adam Trading distributor.

Company	**Market**	**Signed ITP**	**On List**	**Information**
Al Falah Trading & Industry	Yemen	Yes	No	May be Yemen Duty Free ? AT Distributor
Al Anees Trading	Yemen	No	Yes	? AT Distributor
Annakha for Tobacco & Matches Importation	Libya	Yes (not produced)	No	? AT Distributor
Assad	Syria	No	Yes	According to Mr Tlais not a TEL distributor

922 There are various other entities whose names appear in the documents about whom little is known and where the chain of supply is unclear. Between October 2002 and April 2003 Adam Trading instructed Misr Transit to release sizeable quantities of TEL goods in Cotonou, Benin to companies apparently from Niger, including:

(a) 9,100 cases of Sovereign Classic to a company called *NTCD*;

(b) 2000 cases to *SATN*; and

(c) 2,000 cases to *Soniret S.A.*

Mr Tlais said that these companies were Adam Trading's distributors and that goods for Cotonou were destined for Libya.

923 A bill of lading of 25th October 2003 shows the shipment by Adam Trading of a container with 1,000 cases from Dubai to Port Said with a notify party named as "*Golden Sun Import, Export and Trading*" about whom nothing is known, it being Adam Trading's customer. A manuscript note shows that the goods were 800 cases of Sovereign and 200 cases of Dorchester. This may be a consignment of damaged Dorchester mixed with sound Sovereign.

Iraqi purchasers

924 Mr Nader Migho was a customer in Jordan with whom TEL made arrangements in March 2003 to clear old Gallaher stock in Syria and in Iraq, once sanctions were lifted. Sales took place in March and October. Mr Houssein Ghanem El Sarraf was another customer in Jordan with whom TEL made a similar arrangement for the sale of old Gallaher stock to Iraq. Both of them were Iraqis. No due diligence was performed on them on the ground that these were clearance sales of spotted goods. Mr Tlais indicated that, if any money could be made, they should pay him something, but his prime aim was to get the stock out of the warehouse to avoid storage charges.

Andalus Al Sharq

925 TEL disclosed an ITP apparently executed by Anadalus Alsharq General Trading LLC ("Andalus"), which between 2003 and 2005 purchased more than 30,000 cases of cigarettes from Adam Trading for sale into Iraq. This was not one of the ITPs disclosed by TEL on 1st August 2005. It is also one of the documents whose authenticity was challenged. Mr Tlais' evidence was that he received the document from Adam Trading.

926 On 9th October 2005 Andalus wrote to Gallaher saying that it had never signed an ITP, that there were never any restrictions imposed on its selling the product, "*since my market was very much prevalent in Iraq only so I was more interested in it, and moreover even if I wanted to go to another market it was difficult for me as I was not getting an adequate supply from Adam Trading*".

927 In the light of that evidence it is not established that Andalus signed any ITP. What is plain is that Mr Tlais regarded the question of due diligence as entirely for Adam Trading to perform and that he did none himself. There is no evidence that Adam Trading did any. Mr Tlais said that Mr Jack knew them well.

Payments

928 The documents disclosed by TEL show a raft of payments to Highstreet for which there is no explanation. These included :

(a) payments from companies based in Montenegro ($ 287,000 to Highstreet from *Crom Ltd*[106], $ 100,000 from *Jim Mount Ltd*);

(b) receipts in 2002 from Hungarian entities which can be reconciled to the Adam trading account;

(c) a payment of $ 25,157 from a woman in Essex with the same unusual surname (Valaitis), and living on the same street, as one of those convicted in November 2003 of involvement in cigarette smuggling through Felixstowe and money laundering and sentenced to 3 ½ years in prison;

(d) a payment of $ 20,000 in July 2003 to Highstreet from SAS Trading Ltd, for the "*transit trade*" and a further payment of $ 60,000 in October 2003, the latter appearing in the Adam Trading account;

(e) further payments, also so described, of $ 162,000 and $ 208,000 from *Grekocom Enterprises Ltd*, the former appearing in the Adam Trading account.

These would all appear to be payments for cigarettes.

929 There are also a number of further payments that are recorded as having been received which cannot be related to any customer account and do not therefore appear to be a settlement of any liability of Adam Trading e.g.:

(i) $ 94,000 from *Cavett Trading* of Monrovia, which, according to Mr Tlais, came from Adam Trading;

(ii) $ 214,500 paid by *Karam Dughmos Export* to Highstreet in August 2003;

(iii) $ 169,500 paid by *BSB Co* in Kosovo to Highstreet in October 2003;

(iv) payments totalling $ 114,000 from *Visar Suhodolli* in Macedonia;

(v) payments by *Achillefs Mitsiades* in 2003 and 2004 totalling over $ 175,000 and

(vi) $ 120,000 paid by *Nabil Karam* in Jordan to Highstreet in 2002.

930 Mr Tlais' evidence, which I accept, was that he had given a guarantee on Mr Karam's behalf to someone in the UAE, and that the $ 120,000 was a payment made by a customer of Namelex to enable Mr Karam to pay, at least in part, the amount that Mr Tlais had guaranteed.

931 In relation to the other payments in paragraph 929 I regard it as implausible that none of them relate to the supply of cigarettes and likely that all of them do.

[106] Which appears to have been credited to the Adam Trading customer account.

932 Between June 2002 and July 2004 TEL received over $ 1.2 million in payments from *Loendersloot Finance* in the Netherlands which can be correlated to the Adam trading account. A number of payments were said to be for "*Mermaid*", a reference which Mr Tlais was not able to explain. His evidence was that, although these and other documents recording payment were seen by Joseph Khatter, his accountant, and sometimes marked "*Khaled*", he was unaware that Adam Trading was selling large volumes in the Netherlands. What he was interested in was the receipt of funds.

933 I find it impossible to believe that Mr Tlais was unaware where funds amounting to over $ 1 million received by Highstreet were coming from. He must have known that very sizeable amounts were coming from Loendersloot because Adam Trading was selling Gallaher cigarettes from the Netherlands.

Pack codes

934 Gallaher contends that TEL made no real effort to ensure that the country coding introduced at the beginning of the TEL era was observed (so that goods were dispatched to the countries for which they were coded) and, thus deprived itself of the ability to monitor whether its customers were behaving responsibly.

935 The country coding consisted of two letters (e.g. "DD" for Iran and "DH" for Syria) which together with other information appeared on the outer of the case. Details of the country codes were sent to TEL on 21st August 2002.

936 The evidence in this respect is significant for what it does not show. No record was kept of which codes were on the goods sold to particular customers. Mr Tlais' evidence was that the warehouses had the codes and that instructions to the warehouses stated that goods should be released with the appropriate codes for the areas to which the goods were going. Mr Clarke's evidence was that the warehouses were given the country codes and were told orally that goods were for a particular market. But, in light of the fact that most of the release instructions that have been disclosed contain no reference to the country codes or the country for which the goods were destined, it seem to me likely that goods will on occasions have been sent to destinations other than those for which they were coded.

937 At one point in his evidence Mr Tlais said that, when TEL was short of goods coded for a particular market, and the question arose of supplying good coded for a different market, Mr Jack had indicated that it did not matter if the goods ended up in a territory other than that for which they were coded provided that they did not end up outside the Territories. It may be that something to that effect was said on a particular occasion or occasions, but I think it most unlikely that Mr Jack indicated that TEL should feel free wholly to disregard the coding system.

938 Goods ended up going to destinations which were different to that specified by the code on the cases. As appears from the examples in paragraphs 771 and 772 goods coded for Yemen were described in the Dubai exit certificate as destined for Iran, and goods coded for Iran were described in the Dubai customs bill as destined for Yemen. Both sets of goods ended up in Loendersloot. The documents also reveal

examples of Syrian coded Sovereign going to Iran and Libyan coded Sovereign to Syria, notwithstanding that, in the latter case, Syria had been specified to the warehouse as the final destination.

939 At the July 2003 meeting with Customs TEL had indicated that it proposed to use some form of secondary case coding (i.e. in addition to what was on the case) for tracking and tracing purposes; and Mr Tlais told Customs and Gallaher that he contemplated having markings on the goods (possibly secret) for use when goods were sent to a country other than that for which they were coded. This never happened. Further, even if the country coding system had been rigorously followed, the fact that there were a number of distributors or sub distributors in each country (see the following paragraph) would have made tracking very difficult. Mr Tlais did suggest to Mr Jack that a system should be adopted where there was a different code for each distributor but nothing came of that.

940 There appear to have been at least five different distributors or sub distributors in *Syria* (TSS, Megamar, Assad, Virginia Trading, Drilon), four in *Afghanistan* (Afghan Watan Wal, Mira Ltd, Alphatrans Ltd and Hormuz Marine); two for *Egypt* (Misr Foreign Trade and El Gizera); three for *Yemen* (Pioneer, Al Falah Trading and Al Anees Trading); and six for *Libya* (Drilon, Tashakariat, Annakha for Tobacco and Matches Importation, NTCD, SATN, Soniret SA).

Breach.

941 To the extent set out below TEL was, in my judgment, in breach of its obligations under clauses 4 (i) (2) and 5 (iv); and also of its obligations under the ITP and thus the TEL Agreement, in failing to make the necessary inquiries to satisfy itself that its customers would behave responsibly, and to procure that its sub-distributors did likewise.

942 In the case of *Adam Trading* the facts evidenced by the Adam Trading Schedules gave reason to believe that Adam Trading was selling outside the Territories and engaged in an illegal trade. TEL was probably aware of those facts and, if it was not, it failed to make reasonable inquiries which would have established enough to justify that belief.

943 In respect of *Drilon* Mr Tlais' original inquiries about Drilon were inadequate. The explanation that goods had been shipped to Bulgaria en route to Syria because a million dollar bond was required if the goods were to be shipped direct was unacceptable and itself gave reason to believe that Drilon, which TEL thereafter continued to supply in considerable quantities, was selling goods outside the Territories. If that explanation was taken at face value there was a failure to make the necessary inquiries e.g. as to the existence of any such requirement.

944 In the case of some companies – *Autotrans Shipping, Hormuz, Truebell*, *TSS Tutun Sugara Savayi*, *Virginia Trading* and *Andalus*, *Ghanem El Sarf* - and *Nader Migho* - the evidence is such that I infer that TEL did not make or procure, the necessary inquiries as to their status and probity and the appropriateness of supplying to them, either because the circumstances called for investigation and there is no evidence of

any, or because, from the evidence that has been given of what inquiries were made, the investigation was inadequate or non existent.

945 In the case of others – (i) *Algemene Panama,* (ii) *Alphatrans*, (iii)*Aziz Poor Trading*, (iv) *El Gizera*, (v) *Kiurdu*, (vi) *Megamar*, (vii) *Mira Ltd*, (viii) *Pioneer Trading Corporation*, (ix) *Prestige*, (x) *Skywards S.A.*, (xi) *Tashapukint Al Wakhrim*, (xii) the companies specified in the table at paragraph 921, and in paragraphs 922-5 – the evidence as to what inquiries were made is effectively a blank. Whilst it is possible that, in the case of some of them, Mr Tlais and Mr Clarke are unable to remember any details on account of the lapse of time or the small quantity of trade involved, I conclude that in respect of many of these companies no substantial due diligence was carried out. Had it been I would expect considerably more information to be available about the result. In respect of those companies that were Adam Trading's customers TEL regarded the question of due diligence as Adam Trading's problem[107]. In that TEL was mistaken, both because under the ITP it was incumbent on TEL to make the necessary inquiries to satisfy itself that Adam Trading would be acting responsibly in selling to its customers, and because TEL had agreed to procure that Adam Trading should conduct its business in accordance with the ITP which obliged Adam Trading to make the necessary inquiries to see that its customers would behave responsibly.

946 TEL submits that many of these customers were small customers who took distressed product off Adam Trading's hands in one off sales. It is not at all clear that that explanation applies to many of the customers referred to above; nor does the fact, if it be such; that customers may have taken distressed goods absolve TEL from compliance with the TEL Agreement and the ITP.

947 I am confirmed in these conclusion by the evidence of Mr Goel as to the type of assessment of an in market distributor that he would have expected as a minimum. This would include (a) details of shareholders and controlling minds, (b) nature of its current business, (c) details of the company's financial standing, infrastructure and employees, (d) an independent background check on past business dealings of the owners of the business and the distributor itself, and (e) details of the distributor's expertise in the market and ability to organise the distribution process. This seems to me a helpful checklist. Not all of that information may have been necessary in all cases, although items (a), (b), (c) and (e) would seem to me to have been important in most. Nor was it necessary that it all be written down. But such due diligence as was performed seems to me to have, in many cases, fallen a long way short of that standard.

948 In the case of a number of companies there was no signed ITP – (a) *Algemene Panama*; (b) *Alphatrans Ltd*; (c) *Auto Trans Shipping*; (d) *Aziz Poor Trading*; (e) *Megamar*; (f) *Mira Ltd*; (g) *Misr Foreign Trade*; (h) *Pioneer Trading Corporation*; (i) *Tashapukint Al Wakhrim*; (j) *Truebell*; (k) the companies specified in paragraphs

[107] Reflected to some extent in Mr Tlais' evidence about a company called SATN: "*Q. What due diligence was performed on this company? A. I told you, all the time, my instruction to Mr Adam Trading to be sure about his distributor. I cannot tell you more than that. I am following Adam Trading, I am following the spotted goods, everything, you know, really in the end, I cannot go to the smoker, he does not give me ITP."*

699- 701; (l) *Al Anees Trading*; and (m) *Assad*. Andalus Al Sharq has not been shown to have signed any ITP. Many of these companies appear to have been direct customers of TEL.

949 Insofar as those companies were customers of TEL, the fact that no ITP was signed meant that TEL was in breach of the undertaking given in the paragraph immediately above Mr Tlais' signature to the ITP ("*I will obtain the same undertaking from any sub-distributors*"). Breach of this obligation is not, however, a breach of the ITP. The ITP is the body of text above the line that separates the text from the paragraph reading "*I have read the above policy…*" . But it was a breach of the obligation under clause 4 (xxxi) to procure that any sub-distributors appointed by TEL conducted business in accordance with the ITP and of the obligation under clause 5 (v) to impose on all purchaser the obligation not to resell the Brands except to persons where there was no reasonable cause to believe that they would sell them outside the Territories.

950 Insofar as those companies were not customers of TEL the absence of a signed ITP suggests a failure on the part of TEL and TEL's customer to make due inquiries about the likelihood of their behaving responsibly. It also evidences a failure to use best endeavours to ensure that those obligations were accepted by all subsequent purchasers contrary to clause 5 (v).

951 TEL also failed to take adequate steps to ensure that the pack coding system was observed and then to use it so as to identify those involved in smuggling - and thus to make the necessary inquiries to see that their customers were behaving responsibly (or to procure that Adam Trading did). The pack coding system was somewhat rudimentary. But it could be used to identify what goods had been supplied to whom. The cases supplied to customers could also be identified not only by the double digit pack code but also by the other indicators stamped on the outers such as production order numbers, SAP codes and single letter month indicators – even if TEL was unaware of the meaning of some of these.

952 The effect of TEL's failure to ensure that goods were only supplied with the country coding for the country for which they were intended, or to keep any list of the codes on the goods sold to its customers meant that it was unable in many cases adequately to investigate the provenance of goods seized.

Materiality

953 These breaches were, in my judgment, taken as a whole material. Instead of there being a distribution structure in which care had been taken to ensure, by the making of necessary inquiries, that goods were not sold to those likely to smuggle them or to sell them outside the Territories, the reality was that goods were sold by TEL without the necessary inquiries having been made and sometimes in circumstances where there was reasonable cause to believe that such improper sales would take place – particularly in the case of Adam Trading, the principal distributor. Sub sales were made by TEL's customers to a range of purchasers in relation to whom TEL had made no inquiry nor satisfied itself that its customers had done so. The fact that, in the event, there were so many seizures of cigarettes supplied by Gallaher to TEL does not automatically establish that TEL was in breach of its obligations. But taken

with the evidence to which I have referred it provides powerful confirmation of a failure of due inquiry and that due inquiry would have revealed reason to believe that Gallaher's cigarettes were to be smuggled or sold outside the Territories, as in the event they were.

Irremediability

954 By March 2005 no remedy was possible within the necessary timescale. Smuggling had taken place on an industrial scale in circumstances where inadequate inquiries had been made which might have prevented or restricted it. TEL had become fatally compromised in the eyes of HMCE and Gallaher as a company in whom confidence could be placed to control the supply of product.

Conclusion on ground 6

955 Accordingly Gallaher was entitled to terminate the TEL Agreement on this ground.

Ground 7 Failure to take proper steps for the distribution, sale and promotion of the Brands

956 Gallaher contends that there has been a breach of the following terms of TEL Agreement:

(a) Clause 3(iii) which provided that TEL would

> *"make all necessary arrangements to transfer the Brands at its cost from its delivery destination in the Territories to registered warehouses and from registered warehouses to its customers."*

(b) Clause 4(ix) provided that TEL would

> *"use its best endeavours to distribute sell and promote the Brands in the Territories and ensure that its ordering and stock controls are such that the Territories and any and all parts thereof are adequately stocked to meet in full the demand for the Brands and that the Brands reach consumers in good condition."*

(c) Clause 4(x) provides that TEL would

> *"maintain directly or indirectly in the Territories a presence so as effectively to promote, distribute and sell the Brands in the Territories…"*

(d) Clause 4(xviii) provides that TEL would

> "*provide all services necessary for the efficient* distribution sale and promotion of the Brands within the Territories"

957 In essence these clauses required TEL to take steps to ensure (i) that there was in place a sales distribution system which ensured that the brands went, on arrival in

the relevant Territory, into registered warehouses and thence to customers; (ii) that the system for ordering and supplying brands was such as to ensure that stocks were available to meet demand; and (iii) that the necessary infrastructure, in terms of, inter alia, personnel and premises was there to ensure the effective promotion, distribution and sale of the Brands. Gallaher contends that there was an absence of proper distributors and proper market assessments with the result that no proper steps were taken to distribute sell or promote the brands.

958 Specific evidence of a sales and distribution infrastructure is limited. I have already referred to Mr Tlais' general evidence – see paragraph 867 above – as to the quality of Adam Trading's distribution network. But Mr Tlais did not appear to know much about the network other than that Dr Al-Mahamid had several businesses, including one involved in stuffed goods, an electronics business, and a property business, and that he was well organised and "*doing good things*".

959 Gallaher was consistently sceptical on this topic. In June 2003 Mr Fawaz produced a presentation which referred to "*lack of distribution expertise and infrastructures by sub-distributors, lack of disciplines in the areas of stock control/inventory management, current activities based on limited market know-how*". Mr Murden, whose contact with the TEL business did not last very long said that he had seen "*no real evidence that brands were established and no evidence of any existing market infrastructure*".

960 Mr Goel in his Industry Report sets out the distribution and sales structures which he thought that TEL should have had in place. These included (a) developing appropriate cycle plans for each salesman and sales team; (b) analysing salesmen's efficiency and improving it by appropriate allocation of sales visits so as to maximize sales per call; (c) daily reconciliation of payments received against invoices and stock issued; (d) setting, agreeing and monitoring the achievement of distribution targets with a view to selling to those outlets which sell the most, including regular retail audits or field visits.

961 Gallaher relies as a paradigm of the inadequacy of TEL's distributorship system on the presentations made by TEL's distributors in August 2004. On 3rd August 2004 Mr Jack wrote to Mr Tlais, in advance of a visit by him and Mr Murden to Dubai, indicating that they would like a proper presentation by the four main distributors on each of their markets including (a) market size; (b) segmentation by taste and price point; (c) key brands and their prices and shares; (d) trade structure; (e) client distribution structure; (f) duty structures; (g) normal trade margin structures; (h) competitor advertising/promotions; and (i) photographs of advertising/promotion.

962 Mr Tlais passed details of this request on to (a) Adam Trading (in respect of GCC, Gulf and Syria); (b) Hafeezullah Mohammed (for Afghanistan and Pakistan); (c) Waheb Tabra of Jode & Sara General Trading (for Iraq); and (d) Mr Mobaraki of Parsian Fougan (for Iran). He impressed on them the need for a good professional western presentation.

963 In the event the meeting took place in December. Gallaher characterises Mr Tabra's presentation in respect of *Iraq* as of "*quite good quality*". It dealt with the size of the market (c 250,000 cases), market segmentation, profit structure, trade structure,

competitors' advertising /promotions and some detailed information in appendices about competitors, market shares, price and taste segmentation, and company total sales.

964 Adam Trading produced a detailed assessment of the *Syrian* market. It contained details of market volume, details of key brands and segmentation by brand and price, the position of the General Organisation of Tobacco and its pricing policy and the remarkably complicated structure of fees and taxes.

965 Parsian Fougan's eight page report on *Iran*, the English of which is not wholly easy to follow, showed that the importation of cigarettes had been made easier in 2000 and estimated that in 2004 Iranian local production would total 12 million cases, which could not be increased, imported cigarettes would be 20 million cases and 18 million cases would be smuggled or unofficially imported. It suggested that there was space for Gallaher in the market and that it could consider local production of tobacco as BAT had done. It gave details of increasing consumption of western "*luxe and light*" cigarettes (now said to be 80%) as opposed to locally produced product, and the identities of Iranian, imported and smuggled brands. It indicated that about 10% of the market was supplied by eastern type cigarettes produced locally by the ITC, about 40% Western full flavour, and about 50-60% Lights and gave details of the retail price ranges.

966 It also identified key trade groups, and methods of distribution. Parsian Fougan was described as active across 28 provinces and in 3 duty free zones; and to own two warehouses, several fairs and stores in the cigarette bourse market in Molavi bazaar together with offices, 110 staff and 45 vehicles. The report referred to BAT and JT having begun to produce Winston (BAT with a partner), Montana (BAT) and Magna (JT) cigarettes locally, and recommended that importation of cigarettes should be the immediate tactic for entering the Iran market with local production as the end plan.

967 Hafeezullah Mohammed's report on *Afghanistan/Pakistan* gave details of the companies Afghan Wantanwal and H & B General Trading; and of general market structure; market shares by brand in Pakistan and Afghanistan; methods of delivery and distribution for each country; duty structure[108]; promotional details and suggestions and comments.

968 Gallaher characterise the last three reports as wholly inadequate. Whilst I regard that criticism as somewhat excessive the reports are undoubtedly lacking in detail on matters on which information was sought: e.g. in the case of Adam Trading items (d), (e), (g) – (i); in the case of Parsian Fougan details of segmentation by price; prices of key brands; and items (e) – (i); and in the case of Hafeezullah items (b); details of the price of key brands and items (d) – (e) and (g).

969 I do not regard the imperfections of these reports as an adequate basis upon which to conclude that there was a material and irremediable breach of TEL's obligations under the clauses relied on; or as justifying the inference that TEL's distribution

[108] In respect of Afghanistan he refers to custom duty of $ 10 on Dorchester based on a proforma invoice of $ 2.5. If this means that it was to be represented to Customs that the cost of a case, the representation would be untrue.

system (by itself and its sub-contractors) was incapable of proper promotion distribution and sale of the Brands within the Territory.

970 Gallaher are on somewhat stronger ground when they point to the fact that there was a hiatus in the supply of Dorchester to the Territory when the damage problem arose. That led to Hazem declining to pay and claiming compensation and TEL failing to make fresh supplies. Gallaher contend that the problem with the old deteriorated stock should have been hived off for discussion between TEL, Hazem and Gallaher and TEL should have supplied Hazem with stock that it had in Dubai.

971 TEL failed to make further supplies to Hazem because Hazem was not paying and because there was uncertainty as to the quality of the Dorchester that TEL possessed. Gallaher's attitude to the disposal of the Dorchester stock had itself varied from an R & D opinion that product was not suitable for sale, to a recommendation from Mr Jack that some of it should be sold, to a decision to destroy much of it. In those circumstances I do not regard TEL's failure to make new supplies as a failure to use best endeavours to distribute the Brands or a breach of any of the other clauses relied on.

Conclusion on ground 7

972 Accordingly I do not regard Gallaher as having established an entitlement to terminate under this head.

Ground 8 Failure to secure proper business conduct by TEL's customers

973 Under this heading Gallaher relies on five matters viz:

(i) TEL's failure to procure compliance with the ITP by Adam Trading (or its sub-distributors);

(ii) TEL's failure to deal in writing with its customers;

(iii) TEL's uncontrolled dealings with Metco;

(iv) TEL's failure to obtain the signature of ITPs from all customers before dealing;

(v) TEL's failure to reduce the debts owed to it.

974 These are said to represent breaches of one or more of TEL's obligations:

(a) to procure that any sub-distributors appointed by TEL to undertake business within the Territories shall conduct business in accordance with the [ITP]: clause 4 (xxi);

(b) to impose on all purchasers of the Brands from TEL the obligation not to resell the Brands except in the Territories, and to resell them only to

persons or firms where there is no reasonable cause to believe that such persons or firms will sell them outside the Territories; clause 5 (v) taken with clause 5 (iv).

(c) to use its best endeavours to ensure that the obligation set out in (b) were accepted by all subsequent purchasers of the Brands supplied; clause 5 (v)..

(d) to use its best endeavours to resell the Brands under terms and conditions that are designed to ensure that the Brands are ultimately sold to distributors legally authorised to sell tax paid in the Territories or in duty free zones within the Territories: clause 2 (v).

(i) Adam Trading

975 As I have already indicated I am satisfied that there was widespread non-compliance by Adam Trading with its obligations under the ITP: see paragraphs 610-621 above and that TEL was in breach of *clause 4 (xxi)*. I regard this claim as, in essence, a duplication of ground 1 and to a limited extent ground 6. To the extent that TEL was in ignorance of Adam Trading's non compliance with the ITP, such ignorance arose because TEL did very little to monitor what Adam Trading's distributors were doing with the goods.

(ii) Terms of business and signature of the ITP

976 TEL did not deal with any of its customers on written terms. In some, but not all, cases the customer signed the ITP. Where a direct customer of TEL ("its sub-distributor") did not sign the ITP, TEL was in breach of clauses 4 (xxi) and 5 (v) since, in those circumstances, it will not have procured its sub-distributor to conduct business in accordance with the ITP; nor will it have imposed on its sub-distributor the obligations (a) not to resell the Brands except in the Territories and (b) to resell them only to persons or firms where there was no reasonable cause to believe that such persons or firms will well them outside the Territories.

977 Where an ITP was signed by its sub-distributor, as with Adam Trading, Drilon, Parsian Fougan, and Virginia Trading, etc, but not by the sub-distributor's customer, TEL was in breach of clause 5 (v), in that it will have failed to use its best endeavours to ensure that obligations (a) and (b) above were accepted by all subsequent purchasers. The ITP does not require the signatories to it to ensure that its obligations are accepted by sub-sub distributors (i.e. the customers of Adam Trading etc); and there is no evidence that TEL saw that there was in place an effective system whereby sub-distributors such as Adam Trading ensured that all such sub-sub-distributors signed the ITP or otherwise agreed to comply with its terms, and many did not. A fortiori these considerations apply where no ITP has been signed by the first sub-distributor in the chain.

978 As to clause 2 (v), there is a range of terms and conditions which could have been used to ensure that the Brands were ultimately sold to distributors legally authorised to sell tax paid or in duty free zones within the Territories. Mr Goel's view was that

in order to plan, develop and monitor a legitimate business in overseas territories, the contract terms should, as a minimum have included:

(a) shipment to the in-market distributor would be only on CIF terms;

(b) the in-market distributor would sell the products only to the wholesale and retail trade within the territory after having paid full duty on the product, and would provide proof of such payment (to TEL) as required;

(c) the in-market distributor would clear goods into the territory duty paid within a short period;

(d) the in-market distributor's territory would be limited to the duty paid territory only, and would specifically exclude any duty free outlet in or around the territory; and

(e) the in-market distributor would provide a range of information on a monthly basis, including sales and stock reports; distribution achievement; commentary on any marketing activity; observations of competitor activity.

979 Some of these somewhat textbook conditions are inapposite for present purposes, in whole or in part. Conditions (a) and (d) are plainly unsuitable for ex warehouse sales, which the Procedural Agreement recognised would be made. Conditions (b) and (d) are inapplicable to duty free sales within the Territory. Some of the information specified in (e) e.g. monthly commentaries on marketing activity is desirable but not essential.

980 TEL submits that it dealt properly with its customers on sufficiently controlled terms to secure compliance with the ITP in accordance with business practice in the TEL territories. However, apart from the ITP (when signed), there were no written terms governing the relationship between TEL and its customers. In particular there do not appear to have been any terms and conditions which imposed an obligation on TEL's customers to give an account of the destination or intended destination of the goods they sold or to permit any form of audit. Nor even, according to Mr Tlais' evidence, was there any agreement permitting brands to be removed if they were being smuggled. There was an entire absence of terms designed to ensure that Brands were ultimately sold to those legally authorised to sell tax paid or only in duty free zones.

981 It was suggested on behalf of TEL that account should be taken of an Arabic cultural bias against having agreements in writing in favour of word of honour and personal trust. I do not accept this. Mr Goel's evidence, which I accept, was that in every country in which he worked with distributors including North Africa, Equatorial Africa and the Middle East there were written contracts. The suggestion that there is an Arabic bias against them appears to me at best a gross generalisation, and, in relation to the many non-Arab territories in respect of which there were no written contracts, an irrelevance. Reliance on such a supposed bias can neither excuse what would otherwise be a breach nor eliminate its materiality.

(*iii*) *Metco*

982 As I have already held – see paragraphs 624-628 above – TEL was in breach of its obligations under clause 4 (xxi) on account of Adam Trading's dealings with Metco. This claim is, therefore a duplication of part of ground 1.

(iv) Failure to obtain the signature of ITPs from all customers before dealing.

983 It is noticeable that none (as far as I am aware) of the ITPs that were signed bear a date. I regard it as likely that several of them were signed some time after trading began. This itself will have involved a breach of TEL's obligations under clauses 4 (xxi) and 5 (v).

(v) TEL's failure to reduce the debts owed to it

984 In his letter of 29th April 2002 Mr Tlais agreed to use his best endeavours to reduce TEL's trade receivables, to conduct as much business as possible on letter of credit terms and otherwise to take cash in advance of delivery of 50-60% of invoice value with the balance payable before the next order. In fact he continued trading on "*open account*" According to the customer accounts *Adam Trading* owed TEL over $ 7.5 million when TEL Agreement was terminated; *Drilon* owed over $ 1 million; *Parsian Fougan* over $ 1.7 million; *Virginia Trading* over $ 2.2. million and over $ 1.8 million was due in respect of sales to *Latin America*. TEL contends that this pattern of trading left TEL financially dependent on its distributors, as a result of which it had reduced ability to control them because TEL would not have wanted to terminate the relationship.

985 It is not apparent to me that Mr Tlais made any endeavours to reduce TEL's trade receivables by conducting business in the manner indicated. But, even if that is so, it does not of itself constitute a breach of the TEL Agreement.

Conclusion on ground eight

986 Accordingly, in my judgment, the matters relied on in sub-paragraphs 973 (i) and (iii) are duplications of grounds upon which I have already ruled. The matter relied on in sub-paragraph 973 (v) is not a breach of the TEL Agreement. There were, however, breaches of the TEL Agreement to the extent set out in paragraphs 976 and 978 -981. These were, in my judgment, taken as a whole, material. The absence of adequate written terms and the failure to take efficient steps to have downstream distributors subscribe to the ITP is likely to have significantly contributed to a loss of control of the Brands. By March 2005 they were irremediable within the necessary time scale. It would not, I think, have been possible to secure compliance with TEL's obligations for the future within 30 days and its non-compliance in the past had contributed to an irreversible breakdown in confidence.

Result

987 In the result I hold that Gallaher was entitled to terminate the contract by the notice given on 4th March 2005 on grounds 1, 2, 3, 6, and 8 (in part).

988 That conclusion renders it strictly unnecessary to consider TEL's counterclaim for wrongful termination of the TEL Agreement. But, in case this matter goes further, I set out my findings in that respect in Appendix B.

989 It is, however, convenient to deal at this point with three issues:

(a) whether the HMCE red card relieved Gallaher of any liability for terminating TEL Agreement;

(b) the term of TEL Agreement had it not been terminated; and

(c) the significance (if any) for the calculation of damages of Mr Tlais' conviction.

The red card

990 Gallaher relies on clause 12 (vi) of the TEL Agreement which provides that neither party shall be liable to the other for any failure to fulfil any obligation under TEL Agreement if the failure is attributable to any cause beyond the reasonable control of the party affected by it including any "*intervention or other act of any government or regulatory authority (such as UK Customs 'Red Card' procedure)*".

991 I do not regard this clause as apt for that purpose. Although the red card procedure is an act of a government authority within the meaning of the clause the procedure did not oblige Gallaher to terminate the TEL Agreement. Whether it did so or not remained within its control.

The term of the TEL Agreement

992 Gallaher contends that it could lawfully have terminated the contract without cause by a notice expiring on 1st May 2007 in accordance with clause 10 (i). That clause provides that TEL Agreement shall continue unless and until terminated by either party giving to the other not less than three months written notice to expire at any time after the fifth anniversary of the Effective Date (which was 1st May 2002).

993 TEL relies on the words in recital B which reads:

> *"The Distributor (whose exclusive business is tobacco distribution) wishes to become GI's exclusive Distributor in the Territories for the Brands for an initial period of 5 years,* ***to be automatically renewed at the end of that period for a further 5 years subject always that: (a) the Distributor shall not have committed a material breach of TEL Agreement which is not capable of remedy as provided for in Clause 10(ii) of this Agreement; and (b) the Distributor shall have achieved the targets contained in Schedule VI to this Agreement for years 1 and 2 of TEL Agreement and subsequent variations***

> ***thereof for the period years 3 to 5 of TEL Agreement; and (c)*** *the Distributor has the ability to effect the efficient and universal distribution of the Brands in the Territories subject to the terms and conditions herein contained and the policy on International Trade of the Gallaher Group which the Distributor has signed and with which it has confirmed that it will use its best endeavours to comply*."

994 The words in bold were inserted in manuscript by Mr Keevil in the original agreement in place of the original words "*with the option to extend that period if GI and the Distributor agree to do so and*", which were crossed out.

995 There are a number of answers to this contention. Firstly, TEL had, in my judgment, committed material breaches of TEL Agreement. However, since the question of damages only arises if TEL had not done so, it is necessary to consider the position on that assumption. The second answer is that TEL failed to achiever the targets contained in Schedule VI and has not established that it only failed to do so on account of Gallaher's breach. TEL submits that it would have achieved these targets but for the problems with the damaged Dorchester. I am not at all sure that that is so. Thirdly, in the light of my findings I am not satisfied that TEL had the ability to effect the efficient and universal distribution of the Brands in the Territories in accordance with the terms of the TEL Agreement and the ITP.

996 On the assumption that these difficulties could be overcome, the next question would be whether TEL was entitled to rely on the words in the recital when they are, at any rate as interpreted by TEL, inconsistent with the body of TEL Agreement.

997 There is a line of authority that where both a recital and an operative provision are clear, but they are inconsistent, the operative part prevails: *Ex p Dawes, Re Moon* (1886) 17 QBD 275, at 286 per Lord Esher MR; *Young v Smith* (1865) LR 1 Eq 180, at 183 per Sir J Romilly MR; *Commissioners of Inland Revenue v Raphael, re Sassoon* [1933] 1 Ch 858, at 879 per Lord Hanworth MR.

998 TEL contends that the parties must have intended the provision specially inserted by Gallaher's own lawyer to have effect and not to be overridden by provisions already contained in the body of TEL Agreement. This is, it submits, confirmed in a draft board briefing note, compiled according to Mr Jack by him, Mr Keevil (whose evidence was that he did not approve it), and Mr Moxon, which recorded that Gallaher and Mr Tlais had recorded an agreement for 5 years:

> *"which in the absence of any material default and compliance with his business plan already agreed with Gallaher for the first two years and to be agreed for the remaining 3 years, will be automatically renewed for a further five years*;"

999 Mr Keevil's evidence was that the commitment was that, if after five years the business had developed in the way expected and if conditions (a) (b) and (c) were satisfied Gallaher intended to renew on a basis to be negotiated. I did not find this evidence convincing as an explanation of the recital. Renewal on a basis to be negotiated is inconsistent with automatic renewal.

1000 TEL submits that the obvious intention of the parties can be given effect by reading the definition of *"Effective Date"* as 1st May 2007. This would be consistent with the principle that TEL Agreement should be looked at as a whole: *Crouch v Crouch* [1912] 1 K.B. 378, 380. The authorities referred to in paragraph 997 relate primarily to deeds. A commercial agreement in which specific provisions are contained in the recital ought not to be construed with the same strictness.

1001 I do not accept this submission. *Crouch v Crouch* was a case where the recital was clear and the operative words ambiguous. In the present case the operative words are clear. To treat the "*Effective Date*" as 1st May 2007 would be to contradict the plain words of TEL Agreement; and would have the effect that, even if conditions (b) and (c) were not complied with TEL Agreement would last for 10 years. In addition the recital is expressed in terms of TEL's wish. That seems to me inadequate to override the clear provisions of clause 10.

Mr Tlais' conviction

1002 Mr Tlais was summoned in about February 2004 to answer charges brought by the Greek authorities against him and other defendants. These charges followed an investigation launched into cigarette smuggling by OLAF in 2001. OLAF prepared a report dated 28th July 2003 which highlighted concerns about the smuggling of cigarettes from Greece into the EU via Bulgaria. The report was provided to the Greek Customs. The Greek Economic Crime Prosecution Department (SDOE) undertook its own investigation and on 13th October 2003 produced a report for the Public Prosecutor. It recommended the prosecution of, inter alios, Mr Tlais as representative of Highstreet.

1003 Mt Tlais was examined, not under oath, by the Investigating Judge on 1st March 2005 when he gave his preliminary response to the proceedings and his anticipated defence. He was admitted to bail in the sum of € 5,000. Thereafter the decision was taken by the relevant authority to commit the case for trial before the Three Judge Appeal Court at Thessaloniki, sitting as a Court of first instance. Mr Tlais did not inform Gallaher of these proceedings.

1004 Mr Tlais was one of 18 defendants who were charged with forgery, money laundering and smuggling. The trial took place over about 30 sessions between 16th November 2005 and 10th February 2006. Mr Tlais was represented during the proceedings. He had the opportunity to appear in person but did not do so. The record of his statement to the Investigating Magistrate and a written memorandum from him were before the Court.

1005 In their submissions to the Court the prosecutors had asked that Mr Tlais and others:

> *".. be pronounced not guilty of the acts with which they are indicted, as said acts are mentioned and thoroughly described in the committal order no 1138.2005 of the Thessaloniki Appeals Court Panel Council"*

1006 In the result Mr Tlais was found guilty, on five counts, of a form of accessory liability, in that in the 14 months preceding 4th December 2001 he had shipped

cigarette cargoes from Cyprus to the first three defendants in Thessaloniki knowing that they were smugglers and would smuggle the goods into Greece. The judges appear to have found Mr Tlais' defence evasive[109]. They found that he was a "*direct accomplice*" to the smugglers and that he knew that cigarettes supplied by him would be smuggled; and that he had used Dr Al-Mahamid to cover his tracks[110]. The offences of which he was convicted as an accessory involved opening imported cigarettes supposedly in transit, repacking them with other cigarettes, ostensibly exporting them from Greece to Bulgaria but in fact bringing them into Greece without payment of duty. The judges were in agreement as to the facts. The Court decided by a majority of 2-1 to convict him of the accessory liability and to acquit him of primary liability. The dissentient would have convicted him as a principal. Mr Tlais was sentenced to four years' imprisonment. He has exercised his automatic right of appeal to a five man Court of Appeal. Judgment in that appeal is pending.

TEL submissions

1007 TEL submits that, if the TEL Agreement had not been terminated in March 2005, the circumstances relating to the Greek proceedings would have been entirely different. As it happened Mr Tlais faced the brunt of those proceedings at a time when the TEL Agreement had been terminated and he had lost his cigarette business. If TEL Agreement had not been terminated his cigarette business would have been at stake. He would have left no stone unturned to ensure the best representation and presentation of his case. In the light of the prosecutors' conclusion the result was surprising. It can legitimately be inferred that the result would or might have been different if a "more Rolls Royce" approach had been adopted.

1008 Even if there had been a conviction it does not follow, TEL submits, that Gallaher would have terminated the TEL Agreement. Mr Tlais could have appealed to the facts (a) that the prosecutor had recommended his acquittal and (b) that the prosecution related to events before the TEL era. Further Gallaher cannot rely on any contention that the quantity of seizures would have caused it to infer that the conviction was justified because Gallaher's inferential case on seizures is ill founded. Gallaher should have known that there were good reasons for product being diverted in the TEL era. In addition Gallaher would, if it believed it in its commercial interest to do so, have discounted the conviction on commercial grounds.

1009 I do not find these submissions convincing. I am sceptical of the proposition that Mr Tlais would have secured a better result if TEL Agreement had not been terminated. The prosecutor's recommendation was eclipsed by the court's determination. The fact that the charges related to events that pre-dated the TEL era would not alter the fact that Mr Tlais had been proved to the satisfaction of the Greek court to be an accessory to smuggling, to an extent that merited a four year sentence. Gallaher would be entitled to draw prejudicial inferences from the volume of seizures and the continuation thereof.

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[109] See N 2/193 ("*[he] makes vague references to other people such as Chaled..*")
[110] See N 2/197 ("*To cover up his participation in smuggling or prevent attaching his face to it, he used for his relevant transactions as mediator his authorised employee Chaled*"

1010 The likelihood is that, had the TEL Agreement still been in existence, Gallaher, after learning of the conviction, would have terminated its relationship with TEL in accordance with the ITP, unless there was cogent reason not to do so. There was none. That was the view of Mr Rolfe and Mr Keevil and in my judgment they were right.

1011 If Gallaher had terminated TEL Agreement it would have been entitled to do so. In the light of the conviction Gallaher would have discovered that TEL had been shown to be behaving improperly. The decision, in a reasoned judgment of the Court of Appeal (sitting at first instance) of a Member State, would have shown that to be so. At the very least, Gallaher would have had further reason to believe that TEL might be behaving improperly in addition to that afforded by the antecedent history of seizures, the Adam Trading Schedules, etc. Gallaher would have placed some weight on the fact that Mr Tlais had not told them about the proceedings when they were launched or in March 2005. It would have borne in mind that Mr Tlais had told Mr Keevil in 2003 about doing bad things in Iraq, not having been candid about that in April 2002.

1012 HMCE would have had, as Mr Byrne confirmed, strong concerns about Gallaher continuing to trade with a convicted smuggler and it would have been very difficult for Gallaher to retain credibility with HMCE if it continued to do so, particularly in the light of the fact that substantial seizures of TEL goods continued during 2005.

1013 Gallaher learnt of Mr Tlais' conviction on about 24th February 2006. Had TEL Agreement still been in existence the Board Committee would probably have met and suspended any further sales pending an explanation from Mr Tlais. Gallaher would probably have waited for the reasoned judgment of the Court, which came forward in June in Greek and would have to be translated. They would also have taken advice on the status of the Greek judgment.

1014 Gallaher has adduced the evidence of Professor Anagnostopoulos, an assistant professor of criminal law and procedure at the University of Athens, and Secretary General of the Hellenic Criminal Bar Association. He confirms that a verdict of guilt is based on "*firm conviction*". He concluded that:

> *"1. This conviction was made unanimously by three senior Greek judges after a major criminal court hearing.*
>
> *2. It was made after consideration by those judges of considerable oral and documentary evidence presented by the Public Prosecutor and in circumstances where Mr Tlais was represented by Greek Counsel and had a full opportunity to present his case.*
>
> *3. Whilst it is fair to say that there is an automatic right of appeal this is a well reasoned judgement delivered by experienced judges with no obvious flaws in it."*

That is likely to represent the advice that would have been given in 2006.

1015 Having taken such advice Gallaher would have terminated the TEL Agreement. I estimate that this would have occurred no later than 31st July 2006. Accordingly, in my judgment, if TEL was otherwise entitled to damages, they would fall to be calculated upon the footing that TEL Agreement would lawfully have ended by that date.

Mr Floratos

1016 I should record that TEL called Mr Floratos, who prepared the SDOE report and was one of the principal witnesses for the prosecution. The tenor of his evidence was that his team had uncovered no evidence of Mr Tlais' involvement in illegal activities and that he was very surprised by his conviction. Goods sold by Mr Tlais had been legally imported in transit and not smuggled out of Greece.

1017 I did not find Mr Floratos a satisfactory witness. He claimed in paragraph 14 of his statement that:

> *"the only basis on which Mr Tlais was referred to in the OLAF report, as subsequently re-reported in my own report, was that he had failed (as of the date of the OLAF report) to provide cooperation to OLAF in their investigation of other parties such as CT Tobacco."*

and he said that during the court case Mr Tlais' lawyer produced a document that stated that OLAF confirmed that he had cooperated. During the course of the Greek investigation Mr Tlais had declined to assist the Cypriot authorities, who had made inquiries at the request of the Greek authorities.

1018 In fact the OLAF Report contained a number of references to Mr Tlais' involvement in suspicious activities. Mr Floratos accepted that the Greek Customs had found records of at least three shipments from Highstreet Enterprises which were supposedly going to Bulgaria but which never arrived at their destination. The SDOE report, which Mr Floratos prepared together with Mr Vlahomitros, recommended that Mr Tlais and Highstreet Enterprises be charged, along with apparent co-conspirators, with smuggling, money laundering and the preparation and use of fraudulent conspirators.

TEL's other claims.

Failure to agree a replacement brand

1019 TEL's claim that Gallaher was in breach of its obligation to use its best endeavours to reach an agreement for a replacement brand is ill founded. Firstly such an agreement is insufficiently certain to be enforceable: *Walford v Miles* [1992] 2 AC 128; *Little v Courage Ltd* (1995) 70 P & CR 469; *Phillips Petroleum v Enron* (Court of Appeal, Unreported 10 Oct 1996). TEL Agreement provides no criterion by reference to which the court or anyone else can adjudicate in the event of dispute: cp *Petromec Inc v Petroleo Brasileiro SA* [2006] 1 Lloyd's Rep 121; *Tramtrack Croydon Ltd v London Bus Services Ltd* [2007] EWHC 107 (Comm).

1020 Secondly, Gallaher did make best endeavours to reach an agreement for a replacement brand, offering first Gold Bond (a Virginia blend), and then LD (an American blend, Gallaher's biggest seller by volume, and a key strategic brand) as well. These were reasonable proposals, which never came to fruition because Mr Tlais wanted to secure more, in terms of financial commitment, than that to which he was entitled. No one has identified what other brand(s) should have been offered.

Failure to cooperate

1021 TEL contends that the TEL Agreement contained the following implied terms:

> *"That GIL would co-operate with TEL so as to assist TEL in the exercise of its best endeavours under clause 2(v) (b) of TEL Agreement and in conducting its business in accordance with the ITP, further or alternatively that GIL would not act in such a way as to frustrate or impede TEL in the exercise of its best endeavours or in the conduct of its business as aforesaid."*

1022 I do not accept that the terms thus formulated are either obvious or arise by necessary implication. They do not satisfy the tests for the implication of terms set out by Lord Simon of Glaisdale in *BP Refinery (Westernpoint) Pty Ltd v Shire of Hastings* (1978) 52 ALJR 20 at p 26. I would accept that it was implicit in TEL Agreement that Gallaher would not do anything to prevent TEL from complying with the ITP or the TEL Agreement. The breach pleaded is that Gallaher was responsible "*for creating or permitting an environment in which (notwithstanding the efforts of TEL) smuggling of cigarettes distributed by TEL was apparently able to occur*". I do not accept that Gallaher was so responsible or that it prevented TEL from complying with the ITP or the TEL Agreement.

Good faith

1023 TEL alleges that there was, also, a further implied term of the TEL Agreement:

> *"That GIL would act in good faith towards TEL in its dealings with TEL and in its dealing with third parties (and in particular HMCE) in relation to TEL's business."*

1024 I do not regard this form of term as one necessarily to be implied into a distributorship agreement of this kind. There is no business necessity for this obligation, and no reason to imply it into the TEL Agreement. It fails the tests for implied terms set out in the *BP v Hastings* case referred to above.

1025 TEL relies on what it characterises as the "eliciting" of the red card, the failure of Gallaher to make clear that TEL was not responsible for seizures, and the termination of TEL Agreement for the purposes of gaining access to TEL's markets and/or motivated by a desire to make TEL the scapegoat for Gallaher's failings. I do not regard Gallaher as having acted otherwise than in good faith. Such steer as Gallaher gave HMCE towards a red card which it was poised to issue anyway was not a breach of good faith. Gallaher thought that TEL was, by virtue of its lack of control, responsible, as I find it to have been, for many of the seizures. If Gallaher

was entitled to terminate the TEL Agreement, as it was, its motive in doing so is immaterial. In any event, Gallaher's prime motive was to bring to an end a distributorship with a company which it had showed such a lack of control and which it believed to be complicit in smuggling.

The Yemen

1026 In 1982 Gallaher appointed Al-Haj Hussein Alwataary & Sons ("*Alwataary*") as its sole in-market distributor for the Yemeni domestic market, for three brands, namely "*Silk Cut King Size Extra Mild; Silk Cut King Size Ultra Mild; Sovereign King Size*". The letter contract provided for arbitration but the arbitrator was to be bound by no substantive law and was to resolve any dispute in accordance with "*general principles and usages of international trade and what is just and equitable under the circumstances*". Between 1985 and 1997 there was an import ban for austerity reasons.

1027 In March 1995, after Gallaher had sold its Silk Cut business in the Yemen to BAT, Gallaher wrote to Alwataary removing the Silk Cut brands from the scope of TEL Agreement. Alwataary took the view that Yemeni law required them still to be the Silk Cut distributor and Gallaher referred them to BAT. The relevant Gallaher files were archived.

1028 By the time of the Namelex and TEL eras, the personnel at Gallaher involved with the Namelex and TEL businesses were unaware of the existing obligations to Alwataary. It is apparent from the minutes of a meeting in September 2000 that Yemen was then regarded within Gallaher as a market which presented an opportunity, for which a "*potential agent*" needed to be sought.

1029 In January 2004 TEL first appointed a distributor for Yemen – Pioneer Trading Corporation. On 22nd January Mr Jack wrote to Mr Bagagsh of Pioneer confirming that TEL had appointed Pioneer. On 25th January Pioneer confirmed to Gallaher that they would act "*through TEL*". In February 2004 TEL's first order for the Yemen was confirmed, subject to production of the necessary banderol stickers (tax stamps) from the distributor.

1030 On 17th February 2004, Mr Clarke wrote to Mr Keevil (Mr Jack being on holiday) to report that the '*Alotari*' (sic) company in Yemen was officially registered as the Gallaher distributor. After Jack's return from holiday, Mr Clarke provided some limited documentation about the registration of 'Alotari'. On 12th March 2004, Mr Jack replied saying that matters surrounding "*the purported Yemen distributor*" were being considered, and that the relevant file was being obtained.

1031 On 7th June 2004, Mr Jack wrote to Alwataary, formally terminating the 1982 agreement with effect from 28th February 2005 pursuant to clause 2 (9) (a) of the contract, on the grounds that (a) Gallaher had had no contact with Alwataary since 1992, save to remove Silk Cut from the business, and (b) having had no dealings for over a decade, it was no longer appropriate or reasonable to remain contracted to Alwataary. Alwataary did not accept this, however, and in subsequent negotiations expressed an ongoing desire to deal in Silk Cut (but did not mention Sovereign).

1032 It is debatable whether that notice was effective to terminate the 1982 agreement. Clause 2 (i) (a) provides for six months' notice but requires the notice to state the reason and justification for the termination "*in accordance with the terms and conditions of this appointment*". That might be interpreted as requiring Gallaher to establish some valid grounds for termination other than the notice itself. According to Alwataary the termination of any agreement with a foreign corporation will only be accepted by the relevant Ministry with TEL Agreement of both parties or in accordance with a court order. Whether that is accurate as a matter of Yemeni law or practice is unknown.[111]

1033 The TEL Agreement does not appear to constitute any breach of clause 2(i) of the 1982 contract with Alwataary since that did not extend to Sovereign Classic or Dorchester International brands. A document recording an agreement between Gallaher and Alwataary in 1988, in the form of minutes of a meeting, signed by Gallaher but not by Alwataary, does, however, provide that "*1. Alwataary shall continue to represent G.I. as G.I.'s sole distributor for its brands of cigarettes in the market of the Yemen Arab Republic*" and that "*5. All sales of G.I. brands of cigartettes (whether locally manufactured or imported into the market of the Y.A.K. shall be distributed through Alwataary*"..

1034 The extent to which TEL ever sought to profit from the Yemeni market, or would have succeeded in dong so is unclear. Mr Tlais gave no evidence of having conducted a market assessment in Yemen. There were a number of different companies which were supposed to be dealing with Yemen – Pioneer, Al Falah Trading & Industry Co, and Al Anees Trading. Yemeni-coded goods were being sold by Adam Trading to Metco in Rotterdam (and were not, therefore, destined for Yemen). A customs bill stating Yemen as the destination of goods sold by Adam Trading was false.

1035 In a letter to Mr Rolfe of 3rd January 2003 Mr Tlais stated:

> "*Yemen poses a real risk of instability due to the current war on terror and as such I would recommend that we continue with Yemen within our programme to grow slowly and redirect the investment focus to the Gulf region which will yield better returns*":

Mr Tlais accepted in evidence that:

> "*We was worried about Yemen. It is true, we were worried but we carry on.*"

1036 Mr Fawaz visited Yemen in December 2002 and saw no sign of Dorchester or Sovereign. Mr Goel's evidence was that Yemen would not have been a profitable market for TEL. Mr Gough accepted that he had no knowledge of this market and he accepted that he could not suggest that Mr Goel's evidence on this market was incorrect.

[111] It appears from a letter of 9th July 2004 to Dr Al-Mahamid that Gallaher had served a notice of termination in 1991 on the basis that there was no business but had withdrawn it following objection from Alwataary.

1037 TEL has not established what damage it would have suffered by reason of not being the exclusive distributor of the Brands in the Yemen; nor has it identified what expenditure it has wasted in relation to the Yemen.

1038 TEL seeks an indemnity in respect of any claim by Adam Trading in respect of wasted investment in the Yemen and other consequential losses arising out of what happened in that market. Quite apart from the uncertainty as to whether Alwataary has any right to be regarded as Gallaher's exclusive distributor, so that Gallaher is in breach of its obligation to make TEL its exclusive distributor under clause 2 (i) of the TEL Agreement, it is not apparent to me what loss, if any, Adam Trading has suffered, or by what route Adam Trading is to be entitled to recover any such loss from TEL.

1039 As to the former Dr Al-Mahamid's Cypriot lawyer wrote letters to TEL in June and July 2004 in the most general terms asserting that Dr Al-Mahamid had suffered $115 million of losses, most of which was attributed to the fact that he had introduced Gallaher products to his business partners in the Yemen and Sudan who were representing government entities, and that any deviation from his agreement with them would have severe consequences. Nothing approaching proof has been tendered of the potential validity or continued maintenance of these assertions, which Dr Al-Mahamid has failed to support in evidence.

1040 As to the latter, in January 2004 Pioneer was confirmed as TEL's distributor. But Pioneer makes no claim. In his oral evidence Mr Clarke claimed that Pioneer Trading "*were Adam Trading's customer but we were going to appoint them directly*". Adam Trading (in an affidavit in support of a claim launched in Cyprus) has claimed that it had a draft contract to appoint Pioneer Trading directly itself[112]. What agreement Adam Trading had with TEL in respect of the Yemen is wholly unclear; particularly because in paragraph 5 of the affidavit the deponent speaks (according to the translation) of Dr Al-Mahamid assigning to TEL and Gallaher the exclusive right of retail sale in Yemen. This is another matter on which Dr Al-Mahamid could have given evidence.

1041 In those circumstances TEL has not established any right to relief in relation to the Yemen.

Damaged Iranian coded Dorchester

1042 Gallaher accepts that it agreed to compensate TEL for certain limited costs arising out of the destruction of damaged Dorchester, subject to verification of the destruction and its cost. Since TEL's claim is for more than what Gallaher says was agreed, it is necessary to determine which party bore responsibility for the damaged Dorchester.

1043 Clause 4 (vi) provided that TEL would:

[112] There is reason to doubt whether this is a genuine claim against TEL by Adam Trading and Dr Al-Mahamid. The claim is based on a draft written agreement – which, if executed would be the only one of its kind for TEL distributors. Attached to the claim are documents which come from Gallaher's disclosure which do not appear to be in the trial bundle, and would seem therefore not to be in the public domain.

> "*be entitled to look to GI for the loss of any of the Brands that are defective due to a mistake in Gallaher's manufacturing process or that are otherwise unsaleable due to reasons for which GI is solely responsible. The Distributor shall, however, bear the loss of any Brands that are unsaleable because of damage suffered after the Distributor takes title to such goods and while such goods are in the hands of the Distributor or its distributors or wholesalers, if any. Except as aforesaid, GI does not warrant the merchantability or fitness of the Brands, and all such warranties, explicit or implicit, are hereby specifically disclaimed and denied.*"

1044 All the sales were CIF sales with payment being secured by a letter of credit. So risk will have passed when the goods crossed the ship's rail and title will probably have passed when the documents were negotiated. It is an implied term of such a contract that the goods will be in such a state that they can endure the normal journey to their destination and be in a merchantable condition on arrival and for a reasonable time thereafter: *Benjamin Sale of Goods*, para 18-226. In other words they must be able to withstand the ordinary incidents of shipping and dockside transition in the part of the world to which they are shipped.

1045 Clause 4 (vi) excludes any implicit warranties. But if the goods, when manufactured, were not fit to withstand the ordinary incidents of a normal journey to the Middle East and to remain sound for a reasonable time thereafter, that would, in my judgment, be something for which Gallaher would be solely responsible. Although the usual warranty of merchantability is excluded it is relevant, in order to determine what Gallaher could be said to be responsible for within the meaning of the clause to take into account of that for which a CIF seller is normally taken to be responsible.

1046 The problem surfaced at the end of January 2003. After it arose the stock in Dubai was quarantined. In March 2003 Mr Ronald Compton, a very experienced member of Gallaher's R & D Department, evaluated two cartons of Dorchester International ex Iran, half of which were manufactured in July 2001 and half in May or June 2002. The goods were sent from Iran to England for analysis. Both products were, in his view, not suitable for sale. The 10 months old stocks were worse than the 20 months old in relation to cigarette paper whiteness and staining, and discoloration of the tobacco. There was print degradation on the younger but not the older packs. The foil tissue and inner surface of the blanks was discoloured on both but much more so on the younger packs. The findings for the 20 months old cigarettes were typical of natural ageing; the younger packs showed signs of accelerated ageing.

1047 In an attempt to understand how the accelerated ageing had come about Mr Compton performed, later in March 2003, an experiment on packs of Dorchester International of May 2002 manufacture. This indicated that the quality faults encountered with the 10 months old product in Dubai, including unacceptable cigarette paper staining, darkening of the tobacco, staining of foil tissue and print degradation on the packet, could be simulated at elevated temperatures (60°C) in a confined space after 7 days. The severe staining of the foil tissue resulting from this experiment, greater than that on samples returned from Iran, suggested that the conditions in Iran may not have been as severe but extended over a longer period of time.

1048 On 4th April 2003 Mr Jack advised Mr Tlais that there was nothing wrong with the packaging itself; and that he was currently focusing on questions of shipping and storage conditions. He advised that there was no evidence that TEL's stocks were likely to deteriorate but that shipments should not be delivered nor distributed to the regions in excessive quantities; should not be left in containers in port; and should be used in market on a strict rotation business. In his reply of 22nd April Mr Tlais expressed his concern, having regard to the importance of the Iran market, which had absorbed the bulk of his investment and for which he needed 10,000 cases a month. The damage problem meant that he had not been in a position to collect money for the past four months and the problem had been compounded by the war in the Middle East. He said that he would follow Mr Jack's instructions fully "*as my principal*" and accept Gallaher's expert opinion; Gallaher would have to make the final decision about what should be destroyed and what released to the market but it would have to be at Gallaher's risk. He said he had never seen anything like this pack change colour before and believed that there was some form of quality or manufacturing problem.

1049 On 25th April Mr Jack repeated his view that the damage was not due to an error in production and indicated that Gallaher's final decision would be given after he had met with Gallaher's R & D.

1050 On 28th April 2003 Mr Jack reported to Mr Tlais that R & D had conducted a test in controlled laboratory conditions using Dorchester from 2002 production and from production 18 months before that. Under the same conditions of temperature and duration the same deterioration was observed. The conclusion was that the problem was not a faulty batch of materials. The same tests were conducted with Sovereign which, if anything, did slightly worse. R & D and Mr Jack concluded that the materials and production of current batches of stock were within specification and that the deterioration was due to the product being subjected to extremes of temperature during transit. R & D were also of the view that, in the light of the quality of TEL and Hazem's warehousing, the damage had probably been done prior to the goods being taken into the warehouse. Mr Jack expressed confidence in the goods in storage in Dubai. He expressed the view that the best solution for the future was to address the logistics of shipping to ensure minimum dwell times in ports and thus minimum exposure to extremes of temperature and temperature variation. This could be achieved if Hazem gave regular orders consistent with a regular sales pattern; if shipment took place direct to Bandar Abbas of duty free goods, and if the Iranians set up a tax stamp regime which would speed up the process of duty payment. But he added:

> *"As to the current old stock in the market, we await the final count from Hazem and the proposed arrangement for destruction …any final count will be done by us and we will wish to supervise the destruction in order to process compensation*".

On 2nd May 2003 Mr Tlais asked Gallaher clearly to state its position.

1051 On 15th May 2003 Mr McDermott of R & D reported the results of further tests, the conclusion of which was that Dorchester and Sovereign packets with cigarettes in

them mottled at 62°C after 6 or 7 days' exposure[113], and that the Iran Dorchester mottling problem had been caused by a combination of conditions including "*storage at elevated temperatures, packet ink thermally degrading and an ink reaction with product volatiles*". No pack deterioration was visible if Dorchester was stored at 48° even if it was for 40 days.

1052 In an internal memorandum to Messrs Rolfe and Keevil of 21st May 2003 Mr Jack referred to the report of 15th May, which he attached. He recorded that the report had the following implications:

> *"In the case of the stock which had suffered deterioration in Iran, it is perfectly feasible that product, when correctly shipped and managed in the chain, can spend 2 weeks port side in the Middle East, With ambient temperatures in the 40° C+ bracket temperature inside containers can rise to the levels used for these experiments. It can fairly be argued, therefore, that the product supplied to the market was not fit for purpose and that we are therefore liable for the deterioration"*

1053 On 9th June 2003 Mr Compton produced a report on his inspection of stock in Dubai on th and 7th June 2003. In respect of Dorchester International cigarettes in the warehouse he reported that the conditions within the warehouse were good and that stock manufactured during July (code K) and August (code L) had a clearly unacceptable level of paper staining with two August samples showing evidence of the early stages of mould spoilage. The October (code N) product had either no or a low level of paper spotting.

1054 He also examined three containers at dockside, which contained Sovereign. The ambient temperature was high (~ 40°C) but the measured temperature inside the container was less than expected (~ 47°C) for containers stored for two months, possibly due to the position of the containers in the main stack. The sampling positions within the containers were deliberately chosen so that the product inspected was exposed to the worst conditions. The entire product in the containers was found to be in good condition. The two months in question will not have been the peak months. But an ambient temperature of around 40°C is high. What Mr Compton found does not provide support for the proposition that the containers would reach temperatures of 62 °.

1055 Mr Compton expressed the view that all stock manufactured before October 2002 (i.e. K - M) was not suitable for sale whereas that produced in October (N) met Gallaher's product quality standards. But it would be prudent not to delay its sale and to move the containerised stock into the warehouse as soon as possible. His overall conclusion, based on his inspections of the warehouses in Dubai, laboratory experiments and field trials with other cigarette shipments, was that the pack and product damage was caused by exposure to extreme temperatures at dockside storage during the peak summer months and before receipt by TEL i.e. before they were received into the warehouse after being stored on the dock.

[113] B & H Gold did not deteriorate in the same conditions – it is a premium product with higher quality packaging.

1056 I see no reason to disagree with Mr Compton's conclusion. That does not, however, resolve the matter. The essential question for present purposes is whether the quality of the cigarettes was such that, assuming a normal voyage and competent handling of the goods on arrival, they would remain merchantable until they had reached the warehouse, having regard to the time during which they could reasonably be expected to be awaiting receipt into the warehouse and the conditions which they could reasonably be expected to encounter during that time, and for a reasonable time after that.

1057 TEL understandably relies on Mr Jack's memorandum of 21st May 2003 as to what can be fairly argued. But what can fairly be argued is not necessarily the same as what can be established. TEL, which bears the onus of proof, has not adduced any expert evidence on the topic[114], in a sphere in which I would have been assisted by it. It would, for instance, be material to know the range of temperatures which would be likely to be experienced in Dubai in containers in the summer months, and the extent to which an importer would be likely to encounter unavoidable delays or be unable to take measures to prevent overheating. Under clause 3 (iii) of the TEL Agreement it was TEL's responsibility to make all the necessary arrangements to transfer the cigarettes from their delivery destination in the Territories.

1058 The evidence from the R & D department to which I have referred does not suggest an identifiable manufacturing fault. Mr Rolfe's evidence was that no similar deterioration had been experienced in respect of goods normally supplied in this supply chain in this or any other market, as could be expected if there was some generic fault in the production of the cigarettes. I have no evidence as to what procedures for stock control and management TEL adopted other than that bills of lading were sent to the warehouse or to the clearing agent for it to deal with. Nor do I have any evidence as to the periods during which the K - M coded stock was left on the docks or outside the warehouse and where and in what conditions it was kept.

1059 Accordingly TEL has not established to my satisfaction that the Dorchester was defective due to a mistake in Gallaher's manufacturing process or otherwise unsaleable due to reasons for which Gallaher was solely responsible.

1060 Various other causes for the defect were suggested such as (i) excessive heat during the voyage (which would not have been a Gallaher responsibility); or (ii) delay on Gallaher's part in sending the paperwork or details of the ETA of the vessel. In relation to the latter Mr Clarke accepted that there was a very efficient lady, who did send weekly schedules with details of bills of lading, the vessel and its ETA, for the first six months of the contract i.e. until October 2002, which was the period during which much of the Iranian coded Dorchester was delivered, the last of it arriving in early December.

1061 In the light of those findings, any entitlement of TEL to recover in respect of the damaged Dorchester arises from such agreements as were made between TEL and Gallaher for compensation. I deal with this in paragraphs 1102 ff below.

[114] It was, as Mr Tlais put it in his letter of 22nd April 2003, only "*experience and logic*" which led him to believe that there was a quality or manufacturing problem.

Dealing with damaged Dorchester

1062 TEL claims that it was caused serious problems by having to deal with the damaged Dorchester stock in the light of Gallaher's instructions as to what should be done.

1063 On 12th June 2003 Mr Jack wrote to Mr Tlais to set out Gallaher's position. At this stage the Dorchester contained in the Thomsun warehouse in Dubai consisted of 66,123 cases made up as follows: Code J – 3,379 cases; Code K – 11,840 cases[115]; Code L – 12,133 cases; Code M – 10,934 cases; Code N – 27,837 cases. There will have been further cases at Modern Freight/GAC. In his letter Mr Jack confirmed that goods coded L, M and N, or any subsequent letter, were acceptable for sale and should be used to re-stock the Iranian market. He said that goods coded J or before were not suitable for sale in the Iranian market due to "*some deterioration*" of the product but were suitable for sale in non core markets. He said that he had not seen any goods coded K but, if there were some, he would assess them separately

1064 According to Mr Clarke Mr Jack explained to TEL that "*non-core market*" meant a market which was not of strategic importance to Gallaher, including Iraq as well as certain African countries (excluding Nigeria), and that dumping in Africa, including outside the TEL territories, would be acceptable, as would Latin America or Asia. In stating this position Mr Jack was, in effect, overriding Mr Compton's conclusion since he had concluded that goods manufactured before October (i.e. codes J, K, L and M) were not suitable for sale.

1065 That decision is open to criticism. On one view it was irresponsible. If the goods were damaged there was a real risk that they would end up being smuggled. That is not necessarily the fate of substandard goods; but, as the evidence of Mr Byrne of HMCE bears out, some smugglers may not be not overly concerned with quality and will find attractive products in which legitimate traders have no interest. A purchaser of substandard goods who finds difficulty in selling them may be tempted to sell them to whoever will take them in order to get them off his hands[116]. Sales of deteriorated stock thus carry a control risk. Mr Keevil took the view that that goods that Mr Compton categorised as not suitable for sale should be destroyed.

1066 At the same time there can be a bona fide difference of view as to what is legitimately saleable. Less sophisticated markets (e.g. Iraq) will accept goods of a standard that would be unacceptable in other markets. Mr Jack, no doubt influenced by the commercial considerations to which I refer in the next paragraph, took a different view to that of Mr Compton. Mr Keevil described a robust debate.

1067 Mr Jack's letter of 12th June proceeded on the basis that Gallaher would be likely to be compensating TEL in respect of at least some of the damaged Dorchester. He referred to TEL being committed to minimising any losses suffered by Gallaher and to the possibility of sales of goods in Dubai allowing Gallaher to "*offset"*. He said that "*whilst not acknowledging liability in respect of the deteriorated goods …*

[115] This amount remained unsold and was eventually destroyed in November 2003 and March 2004.

[116] It may be that this is what happened to K coded Dorchester, which was some of the earliest produced for Iran. 16,882 cases appear to have been distributed (28,722 produced less 11,840 destroyed) in Iran of which c 3,500 cases were seized.

Gallaher have made an offer of $ 2 m in settlement of all claims" (as it had) which had been rejected. He referred to "*our unquantified exposure*" and the fact that the final total of "*your exposure*" would be dependent on a final count from Teheran, TEL's ability to sell the Dubai goods and the position about Iranian duty.

1068 Thereafter Gallaher sought to minimise the amount that it would have to pay (or credit) in the settlement that it intended to seek with TEL by seeing if the damaged Dorchester could be sold: see, also Mr Jeffery's letter of 23rd June ("*..we are both clear that the overall objective is to mitigate the losses suffered by Gallaher as a result of the deterioration*" of stock in Iran). TEL would have preferred it if all the stock had been destroyed and it was provided with fresh stock.

1069 Mr Clarke's evidence was, shortly after the 12th June 2003 and probably before 16th June, TEL expressed disagreement with the suggestion that Dorchester coded L, M and N should be sold to Iran, on account of the high risk of damage to the brand. Mr Jack then told TEL to sell all of the damaged goods into non core markets, saying "*just get rid of them*". TEL did just that.

1070 The requirement to sell damaged product into non core markets was, TEL submits, intrinsically likely to lead and probably did lead to the product being smuggled. This proposition sits uneasily with the figures for seizures (in sticks) of Dorchester by month of production which were as follows:

July (K)	35,459,614
August (L)	39,764,576
September (M)	34,850,963
October (N)	122,878,942

As can be seen, the seizures of October production, which Mr Compton regarded as suitable, exceed those in respect of the seizures for all three previous months.

1071 I do not accept that in June 2003 Mr Jack told Mr Clarke or anyone else at TEL to dispose of all the damaged Dorchester into non core markets. There is no documentary reference to such an instruction; nor is it referred to in the pleadings. It would have been a surprising volte face from a considered position taken so shortly before. It is also impossible to square with the correspondence between the parties in the last two weeks of June.

1072 On 19th June Mr Jack wrote to Mr Clarke to give "*timely advice on the actions to be taken in respect of Iran*". In his letter he said:

> *"In Dubai I indicated you will supervise the separation of stocks according to code and will focus on releasing the approved codes to market in accordance with whatever agreements Abu Hameed reaches with Hasem".*

This must relate to the approved codes i.e. L, M and N, which were to be released to Hazem, i.e. to Iran – as specified in the letter of 12th June. On 20th June Mr Clarke

replied saying that TEL had already started with the segregation of the various codes of the Dorchester stock located in Dubai, and said that *"the goods classified by Gallaher as "OK""* would start to be moved once the problems with Hazem had been resolved. This again must be a reference to the approved codes for supply to Iran. Mr Rolfe's letter of 23rd June 2003 to Mr Tlais referred to R & D having identified which goods could be immediately re-supplied to the Iranian market.

1073 Mr Tomson submitted that this separation into codes would have been needed because the saleability, in a non core market, of the stock would or could depend on how badly damaged it was. Mr Clarke's evidence was that the segregation had been done on the instructions of Mr Jack. But there is no suggestion in the correspondence in June that the purpose of the separation was in order to decide how the stock should be disposed of in non core markets. The tenor of the correspondence is that the purpose was to segregate out the stocks to be supplied to Iran.

1074 On 21st July 2003 Mr Jack recorded in a letter to Mr Tlais that Mr Clarke had now effected separation and analysis of stocks in Dubai. He recorded that TEL had agreed to see whether it could sell the 39,000 cases of "*suspect stocks*" in Dubai (which included – as he said -13,000 cases returned from Iran) at a discount. This was the stock coded J, K, L and M. The letter contains no reference as to where the goods are to be sold.

1075 On 16th January 2004 Mr Jack said that, if TEL wanted to seek compensation from Gallaher in respect of the 46,500 cases[117] of Dorchester Full Flavour in Dubai, of which it had been agreed that some 26,000 cases came from codes affected by the Iranian problem, then the goods should be treated in the same way as the goods in Iran i.e. that they should be subject to 100% inspection (by Gallaher) as to condition and to the extent that they were unsaleable due to extreme spotting a settlement should be considered. By his letter of 22nd January Mr Tlais agreed. On 27th January 2004 Mr Jack, following a conversation with Mr Rolfe, clarified Gallaher's position, which was that goods in a saleable condition should be sold for value and any that, on inspection by TEL, were found not to meet the minimum acceptable standard should be set aside. Gallaher would arrange inspection and compensation as deemed appropriate. No mention was made of where the goods should be sold. TEL believed that the goods were unsaleable (or, if saleable, gave rise to control risks).

1076 On 29th January 2004 Mr Tlais referred to the Dorchester in Dubai and said that he had proceeded to follow Gallaher's letter of 12th June 2003 with shipments to Libya and Latin America of codes L, M and N. (The letter of 12th June 2003 had in fact provided for goods with those codes to be used to re-stock the Iranian market). He referred to major quality problems with 6,000 cases shipped to Latin America and 3,000 cases shipped to Libya (from which the goods had arrived in Nigeria, as Mr Tlais had previously explained to Mr Rolfe), for neither of which shipments had he been paid. Since then he had ceased shipment except for some shipments to Iraq, where he had a 50:50 chance of payment. He claimed that it was "*not possible to*

[117] If this figure was accurate this must have included stock at Thomsun warehouse and elsewhere. The Thomsun figure for January is 31,223 cases.

sell to regular customers or put conditions on people who are stupid enough and prepared to pay for this rubbish". He asked for permission to liquidate the goods without condition. Mr Tlais meant that to mean, inter alia, he should not be required to get people to subscribe to the ITP.

1077 In a letter of 30th January 2004 Mr Jack said that Mr Rolfe fully appreciated that, if there was a problem, Gallaher would have to deal with it, and indicated that he and a representative of R & D would inspect the goods remaining in Dubai, and then return to Weybridge with a view to finalising the whole matter.

1078 Nothing was said about the fact that the goods had been sold not to Iran but to non core markets. I infer that at some stage in the summer or autumn, before the sales to Libya or Latin America, selling to non core markets was either agreed with Mr Jack or, if not, Gallaher by January 2004 was no longer concerned about selling the goods coded L.M and N into such markets. This would be consistent with the fact that Mr Jack proposed – in an internal memorandum of 10th December 2003 – that up to 1.2 billion cigarettes, including what remained of the goods pledged to the bank, the goods TEL had taken over from Namelex, and the remaining damaged Dorchester should be sold off in Iraq as a "*dumping ground*", even though he recognised that that would mean that Dorchester could not be sold there for the foreseeable future.

1079 The fact that TEL disposed of goods into non core markets, even if with Gallaher's agreement or acquiescence, did not, however, mean that it was open to TEL to disregard the TEL Agreement or the ITP. TEL remained under an obligation to comply with the ITP and procure that its distributors did likewise[118]. It is noticeable that TEL did not claim at the time that the effect of selling into non-core markets was that TEL was entitled to make sales in an uncontrolled fashion or without regard to the ITP.

1080 Following the inspection contemplated by the letter of 30th January 2004 Gallaher expressed its position in a letter from Mr Jack to Mr Tlais of 13th February 2004. In it he said that cases of Codes K and L cases should be destroyed and that Gallaher would be responsible for the destruction costs as well as compensation for the goods themselves. He asked that Code M with a total quantity of 15,454 cases (at Thomsun and Modern Freight) should be sold for best value, a request that is surprising in the light of the report that Mr Jack had received from Mr Compton (see next paragraph), and that Gallaher would compensate for the balance of value.

1081 This letter followed a report from Mr Compton in which he had classified the K (July) and L (August) stock as *"well below the minimum Gallaher product quality limit*s", 40% of the samples having advanced mould growth on the tobacco and a strong mould odour within the packet. In respect of M (September) stock Mr Compton had detected an unacceptable level of staining on the cigarette paper for 40% and adverse mould growth on the tobacco for 25% of the samples in the Thomsun Mercantile Warehouse; and unacceptable paper staining on 7% and advanced mould growth on 50% of the samples at the GAC warehouse. The N

[118] Mr Keevil had reminded him of this in his letter of 8th October: "*The basis upon which you sell to your distributors is entirely at your discretion, subject always to complying with your obligations under the distribution agreement".*

(October) stock had the onset of a cigarette paper staining and mould problem. The stock had obviously deteriorated further.

1082 Both Mr Clarke and Mr Tlais claimed that TEL got permission to sell without regard to the ITP. Mr Clarke said that such permission arose because Gallaher did not respond adversely to the request contained in Mr Tlais' letter of 29th January. According to Mr Tlais Mr Jack "*gave the green light*" expressly. I do not accept this. It is noticeable that in his letter of 1st October 2004 Mr Tlais indicated to Gallaher that, in respect of *all* sales, he complied with the ITP and that all his customers had signed the ITP.

1083 On 3rd August 2004 Mr Jeffery had notified TEL of three seizures of Dorchester International goods supplied to TEL: two in Poland (one manufactured for Iran and one for Iran/Sudan) and one in the Canaries together with the seizure of three containers of Dorchester supplied to Namelex by Spanish customers. On 17th August Mr Tlais pointed out that being told that the goods seized were destined for Iran and their month of production was of no use because he had had to sell the damaged goods outside of the coded destination "*to avoid damage to the destination market at the instruction of Gallaher*". He explained that he had supplied the damaged Dorchester to Latin America, Libya, Afghanistan, and Iraq mostly on an FOC basis in order to avoid storage costs and that it was unlikely that he would ever collect any income from the goods as he had many claims on file from customers who could not sell them. The goods were packaged with Sovereign in some instances as they were so damaged as to make normal sale to regular customers impossible because those customers had rejected them.

1084 He observed:

> "*It would have been in everyone's interest if they [the Dorchester] had been destroyed from the beginning. The problem is that when a customer is sent out of condition goods they would immediately start to incur costs that at some point they will seek to recover and then the goods are sold again and again to unsuspecting individuals.*
>
> *I have no knowledge of the individual shipments you have quoted and cannot, in this instance, tie down the shipments to particular clients. We have endeavoured to clear the goods within our markets as agreed with Gallaher…We are very disappointed these goods have entered the transit market as this was not something that would have happened in the past with Dorchester and can only be as a result of the clearance of these damaged goods."*

Mr Tlais said that until he was otherwise advised he would continue with the clearance of these goods in the way that had been agreed with Gallaher.

1085 On 2nd September 2004 Mr Jeffery replied. He did not suggest that TEL should not be clearing the deteriorated goods or not doing so in non core markets, even though the first of the Polish seizures was of October 2000 stock (i.e. coded "N"). But he pointed out (see paragraph 480 above) that until such time as new arrangements were entered into the terms of the existing distribution agreement remained binding

under which TEL had various obligations, including obligations to comply with the ITP and to ensure that anybody to whom it sold stocks complied with the ITP. He asked for details of the parties to whom TEL had supplied Iranian and other Dorchester product in Libya, Afghanistan, Iraq and elsewhere, the countries in Latin America to which it had supplied Dorchester, the volumes of Dorchester mixed with Sovereign and the parties supplied with the mixed goods, and details of the steps TEL had taken to ensure that its customers exercised proper control and management over goods supplied.

1086 On 1st October, after a reminder from Gallaher on 24th September 2004, Mr Tlais confirmed to Gallaher that, "*as you state correctly*", until such time as the new arrangements are agreed and formalized the existing agreement was binding on both parties. He said that he was fully aware of his obligations and fully complied with the ITP and that *all* his customers had signed the ITP and it was regularly discussed with them. He had shipped the goods primarily to Iraq. Mr Tlais attached to his letter a number of documents in respect of shipments to Iraq and South America. These were not entirely satisfactory proof of sales. Some of the documents did not refer to TEL or to Adam Trading, or referred to cigarettes without specifying the brand (or only doing so in a manuscript reference). The documents did not vouch all the sales to Latin America and none of the sales to Libya. A number of the Customs documents were unsigned or unstamped.

1087 By 1st November 2004 33,794 cases of damaged Dorchester from the Thomsun warehouse had been cleared into non- core markets.

The 365 day goods

1088 Gallaher claims $ 3,239, 450, being the price of the cigarettes supplied to TEL on 365 days credit between May 2002 and January 2003 less such of the price as was paid by means of the $ 10 supplement on Sovereign or by a particular set off in relation to water damaged goods. The goods numbered 621,160 cases in all, with prices per case of either $ 10 or $ 5.

1089 TEL admits delivery of the goods and that, if any sum is due, $ 3,239,450 is the outstanding amount - subject to any monies payable to TEL in respect of damaged Dorchester. It contends that no sum is due because of a variation of the payment terms in respect of the 365 day goods in 2003 or 2002. It alleges that in 2003 Gallaher agreed that TEL would not be obliged to pay for the 365 day goods by any means other than the $ 10 supplement on Sovereign cases and that in 2003 and/or 2002 it was or had been agreed that TEL would only be liable to make payment at all to the extent that it sold and received value for the 365 day goods.

The alleged agreement as to payment from the $ 10 supplement

1090 In June 2003 the parties agreed that the 365 day goods would be paid for by means of a $ 10 supplement on each case of Sovereign. TEL Agreement is recorded in Mr Rolfe's letter of 23rd June 2003 in the following terms.

> *"365-day credit*
>
> *The matter of the 365 day receivables was discussed at some length. It is your position that you accepted these agreed goods to assist Gallaher in the clearance notwithstanding that they were not in the correct mix for your needs. Equally you recognise that a part of the goods, the full flavour Dorchester in particular, were urgently required by yourself and have flowed to market and been sold. Other goods of these shipments remain in your warehouse ….*
>
> *You agreed your immediate liability in respect of the various full flavour stocks sold and asked that you pay us for Lights only when you sell them. It was also noted that payments would be subject to resolution of the damaged stock in Iran and any required offsets.*
>
> *I expressed my concern that support within Gallaher for our business in the Middle East was being affected by the current trading losses and poor cash flow. You then raised the matter of the $10 per case currently payable on Sovereign purchases to repay our $1m advance. Settlement of the $1 million is now well advanced and you proposed that after it is complete, this $10 supplement should continue and be used to draw down the account in respect of the goods sold at 365 days and for which we remain unpaid.*
>
> *I advised you that I was agreeable to this but that, as part of your co-operation on this matter, we would need to receive your sales and stock report on a more regular basis (i.e. monthly) to give my fellow directors the necessary level of comfort in the management* of this matter."

1091 As at June 2003 TEL owed Gallaher over $ 3 million in respect of the 365 day goods. It was open to Gallaher and TEL to agree that that debt would only have to be satisfied by payment of $ 10 extra in respect of each case of Sovereign supplied. But the parties are not readily to be regarded as having made such an agreement, which would mean that Gallaher would lose any claim to the balance of the debt if for any reason supplies of Sovereign ceased. Such cessation might occur if, as a result of events outside Gallaher's control, it became impossible to supply Sovereign (e.g. because of governmental restrictions), or because Gallaher exercised its right to cease supply for what might be overwhelmingly sound reasons or bad ones, or because TEL ceased to order Sovereign (subject to any term that might be implied limiting TEL's freedom of choice).

1092 In my judgment the parties did not reach such an agreement. Mr Rolfe's letter contains no reference to the $ 10 supplement becoming the *only* or exclusive source

from which the debt was to be paid[119]. It records agreement with a proposal that, once the $ 1 million has been settled, the $ 10 supplement should continue and be used to drawdown the amount payable for the 365 day goods. This is an agreement as to a mechanism of payment; not that, if the mechanism ceased to work, the debt would disappear. TEL Agreement appears to have been something of a compromise between TEL's wish to pay for Lights only when paid and Gallaher's wish for cash flow. I accept Mr Rolfe's evidence that he never accepted that the supplement was to be the only means by which the debt in respect of the 365 day goods was to be satisfied, and never waived any entitlement to the balance of the debt if it could not be paid out of the supplement. This is consistent with the inherent probabilities, his letter and his contemporaneous manuscript note of the meeting of 17th June 2003 in Lebanon:

> *"6. $10 per case premium on Sovereign agreed going forward post $1 million."*

1093 Mr Tlais, who was present at the meeting, claimed that Gallaher and TEL did *not* agree in 2003 that the 365 day goods would not have to be paid for if the $ 10 supplement ceased to be payable because supplies of Sovereign had stopped. His evidence was that it was agreed in 2002 that TEL would not have to pay for the 365 day goods at all unless they sold them and were paid for them.

The alleged agreements as to payment only when paid

1094 An amendment was made during the course of the trial to allege that in the summer of 2002 Gallaher dispatched a quantity of 365 day goods to TEL in Dubai for which TEL had no requirement and that, when challenged about the delivery, Mr Jack agreed with Mr Tlais to vary the arrangements in respect of the 365 day goods so that Gallaher would only expect payment to the extent that TEL sold them and received value for them. An amendment was also made at trial to allege that Mr Rolfe agreed in June 2003 that TEL would only be liable to pay for such of the 365 Day Goods as it sold and was paid for.

1095 I reject these claims. If such an agreement had been made in 2002 or 2003 I would expect it to have been referred to in the correspondence and pleaded from the outset. The first reference to such an agreement (in 2002) appears in paragraph 474 of Mr Clarke's first witness statement. It sits uneasily with the contention that it was agreed in 2003 that payment would only be made from the $ 10 supplement since, if TEL only had to pay when it received value, it is difficult to see why Gallaher should accept payment by instalments. The alleged agreement, whether in 2002 or 2003, is impossible to square with (i) Mr Rolfe's recording in his letter of June 2003 that TEL had asked to pay for the Lights only when they were sold (not only when sold and paid for); (ii) the absence of any reference by Mr Rolfe to his accepting that position; (iii) the absence of any communication from TEL, or in any other documentation, referring to either of the supposed agreements; and (iv) Mr

[119] Mr Tomson submitted that when Mr Rolfe said he was "*agreeable to this*" he was referring to the payment by $ 10 supplement, referred to in the previous paragraph, and the payment for Lights only when sold, referred to in the paragraph before that. I disagree. I regard the "*this*" as referring, as is usual, to its immediate antecedent.

Tlais' letter of 22nd January 2004 in which he confirmed the continuation of the $ 10 supplement without any suggestion that nothing was due unless the goods had been sold. I accept Mr Rolfe's evidence that, as he put it, "*this was not a sale or return business*".

1096 I do not accept that in the summer of 2002 Gallaher received unwanted shipments of 365 day goods to such an extent as to cause Mr Jack to agree that TEL would only have to pay for them if they themselves were paid. It is apparent that in April, May, June and July 2002 TEL wanted and received Dorchester cigarettes, both full flavour and lights, for sale into Iran. On 26th November Mr Clarke wrote to Mr Jack to say that TEL was now in a position to accept the remaining 365 days stock, consisting of Sovereign Lights, into Dubai for onward shipment to Iran and asking for them to be shipped during early December. Mrs Schiavetta's schedule indicates that they were shipped there.

1097 Mr Clarke's evidence was that he was asked to write the letter of 26th November by Mr Jack because the goods were taking up space in Crewe. Mr Tlais also gave evidence that he agreed to take the goods because Gallaher needed the warehouse space. All that may be so. TEL may have felt that the mix of the goods was not exactly what it wanted. But it seems to me unlikely that Mr Clarke would have written in the terms that he did if there was any significant reluctance on TEL's part to take them, and that, if, on account of such reluctance, there had been an agreement that they did not have to be paid for until TEL had been paid for them, it would have been referred to in that or another letter.

1098 Further, variations to the TEL Agreement were only effective if made in writing, any such amendment requiring the signatures of two duly authorised representatives of Gallaher: clause 12 (x). The requirement for two representatives was removed when TEL Agreement was amended in January 2003.

1099 If the alleged agreement for TEL to make payment only when it received value had been established it would have been necessary to determine what proportion of the TEL goods remained unsold and unpaid for. TEL pleads that a significant proportion of the goods remained unsold. Instead of relying on figures from their records TEL relies on Mr Jack's assessment in January 2005 of the quantity of unsold Dorchester and Sovereign Classic Lights, being 190 million and 162 million respectively. If the total of these, which is 352,000 cases, is deducted from the 621,160 cases the balance is 279,160 cases which appear to have been disposed of.

1100 It is said that little or no value was received for these goods. This seems to me unlikely. Mr Rolfe's letter of 23rd June 2003 records that TEL had sold the full flavour stocks as well as some lights. Mr Clarke's evidence was that these goods had been released to Adam Trading and by Adam Trading to Hazem but not paid for. Parsian Fougan's customer account shows the supply of Dorchester full flavour and Lights[120] and an unappropriated payment of about $ 1.9 million. TEL has also been paid for some Sovereign Lights supplied to OTI. In addition there is evidence of quantities of Sovereign Classic Lights having been released by TEL to Megamar and Drilon.

[120] Lights must be 365 day stock as no new Lights were produced.

1101 Had I found that TEL Agreement relied on was made, I would have assessed the amount due in respect of the 365 day goods as 279,160 x $ 6.50. I take $ 6.50 because, although the average cost of the 365 day goods was about $ 5.50 per thousand, the average cost of the full flavour was approximately $ 6.50 and it is those that, predominantly, were cleared. The total due would then be $ 1,814,540.

TEL's counterclaim

Damaged Dorchester and the Arabic goods

1102 TEL's claim is in respect of four categories of goods lettered A to D:

(i) *Category A*: Dorchester produced for Iran but never sent to Iran. The total quantity of this stock, which was held in Dubai, was 29,306 cases. Of these, 13,852 cases, (Category A (1)), were said to have been destroyed in Oman. The remainder, 15,454 cases (Category A (2))), were said to have been "*liquidated*" following termination.

(ii) *Category B*: Dorchester produced for Iran, sent to Iran and then returned to Dubai. The total quantity of this stock was said to be 13,500 cases, which was said to have been ultimately destroyed in Oman.

(iii) *Category C*: Dorchester produced for Iran, sent to Iran and ultimately destroyed in Iran. The total quantity of this stock is pleaded as 40,625 cases but appears to have been 40,964 cases.

(iv) *Category D*: loss claimed in relation to the Arabic Goods: see paragraphs 367ff above.

1103 The quality of the evidence produced to support TEL's claim for over $ 12.9 million is poor. In relation to Categories A, B and D TEL handed over the stock to Adam Trading and left them to make arrangements for their destruction. Such documentary evidence as there is has been obtained from Adam Trading. In the light of the fact that Adam Trading has been shown to have produced false documentation in the form of (i) the forged UAE customs exit certificate referred to in paragraph 376 (i) and the (ii) the UAE customs exits certificates and customs bill with false statements of destination (Iran and Yemen when the goods were going to Rotterdam, Adam Trading being the shipper) referred to in paragraph 771 , and in the absence of Dr Al-Mahamid to give evidence, I approach the documentation with a degree of circumspection.

Category A (1) *Iranian coded Dorchester never sent to Iran and destroyed in Oman*

1104 In his letter of 12th June 2003 Mr Jack had told TEL to use goods coded L, M and N to restock the Iranian market. The sequence of communications thereafter is set out in paragraphs 1068ff. On 27th January 2004 Mr Jack had said that goods in a saleable condition should be sold for value and any that, on inspection by TEL, were found not to meet the minimum acceptable standard should be set aside.

Gallaher would arrange inspection and compensation as deemed appropriate. Gallaher's letter of 13th February 2004 instructed TEL to arrange the destruction of the stock coded K and L. A manuscript notation on one version of this letter indicates that there were 6,840 cases of K code and 7,012 of L i.e. 13,852 in all[121].

1105 TEL's pleaded claim is as follows:

13,852 CASES AT $ 50 PER CASE	$	692,600
Expenses of de-stuffing and warehousing $ 2 per case	$	27,704
Storage costs: 1,539 cubic metres for 550 days @ 70 fils/ cubic metre = 544,036 Dirham @ 375	$	149,051
Costs of destruction	$	232,642
Subtotal	$	**1,101,997**[122]
879 days interest at 8/15%	$	211,328
Total	$	1,313,325[123]

1106 Gallaher agreed by its letter of 13th February 2004 to be responsible for the destruction costs and the cost of the goods themselves. On 15th March 2004 Gallaher confirmed that these goods should be destroyed in Khasab (in Oman). The Thomsun warehouse records confirm the release in March of 6,840 K code and 6,522 of L code with an additional 490 of M code, making 13,852. I infer that the 490 cases of M code were in the same state as the K and L coded stock. The destruction of 13,852 cases of Dorchester made in the UK is attested by a destruction certificate of the relevant Ministry of the Sultanate of Oman dated 22nd March 2004, which Mr Clarke sent to Gallaher on 8th April. On 2nd April Mr Jack had written to TEL saying that he looked forward to receiving a destruction invoice.

1107 Gallaher observes that there is nothing in the certificate that shows that it was the goods that TEL released to Adam Trading that Adam Trading released for destruction. That is true but it appears to me inherently improbable that some completely different set of goods was destroyed (of exactly the same quantity as the stock released by the warehouse) and likely that these goods are the damaged Dorchester supplied by Gallaher for Iran, coded (predominantly) K and L, but never taken there.

1108 The value of the goods is not in dispute at $ 50 per case making a total of $ 692,600.

1109 The 15th October 2004 letter recorded agreement as to the quantity of 13,852 cases at $ 50 per case and an agreement on Gallaher's part to pay the costs of destruction,

[121] The letter also asked TEL to sell a total of 15,454 cases at Thomsun and Modern Freight as quickly as possible for best value.
[122] Miscast in the pleading as $ 1,076,997.
[123] Miscast in the pleading as 1,288,379.

subject to documentary substantiation, which TEL agreed to cap at $ 200,000. Since any agreement never became binding I decline to regard the cap as contractually agreed.

1110 The only document which purports to vouch the destruction costs is a fax, apparently sent by Adam Trading to TEL in September 2004 totalling $ 232,263 (not $ 232,642 as pleaded). This lists four items (i) Taxes in Khasab - $ 41,556; (ii) transportation charges from warehouse to Jebel Ali to Khasab - $ 96,964 (iii) Municipality charges - $ 12,000 and (iv) "Other expenses" - $ 81,743. The document gives no indication as to what the latter were. Mr Clarke's evidence was that he believed that this item constituted a consultancy fee to someone to procure the necessary authority from the Omani officials. TEL had found great difficulty in arranging for the destruction of the goods. Dubai refused. A sheikh from Ras al-Khaimah then wanted a huge sum to allow or procure destruction. In the end it was possible to make arrangements in Oman.

1111 TEL did not pay the $ 232,263. According to Mr Clarke Adam Trading paid it and did not pay TEL money due in consequence. There is no account between TEL and Adam Trading that shows the offset of this sum.

1112 Whilst this evidence is far from satisfactory, I accept that TEL has in fact incurred a liability to Adam Trading, and that Adam Trading has claimed an entitlement to deduct its claim from amounts otherwise due to TEL[124]. The goods have been destroyed, a process which is agreed not to be cheap, and which must have involved payment for transporting the goods to Oman, and any taxes and fees payable there. I propose to take $ 150,520 as the costs of destruction, being the $ 232,263 in Adam Trading's fax less the $ 81,743. The latter figure is so vaguely itemised as to leave me in doubt as to whether it represents a proper cost of destruction at all.

1113 TEL also claims $ 27,704 as the expenses of de-stuffing and warehousing together with $ 149,051, the storage costs incurred by TEL. Gallaher submits that it did not agree to pay these costs and they have not been proved. As to the cost of destuffing, Mr Rolfe did not quibble with the proposition that taking goods out of containers for the purposes of destruction (or transporting them for the purposes of destruction) was part of the costs of destruction. These goods were taken from destruction from the warehouse in Iran in which they had been stored. They had to be taken down from the pallet racking, put into trucks and taken to the vessel. Transportation from the warehouse is included in Adam Trading's fax. The $ 27,704 appears, therefore, to be a duplication of the $ 232,642 claim. In any event it is not proved. TEL's warehousing costs (presumably from the time that it received the goods) are not part of the costs of destruction and Gallaher did not agree to pay them.

1114 Accordingly the total amount recoverable is:

Value of goods	$ 692,600
Costs of destruction	$ 150,520
	$ 843,120

[124] The customer account for Adam Trading shows over $ 5.8 million due as at the end of October 2005.

Category A (2). A further 15,454 cases of Iranian never sent to Iran and sold at a discount.

1115 The remaining 15,454 cases in this category are M coded cigarettes. In his letter of 13th February 2004 (see paragraph 1080) Mr Jack had asked for these goods, which were in the Thomsun and Modern Freight warehouses, to be sold for best value and agreed to make compensation for the balance of value. These goods were said by Mr Clarke in his witness statement [125] to have been" *liquidated*" by TEL after the termination of the TEL Agreement. By that he meant that the goods had been invoiced with a view to trying to get rid of them, but not paid for, as Mr Tlais confirmed. Mr Clarke believed that the invoicing had been at about $ 10 per case. The amount due to TEL was said to be $ 1,077,647, a figure whose make up neither Mr Clarke nor Mr Tlais was able to explain (notwithstanding that there must at some stage have been a very precise calculation). Mr Clarke believed that it covered the cost of goods, storage and interest.

1116 The documents reveal that the 3,934 cases of M coded goods held in the Thomsun warehouse in February 2004 had been released by mid July 2004 (i.e. before termination) and the same had happened to almost all the 11,520 cases held in the GAC warehouse (GAC took over Modern Freight) in June and July 2004. The Adam Trading customer account reflects sales of Dorchester in the second half of 2004 with a price of $ 30 per case.

1117 Mr Tlais' evidence was that he had sold 8,000 – 9,000 of these cases to "Mr Araf and Al-Itihad" but had received no payment. Al-Itihad was an Iraqi enterprise. But that seems impossible to square with the evidence as to the release of the goods to Adam Trading and the entries in the customer accounts. No documentation in relation to such sales has been produced.

1118 The figure of $ 1,077,647 is unproven and must include items such as storage and interest which Gallaher did not agree to pay. At a full value of $ 50 the claim would only total $ 773,700. I propose to take a figure of $ 20 per case as representing the difference between the cost of the goods ($50) and the sum ($30) appearing in the Adam Trading customer accounts. It may be that $ 30 was not recovered or recoverable from Adam Trading but it represents a maximum figure that TEL may have received or been entitled to. Given the unsatisfactory nature of the evidence for, and presentation of, this claim I do not regard it as safe or just to proceed on the basis that any greater loss has been established.

1119 Accordingly the amount due is 15,494 x $ 20 = **$ 309,800.**

[125] The claim appears in the pleadings only as a claim for "*an amount in respect of losses incurred by TEL on unsold stocks held by it following the termination"*.

Category B *Iran coded Dorchester sent to Iran and returned to Dubai and destroyed in Oman.*

1120 These are the 13,500 cases produced for Iran and returned to Dubai for destruction but said to have been destroyed in Oman. In his letter of 21st July 2003 Mr Jack had expressed himself happy that they be destroyed subject to his supervising the start of the process. On 22nd September Mr Jack recorded that Mr Tlais was to confirm when the Iranian stock returned to Dubai could be destroyed. It was implicit in the communications between the parties that Gallaher would compensate TEL for the costs of destruction – as is reflected in Gallaher's subject to contract agreement to pay those costs recorded in Mr Rolfe's letter of 15th October 2004.

1121 The amount claimed is as follows:

13,500 CASES INVOICED AT $ 50 PER CASE	$ 675,000
Port expenses and restuffing $1 per case	$ 13,500
Shipment Dubai/Banderabas/Tehran $ 3 per case	$ 40,500
Shipment Tehran/Banderabas/Hassab $ 3 per case	$ 40,500
Storage costs in Iran at $ 1.50 per case	$ 20,250
Cost of destruction	$ 228,743
Sub total	**$ 1,018,493**
879 days interest at 8.15%	$ 199,899
Total	$ 1,218,392

1122 On 28th May 2003 Mr Clarke told Mr Jack in a letter that the "*Dorchester full flavour stocks include around 13,000 cases that have been returned to us by Hazem*". None of the disclosed warehouse documents for the warehouses used by TEL makes any reference to these cases being received at any time between February and November 2003. Mr Tlais said that the goods had been checked by Mr Jack. Mr Tlais thought that the goods might have been received at a warehouse used by Dr Al-Mahamid and not TEL. But a TEL release instruction to Thomsun Mercantile of 11th November shows the release of 13,500 cases of Dorchester, and matches an entry in the Adam Trading customer account of the same date recording the release "*for destruction*" of that quantity of goods at Thomsun Mercantile. The Thomsun warehouse records show that 13,500 cases were released in November (Code J 3,379; Code K 5,000; and Code L 5,121).

1123 TEL has produced an Omani destruction certificate dated 16th December 2003 in respect of 13,500 Dorchester cigarettes which were destroyed on 9th December. Gallaher submit that TEL cannot show that the stock that was destroyed was the 13,500 cases brought back from Iran.

1124 Despite the absence of a receipt for the 13,500 cases from Iran it seems to me likely that 13,500 cases were in fact received back from Iran and then destroyed in Oman. If that did not happen, the account given in respect of the 13,500 cases is a complete invention put forward, at an early stage, for the purpose of inflating the counterclaim. I regard that as intrinsically unlikely and inconsistent with the

contemporaneous communications about the anticipated and then actual arrival of about 13,000 cases from Iran (see Mr Tlais' letter of 22nd April and Mr Clarke's letter of 28th May 2003). It is also apparent from the correspondence that Mr Jack was satisfied as to the return of these goods (see his letters of 12th June 2003 and 21st July). He may, indeed, have seen them since he refers to them in his memorandum to Mr Rolfe of 30th October 2003 after his visit to Dubai. Accordingly I propose to adopt the figure of $ 675,000, being $ 50 per case.

1125 In respect of the destruction costs the evidence in support again consists of the fax of September 2004, where the total amount is $ 228,743, made up of the same 4 items as in respect of Category A (1), including $ 81,743 for "*Other expenses*". As with Category A (1) I regard TEL as having established no more than $ 228,743 – $ 81,743 = $ 147,000. The position in respect of this category is complicated by the fact that there is also in the documents an invoice (not described as such) dated 25th February 2004 in respect of 13,500 cases totalling $ 180,201. It is not possible to reconcile this invoice with the fax of September 2004.

1126 TEL also claims $ 114,750 (the sum of the 2nd to 5th items claimed under this heading) as the cost of taking the goods from Dubai to Iran and from Iran to Oman (not apparently via Dubai) together with storage costs in Iran and port expenses and re-stuffing. However, Gallaher did not agree to compensate TEL for the original costs of taking the goods to Iran from Dubai and bringing them back to Dubai and they are also unvouched. Insofar as the amounts claimed include the cost of shipping the goods from the warehouse in Dubai to Khasab in Oman they are covered by Adam Trading's faxed account.

1127 Accordingly the amount established under this head is $ 675,000 + $ 147,000 making **$ 822,000.**

Category C: Cigarettes destroyed in Iran

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1128 These are the cigarettes which were destroyed in Iran in 2004. In his letter of 12th June 2003 Mr Jack had made it clear that Gallaher would be looking to destroy these goods and that he would make the final and binding count and supervise their destruction. On 9th October 2003 Mr Tlais told Mr Jack that Hazem was looking for instructions in relation to the destruction. On 4th December 2003 Mr Jack indicated that he wished to see the matter of Iran resolved before the end of the year and that he would visit Iran to agree and monitor the stock destruction process. Mr Jack and Mr Clarke travelled to Iran in December to meet Parsian Foujan and KPMG in Tehran and Chah Bahar (the free trade zone) to make arrangements. Counting of the stock began.

1129 On 22nd December 2003 Mr Jack outlined to TEL what was to happen and in particular what would be KPMG's role. His letter indicated that, after KPMG had raised a destruction certificate, Gallaher would credit the goods, duties and destruction costs as agreed in relation to each batch. In early 2004 a stock count began. On 23rd January 2004 Mr Jack had told Mr Tlais that he accepted Hazem's quote of $ 4 per master case for destruction in Chah Bahar; that destruction could commence immediately in respect of goods already checked by KPMG, and that no claim in respect of destruction would be entertained without the original destruction

certificate. On 2nd April he said that he looked forward to certification of destruction and destruction invoices in respect of the goods destroyed in Oman (being goods that had been shipped there from Dubai) and that he "*likewise*" looked forward to the Iran matter being finalised. On 10th May Mr Jack indicated that he expected to receive destruction certificates and that these would allow him to finalise financial matters in respect of Iranian stocks. In a letter to Mr Tlais of 1st June 2004 Mr Jack indicated that if the destruction process took longer than two weeks he would pay KPMG's bill in the first instance but would deduct all professional charges in excess of 2 weeks "*from financial compensation in settlement*". It is apparent from these communications that Gallaher would be compensating TEL for goods destroyed.

1130 The final stock count was completed by early May 2004. On 7th June 2004 Gallaher gave KPMG formal written instructions in relation to destruction. It was to satisfy itself that the necessary authority for destruction was in place, to attend the destruction, to count the quantity of goods being destroyed and ensure that only full flavour goods were destroyed and to issues certificates of destruction. The letter indicated that Gallaher had left "*our local partner*" in no doubt that he would not be compensated unless and until KPMG provided a destruction certificate.

1131 The destruction began on or about 6th July 2004 and was completed by September 2004. Destruction of 40,964 cases is vouched by a certificate forwarded to Gallaher on 10th October 2004 by KPMG in Iran signed by a KPMG manager, two representatives of Mr Mobaraki and Mr Mobaraki himself. The amount claimed in the pleading is as follows:

40,625[126] cases, landed in Iran at $ 110 per master case		$ 4,346,875 [127]
Port expenses and re-packing: shipment Dubai/ Banderbas. Expenses incurred in Iran for loading/ unloading, warehousing, transport and destruction costs at $ 18 per case		$ 731,250
	Subtotal	**$ 5,078,125**
879 days interest at 8.15%		$ 996,682
	Total	$ 6,074,807.

1132 There is no evidence that TEL paid Parsian Fougan anything in respect of this stock. TEL relies upon an invoice from Parsian Fougan of 25th September 2004 addressed to Gallaher which refers to 40,964 cases at $ 50 per case and "*Clearance, bandroll and tax charge for each carton 57 US*". The total is, therefore, $ 107 per case, which is the figure per case implicit in the claim for $ 4,346,875.

1133 Mr Clarke's evidence was that TEL sold the goods to Parsian Fougan and was paid $ 29 per case by letter of credit. TEL has produced a Tlais Trading Company invoice of 26th August 2002 for 32,000 cases of Dorchester full flavour and 8,000

[126] This figure probably does not include the last consignment destroyed of 340 cases.
[127] This is in fact $ 107 per case.

cases of Dorchester Lights i.e. 40,000 in all at a price of $ 29 per case. The invoices, which have a letter of credit reference number, were sent to Novin Bahadar, a company related to Parsian Fougan, but Parsian Fougan received the goods. This may have been because Novin Bahadar had the necessary authorisation for foreign exchange transactions. The invoice states that it is the only invoice issued for the goods described in it and "*shows their exact value*". What appears to be the corresponding entry in the Parsian Fougan customer account shows a price of $ 60 per case.

1134 Mr Clarke's evidence was that the price was $ 50 per case, which was the launch price as between TEL and Adam Trading or Parsian Fougan and between Adam Trading and Parsian Fougan. The balance of $ 21 ($ 50 - $ 29) was due to be paid when Parsian Fougan had sold the goods on but was never paid. Parsian Fougan stopped paying Gallaher because of disputes about (i) Gallaher having been in contact with Mr Homayoun; (ii) Gallaher having shipped some LD to Iran; and (iii) the problems with the damaged Dorchester.

1135 There is no product numbering (or other distinguishing feature) which makes it possible to marry the goods the subject of Parsian Fougan's invoice of 25th September 2004 with Tlais Trading's invoice of 26th August 2002. According to Mr Clarke Adam Trading also sold on 5,631 cases to Parsian Fougan, a number which is almost certainly too small. There is no information which would enable one to know whether the 40,964 cases destroyed include some or all of those cases. Since, however, the goods invoiced by Tlais Trading in August 2002 only totalled 40,000 the likelihood is that at least 964 came from Adam Trading. It is not, however, clear what payment TEL received for the 5,631 cases.

1136 Parsian Fougan's invoice to TEL, issued after the goods were destroyed, specifying $ 50 as the cost of purchasing the goods is misleading given that only $ 29 was paid. It does, however, provide some support for Mr Clarke's evidence that the price was $ 50.

1137 Gallaher submits that the only safe course is to reject the claim altogether. TEL has been paid $ 29 per case for the goods sold to Parsian Fougan. The extent to which Parsian Fougan has set off any sums against the amounts outstanding from TEL is entirely unclear; and, since Mr Mobaraki was not called as a witness, it has proved impossible to ask him any questions about it.

1138 I decline to do that. The evidence is sufficient to satisfy me that 40,964 cases were destroyed and, the likelihood is that these included the 40,000 goods sold by TEL to Parsian Fougan at $ 50 but only paid for to the extent of $ 29. On that footing Parsian Fougan is entitled to set off against any amount due by it[128], or to claim, the $ 29 which it has paid, the goods being worthless and having to be destroyed, and would not be liable for the remaining $ 21. $ 50 has been the amount taken for the cost in respect of the other Dorchester claims. I regard it as the appropriate value to take for the 40,000 the subject of the invoice of 26th August 2002 and for the remaining 964.

[128] The customer accounts show $ 1,760,055 as due at the end of November 2002.

1139 Accordingly TEL are entitled to recover the cost of the goods of $ 50 x 40,964 = $ 2,048,200.

1140 As to the payment of duty, Gallaher submits that there is no evidence, other than the statement in Parsian Fougan's invoice of 25th September 2004 that shows the receipt of duty by the Iranian authorities. KPMG's letter of 2nd October 2004 records that a total number of 37,000 cases were duty paid. I infer from that that the cigarettes had the necessary banderols or stamps establishing payment. This is the same quantity of duty paid goods as Hazem had reported in May 2003 (see Mr Jack's memorandum of 21st May 2003).

1141 The sort of figure for duties that had been contemplated by Mr Jack was $ 41 per case: see his memorandum of 14th April 2004. This is similar to the figure of $ 40.15 per case that he had calculated, in considerable detail, in a memorandum of 29th October 2003, following a visit by him to the Iranian Tobacco Company. I regard it as the appropriate figure to take in the absence of any receipt from the ITC or any explanation as to exactly what is covered by the expression "*Clearance*" in Parsian Fougan's invoice.

1142 Accordingly the amount due in respect of duty is 37,000 x $ 41 = $ 1,517,000.

1143 TEL also claims destruction costs of $ 18 per case making $ 731,250. . In this respect it has produced two invoices dated 25th September 2004, which total 667,549,400 tomans (1 toman = 10 rials). The amounts itemised include (i) transporting cigarettes from Bandar Abbas to Tehran; (ii) collecting cigarettes from all around the country and bringing them to Tehran; (iii) bringing the cigarettes to a central warehouse in Tehran; (iv) transporting the cigarettes back to Bandar Abbas; (v) and from Bandar Abbas to Chah Bahar; (vi) "*other charges*"; (vii) unloading and loading charges "*in several cycle*s"; (viii) warehousing charges for 18 months; (ix) destruction charges in Chah Bahar; (x) payment to sale agents; (xi) staff charges and (xii) further "*other charges"*, which I was told by Mr Clarke, covered, together with (vi), a consultant for the purpose of obtaining a licence for the destruction of the goods. Mr Rolfe recalled that at the meeting in October 2004 when these costs were considered Mr Tlais had indicated that he could not support all of them. He also said that he thought that these charges were higher than they should have been, that some of the costs involved Parsian Fougan's own vehicles and they should suffer some of the pain too, and that he was going to attempt to negotiate them down.

1144 The generality of the description of the charges is such that it is not clear exactly what is covered. Item (i), for instance, appears to be the original cost of taking the goods on arrival in Iran to Tehran. Items (ii) – (v) and (ix) appear to be costs of destruction (in which I include gathering the goods up in order that they can be destroyed). Items (vii) and (xi) may, in part represent the cost of destruction. If items (vi) and (xii) cover what Mr Clarke says they do (what you have to pay to get things done) they may be said to represent a destruction cost; but the description "*Other charges*" is wholly inadequate. Item (viii) is not a cost of destruction. It represents wasted expenditure which Gallaher made no agreement to reimburse. Item (x) is also something which Gallaher did not agree to pay. In that state of the

evidence I am only prepared to take items (ii) – (v) and (ix) as representing the destruction costs. They total 194,258,200 tomans. I was told that the exchange rate in late 2007 was approximately 935 tomans to the $. Subject to any further argument as to the appropriate exchange rate I propose to use a figure of (194,258,200 ÷ 935) = $ *207,762*.

1145 Accordingly the total amount due in respect of this category is $ 2,048,200 + $ 1,517,000 + $ 207,762 = **$ 3,772,962**

Category D The Arabic goods

1146 These are the 33,505 cases of stock with an Arabic health warning which had been purchased from Gallaher in the Namelex era: see paragraphs 367ff above. The amount claimed in the pleading was as follows:

33,505 CASES. INVOICED AT $ 110 PER CASE	$ 3,685,550
Storage costs 3.72277 cubic metres for 821 days At 1 dirham/cubic metre	$ 837,368
Cost of destruction	$ 448,137
Sub Total	**$ 4,971,055**
1367 days interest at 8.15%	$ 1,030,407
Total	$ 6,001,462
Deduction of free goods received by TEL	$ 1,595,264
Total	**$ 4,406,198**

1147 The destruction of 33,505 cases is supported by an Omani certificates dated 1st October 2003 issued at Adam Trading's request. Although there is nothing in them that identifies these goods as the Arabic goods it seems to me likely that the certificates do relate to those goods.

1148 TEL Agreement made is set out in paragraph 371 above. Pursuant to it TEL is entitled to recover

(a) the net value received by Gallaher in respect of the sale of the Arabic goods, allowing for rebates, namely $ 2,345,350

(b) lees free goods received by TEL - $ 1,595,264

(c) making $ 750,086.

(d) plus ½ the destruction costs.

But TEL is not entitled to storage costs.

1149 The claim for $ 448,137 by way of destruction costs (not paid by TEL to Adam Trading but offset) is supported by an Adam Trading invoice of 24th February 2004 in that sum. It includes a figure of $ 125,000 as "*Local charges for the destruction process*". The September 2004 fax shows a higher figure of $ 470,300 which includes wholly unspecified "*Other Expenses*" of $ 100,000. It also contains two entries ($ 5,240 and $ 12,000) in respect of 4000 cases which are described as "Return Cases" and are separate from the 33,506 cases. If the latter two entries are deducted the sum due for the 33,506 cases is $ 453,060.

1150 I propose to take the lower figure of $ 448,137 and to deduct from it the sum of $ 125,000 on the ground that what, if anything, it really covers is wholly unexplained, producing $ 323,137. Half of that is $ 161,570 (rounded up). The total is **$ 911,656**. ($ 750,086 + $ 161,570).

Summary in respect of damaged Dorchester

1151 Accordingly the amount that I regard as due in respect of damaged Dorchester, to which interest will need to be added is as follows:

Category A (1)	$ 843,120
Category A (2)	$ 309,800
Category B	$ 822,000
Category C	$ 3,772,962
Category D	$ 911,656
TOTAL	**$ 6,659.538**

Gallaher's personal claim against Mr Tlais

1152 Under the arrangements made in April 2002 for the deposit by Gallaher of $ 5,000,000 in a deposit account at BLOM Mr Tlais agreed to pay Gallaher $ 1 million on 5th May for 5 years beginning on 5th May 2003: see paragraphs 22-25 above. By his letter of 30th April 2002 Mr Tlais provided Gallaher with his personal guarantee that, if he failed to make any of the $ 1 million annual payments, he would within six months of Gallaher's demand reimburse Gallaher "*without any set off, deduction, withholding or impost whatsoever*" the difference between the $ 5 million and the amount Mr Tlais had paid at the date of the demand. Mr Tlais paid the first instalment in May 2003 but failed to pay any more. Prima facie, therefore, Gallaher is entitled to recover the balance.

1153 Mr Tlais contends that he is not liable to pay the $ 4 million or any sum on the ground that his obligation to repay was conditional on Gallaher's proper performance of the TEL Agreement, and that Gallaher's failure to comply with TEL Agreement and wrongful repudiation of it has the consequence that he is no longer liable to repay the deposit. Mr Tlais also counterclaims in respect of the $ 30 million which he claims to have lost in the Namelex era and for which he holds Gallaher responsible.

1154 Gallaher contends that any such claim to $ 30 million is invalid and that, even if it was ever valid, it has been irrevocably waived by the compromise agreement of 30th April 2005. That agreement recited that:

> *"(4) [Gallaher] and Mr Tlais want to enter into a direct trading agreement via a company that he has procured is incorporated [sic], if the current Distribution Agreement between NTA and [Gallaher] can be lawfully and properly terminated*
>
> *(5) The parties hereto desire to acknowledge, represent and warrant to each other that there are no direct or indirect actions, claims or disputes arising out of or related to the Distribution Agreement or otherwise between them*"

and provided that:

> "in consideration of the above recitals and their desire to enter into a new business arrangement (immediately following the termination of the Distribution Agreement) the parties hereto agree, acknowledge, mutually covenant, represent and warrant to each other as follows:
>
> 1. *There are no direct or indirect actions, claims or disputes between them of whatever nature whether actual or pending or prospective (a) arising out of or in connection with the Distribution Agreement or (b) any other course of trading relationships, business dealings, discussions or exchanges of correspondence between (i) GI or other members of the Gallaher Group or their respective directors or employees and (ii) NTA, Mr Tlais or Highstreet Enterprises or any company or business of which NTA, Highstreet Enterprises or Mr Tlais is a director, officer employee, shareholder or with which NTA, Mr Tlais or Highstreet Enterprises is otherwise directly or indirectly connected;*
> 2. *If any party to this agreement believes that it has any such claim as is described in Clause 1 of this Agreement such claim is hereby irrevocably waived."*

1155 The effect of these very wide provisions was that, if the compromise is effective, any claim such as that which Mr Tlais now seeks to pursue (which he had asserted before TEL Agreement was made) has been agreed not to exist and is irrevocably waived. The purpose of the provisions was, inter alia, to compromise Mr Tlais' asserted claim to $ 30 million in respect of the free goods issue.

1156 Mr Tlais contends that the compromise is ineffective. In his closing submissions Mr Tomson put the matter thus. It is, he submits, a matter of construction of the relevant agreement whether a claim is compromised by (a) the promise to do something in return or (b) the doing of that something: *British Russian Gazette and Trade Outlook Limited v Associated Newspapers* (1933) 2 KB 616. As Lord Atkinson said in *Morris v Baron & Co* (1918) A.C.1,35:

> "*The law as to the accord and satisfaction of a breach of an agreement was much discussed in argument. There is no doubt that the general principle is that an accord without satisfaction has no legal effect, and that the original cause of action is not discharged as long as the satisfaction agreed upon remains executory. That was decided so long ago as 1611 in Peytoe's Case. If however, it can be shown that what a creditor accepts in satisfaction is merely his debtor's promise and not the performance of that promise, the original cause of action is discharged from the date when the promise is made: Sibree v Tripp; Hall v Flockton; Evans v Powis.*"

In the present case the proper construction of TEL Agreement is, as he submits, that the consideration for the compromise was the performance of the TEL Agreement, which would enable Mr Tlais to recoup his losses. If that was wrongfully repudiated by Gallaher, as TEL contends, the compromise is ineffective.

1157 I do not regard the consideration for the compromise agreed in the latter of 30th April 2002 as either the performance or the making of the TEL Agreement. In its terms the compromise involved each party providing consideration to the other by the abandonment of their respective claims. The closest that one gets to the TEL Agreement is recital (v) that Gallaher and Mr Tlais "*want to enter into a direct trading agreement via a company that he has procured is incorporated, if the current Distribution Agreement between NTA and GI can lawfully be terminated*" and the opening words "*in consideration of the above recitals*". But a desire to enter into an agreement is not the entering into, much less the performance of, TEL Agreement itself. If that is too strict a view, the consideration is, at its highest the making of the direct trading agreement to which the recital refers.

1158 Mr Tlais places reliance upon the relevant parts of the letter of 29th April 2002 which read:

> *"Legal Matters*
>
> *(ii) It was further agreed that the termination letter would confirm that;*
>
> *…*
>
> *(b) that (sic) you, High Street Enterprises Ltd., NTA and its directors, officers, employees and shareholders will have no claims against the Gallaher Group Plc, its associated companies, its directors or employees arising in any way out of the NTA contract or its termination and GI shall give an equivalent confirmation to you, NTA and its directors*

(iii) It was agreed that you would sign and observe both our International Trade Policy and a new five year distribution agreement between Gallaher International and Tlais Enterprises Ltd, copies of which have been supplied to Dinos."

1159 This takes the matter no further. The reference in (ii) (b) to confirmation of the absence of claims by Highstreet etc and Gallaher makes clear that the release is mutual and the TEL Agreement is then dealt with separately in (iii). I am quite prepared to accept that the parties recognised that the TEL Agreement was to be the means by which Mr Tlais was, hopefully, to trade out of his problems and recoup the losses that he had suffered in the Namelex era; and that, if TEL Agreement was at an end, the means of recoupment would be lost. It does not, however, follow that the consideration for the compromise was the fulfilment of the TEL Agreement.

1160 Mr Tomson submitted that the parties cannot have intended that Gallaher could rely on the compromise if it repudiated TEL Agreement the day after it was made. Further, the letter agreement required Mr Tlais to sign and observe the TEL Agreement. It could scarcely be contended by Gallaher that the parties supposed that Gallaher was free to disregard its term at will.

1161 But Gallaher was not free to disregard the TEL Agreement without sanction. If it did so wrongfully, it would be liable in damages. The example of repudiation the day after the contract (a circumstance that the parties cannot have had at the forefront of their minds) may be matched by postulating a repudiation in the final year of TEL Agreement, at a time when only some of the $ 30 million has been recouped because the contract has proved unprofitable. It seems to me far from obvious or necessary that the efficacy of the parties' compromise should be dependent on Gallaher's continued performance over a 5, or 10, year period of an agreement which, although expected to be profitable might not in fact be so. In any event, on my findings, Gallaher has not repudiated or wrongly terminated the TEL Agreement.

1162 In case I am wrong on that I shall set out, briefly, my conclusions on Mr Tlais' counterclaim on the assumption that it has not been compromised.

Mr Tlais' counterclaim

1163 Mr Tlais claims to have been defrauded by Hadkinson during the Namelex in two respects. He first contends that the operation of the "*duality*" (see paragraph 92 above) whereby Gallaher would raise invoices for a "gross" sum, which he would pay via a letter of credit, and then charge Namelex in effect a net price, by rebating sums or – to a much lesser extent - providing free goods to Namelex, or in accordance with Namelex's directions, involved a fraud upon him.

1164 I do not agree. Mr Tlais was Namelex's customer. Namelex was entitled to make a profit when acting as the middle man between Gallaher the manufacturer and Mr Tlais/his companies as the sub distributor. Neither Gallaher nor Namelex was bound to disclose what that profit was. Mr Clarke's evidence was that the rebate process was set up without any intention to deceive, he being "*100% involved*" in setting it up (although not in its operation i.e. the actual supply of free goods thereafter which

was dealt with by Mr Hadkinson and Mr Nammour). The intention was that Namelex would, using the rebate, provide free goods (purchased from Gallaher) to the customer as an incentive. It would be easier to wean customers off the free goods than provide no free goods and increase the price. He had discussed and agreed the whole idea with Mr Jack, whose understanding of the way in which it was intended to work would have been the same as his. Mr Jack, he said, was in no better position than he was to know what was happening in relation to the supply or non supply of free goods by Namelex. Mr Clarke confirmed that Gallaher were not aware of Namelex's failure to pass the free goods on.

1165 The second way in which Mr Tlais claims to have been defrauded is by the free goods deception i.e. by being persuaded to purchase Gallaher stock and sell it at a discount upon the faith of a fraudulent assurance from Mr Hadkinson that Gallaher had agreed to make good his losses on discounted sales by the provision of free goods. Gallaher is alleged to have become party to this deceit and/or to have conspired with Mr Hadkinson to injure Mr Tlais by the giving of false assurances. Gallaher is also alleged to have ratified an agreement purportedly made on its behalf to provide 268,000 free cases or $ 30 million. This claim was not originally included in Mr Tlais' defence but was added by amendment after Gallaher had issued an application for summary judgment.

Gallaher involvement in the fraud

1166 TEL's case in relation to Gallaher's involvement in the fraud rests, essentially on the letters of 13th September 2001 (paragraph 208 above) and 21st December 2001 (paragraph 215) to which I have already referred.

Deceit

1167 In order to succeed in a claim in deceit TEL would need to establish (i) that Gallaher made, in one or other or both of the September and December 2001 letters, a representation of fact which was false; (ii) that the representation was known by Mr Jack to be untrue, or was made without belief in its truth or reckless as to its truth or falsity; (iii) that it was made with the intention that it should be relied upon; (iv) that it was relied upon by Mr Tlais; and (v) that Mr Tlais suffered loss by reason of that reliance. In determining whether someone has been guilty of deceit the Court will recognize that deceit is intrinsically less likely than innocence or carelessness and therefore requires stronger evidence if it is to be established: *Re H* [1996] AC 563, 586. I am conscious also of the need to proceed with caution when Mr Jack has not been called to give evidence because Gallaher chose not to call him.

1168 As I have already indicated (see paragraphs 211 and 215 above) the letters contained the false representation that Gallaher intended to make a $ 30 million one off payment to Mr Tlais or the equivalent in free goods as part of the arrangement for Gallaher to provide goods free of charge which Mr Hadkinson had explained to him. I do not accept, as Gallaher submits, that the letters are ambiguous, or that they can only properly be understood with greater knowledge of what Mr Jack and

Mr Tlais knew at the time or of what Mr Clarke and Mr Hadkinson were saying to Mr Tlais[129].

1169 In order for the maker of a statement to be guilty of deceit he must have known the statement to be untrue in the sense in which he intended, or was willing, that the representee should understand it. Mr Jack must have intended that Mr Tlais should understand what he wrote as containing the false representation I have identified. At the very least he was willing for Mr Tlais to interpret it in that way, as he did. Mr Jack chose the version of the September letter that he thought was the most ambiguous, no doubt hoping that he could avoid responsibility by claiming that his letter had been misunderstood.

1170 Gallaher, as Mr Jack knew, had no intention of making a $ 30 million one off payment to Mr Tlais or the equivalent in free goods. Mr Jack intended that Mr Tlais should rely on what was being said to him, continue financing the purchase of goods, and remain prepared to provide a $ 30 million letter of credit. That he had such a motive strengthens TEL's claim in deceit since "*a man is more likely knowingly to make a false statement if he has some reason for doing so*": *Derry v Peek* [1889] 14 App.Cas 337, 374.

1171 It is not sufficient to escape liability that Mr Jack may not have intended that Mr Tlais should suffer loss, or that he believed that no harm would result because he expected that Namelex would obtain the necessary finance, or that his purpose was, as Mr Clarke characterised it, to buy time for Namelex to pay its bills: *Brown Jenkinson & Co Ltd v Percy Dalton (London) Ltd* [1957] 2 QB 621; *Chartered Bank v Pakistan National Shipping Corporation* [2000] 1 Lloyd's Rep 218, paras 2 & 3; *Society of Lloyd's v Jaffray* [2002] EWCA Civ 1101, para 66; *GE Commercial Finance Ltd v Gee* [2006] 1 Lloyd's Rep 337,340.

1172 If I am wrong on that, then Mr Jack on behalf of Gallaher must, at the lowest, be taken to have assumed a responsibility to take care to ensure the accuracy of his representations in the September and December letters; and failed to do so.

1173 Mr Tlais has, however, failed to prove that, in reliance on the false representations contained in the letters of September and December 2001, he did or failed to do anything which has caused him loss. His claim would, therefore, fail on this ground alone.

The $ 30 million claim.

1174 Mr Tlais' central claim was that he had lost $ 30 million in the Namelex era from selling goods at a loss. The business plan contained in Schedule VI to the TEL Agreement showed how it was envisaged that the $ 30 million would be recouped. It is not, however, at all clear whether any losses that were suffered during that era were suffered by Mr Tlais personally as opposed to his elder brother, other members of his family, or Highstreet. The letters of credit opened during the Namelex era

[129] There is, I accept, significant obscurity as to the relationship between Mr Hadkinson and Mr Tlais. Before the Namelex era Mr Tlais had had problems with Mr Hadkinson involving litigation; and from time to time during their relationship Mr Tlais had reason to believe that Mr Hadkinson had been, or was, telling lies to him. He found him a slippery customer ("*He is like the soap, however you catch him he escapes*").

were opened either for the account of Namelex or "*Ste Taleb and Mohammed and Khaled Tlais*". The amounts due under those opened for Namelex were debited to an account of Abu Ahmed, Mr Tlais' brother.

1175 Mr Tlais' pleaded case is that by September 2001 the "*free of charge goods account*" representing the accumulated losses stood at in excess of 268,000 cases with a value of some $ 30m. This loss, if suffered, cannot have been the result of reliance on letters written on 13th September and 21st December 2001.

1176 The figure of $ 30 million itself is highly suspect. To begin with, it is not clear exactly what it represents. When Mr Clarke first learnt of the figure he found it incredible, not least because it would mean that Mr Tlais was to get about one free case for every case purchased. Since Mr Tlais' evidence was that he was selling goods at up to 70% below cost price, the $ 30 million figure would be greater than his loss as measured by the cost of the goods. In parts of his evidence, however, Mr Tlais claimed that the free goods were also to provide him with some measure of profit. The 70% figure cannot be verified because there are no records showing what discounts were given to customers during the Namelex era. Nor do the customer accounts provide a reliable guide as to what is truly due.

1177 Mr Clarke's evidence was that the free goods account had reduced to nil by December 2000. This is consistent with a letter of 13th December 2000 from Mr Hadkinson which showed that Mr Tlais had already received 19,185 cases of free goods prior to that date and that he was owed a further 42,469 (after which no more would be due) in respect of which release arrangements had been made. Mr Tlais identified the 42,469 as the goods with which he was provided because he had paid some "demurrage".

1178 If the account was at zero in December 2000, that would mean that the $ 30 million figure accrued in a nine month period. When it was put to Mr Tlais that that would mean that he would have to have sold about £ 40 – 45 million of goods during that period (assuming that he sold them at 70% below cost) he claimed that the figure also covered money which he was unable to collect from customers of Mr Hadkinson which Mr Hadkinson had guaranteed would be paid (including $ 1 million said to be owed by a Syrian distributor). He claimed to have been told by Mr Hadkinson to sell, or that Gallaher wanted him to sell, to various customers such as CT Tobacco. (In earlier parts of his evidence he had suggested that the dealings with CT Tobacco were carried out Tlasco or Tlais Trading from which he was independent).

1179 It is impossible to verify the $ 30 million figure because, as Mr Tlais confirmed, he had no calculations which showed how it was reached. Everything was apparently left to Mr Hadkinson who would tell Mr Tlais to open a letter of credit and tell him that he would get a given quantity of cases free of charge.

1180 Gallaher has performed an exercise of taking the letters of credit opened by Mr Tlais or his associates in the Namelex era, as specified in a TEL disclosed document, and examining what appears from other disclosed documents to be the price at which the goods were sold or, at any rate, the price that Mr Tlais was charging or seeking to charge for similar goods. This exercise is not an exact one. It

is, in part, based on the customer accounts which will in some cases (of uncertain number) not reflect the price actually obtained, and it makes certain assumptions (e.g. that the goods sold were the goods purchased by the letters of credit financed by his family). Taken at face value, it shows that, broadly speaking, Mr Tlais and his associates were not engaged in loss making operations but were making a profit of around 10% of cost.

1181 So far as losses after September 2001 are concerned, Mr Tlais relies on the alleged fact that he continued to finance further purchases of more than $ 6.7 million (originally pleaded as $ 10 million) of stock at a loss in accordance with his mistaken understanding that these losses were to be compensated by free of charge goods from Gallaher and that his losses totalled more than $ 3 million: paragraph 8A.11 of his Re-Amended Defence and Counterclaim.

1182 The letters of credit relied upon are those numbered (a) 2206, (b) TR 1774-01, (c) 1264 and (d) 11265. The first three were opened on 2nd May, 25th May, and 7th June 2001 and shipment of the goods took place between May and August 2001 i.e. before the September letter. The fourth was opened in June 2001. The obligation to make payment under it arose after September but before December 2001. It is not, however, apparent that any loss was made on the 5400 cases of Stateline at $ 75 per case the subject of this letter of credit. There is evidence in the customer accounts that Stateline was being sold at $ 90 per case.

1183 Mr Tlais' evidence was that on the back of Mr Hadkinson's assurance about free goods he was persuaded to open a further letter of credit for $ 6 million. This letter of credit was never identified; nor its exact amount. He said that it could have been opened "*by the name of Fahad or Mohammed or Taleb or Khaled*". If so, any loss is not his.

Alternative claims

1184 Since I have concluded that Mr Tlais (a) irrevocably waived any claim and (b) has not established any recoverable loss on account of the September and December letters, but would have succeeded in deceit if neither (a) nor (b) applied I do not propose to consider the alternative claims in conspiracy or ratification in any detail.

Conspiracy

1185 As to the former, TEL Agreement of Mr Jack (on behalf of Gallaher) and Mr Hadkinson that Mr Tlais should be sent the September and December letters was an agreement to use unlawful means, namely the deceit contained in those letters. The dispatch of the letters was the relevant overt act. Since Mr Jack intended that Mr Tlais should continue to finance orders in the belief that Gallaher would be providing him with free goods, when in fact the responsibility for providing free goods rested with Namelex, which was showing every sign of being unable to pay, it seems to me that the necessary intention to injure Mr Tlais could be established. As a result of the deceit Mr Tlais was being exposed to a risk of continued losses.

Ratification

1186 As to the latter, I am left in such doubt as to the terms of TEL Agreement about free goods as to be unable to specify what exactly it was that Gallaher ratified, if it ratified anything. Firstly, it is not clear (a) what Mr Tlais' obligations were (in particular whether there was any lower limit as to the price at which Mr Tlais was to sell); and (b) what he was to be compensated for. His evidence, in cross examination suggested that he was to be compensated for (i) losses, being the difference between his sale and purchase prices, (ii) for some loss of profit, and (iii) for losses arising from bad debts; but on what basis these were to be computed was unclear. Nor is it clear whether TEL Agreement covered both him and his brothers. Finally there appears to have been no agreement as to how the value of any free goods would be calculated – the matter being left to Mr Hadkinson/Gallaher - and whether Mr Tlais had the option of requiring payment in cash.

1187 If I leave those considerations aside and assume that TEL Agreement said to have been ratified was simply that Gallaher would provide free goods sufficient to compensate Mr Tlais for any losses that he (or his family) suffered as a result of selling Gallaher cigarettes at less than the cost to him, the next question is whether the September and December letters constitute a ratification of that agreement.

1188 "*Ratification will be implied whenever the conduct of the person in whose name or on whose behalf the act or transaction is done or entered into is such as to amount to clear evidence that he adopts or recognises such act or transaction in whole or in part*": *Bowstead* Article 17 (3). The letters are, in my judgment, capable of amounting to a recognition, at least in part, of an agreement made on behalf of Gallaher to provide free goods to compensate Mr Tlais for losses.

1189 For ratification to take place the ratifier must have full knowledge at the time of the ratification of all the material circumstances in which the act was done, unless he intended to ratify the act and take the risk whatever the circumstances may have been; although it is not necessary that he should have notice of collateral circumstances affecting the nature of the act: *Bowstead* Article 16; *Suncorp Insurance and Finance v Milano Assecurazioni SpA* (1983) 2 Lloyd's Rep 225. As Waller, J, as he then was, pointed out in that case the commentary to Bowstead records that the requirement for full knowledge of all the material circumstances is less strictly applied in the contractual than in the tort context. Further, the distinction between material and collateral circumstances is not always easy to draw. Several of the authorities relate to the rather special situation of claims for wrongful restraint of goods, where knowledge of the irregularity of the distraint, or that the thing distrained was not a chattel, is necessary.

1190 In my judgment Mr Jack did know the material circumstances. These were that Mr Tlais had been told by Namelex that Gallaher would be providing him with free goods in sizeable quantities by way of support for his business, and, in particular, losses incurred in starting up, and that the loss which was said to be recoverable under this arrangement was $ 30 million. In choosing, as he did, to confirm Mr Tlais in his mistaken belief that Gallaher would provide $ 30 million or the equivalent in free goods he must be regarded as having taken the risk that TEL

Agreement would oblige Gallaher to pay that sum, whatever the precise route by which it did so or the circumstances in which TEL Agreement to do so was made.

1191 The last question is whether Mr Jack had actual or apparent authority to ratify such an agreement. Mr Jack did not have actual authority to commit Gallaher to expenditure of $ 30 million. His authority to authorise payments was limited to something like £ 150,000. He was a Divisional Manager and a director of the New Business Division, and he was Gallaher's signatory to the Namelex Agreement. But there was, as Mr Tlais knew, a level of senior executive management above him, with whom Mr Tlais had dealt. It was intrinsically unlikely that someone in Mr Jack's position could, himself, authorise a commitment of $ 30 million.

1192 Mr Tlais' evidence was that some time after June 2000 Mr Hadkinson had told him that Mr Jack did not know of Mr Hadkinson's involvement with Namelex and that, unknown to Mr Jack, Mr Hadkinson was liaising directly with Mr Northridge. That would serve to confirm that important decisions were being taken at a level higher than Mr Jack and without reference to him. I am not persuaded that Mr Jack had apparent authority to ratify the supposed agreement.

1193 That is not necessarily the end of the matter. Although the point was not raised in argument it seems to me that Mr Jack had apparent authority to communicate to Mr Tlais the acceptance by those with authority to bind Gallaher that Gallaher was bound to honour TEL Agreement purportedly made on its behalf: *First Energy (UK) Ltd v Hungarian International Bank Ltd* [1993] 2 Lloyd's Rep 194. Such acceptance is apparent in the letters of September and December 2001. Mr Jack was placed by Gallaher as the interface between Gallaher in the UK and TEL/Mr Tlais, in a position where it would be natural for him to communicate to Mr Tlais Gallaher's decisions. It could scarcely have occurred to Mr Tlais, or anyone in his position, that when he read the words "*We wish to confirm …We are currently studying the various questions* " etc in the letter of 13th September, it was incumbent on him to inquire of Gallaher's top management whether that was indeed what they were doing. If, therefore, authority had been the only critical question, I would have been minded to conclude that the ratification was not unauthorized.

Finale

1194 Accordingly there is due from Mr Tlais to Gallaher the sum of $ 4 million in respect of the guarantee and from TEL to Gallaher the sum of $ 3,239,450 in respect of the 365 day goods making $ 7,239,450. There is due from Gallaher to TEL in respect of the damaged Dorchester $ 6,659,538. Subject to any further submission as to the form of the order, and in the light of TEL Agreement as to set off I propose in the TEL action :

(i) to declare that by its written notice of 4th March 2005 Gallaher lawfully terminated the TEL Agreement and that TEL is not entitled to any compensation or damages from Gallaher in consequence of that termination;

(ii) to enter judgment for Gallaher against TEL for the sum of $ 579,912 ($ 7,239,450 - $ 6,659,538) together with interest

and in both actions

(iii) to dismiss the counterclaim.

1195 I invite further submissions as to the form of the order and the date from which, and the rate at which, interest should run. I will, also hear argument, as to whether I should make the declaration and order sought in paragraphs 721 (3) and (4) of Gallaher's closing submissions. Both of them, particularly the former, seem to me too wide.

Postscripts

TEL's letter of 12th March 2008

1196 On 13th March 2008, when I was about to circulate this judgment in draft, I received a letter from TEL with a number of enclosures. The letter, dated 12th March 2008 enclosed a notice that TEL was now acting in person, made a number of points, and sought to introduce new evidence including (i) an affidavit from one Heiko Franz Arjes, (ii) various e-mails apparently emanating from him, (iii) a copy of an agreement between JR International SA and the European Community, and (iv) a witness statement of Mr Norman Jack dated 21st November 2007 apparently relating to criminal proceedings in Lebanon, said to have been provided to TEL on 6th February 2008.

1197 I do not propose to entertain this evidence. Much of it, including in particular the evidence of Mr Arjes appears irrelevant or, at best, only marginally relevant to the issues in the actions. The evidence of Mr Jack was, according to the letter of 12th March 2008, known to TEL and was not adduced for reasons that are unclear. There is no acceptable explanation for seeking to adduce it now; or for the Court to take the extraordinary step of re-opening the evidence. Even if I were to accept it, it would not affect the outcome.

Last things

1198 I am conscious that this judgment is extremely long; although, by comparison with the material put before the Court, its length is modest. It constitutes a good example of the type of case that would have benefited from the proposals set out in the Long Trials Working Party. Swathes of material have been copied but unread and unused. Much if it is not in e-form. The expert reports of the claimants were inordinately long. The four volumes of pleadings were, as so often, of little assistance for trial purposes. The possibility of a preliminary issue(s), or, at least, a structured sequence of decision making, was not put before the Court. I suggested such an issue – in relation to ground 3 – at the beginning of the trial; but, by then, it was too late to be a satisfactory course – certainly so absent the possibility of a speedy determination by the Court of Appeal of any appeal. These are all defects in the procedure current when the case was prepared for trial, which the Working Party's proposals seek to make good.

1199 Nothing that I have said in the previous paragraph detracts from my appreciation of the high quality of the preparation done by the solicitors of the parties and of the conduct of the case and submissions by Counsel, all of which have greatly assisted me.

APPENDIX A

The development of Gallaher's case

1. Gallaher's calculations in respect of the proportion of Customs seizures consisting of cigarettes supplied by Gallaher to TEL have gone through a number of changes prior to and during the course of the trial. They are derived from a large database (first established in August 2005 on the basis of information derived from the spreadsheets referred to at paragraph 21 below). The information in the database is amended over time. Updates take place on a daily basis.

2. The evidence on this topic, which underwent a process of amendment and expansion, came from (i) Mr Espin, who became Manager of Gallaher's Group Security and Brand Protection Unit ("the Unit") in December 2003 having previously been in the West Midland Police or in roles associated with corporate security; (ii) Mrs Schiavetta (née James), Gallaher's Inter-Group Finance Manager, and (iii) Ms Kathryn Sweeney, Intelligence Manager of the Unit. They were all honest witnesses who sought to give me an accurate explanation of the division of the goods as between Old Stock (Cyprus/Dubai and 365 day goods) and TEL Coded stock and how much of it appeared to have been seized.

3. The way in which Gallaher's internal records work and what they signify is not at all straightforward. Mr Espin's original evidence did not entirely satisfactorily explain the complex process by which the Old Stocks could be attributed to TEL. When he gave evidence he had, on a number of occasions, to correct explanations that he had previously given e.g. about what the documents showed or the basis upon which parts 1 and 2 of the relevant Schedule to the Particulars of Claim had been compiled, or was unable to give an explanation. Gallaher had to call the two further witnesses to remedy the deficiencies in the evidence up until then, some of which had been revealed by the cross-examination of Mr Espin. Their statements were produced during the course of that cross examination.

4. Gallaher's original pleaded schedule (Schedule A), the effect of which was summarised in paragraph 22 of the Points of Claim, was served on 20th April 2005. It gave aggregate figures of volumes seized by year, brand, customer and place of seizure. The first schedule detailing specific seizures was provided in November 2005. It was difficult for TEL to respond to this because it contained details of HMCE seizures whereas most of the notifications to TEL were of overseas seizures such that there was a large discrepancy between what had been notified and what was contained in the Schedule. On 17th November 2006 Mr Espin's first witness statement was filed with various tables and schedules including a massive bundle C3 containing details of all the seizures relied on. This followed a manual back check of the database.

5. On 10th April 2007, four working days before skeleton arguments were due to be exchanged, Mr Espin's third witness statement was produced containing a series of statistics which differed substantially from those previously relied on. On 30th April a revised and updated schedule (Schedule A2) was produced. This Schedule incorporated further seizures which had been notified to Gallaher since March 2005. In compiling it certain assumptions which had previously been made were no longer made (the changes being favourable to TEL); an exercise was carried out to ensure that there was no duplication of seizures reported by an overseas Customs authority and those reported by HMCE; some goods not previously attributed to TEL were found to be so attributable because of the code on the outer; further documents were discovered recording seizures before March 2005 of which account had not previously been taken; and some data inputting errors were corrected.

6. The amendment that Gallaher finally sought to make, which relied on the 30th April schedule, was received by TEL on 11th May 2007 – in the course of Mr Espin's cross examination, which had begun on 3rd May. Gallaher's case was supplemented by Mr Espin's 4th statement of 3rd May (correcting some evidence he gave the day before), Bundle H 36A (a disclosed document not included in the trial bundles) and the statements of Ms Sweeney and Mrs Schiavetta.

7. The process that I have described has led to a number of significant changes to Gallaher's original figures and some unexplained differences between Gallaher's current and earlier data.

8. TEL complains, and I accept, that the timing and nature of Gallaher's amendments and additional evidence, coupled with a degree of confusion generated by Mr Espin's evidence, placed considerable difficulties in the way of its small team. I am, however satisfied that these difficulties were not insurmountable. The upshot of the evidence is that the methodology that has led to the figures on which Gallaher now relies is as follows.

Sampling

9. Working out the proportion of goods seized that consists of goods supplied to TEL is not easy. Firstly, Gallaher is dependent on the information supplied by the Customs authorities. In notifying Gallaher that certain brands have been seized it is possible that Customs may have taken samples that are not representative e.g. because they have been taken sample from one part of the container which is not representative of the product in the rest or other parts of it. There is nothing that Gallaher can do about this, although it is to be expected that Customs, in whose interests it is to have full information as to what is being smuggled, would endeavour to carry out a search sufficient to discover what different products are there and in what quantities. Further it is possible that counterfeit goods may go

undetected if the samples with which Gallaher is provided do not contain the counterfeit product.

10. Gallaher received notification of seizures either from (i) HMCE in respect of a seizure made by it; (ii) HMCE in respect of a seizure made by an overseas Customs authority; or (iii) from an overseas Customs authority or other overseas source (such as a local agent or lawyer whom Customs has notified or an investigator). In the latter case the information may be either more or less reliable than it would be in case (i).

Attribution between different brands

11. Customs' notifications of seizure, which would usually be accompanied by samples[130] of the product seized (usually one or two outers), including where the seizure was by an overseas customs authority, would often state the quantities of each different brand. If they did Gallaher would include those quantities in the schedule. In some cases Customs would specify the total quantity seized and the different brands but would not specify the quantities of each brand seized. In such cases Gallaher assumed that an *equal* quantity of each brand had been seized. Gallaher divided the total quantity by the number of pack codes in the samples sent from the seizure. The calculation was done by pack code rather than by brand variant. This is a more accurate method because it enables Gallaher to discover the customer for whom the goods were supplied.

12. Gallaher's assumption may be wrong. It is obviously possible that there was a much greater proportion of one brand (e.g. a brand not supplied to TEL) in the seizure than another. If, however, the exercise of attempting to discover the quantity of TEL stock is to be attempted, some assumption has to be made, and the equality assumption seems to me a reasonable one to make and apply across the board, particularly since any differences between the assumption and reality are likely to even out over time.

13. Sometimes the Customs' notification specified the seizure of Gallaher and non Gallaher brands. In such a case Gallaher assumed (when composing Schedule A 2) that the *whole* of the stock seized was a non-Gallaher brand. Gallaher took this approach, which might appear unduly favourable to TEL, because Customs notifications usually failed to specify how many non-Gallaher brands were involved, so that it was impossible to know what denominator to use.

14. The number of occasions when Customs did not specify the quantity of each brand seized was, in any event, limited. It occurred in respect of about 25% of seizure volumes. That statistic also means that the proportion of cases where there

[130] Originally Gallaher assumed that, where they had not received a sample but had a pack code number, which appeared genuine, the product was genuine. In their later calculations no assumption was made that seized goods were genuine unless a sample showed that to be so.

may have been sampling errors (which themselves could be expected to even out over time) is correspondingly reduced.

Pre TEL era stock

15. Goods from the beginning of the TEL era had a pack code which indicated the customer for whom the goods were destined e.g. TEL. Goods produced prior to that did not. So it was not immediately apparent whether such goods had been supplied to TEL.

16. Gallaher adopted a method of tracing and identifying the first customer which was, broadly, as follows. It took the *pack code*[131] from the sample from the seizure. From the pack code it is possible to identify the date and place of manufacture, and the machine and shift on which the stock was made. It is then possible to locate the *packing machine schedule* (effectively the production records) for that machine. (These have not been disclosed). From those records Gallaher could obtain the *material/production code* (e.g. Y P 122 TO 70). In cases where the whole production run for a material code was sent by Gallaher to the Cyprus and/or Dubai warehouses, the purchaser could be identified from the *Cyprus and Dubai release sheets*.

17. Otherwise the purchaser would have to be traced through a system known as the CODA system[132]. The material code identifies the month of production [Y], the type of product (cigarettes [P], cigars, tobacco or roll your own tobacco), the brand [122], the quantity of cigarettes in a case [TO], the health warning [70] , and whether the goods have a paper parcel outer [which is shown by a P suffix). With the material code it was possible to discover the customers to whom the product had been supplied (by a process that involved searching through files of release documents and *Factory Despatch Advices*[133] in the manner described in paragraphs 3-7 of Mrs Schiavetta's 3rd witness statement). It is also possible to check whether goods with a given material code were supplied only to TEL by the two methods described in paragraph 15 of that statement.

18. Gallaher entered all identified purchasers in the "*purchaser*" field in its database where the search for the purchaser of Namelex-era product identified a range of possible purchasers. It regarded it as safe to attribute a seizure to a particular purchaser of such goods only if the *whole* of the production run went to that purchaser. Gallaher, therefore, only attributed seized volumes to TEL in the "*Stock only ever sold to TEL*" category in Schedule A2 Part 2 if the *whole* production run went to TEL. Gallaher concluded, in my view justifiably, that all stock from seven material codes was released to TEL (apart from a small volume that went to OTI, one of TEL's customers). This approach is favourable to TEL.

[131] Which is to be distinguished from the label attached to the outside of the master case.
[132] The system has not been disclosed although printouts can be made of data in it.
[133] Which have not been disclosed.

Goods made for TEL

19. These goods, which were all entered on a different system known as the "SAP" system, had pack codes which indicated, in addition to the information set out in paragraph 17 above the identity of the first customer (i.e.TEL) and the destination market for which the cigarette was produced.

Overruns

20. TEL submits that there may have been overruns of goods produced for TEL. Mrs Schiavetta's evidence is that there were such overruns in the Namelex era but that product made for TEL was not sent to any other customer and that orders were produced to the exact quantity unless there was a production shortage and Gallaher was unable to fulfil the order. This is information relayed from the person responsible at the Lisnafallan factory and, therefore, hearsay but I see no reason to doubt its accuracy.

Spreadsheets and Overseas seizures

21. When HMCE reported a seizure Gallaher would be asked to confirm whether the product was genuine and to give details of where and when the product was made and for what market (a "track and trace" request). It did this on a spreadsheet provided and in part completed by HMCE. It would often provide a witness statement for use in any proceedings. In the case of overseas seizures Gallaher would not complete a spreadsheet or a witness statement but information about the product seized would be recorded in the database.

Totals

22. The totals produced by these methods are those summarised in paragraph 11 of the judgment and pleaded in Schedule A2 Part 2 of Gallaher's Amended Particulars of Claim, and the relevant appendix thereto
These figures constitute a substantial reduction from earlier figures. For instance, Gallaher's opening put forward a figure (derived from Mr Espin's evidence) of 586,156,445 seizures of TEL coded goods notified to Gallaher by HMCE. This may be compared with the figure of about 447 million now relied on – a decrease of about 139 million (13,900 cases).

23. The figures are put forward as approximate ("*in the region of at least*") and rightly so. They involve assumptions that may be wrong. The number of seizures is so large that some errors of attribution are bound to have been made in the database[134]. There are potential weaknesses in the methodology. For instance, one of the two means used for verifying whether a material code was exhaustively

[134] E.g. Seizure entries 01HMC004 and 01HMC004A which attribute the whole of a seizure's volume to Namelex even though the HMCE notification shows that the seizure was partly of Sovereign and partly a non-Gallaher brand so that the attribution should have been zero.

supplied to TEL was to match the quantity of run to releases from the Cyprus/Dubai warehouses. The production records from which the run data is derived are, however, records of the run which was planned rather than completed. It is possible that there was an increase in the run which was not recorded.

24. Ms Sweeney also accepted that there was a possibility that some stock with a particular material code could have gone to some destination other than Cyprus & Dubai, even though stock with that code had been released from Cyprus/Dubai; and, also, that goods of the same type but from a different run could share a common material code, although she thought that would be highly unusual. If so, the apparent release of the whole of one code to TEL (because the amount released equates to the amount of the run) may not reflect what happened. Further, stock which had been sent out and returned or stock that was swapped would apparently not have had its subsequent release recorded on the release sheets.

25. I do not, however, regard these considerations (or the various points made by TEL in relation to specific seizures) as invalidating the assessment of the degree of magnitude of seizures of goods supplied by Gallaher to TEL in the TEL: era.

APPENDIX B

DAMAGES

The claim

1. TEL's claim to damages is divided into three parts:

   (i) Loss of profits;

   (ii) Losses such as wasted expenditure, claims to an indemnity, loss of reputation etc;

   (iii) The cost of the destruction of the defective Dorchester and the Arabic goods (dealt with in paragraphs 1102 - 1151 of the judgment).

Loss of Profits

2. The claim for loss of profits is set out in Schedule 1 to TEL's Amended Defence and Counterclaim ("Schedule 1"). TEL's claim in respect of what it calls the initial term of TEL Agreement i.e. down to 1st May 2007 is as follows.

Background to the claim

2002/3

3. In the year 2002/3 TEL made, it is claimed, about $ 9 million in profit, despite various obstacles, across all territories on sales of $ 15,407,415 - 391,259 cases having been released. One of those obstacles was the supply of damaged Dorchester from February 2003, prior to which time that brand is said to have achieved "*at least a 4 to 7% share*" of the market. TEL claims that its profits would have been significantly higher but for Gallaher's breaches of the TEL Agreement.

4. Mr Tlais' witness statement (paragraph 138) refers to sales in excess of $ 15 million and a profit of $ 9 million; but there are no accounts which support these figures. That claim implies an average selling price of $ 39 per case and an average profit of $ 23 per case. Those figures may be compared with figures of $ 52 and $ 10 which are implicit in the plan in Schedule VI to the TEL Agreement in respect of 2002/3, and a sale price of $ 73 per case which is implicit in the historic trading account. The latter figure may well be inflated because the apparent sale prices were in some cases not the real ones.

5. Mr Gough and Mr Goel are agreed that the total cigarette market in Iran is in the region of 50 billion cigarettes. If so, 4 – 7% of the market would amount to between 200,000 and 350,000 cases. Gallaher's sales to TEL of Iran coded cigarettes in 2002/3 amounted, on Mr Pollock's calculation, to 276,049 cases of which 183,922 were cases of Dorchester: see Pollock Sub Appendix 4.5.4[135]. Sales to Parsian Fougan and Adam Trading as set out on the TEL customer account statements show that a total of 184,327 cases, of which 110,892 were Dorchester (60,000 cases being sold to Parsian Fougan), were sold in 2002/3. It is by no means clear that all Adam Trading's purchases went to Iran[136]. The 183,992 and 110,892 figures, neither of which represents sales by TEL's distributors, are less than 4% of the market. Even allowing for mixing of Old Stock, it would seem that sales for Iran would, at best, be at the lowest end of the range.

2003/4

6. In the period 2003/4 TEL is said to have made an overall profit of about $ 7 million - 198,000 cases having been released. The overall sales figure is not stated. The figure of $ 7 million implies an average profit of $ 35 per case. TEL claims that its profits would have been significantly higher but for the fact that it was selling consignments mixed with Old Stocks in order to clear the latter, which involved selling at a lower price than would otherwise have been the case for each container and additional costs in respect of distribution, warehousing and mixing. No claim, however, is made for reduced margins on sales actually made. The claim is for the profit margin on lost sales.

2003/4 – the first year of claim

7. In relation to 2003/4 TEL claims that its sales in Iran, Libya and Latin America were depressed by reason of Gill's breaches of contract in respect of the damaged Dorchester which had been originally supplied to Iran.

Iran

8. In respect of Iran it is said that TEL was unable to trade due to the problem of the damaged Dorchester cigarettes. TEL's pleaded estimate of lost profit for Iran is as follows:

[135] These figures are higher than those used by Mr Goel – see paragraph 813 of the judgment – for a reason that I have not been able to discern.
[136] The Adam Trading Schedules appear to indicate shipments to Iran in 2002/3 of 47,854 cases of which 25,872 were Dorchester. If the 60,000 cases sold to Parsian Fougan are added the total supplied to Iran in 2002/3 becomes 85,872.

BRAND	**No of CASES**	**SALE PRICE**	**COST OF SALES**	**PROFIT**
Dorchester FF	300,000	$ 21,500,000	$ 18,250,000	$ 3,250,000
Dorchester Lights	60,000	$ 4,100,000	$ 3,650,000	$ 450,000
			Total	**$ 3,700,000**

9. The claim made reflects closely the figures contained, explicitly or implicitly, in Schedule VI in respect of the "*Iran region*" (brands unspecified), as appears from Mr Pollock's Table 8.7:

Table 8.7

2003/04 Iran – ADC Schedule 1 compared to Schedule VI

	Volume	**Revenue**	**Profit**	**Margin**	**Profit / case**
	Cases	US$'000	US$'000	%	US$
Schedule 1	360,000	25,600	3,700	14	10
Schedule VI[137]	360,000	26,400	3,600	14	10

10. The claim is based upon an inability to trade in Iran. There is, however, evidence that TEL made some sales into Iran in 2003/4 as appears from Table 8.8. of Mr Pollock's report which specifies the data derived from shipping documentation disclosed:

[137] Sub-appendix 7.1.9.

Table 8.8

2003/04 Possible shipments to Iran

	Bill of lading	**Customs exit / entry forms**	**Customs bills**	**Sub distributor letters**
	Cases	Cases	Cases	Cases
Bandar Abbas	16,183	-	-	2,850
Iran	-	5,350	11,250	-
Total	**16,183**	**5,350**	**11,250**	**2,850**

Libya

11. In relation to Libya TEL's claim is that, as a result of being told by GIL to sell some of the damaged Iranian Dorchester to Libya TEL's reputation and that of Dorchester and Sovereign were severely affected as a result of which TEL lost the following amounts:

BRAND	**No of CASES**	**SALE PRICE**	**COST OF SALES**	**PROFIT**
Sovereign FF	28,000	$ 3,500,000	$ 2,366,480	$ 1,133,520
Dorchester FF	28,000	$ 3,500,000	$ 2,366,480	$ 1,133,520
			Total	**$ 2,267,040**

12. This claim can be compared with the Schedule VI estimate for sales in the North East Africa region as follows:

Table 8.9

2003/04 Libya – ADC Schedule 1 compared to Schedule VI

	Volume	**Revenue**	**Profit**	**Margin**	**Profit / case**
	Cases	US$'000	US$'000	%	US$
Schedule 1	56,000	7,000	2,268	32	41
Schedule VI	24,000	2,060	379	18	16

13. Paragraph 9.3 of Schedule 1 avers that in 2002/3 there had been sales of 7,000 cases per month and annual profits of $ 2 million. This amounts to about $ 24 profit per case. The claim in respect of both Sovereign and Dorchester implies a

loss of profit of $ 41 per case. There is no documentation that shows shipment to Libya in 2003/4. But the Gallaher sales records indicate a final destination of Libya in respect of 1,600 cases.

Latin America

14. In relation to Latin America, where there is said to have been a growing demand, TEL claims that the requirement of Gallaher for TEL to sell a proportion of the damaged Dorchester in Latin America led to the seizure of those stocks by Customs in Chile on the grounds that they were not fit for consumption. That left the market without any immediate supply and TEL was reluctant to attempt to supply further consignments until the cause of the spotting had been identified and it could be assured that the same problem would not arise again.

15. As a result of not being able to supply Latin America in 2002/3 TEL claims that it lost the following profits:

BRAND	**No of CASES**	**SALE PRICE**	**COST OF SALES**	**PROFIT**
Dorchester FF	60,000	$ 7,500,000	$ 4,949,600	$ 2,550,440
Dorchester Lights	30,000	$ 3,750,000	$ 2,474,800	$ 1,275,200
			Total	**$ 3,825,600**[138]

16. This claim reflects a similar volume, but a much greater profit margin than that forecast in Schedule VI:

[138] Sic

Table 8.10

2003/04 Latin America – ADC Schedule 1 compared to Schedule VI

	Volume	**Revenue**	**Profit**	**Margin**	**Profit / case**
	Cases	US$'000	US$'000	%	US$
ADC Schedule 1	90,000	11,250	3,825	34	43
Schedule VI[139]	100,000	8,333	1,323	16	13

17. There appears to have been some shipment of goods to Latin America in 2003/4 as appears from the following table

Table 8.11

2003/04 Possible shipments to Latin America

	Bill of lading	**Customs exit / entry forms**	**Customs bills**	**Sub distributor letters**
	Cases	Cases	Cases	Cases
Buenos Aires	2,000	-	-	-
Chile	-	1,900	1,900	2,000
Iquique (Chile)	9,710	-	-	4,900
Total	**11,710**	**1,900**	**1,900**	**6,900**

18. The total loss of profit claimed in respect of 2003/4 is **$ 9,792,640[140].** This is based on 506,000 cases whose aggregate sales price would have been $ 43,850,000. Since this is a claim for lost profits the implication of it is that, but for the breaches complained of, the total profits would have been $ 16,793,000 ($ 7,000,000 + $ 9,793,000) and the total number of cases 704,000 (506,000 + 198,000). The total volume of cases is similar to the total volume predicted for 2003/4 in Schedule VI of 724,000.

2004/5

19. In respect of 2004/5 TEL makes a claim in respect of its estimated loss of profits in respect of all the territories. The breach relied upon is the effective

[139] Sub-appendix 7.1.9.
[140] This is what is pleaded. But $ 80 is missing from the claim in respect of Latin America.

cessation of supply of product by Gallaher to TEL from May 2004 and the continuing problems in respect of Iranian Dorchester. Paragraph 12 of Schedule 1 sets out a table of estimated loss profits. The claim is put forward on the basis of seven assumptions namely:

(i) The Old Stocks had been cleared by the start of the 2004/05 year and new product was being shipped directly to market;

(ii) The problems with the Iranian Dorchester had not arisen. Figures for Iran, Iraq, and Latin America have therefore been extrapolated from the 2003/4 estimated figures;

(iii) Gallaher had provided a suitable and timely replacement for the Sovereign brand, which would have ensured that TEL suffered no loss of volume or margin;

(iv) Gallaher had provided regular and timely supplies to TEL as TEL was entitled to expect;

(v) Gallaher had not ceased supply in May 2004, and had not ceased to accept TEL's orders in March 2004;

(vi) Gallaher had provided appropriate support to TEL for the markets in question and had not undermined TEL's efforts;

(vii) Historic price levels were maintained and built through the life of the plan as had been envisaged in the marketing plans drawn up by Gallaher.

20. As to those assumptions:

(i) it is unclear how much Old Stock remained at the start of 2004/5, although there is likely to have been a considerable amount; if it is to be assumed that there was no such stock then, credit would have to be given against the claim in respect of the value (if any) of the Old Stock remaining at the end of the TEL period;

(ii) it is not clear how exactly the 2004/5 figures for Iran, Libya and Latin America, have been extrapolated from the 2003/4 figures;

(iii) the calculation appears unrealistically to assume an absence of any reduced sales or increased costs on account of or during the transition;

(iv) the volume of stock projected for 2004/5 in Schedule 1 is about 1,702,000 cases. It is unclear whether Gallaher could supply product at that rate. Clause 6 (i) of TEL Agreement provided that Gallaher would endeavour to

meet any agreed delivery dates but would not be liable for the consequences of any delay in supplying or failure to supply;

(v) the calculation assumes that Gallaher was bound to replace Sovereign (which it was not);

(vi) the nature of the support is not identified;

(vii) the assumption that historic price levels would be maintained assumes that no market or commercial pressures precluded the maintenance of those levels. The price levels in Schedule 1 range, in the case of Sovereign, from $ 120 to $ 140 per case, and, in the case of Dorchester, from $ 92 to $ 150 per case. These figures compare with sales made, according to the disclosed documents, at between $ 70 and $ 145 per case for Sovereign and $ 10 to $ 100 for Dorchester. Between 2002 and 2003 99% of Dorchester sales were below $ 92 and 93% at $ 68. The extent to which the prices for the Dorchester sold were affected by damage problems is unclear.

21. TEL's estimated profits for 2004/5 are pleaded in the table at paragraph 12 of Schedule 1 as follows:

TERRITORY	BRAND	NO OF CASES	SALE PRICE	COST OF SALES	PROFIT
Sudan	Sovereign Full Flavour	48000	$5,760.000	$4,239,680	$1,520,320
	SovereignLight	12000	$1,440,000	$1,059,920	$380,080
Afghanistan/ Pakistan	SovereignFull Flavour	60000	$7,200,000	$5,299,600	$1,900,400
	DorchesterFull Flavour	36000	$4,320,000	$3,179,760	$1,140,240
	Dorchester Light	12000	$1,440,000	$1,059,920	$380,080
Egypt	Dorchester Full Flavour	24000	$2,280,000	$1,673,200	$1,206,800
	Dorchester Light	6000	$720,000	$326,640	$393,360
	Stateline Full Flavour	24000	$2,880,000	$1,673,200	$1,206,800
	Stateline Light	6000	$720,000	$326,640	$393,360
Syria	Dorchester Full Flavour	24000	$2,400,000	$1,673,200	$726,800
	Dorchester Light	24000	$2,400,000	$1,673,200	$726,800
Iraq	Dorchester Full Flavour	80000	$11,400,000	$6,998,766	$4,401,234
	Dorchester Light	20000	$1,900,000	$1,749,166	$150,834

SouthAfrica	Dorchester Full Flavour	48000	$4,560,000	$4,079,680	$480,320
	Dorchester Light	6000	$570,000	$529,960	$40,040
Libya	Sovereign Full Flavour	24000	$2,880,000	$2,119,840	$760,160
	Dorchester Full Flavour	36000	$5,400,000	$3,179,760	$2,220,240
	Dorchester Light	6000	$900,000	$509,960	$390,040
Yemen	Sovereign Full Flavour	48000	$5,760,000	$4,199,680	$1,560,320
	Sovereign Light	24000	$2,880,000	$2,119,840	$760,160
Iran	Sovereign Full Flavour	120000	$16,800,000	$8,500,000	$8,300,000
	Dorchester Full Flavour	480000	$44,000,000	$34,000,000	$10,000,000
	Dorchester Light	120000	$11,000,000	$8,500,000	$2,500,000
	Stateline Full Flavour	180000	$14,700,000	$12,750,000	$1,950,000
	Stateline Light	120000	$9,800,000	$8,500,000	$1,300,000
Latin America	Dorchester Full Flavour	48000	$5,760,000	$4,079,080	$1,680,920
	Dorchester Light	24000	$2,880,000	£1,673,200	$1,206,800
	Stateline Full Flavour	24000	$2,880,000	$1,673,200	$1,206,800
	Stateline Light	6000	$720,000	$326,640	$393,360
				TOTAL	**$ 49,656,348**

22. The pleading does not state the basis upon which these figures are put forward. No reference is made to any actual sales in this period. The historic trading account shows actual sales revenue of about $ 5.6 million in 2004/5.

23. The figures in Schedule 1 assume a very substantial increase in sales. These are forecast to rise in excess of ten times over three years (from $ 15.4 million, the alleged actual figure in 2002/3, to $ 178 million in 2004/05) as appears from Mr Pollock's table 8.12 reproduced below. The absence of any actual sales figures for 2003/4 and of any breakdown of sales per country for 2002/3 makes it impossible to see where exactly the increase lies.

Table 8.12

2002 to 2005 actual performance and losses claimed per Schedule 1

	Sales	**Profit**	**Margin**	**Cases**	**Price / case**	**Profit / per case**
	US$'000	US$'000			US$	US$
2002/03 actual	**15,407**	9,000	58%	391,259	39	23
2003/04 actual	*Not known*	*7,000*	*Not known*	*198,000*	*Not known*	*35*
2003/04 claim	*43,850*	*9,793*	*22%*	*506,000*	*87*	*19*
2003/04 total		16,793		704,000		24
2004/05 claim	**178,390**	49,656	28%	1,702,000	105	29

24. The figures in the Schedule also greatly exceed the figures contemplated in the Clarke/Jack plan of January 2004 as appears from the following table.

Table 8.13

2004/05 ADC Schedule 1 compared to business plans

	Volume	**Cost of sales**	**Cost / case**
	Cases	US$'000	US$
Schedule 1	1,702,000	128,734	76
NJ Middle East Plan	419,200	32,722	78

25. Mr Pollock rightly observes in relation to these figures that they betray no recognition that some products may have been new to some territories and required launching and phasing in. Nor is there any apparent recognition of investment costs (unless they are in the costs of sales, which are not broken down). The figures thus appear to assume that no increase in infrastructure would have been needed to accommodate a tenfold rise in sales. Nor is there any recognition of finance costs. The assumption must be that TEL would have been able to fund any increase in working capital and cash flow as the business grew.

2005/6

26. TEL's claim in respect of 2005/6 is that its volume of sales would have increased by 10% and its profits by the same percentage, so that the overall profits would have been $ 54,621,983. Thus a constant margin is assumed. In

respect of 2006/7 TEL's claim is that its profits would have grown by 5%, so that the overall profits would have been $ 57,353,052.

27. The 10% and 5 % figures are applied to all territories into which it is assumed that sales would have been made. The explanation given for the growth rates adopted is that "*rate of growth predicted in these figures takes account of increasing market penetration and reduced rate of sales growth as market share increases*". No account is taken of possible differential rates of growth of sales (or sales of different brands) in different territories. No deduction is made for any actual sales. Mr Pollock's review of documents established that about $ 1.5 million of sales were made during the period.

28. Accordingly TEL's pleaded claim for lost profits during 2003 to 2007 is as follows:

2003/4	$ 9,729,640[141]
2004/5	$ 49,656,348
2005/6	$ 54,621,983
2006/7	$ 57,353,082
Total	**$ 161,631, 418[142].**

The second term

29. TEL claims that the TEL Agreement was due to run for another five year period ("the second term") automatically in accordance with Recital B to the TEL Agreement. In respect of those five years it projects a rate of profits growth from 4 % down to 0 % with the following resultant losses:

Year	**% Increase**	**Loss of profit**
2007/8	4 %	$ 59,647,205
2008/9	3 %	$ 61,436,621
2009/10	2%	$ 62,665,354
2010/11	1%	$ 63,292,007
2011/12	0%	$ 63,292,007
	Total	**$ 310,222 195**

[141] In fact this claim should be for $ 9,792,680. 729 has been transposed from 792 and the additional 40 is a casting error.
[142] This is not the total of the individual items. The correct total is $ 171,361,053.

30. The growth rates claimed may be compared with the following predicted growth rates derived from ERC data:

Table 8.14

Growth rates 2007 to 2012

Year	ADC Schedule 1	High from ERC data	Average from ERC data	Low from ERC data
2007/08	4%	8.1%	4.0%	1.7%
2008/09	3%	7.6%	3.7%	1.6%
2009/10	2%	7.6%	3.4%	1.1%
2010/11	1%	7.1%	3.1%	1.2%
2011/12	0%	6.8%	2.9%	0.7%

Total loss of profits claim

31. So the aggregate claim for loss of profits in respect of the period from 2003 to 2012 is $ 161,631,413 + $ 310,333,195 = $ **471,964,608**.

32. TEL has two further pleaded claims which are, in effect, subsets of its general loss of profits claim.

Removal of the Sovereign brand

33. Firstly, TEL claims $ 147,906,300 as the loss that it has suffered on account of the removal of the Sovereign brand and Gallaher's failure to replace it. The assumption is that Gallaher would have replaced Sovereign with a product of similar quality and market positioning, but without the control risks, so that the volumes and margins would have been identical to those that would have been achieved in respect of Sovereign on the basis of the contentions set out in the claim in respect of 2003 to 2012 i.e. that Sovereign would have been sold in the amounts set out in the table in paragraph 21 above and the volumes and profits would have increased by the percentages pleaded. Again the pleading assumes, unrealistically, a seamless transition from one brand to another without any reduction of volume of sales or profitability in the process.

The effect of damaged Dorchester

34. The second claim of this nature is in respect of the alleged effect of Gallaher (i) delivering defective product for sale in Iran; (ii) failing to support TEL's efforts by providing the promised business plan; and (iii) supplying another distributor directly and thus damaging TEL's relationship with Hazem. The combined effect of these is said to have been that demand for product from TEL fell significantly allowing other imported (non Gallaher) brands to displace Gallaher brands from their leading position in the market. TEL's

claim is that from early 2003 it did not have any product which was suitable for distribution even if demand remained; that between May and December 2002 TEL had sold about 140,000 cases of Dorchester; and that, but for the Dorchester problem, TEL would probably have achieved an overall market share of 20% with Dorchester maintaining a 5% share.

35. TEL claims to have lost profits attributable to the matters referred to above. In respect of the years 2004/5 to 2011/2 TEL claims $ 228,586,057 which is to be added to the claim in respect of 2003/4 in relation to Iran of $ 3,700,000 – see paragraph 8 above. This claim assumes that but for the breaches alleged TEL would have sold 1,020,000 cases in 2004/5 (being the aggregate of the figures for Iran in the table at paragraph 21 above covering Sovereign, Dorchester and Stateline) and that the volume of sales (and profits) would have increased by 10% in 2005/6, 5% in 2006/7 and at the 4% – 0% rate referred to in paragraph 29 above in respect of the years from 2007/8 to 2011/12.

Observations on the loss of profits claims

36. TEL's claims are largely based on the sales volumes, sales revenue and associated profit margin for 2004/5 which are then grown at the percentage rates for subsequent years set out above. The figures for 2004/5 are put forward without any support from the documentation disclosed. The composition of the costs in Schedule 1 is not broken down. It is, thus impossible to tell what are said to be (i) the costs of sale; (ii) the operating costs (if not included in the costs of sales); (iii) the overhead or administrative costs (if anything has been included in that respect); or (iv) the financing costs. The claim assumes a constant margin, unaffected by the effects of competition or increases in administrative, marketing or financing costs (unless any of these have been included in the costs of sales). The claim also assumes a very large development of the business from around $ 15 million of sales in 2002/3 to $ 178 million in 2004/5 and $ 225 million by 2010/11.

Factual evidence in support of the claim

37. Mr Clarke said in his witness statement (paragraph 905):

> *"I have undertaken my own analysis of TEL's financial records, and also the financial and trading records from the Namelex era. These documents have been disclosed to Gallaher. I can confirm that the figures set out in the Counterclaim Schedule to TEL's Amended Defence and Counterclaim are based on correct assessments of the finances of the TEL business and its profitability (and projected profitability). The schedule to the counterclaim accurately*

assesses the losses arising from Gallaher's breaches of contract."

38. This analysis, of a claim for hundreds of millions of dollars, was carried out in manuscript and the working papers were then thrown away. Its nature, content and validity are, therefore, impossible to assess.

The Expert Evidence on markets

TEL

Mr Gough's first report

39. On 16th January 2007 Mr Gough produced a one page report in which he expressed the opinion that the projections of growth in the various markets as set out in Schedule 1 were "*essentially reasonable, on the basis of the assumptions stated*" and that the assumptions themselves were inherently reasonable. He had three qualifications in that he believed (a) that the figures for Lights in Syria were over estimated by about 25%; (b) that the figures for Lights for other markets with the exception of Sudan were overestimated by about 10% and (c) that he felt that he had insufficient knowledge of the markets in Sudan to be able to comment on the figures for that country.

40. I note that Mr Gough's evidence was that there was no market in the Namelex era in the Namelex territories (which included Iran, Syria, Lebanon, Jordan, Libya, Iraq, Yemen, Sudan, Egypt, and Afghanistan) for any of Gallaher's brands.

Mr Gough's second report

41. On 13th February 2007 Mr Gough produced a further Market Report in which he expanded on his earlier views. In relation to the claim in respect of 2003/4 he expressed the following views:

(a) **Iran.** TEL's allegation is that it would have sold 300,000 cases of Dorchester Full Flavour and 60,000 cases of Dorchester Lights. This would indicate a market share (of a market of 50 billion sticks) of 6% for Full Flavour and 1.2% for Lights. He initially thought that this level of market penetration was somewhat greater than he had expected to see and would have anticipated that penetration would be perhaps 4.5% and 1% respectively at the price point being charged in year 2 of the TEL Agreement. But he noted TEL's allegation that the historical sales figures by the end of 2002 were between 4% and 7% and growing and Gallaher's evidence suggesting demand of 20,000 cases per month by March

2003[143]. On the basis of those figures he thought that TEL's figures of 300,000 and 60,000 were realistic.

(b) **Libya:** He estimated that the Libyan market was in the region of 10 billion sticks so that TEL's projections would have been some 5.6% in 2003/4, which he thought was a reasonable figure. He believed that the TEL volume figures were broadly correct. The price of $ 125 per case was at the top end of expectations but not "*totally unreasonable*". Gross profits of roughly 30% were what he would expect[144].

(c) **Latin America**. He estimated that the Latin American countries within the TEL territories had total demand in excess of 150 billion sticks so that the projected sales were less than 1%. He thought that the price of $ 125 was a little excessive and would have expected a price of nearer $ 120.

42. In respect of the projected figures for 2004/ 2005 and subsequent years Mr Gough's expressed views which I have set out in the table at Sub-Appendix B.1, where the "*Market*" figures are Mr Gough's estimate of the total market, the *"%"* column is the penetration of the market assumed by TEL's figures, "*View*" is Mr Gough's view and "*C*" stands for "conservative" and "*R*" for reasonable.

43. There were a number of respects in which Mr Gough took a different view to that implicit in Schedule 1 as to sale prices:

[143] It is not clear exactly what evidence Mr Gough was referring to.
[144] The gross profit margin inherent in the figures for Sovereign Full Flavour was about 32%.

Table 11.4

Comparison of 2004/05 sales prices between Schedule 1 and Mr Gough

Territory	**Brand**	**Volume (cases)[145]**	**Sales price / case (US$)**		**Difference (US$)**
			Mr Gough	**ADC Schedule 1**	
Afghanistan/ Pakistan	Sovereign Full	60,000	110	120	(10)
	Sovereign Light	12,000	110	120	(10)
	Dorchester Full	36,000	110	120	(10)
	Dorchester Light	12,000	110	120	(10)
Egypt	Stateline Full	24,000	110	120	(10)
	Stateline Light	6,000	110	120	(10)
Syria	Dorchester Full	24,000	110	100	10
	Dorchester Light	18,000	110	100	10
Iraq	Dorchester Full	80,000	120	143	(23)
	Dorchester Light	20,000	105	95	10
Libya	Dorchester Full	36,000	125	150	(25)
	Dorchester Light	6,000	125	150	(25)
Yemen	Sovereign Full	48,000	107.5	152	(44.5)
	Sovereign Light	24,000	107.5	120	(13.5)
Iran	Sovereign Full	67,692	110	140	(30)
	Dorchester Full	270,769	120	92	28
	Dorchester Light	55,000	115	92	23
Latin America	Stateline Full	24,000	105	120	(15)
	Stateline Light	6,000	105	120	(15)

44. There were also instances where he took a different view as to margins:

[145] Taken from Appendix 11.4

Table 11.5

Comparison of 2004/05 gross profit margins between Schedule 1 and Mr Gough

Territory	**Brand**	**Volume (cases)** [146]	**Gross profit / case (US$)**		**% Difference**
			Mr Gough	**ADC Schedule 1**	
Egypt	Dorchester Full	24,000	30%	42%	-40%
	Dorchester Light	6,000	30%	55%	-83%
	Stateline Full	24,000	<30%	42%	Not known
	Stateline Light	6,000	<30%	55%	Not known
Iraq	Dorchester Full	80,000	30%	39%	-30%
	Dorchester Light	20,000	30%	8%	73%
Libya	Dorchester Full	36,000	29%	41%	-41%
	Dorchester Light	6,000	32%	43%	-35%
Iran	Sovereign Full	67,692	30%	49%	-63%
	Dorchester Full	270,769	30%	23%	23%
	Dorchester Light	55,000	30%	23%	23%
	Stateline Full	101,578	30%	13%	57%
	Stateline Light	55,000	30%	13%	57%
Latin America	Stateline Full	24,000	<30%	42%	Not known
	Stateline Light	6,000	<30%	55%	Not known

45. Mr Gough thought that, with the exception of Iran, the percentage increases applied to volume each year from 2005 to 2012 were not in any way unrealistic and might be conservative. In relation to Iran he expressed the view that, even if TEL had not suffered because of the damaged Dorchester problem, its sales volumes and profits in Iran would not have increased to any more than the figure of close to 11% penetration overall which he projected for 2004/5 with a split of say 8% full flavour and 3 % lights. He did not therefore agree with TEL's allegation that without the damaged Dorchester

[146] Taken from Appendix 11.4

problem Gallaher brands would have obtained a 20% market share in the Iran market if a full portfolio of brands had been supplied.

46. He also thought that TEL's suggestion that, with a full portfolio of products, its profits by 2012 would have been 15-20% higher was not at all unrealistic.

Gallaher Mr Goel's report

47. Gallaher's expert was Mr Rajiv Goel. I shall consider his report of 27th April 2007 in detail hereafter. It is sufficient for the moment to record that, on the basis of the figures pleaded in Schedule 1, his view was that TEL would not have been able to have any significant business in any of the Territories.

Mr Mathew-Jones' report of 19th March 2007

48. Meanwhile Mr Mathew -Jones had produced a report of 19th March 2007[147] which, not surprisingly, was based in some respects on Mr Gough's second report.

49. Mr Mathew-Jones' loss of profit calculations covered the period from 1st May 2002 to 30th April 2007. He calculated the level of profits that TEL expected to earn less actual earnings or losses for the period 1st May 2002 to 30th April 2007. This is not the approach adopted in Schedule 1 which makes no claim in respect of 2002/3 and claims losses of profit attributable to lost sales (i.e. not anticipated profits less actual profits or plus actual losses) beginning in 2003/4 in respect of Iran, Libya and Latin America and then losses in respect of all the Territories from 2004/5 onwards.

50. In order to calculate a level of expected profits Mr Mathew-Jones took, in respect of the figures for the period 1st May 2002 to 30th April 2004, the figures in Schedule VI to the TEL Agreement. Those figures are presented by region and not by territory or brand. In respect of the period from 1st May 2004 to 30th April 2007 he took the figures produced by Mr Gough's second market report, which in effect makes certain adjustments to Schedule 1. He deducted certain amounts for administration, storage and finance costs. In respect of the actual position he took the figures for total losses in respect of the period 25th April 2003 and 31st December 2005 as they appear in the Cypriot accounts prepared by C Agathocleous & Co, for that period. These accounts are agreed to be unreliable.

51. Mr Mathew-Jones also calculated an estimate of profits based on margin increases of 15 and 20%. He did so because of the averment in schedule 1 that, if the product portfolio had been expanded, there would have been an increase in margin of between 15 and 20% for the period of TEL Agreement until 30th April 2012.

[147] Following instructions given on 22nd February 2007.

52. As can be seen from the foregoing, calculations of expected profits can be made using (a) Schedule VI to the TEL Agreement (down to April 2004) or (b) Mr Gough's second report (qualifying the figures in Schedule 1) or (c) a hybrid of Schedule VI and Mr Gough's second report. There can then be incorporated a 15% or 20% margin increase.

The joint memorandum

The "but for" the breach profits

53. In their joint memorandum of 26th June 2007 Mr Mathew-Jones and Mr Pollock agreed the arithmetical accuracy of the following figures as the figures for expected profits based on the assumptions contained in either (a) Schedule VI to the TEL Agreement; (b) Mr Gough's second report; or (c) the hybrid, both with and without a 15 – 20 margin increase. These figures are derived from calculations carried out in section 11 of Mr Pollock's report, which have been slightly adjusted. They do not agree the validity of basing loss calculations on Schedule VI or the respective views of the market experts.

54. The calculation makes certain assumptions including (a) the exclusion of sales to South Africa/Mozambique (as not being within the TEL territories); (b) the use, in respect of the Schedule VI calculation for the later years, of annual ERC growth rates applied on a weighted average basis (based on the relative cigarette consumption of each territory in the regions listed in Schedule VI); (c) in respect of the 15 and 20% margin increases, that the margin is to increase over the period down to 2012; (d) the inclusion of operating costs of $ 1.2 million per annum, the figure in Schedule 6, for the calculations based on that schedule, and $ 2.4 million for calculations based on Mr Gough's report (to take account of the increased level of operating costs associated with increased sales); (e) the inclusion in each year up to 30th April 2007 of finance costs of $ 1,157,000 ($ 4,627,000 divided by 4), being the average annual cost taken from the historic trading account.

55. The resultant figures are as follows:

"But for" net profit calculations before discounting					
	2002/03	**2003/04**	**2004/05**	**2005/07**	**2007/12**
	US$'000	US$'000	US$'000	US$'000	US$'000
Schedule VI	8,341	6,144	5,993	12,687	41,985
Goel	N/A	Nil	Nil	Nil	Nil
Gough – nil margin increase	N/A	9,343[148]	35,151	77,003	216,434
Gough – 15% margin increase	N/A	9,343	35,151	79,724	241,040
Gough – 20% margin increase	N/A	9,343	35,151	80,631	249,241
Schedule VI & Gough – nil margin increase	8,341	6,144	35,151	77,002	216,434
Schedule VI & Gough – 15% margin increase	8,341	6,144	35,151	79,724	241,040
Schedule VI & Gough – 20% margin increase	8,341	6,144	35,151	80,631	249,241

Deducting the actual profit made

56. The figures set out in the table in the previous paragraph are figures that might represent the profit that TEL would have earned but for the breaches alleged. From these figures there would have to be deducted the actual profit made by TEL.

57. As to that, since it is not possible to make a reliable calculation of TEL's cost of sales, no profit and loss account can be prepared for any period of TEL's trading. It is, therefore, necessary to adopt some alternative approach to calculating actual profit.

58. It is possible to deduce from the historic trading account a "*raw gross profit margin*" (namely total sales less total purchases over the TEL trading period expressed as a proportion of total sales)[149]. That figure is 47.2%. The percentage can then be applied to sales to calculate a "*raw gross profit*" per year[150], and, after the addition of other income and the deduction of operating expenses and finance costs, a figure can be calculated for "actual" profits per year to be deducted from the "but for" calculations in the table in paragraph 55. This exercise produces figures for gross profit for 2002/3 and 2003/4 not far off the pleaded figures of $ 9 million and $ 7 million: see Table 11.8 to Mr Pollock's report.

[148] This figure is in respect of lost sales in Iran, Libya and Latin America because Mr Gough's report only deals with those countries for this year; and the claim is only in respect of those countries.
[149] "Raw gross profit margin" is not a term generally recognised by accountants.
[150] Since the percentage is derived from the sum of the sales and purchase figures over the period it reveals nothing new about the total figures. Its utility lies in the fact that it enables the calculation of a raw gross profit for each financial year.

59. It is Mr Mathew-Jones' view that this exercise produces a reasonable estimate of the profitability of TEL in the period before any provisions for destruction costs and irrecoverable debtors. He would thus take as the actual profits for the period from 1st May 2002 to 30th April 2006 the $ 12,041,480 net trading result derived from the historic trading account.

60. If expected profits are taken to be the figures in Schedule VI, as adjusted by ERC growth rates, and the $ 12 million figure is taken as the profit earned during the TEL trading period, then the net loss over the period from 1st May 2002 to 20th April 2007 is $ 33.2 million (the sum of the Schedule VI profit figures down to 2006/7 in the table) less actual profit of $ 12 million, leaving a net loss, before discounting, of **$ 21.2 million**. These figures do not take account of destruction costs or debtor write-offs.

61. If the Gough or hybrid calculations are taken the loss figures for the same period would *increase* by the following amounts:

	US$million
Gough – nil margin increase	88.3
Gough – 15% margin increase	91.1
Gough – 20% margin increase	92.0
Schedule VI & Gough – nil margin increase	93.5
Schedule VI & Gough – 15% margin increase	96.2
Schedule VI & Gough – 20% margin increase	97.1

62. In Mr Pollock's view the historic trading account and the calculation therefrom of a raw gross profit leading (after the addition/deduction of items contained in the historic trading account) to a raw net profit are unreliable because of the extent of the deficiencies in the documentation disclosed from which the historic trading account is derived.

63. Mr Mathew- Jones would reduce the trading results by stock destruction costs of $ 2.6 million and a debtor write off of $ 12.9 million. The accountants agreed that they had seen no evidence that TEL paid these costs.

Gallaher Mr Rajiv Goel

64. Gallaher's expert witness was Mr Rajiv Goel. He has, with the exception of two months been employed in or worked with the tobacco industry since 1990; and is presently employed by Gallaher, having been a consultant and later an employee from January 2005. Between 1990 and 2004 he was employed by BAT in increasingly senior operational roles. Since 1995 the geographical focus of his work has been the Middle East, Africa, and Central Asia and the Caucasus. In order that he might give evidence he was seconded

from his usual commercial role on terms that nothing that he said in his report would be considered in making any decisions about his employment.

65. I found Mr Goel an impressive and reliable witness. His reports were detailed and his analysis thorough and well reasoned. I did not regard the value of his evidence as materially diminished by reason of the fact that he was an employee of Gallaher. I noted his unhesitating acceptance of the proposition that Gallaher's actions in Andorra were not those to be expected of a responsible international tobacco company.

Mr Goel's first report

66. In his market report of 27th April 2007 Mr Goel examined those cigarette markets allotted to TEL in respect of which TEL had made a claim in order to see whether the prices at which TEL claimed that it would have sold to the in-market distributors (as computed from Schedule 1 of the ADC) would allow TEL's products to be positioned in the relevant price segment once account had been taken of all duties, taxes, trade margins and costs, and whether the blends being ordered by TEL would be competitive in the market. His report was based on reports of his own for markets where his direct experience allowed him to make one, and, where it did not, on analyses of available data sources.

67. The gist of his report was this. The key determinant of consumer preference is the *blend* of the cigarette (e.g. Virginian or American). Blends have distinctive tastes and consumer preferences for them can only be changed at a high cost and over the long term (i.e. not within 3 – 5 years). Mr Gough believes it is possible to change consumer preferences in the short term (i.e. within 3-5 years). The industry generally views markets in terms of *price segments*. A segment is a range of prices in which consumers regard the variety of products available as being of equal quality. Usually brands are positioned in the same price segment in each market around the world, their position being derived from the position of the brand in the brand's largest or home market. The price segments may have slightly different names but are often described as (i) "Premium", (ii) "Mid price", and (iii) "Value" or "Low". There may then be an even lower locally produced segment.

68. Mr Goel examined in relation to each market (a) whether there was a blend segment (e.g. Virginian or American) suitable for the blends of the brands specified in Schedule 1; and (b) what were the price segments occupied by international brands. He then took for each brand and market the TEL sale prices and TEL cost of sales figures implicit in Schedule 1 and developed a price structure for each market (incorporating all relevant margins and duties

as derived from a wide range of publicly available data[151]) leading to a sale price to the consumer. The price structure thus calculated made it possible to assess whether at the TEL sales price to the consumer implicit in Schedule 1 the brands would be competitive. If not, he computed what would be the effect of charging the consumer a competitive price. In some cases this exercise showed that TEL would have to sell at a loss.

Mr Goel's key assumption

69. The underlying assumption of Mr Goel's first report is that brands are generally positioned in the same price segment in each market around the world. There are said to be a number of reasons for this. Consumers who are prepared to pay a premium or mid range price may well cease to be willing to do so and the brand may be tarnished if in some countries the product is available in a lower segment. If so, it will become impossible to sustain the price. Conversely, consumers who are used to getting their cigarettes at a low or medium price level will show considerable resistance to paying a higher price. Consistency of price generates loyalty at any rate in the mid to lower segments. If repositioning takes place it will almost certainly be downwards.

70. TEL disputes the validity of this assumption. It placed reliance on a BAT document headed "*The Role of Price in the Global Cigarette Market*" which appears to have been written not long after April 2nd 1993 - "Marlboro Friday" - when the price of Marlboro to wholesalers was cut by about 10% in America, although the brand stayed in the premium segment. Under the heading "*Competitor Pricing Strategies*" the document recorded that Reynolds would maintain the price positioning of Camel and Salem, seeking to grow sales and profitability on the back of their added value and premium price in most markets, but that they would be "*more flexible*" in Europe particularly with Camel to ensure further growth.

71. An appendix to the document giving details of the price segmentation of leading brands showed *Camel* in the top "*full revenue*" segment in Argentina, Belgium, France, Germany, Hungary and Italy, but in the mid price section in the Netherlands. *Rothmans* was in the full revenue segment in Italy and the Middle East but in the mid price segment in China. *L & M* was in the mid price in Argentina and Spain but in the low price segment in Brazil, Finland and the Middle East. *Winston* was in the premium section in Spain but in the mid price section in China, France, Hong Kong, and in the low value section in Finland. The theory that cigarettes are maintained in the same price segments to avoid adverse consumer reaction is not borne out, TEL submits,

[151] Mr Goel assumed that the duties, taxes, regulations as applied to the import, distribution and marketing of cigarettes remained the same between 2002 and 2012. This is unlikely to be true but the tendency of duties and taxes is not to reduce.

since Brazil and Argentina share a long border and their inhabitants could be expected to be aware of prices in the neighbouring country.

72. Mr Goel's evidence was that the document was a discussion document, not the result of any retail audit, and might not be totally accurate. Camel was sold in premium segments all across Europe (as the Appendix largely vouches). The document also recorded that Winston was being used tactically and flexibly and gave details of its positioning in the Appendix. Mr Goel explained that Winston was a premium brand that was not selling enough in that segment and was, therefore, repositioned downwards so that by 1995-7 it was positioned in the mid price bracket.

73. Mr Goel cited an article by Dr Iqbal Lambat in *Tobacco Reporter* of February 2007 in which he observed that tobacco companies in general attempt to maintain a uniform pricing strategy across all markets. However, as he observed, in specific markets, price repositioning – generally downward – may be necessary to maintain volume and market share. His view was that there were five international price classes: Super premium; Premium (which embraces, inter alia, Marlboro the world's bestselling brand); Sub-premium, Mid-price; Value.

74. Dr Lambat's observation strikes me as an appropriate assessment of the position. Manufacturers and distributors will, subject to any contractual restraints, do what they judge to be in their best commercial interests. There can, therefore, be no inflexible rule as to the price segment in which they will seek to position their product. Further consumers are not necessarily so sensitive to price segmentation that a product can never successfully be sold in different segments in different countries. Manufacturers are likely to position their product in the same segment across all markets but may reposition one or more of their products in a given market if they think it is in their interests to do so. Any such repositioning from one segment to another may be upwards or downwards. Gallaher, for instance, increased the price of St George in Russia to deter smugglers who had previously smuggled the brand into Lithuania from Kaliningrad. But it is more likely to be downwards since consumers are unlikely to be attracted by the idea that they should pay more than they paid before. Manufacturers and distributors will be resistant to launching a brand in an unusually low price segment because over time that is likely to lead them to having to lower their prices in all of their territories.

75. In making his market assessments Mr Goel regarded himself as hampered by the absence of what he would regard as reliable market assessments by TEL and of reliable historic sales documents showing duty paid sales into individual Territories. He assumed, in making his assessments (a) that TEL had sufficient resources and expertise to manage the business in the Territories on a day-to-day basis either directly or by supervision of appointed in-market distributors; (b) that TEL had taken appropriate steps to build a

legitimate market; (c) that TEL and its in-market distributors would comply with all the terms of the TEL Agreement and of the ITP; and (d) that TEL would not sell at prices lower than its costs in order to break into the market and (e) that there were no definitive plans to access the markets through local manufacture. Assumptions (a) – (c) are dubious.

76. Mr Goel assumed that the segment where the relevant brands would be positioned was as follows:

(i) Stateline: at the *lowest imported* international price segment because that is where it is positioned in its largest market – Kazakhstan;

(ii) Dorchester: as Stateline because that is where it is positioned in its home market (UK);

(iii) Sovereign: at the segment immediately above Dorchester as this is where it is positioned in its home market (UK).

Broadly speaking, therefore, Stateline and Dorchester are Low price products and Sovereign is mid price.

77. TEL did not enjoy complete autonomy as to prices. Clause 4 (xiii) of the TEL Agreement required TEL to sell the Brands at the price recommended by Gallaher (after consultation with TEL) whilst maintaining the trade margins notified by Gallaher. In my judgment the likelihood is that Gallaher and TEL would have aimed to position the Brands in the segments to which Mr Goel has assigned them.

78. In determining the extent to which TEL might penetrate markets in the Territories it is material to note that in the segments of the markets to which TEL had access there tended to be a few big players who between them dominate the market and who will act to defend their market share. As a result TEL would probably be competing for that portion of the market not already occupied by established brands. Consumer loyalty for established brands is strong and restrictions on advertising make it difficult to wean customers away.

79. Mr Goel's report summarised the upshot of a number of individual market reports from which he derived conclusions in relation to each of the countries concerned. I set these out in Sub-Appendix B.2 (together with Mr Gough's rival calculations). This led him to the overall conclusion that, on the basis of the figures pleaded in Schedule 1, TEL would not have been able to have any significant business in any of the Territories. Either the blends were wrong for

the market (e.g., Virginian for a market with no Virginian segment) or the brands could not have been profitably sold.

80. As to the latter Mr Goel concluded that sales of the following brands, would not be profitable (as well as being, in the case of Sovereign and Dorchester in Iran, of the wrong blend for the territory):

Territory	**Brand(s)**	**Paragraph of Mr Goel's market report**
Iran	Sovereign, Dorchester, State Line	150
Iraq	Dorchester	151
Libya	Sovereign, Dorchester	152-3
Afghanistan	Sovereign, Dorchester	156
Egypt	Dorchester, State Line	158
Yemen	Sovereign	159
Mozambique	Dorchester	160

Mr Gough's third report

81. On 18th July 2007, some 3 weeks after the Joint Statement of the Expert Accountants, Mr Gough produced his third market report. He remained of the view that the *volumes* projected by TEL were generally reasonable, subject to the qualifications expressed in his report of 13th February 2007, which include a big reduction in volume for Iran. In this report he carried out an exercise, in relation to Iraq, Iran, Libya, Afghanistan, Egypt, and Syria. South Africa and Yemen. He postulated a pack price that would place the product in what he regarded as an appropriate segment (either value or low mid price) and, working backwards from that, he deduced what CIF price would have to be charged by TEL in order to produce that pack price.

82. Thus, to take an example, in respect of 2004/5 Mr Goel had calculated that, using the figures contained in Schedule 1, which implied a TEL cost of $ 87.48 per case, a TEL Sale price of $ 142 .50, and a gross margin of $ 55.02, the pack price for Dorchester Full Flavour in Iraq would be $ 0.43. Mr Gough assumed a pack price of $ 0.30 which, by back calculation would produce a TEL Sale Price of $ 97.48 and, therefore, a gross margin of $ 10. That calculation was reached by removing 2 sets of wholesaler margins of $ 2, increasing a Regional Wholesale Margin from $ 3 to $ 3.46 and eliminating a freight charge from UAE to Iraq.

83. By this means he calculated that the profits, from which operating costs would have to be deducted, should be in the amounts appearing in the last column of the following table:

Year	Original	Adjusted
2003/4	$ 16,792,640	$ 16,792,640
2004/5	$ 49,656,348	$ 16,553,520
2005/6	$ 54,621,983	$ 18,198,774
2006/7	$ 57,353,0822	$ 19,108,713
2007/8	$ 59,647,205	$ 19,894,069
2008/9	$ 61,436,621	$ 20,426,863
2009/10	$ 62,665,354	$ 20,792,715
2010/11	$ 63,292,007	$ 20,079,300
2011/12	$ 63,292,007	$ 20,979,300
TOTAL	**$ 471,964,607**	**$ 156,933,254**

84. The figure of $ 16,792,640 for 2003/4 in the second and third column is a figure which Mr Gough was unable to explain. The explanation would appear to be that it is the product of (a) TEL's pleaded actual profit for 2003/4 ($ 7,000,000 – see Schedule 1, para 8) and (b) the loss of profits claim for 2003/4 in respect of (i) Iran ($ 3,700,000 – para 9.2.); (ii) Libya ($ 2,267,040 – para 9.5); and (iii)Latin America ($ 3,825,640 – para 9.8[152]). The figure for 2004/5 in the second column is derived from TEL's pleaded estimate of profits for 2004/5 - see paragraph 21 above. The figures for the succeeding years are then increased by the following percentages: 10%, 5%, 4%, 3%, 2%, 1%, and 0%. The figure of $ 16,553,520 in the last column for 2004/5 is produced by using TEL's pleaded quantity of sales but using the margin figures derived from taking Mr Gough's packet price assumption, e.g. $ 0.43 for Dorchester full flavour for Iraq, producing a sale price of $ 97.48 less TEL's $ 87.48 cost of sales figure leading to a $ 10 gross margin. The figure for 2005/6 is a 10% increase. The figures for the succeeding years are increased by figures which are close to but not always the same as the original 5, 4, 3, 2, 1, and 0 %. The difference is to take account of the fact that Mr Gough believed that TEL would never capture more than 542,850 cases in Iran (nearly 11% of the Iran market).

85. As is apparent from the above, the figures which Mr Gough's third report supports are about one third of the previous figures. If Mr Goel's basic premise is accepted, these figures render irrelevant the work carried out by the accountants on the basis of Mr Gough's second report. It is relevant, however, to point out that Mr Gough said in this third report that he does not believe that TEL would "*necessarily generally"* only have been able to sell its brands in the value segment. It could have commanded a retail sales price at the lower end of the mid price segment. He disagreed with Mr Goel's views that there is no Virginia segment in various markets, such as Latin America and Iran, or that no sales of Virginia cigarettes could be made there.

[152] Where the figures are wrongly cast so as to total $ 3,825,600.

86. The bulk of Mr Gough's third report is taken up in setting out his disagreement with a number of different items in Mr Goel's calculations.

Duty free zones

87. In a supplemental report of 20th July 2007 Mr Goel addressed the question of duty free zones.

88. Duty free zones are usually established by Governments, often in area where they wish to stimulate investment, economic activity and employment. Goods sold in the duty free zone are not necessarily subject to regulations on ingredients, packaging and labelling which are mandatory in the territory, although different territories have different rules in this respect. Usually, import duties and taxes are not levied on any goods in the free zone unless the goods are intended for sale and distribution in the territory concerned.

89. In general goods removed from the duty free zone and taken into the domestic market become subject to the applicable taxes, duties, ingredient/labelling/packaging restrictions, unless they form part of a duty free personal allowance under which an individual can take possession of goods at the point of his/her departure from the territory. There is, thus, no advantage in supplying duty free zones in order that the cigarettes would thereafter legitimately enter the domestic duty paid market of the territory or any other territory. The supplier might just as well ship direct to market and store the goods in bonded warehouses where necessary.

90. In Mr Goel's view the quantity of sales in duty free zones other than from traditional duty free outlets is minimal. Such sales would comprise diplomatic and military stores and ship's chandlers. Mr Goel's experience at BAT was that legitimate sales to *diplomatic stores* were very small, a maximum of 100 cases per year. Sales to *military stores* were usually handled directly by the manufacturer, not a distributor, as military organisations purchased supplies for a number of countries from one source, usually in the home location of the manufacturer. So far as *ships' chandlers* are concerned , his experience in 1998 – 2001 was that most manufacturers limited sale to ships' chandlers to below 50 cases per month, which would allow most of them to supply up to 2 cases per month to each ship of any particular brand.

91. Mr Goel sets out in his third report the packaging and other restrictions applicable to sales in duty free zones or duty free shops. I set these out in Sub-Appendix B.3.

92. The upshot of his report is that sales would be limited because, leaving aside stores and ships' chandlers, (a) the market is limited to travellers/visitors making use of their personal allowances; and (b) in many of the countries there are specific packaging and labelling regulations with which the cigarettes supplied

to TEL did not comply in addition to the fact that in Latin America and other places the blend preference is American. In his view TEL could not have legitimately sold significant quantities of goods in duty free zones and shops in its territories.

93. As I have already indicated, I do not regard TEL as having been disentitled to sell into duty free zones for sale in those zoned (even from a shop). Even so the duty free market is limited. It is relevant also to record that TEL's pleaded case is that, once the Old Stock had been cleared TEL intended that the vast majority of its business would be based on selling goods on a duty paid basis in the Territories with appropriate local health warnings for duty paid sales in those markets: Paragraph 9.1 of the voluntary further information of 13th June 2007.

Discussion

94. I am wholly unpersuaded that the figures contained in Schedule 1 represent an acceptable estimate of the profits that TEL would have made from 2004/5 onwards on the basis of the pleaded assumptions. I say that for a number of reasons. *Firstly*, the evidence originally put forward in support by Mr Clarke and Mr Gough was of the most general character, consisting, in effect, of assertion unsupported by any analysis.

95. *Secondly*, I entertain considerable doubt as to the extent of Mr Gough's expertise and the validity of his opinions as to the volumes and prices inherent in Schedule 1 for the reasons set out in the following paragraphs.

96. Mr Gough was employed by JT International (Europe) Ltd, a subsidiary of Japan Tobacco, from August 1997 until 1999, as a commercial manager, in an accountancy role. That included approving, on behalf of the Finance Director, the sales price and marketing spend for the Middle East, and considering the cost of sales. Part of his role also involved liaising with HMCE to satisfy it that the volume of exports to the Middle East was commensurate with market demand. Between 1999 and the end of 2001 he was manager of an internal audit team at RJ Reynolds International, whose business Japan Tobacco had acquired. This was also an accountancy role but included responsibility for indirect tax policy. Part of his responsibility was to take steps to reduce the level of diversion of JTI's international brands in Latin America, Africa and the Middle Estate by, inter alia, ensuring that volumes supplied were commensurate with demand.

97. Mr Gough has never worked in the industry in an operational role. His four years in the industry were not in the material period (namely, between 2002 and 2005). He had never been to the Middle East, to Africa, or to Latin America.

98. Mr Gough had showed himself capable of making assertions - e.g. that Gallaher had between 2002 and 2005 sold front of pack, UK health warning products, particularly Mayfair, in transit, and that Gallaher had not discussed this with

Customs - which were not supported by, and inconsistent with, the documents said to establish them.

99. He claimed, on the basis of the material he had reviewed, that Gallaher could not have implemented various steps to reduce smuggling that he identified at paragraph 63 of his industry report. The basis for this allegation lay in two documents with which he had been provided as part of his instructions. The first of these[153] was published in May 2001 and its only reference to Gallaher was in relation to Andorra and some 1983 correspondence. The second made no reference to Gallaher at all[154].

100. Large sections of his Industry report consisted of discussion of matters of fact beyond his remit. Some of his opinions crossed the border between opinion and advocacy. It is also apparent to me that he did not approach his task with the neutrality to be expected of an expert. He was provided with three documents critical of tobacco manufacturers and with the TEL witness statements (as well as some other documents) but not with the Gallaher witness statements. He appears to have held the view, before knowing anything about the facts of the case, that Gallaher, and the rest of the tobacco industry, was creating an impression of cooperation with HMCE without any real intention of co-operating with them in a bona fide manner. His Industry report contained a number of very broad allegations about tobacco manufacturers in general, including, therefore, Gallaher e.g., that they were motivated by a desire to promote smuggling, for which, apart from the Andorran episode, there was, so far as Gallaher is concerned, a dearth of evidence.

101. Mr Gough's first report was woefully inadequate, lacking any real analysis at all. His second report involved no further research and consisted largely of comments on TEL figures. His third report produced lower TEL sales prices, in order to accommodate lower pack prices. It is entirely unclear whether TEL would have sold at those prices – TEL's factual evidence, such as it was, having been that the Schedule 1 figures represented the "*correct assessments of the finances of the TEL business and its profitability (and projected profitability)*". There were some notable inconsistencies between the third and the second report and one marked inconsistency with the industry report (which refers to there being no market for Stateline whereas the third report assumes a sale in 2004/5 of 2.9 billion sticks).

102. *Thirdly*, I regard Mr Goel as a more reliable guide to the prospects of profitability in the relevant markets, although in my view he has underestimated the prospects for a Virginia blend in Iran. I found the exercise carried out by him in relation to the Schedule 1 figures instructive. The fact that Mr Gough's responsive exercise produced figures of about a third of the earlier claim rendered the Schedule 1

[153] '*Illegal Pathways to Illegal Profits'*
[154] 'The Cigarette Transit Route to the Islamic Republic of Iran and Iraq'.

claim unsustainable; and the size of the reduction cast doubt on the validity of Mr Gough's opinions[155].

103. Accordingly I am not prepared to regard either the original Schedule 1 figures or Mr Gough's revision of them (in the last columns of the table at paragraph 83 above) as reliable indicators of future profitability. Those revised figures are based on volumes derived from the table at paragraph 21 (revised in accordance with the 13th February 2007 report), which are themselves highly optimistic, and on Mr Gough's views on appropriate margins being well founded when I regard Mr Goel's calculations as more reliable[156].

104. A further complication is that the Schedule 1 claim is put forward on the basis of assumptions the non fulfilment of which was not a breach of contract (i.e. clearance of the Old Stocks by 2004/5, and the provision of a suitable and timely replacement for Sovereign which would have ensured that TEL suffered no loss of volume or margin), or which are dubious (i.e. the continued maintenance of historic price levels). They are also put forward on the basis not only that there had been no termination but also that there had been no problem with the damaged Dorchester. If the termination was unlawful but Gallaher is not legally responsible for the damaged Dorchester one of the assumptions is misplaced.

TEL's alternative claim

105. TEL's alternative claim is that its damages should be calculated on the basis that, but for the breaches complained of TEL would at least have earned the profits assumed by Schedule VI, carried forward using ERC growth rates[157]. On that footing the claim, being the anticipated Schedule VI gross profits less (i) operating costs of $ 1,200,000 per annum, (ii) finance costs of $ 1,156,815, per annum and (iii) "*actual*" net profit calculated by applying the raw gross profit figure of 47.2% to the sales revenue for the relevant years derived from the historic trading account is as follows:

	2002/3	**2003/4**	**2004/5**	**2005/06 –006/7**	**2007/08-2011/12**	**TOTAL**
	$ 000	**$ 000**	**$ 000**	**$ 000**	**$ 000**	**$ 000**
Undiscounted	940	1,029	5,578	13,576	41,984	63,108
Discounted @ 9%	940	1,029	5,578	13,576	32,494	53,618
Discounted @ 15%	940	1,029	5,578	13,576	27,915	49,039

106. There are considerable difficulties in taking Schedule V1 as a measure of

[155] A document put to Mr Gough on Day 51 shows the considerable differences by reference to 2004/5.
[156] I do not assume that they are 100% accurate. The complexity of the tax and duty regimes in the several countries is such that some error is likely.
[157] Calculated on a weighted average basis having regard to the relative cigarette consumption of each territory in the regions listed in Schedule VI,

likely profitability. In particular:

(a) the *number of cases sold* predicted in Schedule VI is 938,533 for 2002/3 and 724,000 for 2003/04 whereas the total number of cases sold in the whole TEL era according to the historic trading account is 553,408;

(b) the *sales revenue figures* for 2003/4 and 2004/5 in Schedule VI are $ 47,666,656 and $ 56,793,300 respectively: see Appendix 12 to the Joint Statement. The figures for sales revenue for those years in the historic trading account are $ 18,472,075 and $ 16,538,729 (see Pollock Appendix 11), and even these figures are unreliable because they derive from customer accounts and invoices which, in some cases, will not represent the actual price really due (or received);

(c) the *cost of sales figures* in Schedule VI for 2003/4 and 2004/5 are $ 36,966,391 and $ 48,292,105. The cost of sales figures for those years derived by applying the raw gross profit margin of 47.2% to sales figures for the same year in the historic trading account are $ 9,774,224[158] and $ 8,722,363[159];

(d) the *raw gross profit margin*, derived from Schedule VI, would have been 22.4% in the first year and 15% in the second – not 47.2%;

(e) the *net profit margin* on the historic trading account figures is 35%. It is 13% on the figures in Schedule VI[160];

(f) there is a similarity between the *net trading result* (of $ 12.5 million) for the first two years derived from the historic trading account, and the operating profit after finance costs of $ 13.2 million predicted by Schedule VI [161]. But the figures are reached on entirely different bases.

107. The very large difference between the Schedule VI and the actual sales volumes, particularly for the first year, suggests that, although described as conservative, the Schedule VI figures were highly optimistic. There is a similarly large difference between the predicted and the actual sales revenue. That is partly a function of the reduced sales volumes but, also, I infer, of the lower cost of old stocks. The figures further suggest that the greater raw gross profit margin and net profit margin actually earned, compared with Schedule VI, derives from the availability of Old Stocks at less than the price for stock

[158] $ 18,472,075 - $ 8,727,851; see Appendix 11.
[159] $ 16,536,729 -$ 7,814,366; ibid.
[160] See paragraph 4.43 of the Joint Memorandum.

[161] Operating profit up to April 2004 of $16.8 million less finance costs of $3.6 million.

supplied under the TEL Agreement. Profit projections based upon the continued availability of such stocks would be misplaced.

108. In addition the exercise of taking the profits predicted by Schedule VI and comparing them with actual profits assumes that the entirety of the difference is attributable to the breaches of contract by Gallaher complained of by TEL. Since a portion of any loss is attributable to the non replacement of Sovereign, which is not a breach, the assumption is misplaced.

109. Even if it is assumed that a failure to replace Sovereign and the supply of damaged Dorchester were breaches of contract, I have no confidence in using Schedule VI to represent the likely level of TEL's loss.

Conclusion

110. The upshot of these considerations is that I do not accept that any of the suggested calculations produces a figure which is likely to represent the loss that TEL will have suffered, even at the lowest, as a result of the premature termination of the TEL Agreement and the problems with the damaged Dorchester. Like Mr Pollock I find myself unable to make a reliable calculation of TEL's alleged loss of profits from these causes, let alone from only one of them.

111. Mr Tomson submitted that the right to distribute a major cigarette manufacturer's brands over, as he would have it, a 10 year period, was an inherently lucrative opportunity. There are, however, four factors that militate against that submission: (a) on the basis of Mr Goel's evidence the scope for profit on legitimate trading is at best doubtful; (b) each of the three bases for recovery put forward is unacceptable both as to volumes and profit margins; (c) TEL's books and records are wholly inadequate for the purpose of establishing actual profit and forecasting future loss of profit; and (d) the factual evidence adduced on TEL's behalf is scant and the expert evidence unconvincing.

112. In those circumstances I am driven to the conclusion that TEL has simply failed to prove its case. I decline, in the absence of any further assistance from the evidence or submission as to what calculation or estimate I should make, if a calculation based on Schedule VI is unacceptable, to determine some figure of my own. On the material before me, such an exercise would not be the application of a robust judgment; but one at best speculative and at worst arbitrary.

Discount rate

113. If any damages were awarded to TEL in respect of the period post 2006/7 it would be necessary to apply a discount rate as Mr Pollock and Mr Mathew-

Jones. They also agreed that a minimum discount rate would be 9% (if TEL were financed by debt), or 15% (if TEL were financed by shareholder funds).

114. In my judgment it would be necessary to apply at least a 15% rate. Mr Tlais and his family conducted their business dealings as a family and TEL was and, I infer, would continue to have been, financed by the Tlais family. In the light of my conclusions I do not think it necessary to decide whether some even higher equity discount rate would be appropriate.

Claims other than for loss of profit or the cost of destruction of damaged Dorchester

115. TEL's claims are these:

(i) *Wasted Investments in Markets.*

The footing on which this is put forward is that during the Namelex era and the TEL era Mr Tlais and then TEL provided cigarettes, for which he/it had paid Gallaher, free or at a significantly reduced cost, in order to generate market demand. The amount claimed - $45,692,494 - as the value of TEL's wasted investment is said to be the difference between the amount paid to Gallaher for the goods by Mr Tlais in the period to April 2002 and the amount received on the sale of these goods;

(ii) *Irrecoverable credit facilities.*

TEL claims that, since the suspension in supply of stock by Gallaher and the purported termination of the TEL Agreement, some of TEL's customers have failed to repay the credit extended to them by TEL as follows:

Name	**Value of Credit**
Adam Trading	$ 6 million
Hazem	$ 2 million
Drilon	$ 1 million
Total	$ 9 million

(iii) *Gallaher's failure to expand the product portfolio.*

TEL claims that it was agreed and/or understood between Gallaher and TEL that Gallaher would provide TEL with further brands (including Sobranie, Red, LD and Ronson) and that the introduction of a wider portfolio including premium brands would have increased the total

margin[162] on the same volume of Sovereign, Dorchester and Stateline. Accordingly TEL claims, as a best estimate, that overall profits for the period down to 2012 would have been 15 - 20% higher; and the loss of profits claim should be increased accordingly. Mr Mathew-Jones calculated this claim as being between $ 72 and $ 96 million;

(iv) *Loss of reputation* amounting to several hundred million dollars arising from the fact that because of the red card TEL cannot deal with any global tobacco companies;

(v) The amount of *claims* from *Adam Trading* in the sum of $ 115 million, in respect of which an indemnity is also claimed, and from *Parsian Fougan/Hazem* (Iran) in the sum of $ 10 million and *H & B Trading Pakistan/Mr Haji/Fisher Tobacco Group* (Pakistan/Afghanistan) in the sum of $ 1 million.

(vi) Losses suffered because of the inability of TEL to provide full flavour product to mix with the lights product from the *365 day goods*;

(vii) Losses, largely in the form of irrecoverable credit extended to *Drilon*, resulting from the cessation of trade with Drilon.

116. These claims can be summarily dealt with. Firstly, in respect of all of them the accountants are agreed that there is insufficient evidence to calculate the heads of loss claimed.

117 As to the particular claims:

(i) this claim cannot be maintained as well as a loss of profits claim. Nor can TEL, which was not incorporated in the Namelex era, maintain a claim for losses suffered by Mr Tlais, who is not a claimant, on account of expenditure wasted by him in that era. It is questionable whether the relevant expenditure was made by him or by his brother and other members of his family. The amount of the claim is unproven;

(ii) the evidence does not establish what were the credit terms for Adam Trading or Hazem or that either of them has any legitimate basis for withholding whatever amount they have failed to pay[163]. It is not possible on the evidence before me to establish why exactly they have not paid nor is it shown that their failure to do so was caused by some breach by

[162] Paragraph 44 of Schedule 1 suggests that an expansion of the product portfolio would increase TEL and Gallaher's market share. But paragraph 46 pleads that the "*the projected volumes estimated by TEL above for all years until 2012 remain the relevant total volume*", but say that it is TEL's case that the introduction of a wider portfolio would have increased the total margin on the same volume as had been projected for Sovereign, Dorchester and Stateline brands alone.

[163] $ 6 million of the $ 9 million is said to be owed by Adam Trading. In a letter of 15th June 2004 Dr Khaled of Adam Trading's lawyer acknowledged an outstanding amount of about $ 8 million.

Gallaher (as opposed to their disinclination or inability to pay what is due) or what remedies are available to TEL to recover the monies in question. The claim in respect of credit extended to Drilon is also claimed under the last head (where the amount claimed is $ 900,000 rather than $ 1 million). The claim double counts the loss of profits claim;

(iii) the evidence does not establish that Gallaher gave any contractual undertaking to expand the product portfolio and certainly not one which was sufficiently certain to enforce. Nor does the evidence explain how, with a wider portfolio of brands but the same volume, overall profits would have been 15-20% higher, nor establish that that would be so. I agree with Mr Goel's comment that, whilst replacing claimed low margin volume with the same volume of high margin products would mathematically yield higher margins, expanding the portfolio would not necessarily cause volumes of the brands already in the portfolio to be reduced and replaced by the new higher margin brands. To infer that it would produce a 15-20% increase would, on the material before me, be nothing other than conjecture.

(iv) a loss of reputation claim is properly the subject of a claim in defamation or malicious falsehood, which this is not; nor is the figure claimed (or any figure) properly quantified or shown to have resulted from any Gallaher breach;

(v) the evidence does not establish that Adam Trading has or is likely to have any valid claim, let alone one in the sum of $ 115 million; or that Gallaher is responsible for it;

(vi) the same applies in the case of Parsian Fougan/Hazem and H & B Trading Pakistan/Mr Haji/Fisher Tobacco Group. The sum of $ 10 million claimed in respect of Parsian Fougan is described as "*Duty, market investment, KPMG costs, destruction costs, indemnities to associates, interest*". There is no breakdown of these items; which may well involve some overlap or potential offset with other claims. The sum of $ 1 million claimed in respect of H & B Trading is said to be a contractual claim for early termination of supply. No detail is given of any contractual term, presumably oral, relied on.

(vii) The claim in respect of the 365 day goods is based on the proposition that Gallaher failed to provide sufficient full flavour product to mix with the lights products from the 365 day goods, as a result of which TEL could not sell the Lights. The losses and their mode of causation are unparticularised. The claim cannot be maintained together with the loss of profits claim since the latter asserts that TEL lost the profit on 90,000 cases of Lights in 2003/4 and 398,000 cases in 2004/5. That necessarily

assumes that it would be able to sell them. The amount of Lights in the 365 day stock was only 31,372 cases.

(viii) *Drilon.* Drilon was red carded. That was TEL's decision. Gallaher is not shown to have acted in such a way as could make it legally responsible for the consequences of TEL's decision. In any event, the suspension of supplies to Drilon lasted only between January and May 2003 during which time, according to the customer account, Drilon paid so much that TEL ended up being a debtor to it. Thereafter supplies and payments resumed. The evidence does not establish that the red carding lost TEL $ 900,000, $ 1,000,000 or any sum.

SUB-APPENDIX B.1.

The "*Market*" figures are Mr Gough's estimate of the total market, the *"%"* column is the penetration of the market assumed by TEL's figures, "*View*" is Mr Gough's view and "*C*" stands for "conservative" and "*R*" for reasonable the price and margin are TEL's figures.

Country	Market	%	View on %	Price	View on Price	Margin	View on Margin
Sudan	Unable to comment						
Afghan-istan/ Pakistan	50 billion	*FF* 1.92 % *Lights* 0.48 %	C	$ 120	$ 120 top end. $110 more reasonable	<30%	C
Egypt	60 billion	*FF* 0.8% *Lights* 0.2%	Very C	$ 120	$ 120 reasonable for D For S'line $110 max	FF 42% L 55%	V high 30% for D and less for Stateline
Syria	20 billion	*Both* 1.2%	Only 0.9% for L	$ 100	C	c 30%	As expected
Iraq	25 billion	*FF* 3.2 % *Lights* 0.8%	R	*FF* $ 143 *Lights* $ 95	$ 120 at most $ 105 more realistic		
Southern Africa	Unable to comment onMozam bi-que			See note[164]			

[164] Mr Gough believed – wrongly that Gallaher was selling to OTI for Mozambique at $ 100 and $ 110 per case.

Libya	15 BILLION	*FF* 4 % *LIGHTS* 0.4 %	C	*S'EIGN* F $ 120 *D'STER*	R $ 125 MORE REALISTIC	C 27% 42 %	R UNREALISTIC
Yemen	7 billion	*FF* 6.9 % *Lights* 3.5%	Top end Realistic	$ 120	Top end $ 110 – 130 more realistic	< 30%	Realistic
Iran	50 billion	*FF* 16% *Lights* 4 %	Total for market of 11 % max.	*S'eign* FF $ 140 *D'ster* FF $ 92 *S'line* $75	$ 110 $ 120 R D'ster Lights $ 115 S'line Lights $ 75		*Sovereign* Margin Excessive *Dorchester* too low *Stateline:* Would expect a lower margin
Latin America	150 billion	*FF* 0.5% *Lights* 0.2%	Very C	*D'ster* $ 120 *S'line* $ 120	C Nearer $ 105		Reasonable for *Dorchester* lower for *Stateline.*

SUB APPENDIX B.2.

IRAN

1. Market size is estimated at 51 billion sticks annually. (In the joint experts' report this is now agreed at in the region of 50 billion). Imported international brands represent 67 % (MEMRB retail audit) or 63% (ERC) of the market. The imported international brands market is American blend. MEMRB identified a small Virginia blend segment in 1999 (0.3%), being the last full year of Silk Cut, a premium price brand, sales in Tehran. Mr Goel's evidence was that there was no data supporting the continued existence of such a segment. Accordingly, as he concludes, the only TEL brand with potential is State Line. (Mr Gough accepts that the market is predominantly American blend but is of the view that there is a significant existing market and growth potential for Virginia, particularly outside Tehran).

2. TEL's claim in respect of 2003/4 is only in relation to Dorchester.

3. There are four consumer price segments with the following approximate prices per pack. with the following market shares (in brackets):

(a)	Premium at	> $ 0.80	(10%)
(b)	Mid price at	< $ 0.65[165]	(30%)
(c)	Value price at	< $ 0.45	(35%)
(d)	Low/Local at	< $ 0. 40[166]	(25%)

The lowest segment is not available for imports because of the taxes and duties applied to imports. Also the distribution for low brands is predominantly in rural areas where distribution is expensive.

Dorchester 2003/4

4. In order to position *Dorchester* in the lowest imported price segment CIF prices to the in-market distributor would need to be $ 50 per case taking into account duties, taxes and typical trade margins[167]. But the costs of sales for Dorchester in Schedule 1 for *2003/4* are $ 60.83 per case. So Dorchester, if sold to the value segment, would be sold at a **loss** of **$ 10.83.**

[165] In paragraph 72 (B) of his report Mr Goel describes the mid price as between $ 0.50 and 0.65 per pack.
[166] Although at paragraph 72 (D) of his report Mr Goel describes Low/Local as at or below $ 0.40.
[167] This calculation produces a figure of $ 0.41.

2004/5

5. In *2004/5* TEL's costs of sales of *Dorchester*, according to Schedule 1 rose to $ 70.83 per case. So, if Dorchester were positioned in the value segment, the **loss** would be **$ 20.83**.

6. If *State Line* was in *2004/5* to be positioned in the value segment the CIF price would have to be no more than $ 50 (see paragraph 35 above)[168]. But the costs of sales of Stateline as specified in Schedule 1 for 2004/5 is, also, $ 70.83. So TEL would suffer a **loss** of **$ 20.83**.

7. The sales price in Schedule 1 for Dorchester, both full flavour and Lights, is $ 91.67, and, for Stateline is $ 81.67. These prices would position the product in the mid price segment (and would do so even if allowance is made for the fact that Stateline sells in packs of 21 such that the $ 0.50 pack price derived from a sales price of $ 81.67 could be reduced to $ 0.475 to reflect a notional 5% discount). Mr Goel assumes that few customers would be willing to pay a mid price amount for a cigarette normally in the lowest segment for an imported product.

8. In respect of sales of *Sovereign* in 2004/5 Schedule 1 assumes a price of $ 140 per case. This would give a price per pack of $ 0.67 which would put Sovereign in the premium bracket. Mr Gough's view is that Iranian consumers would not pay a premium price for a mid-price brand. In order to position Sovereign (or any other cigarette) in the imported mid price section (i.e. the section immediately above the value section) the CIF price would need to be less than $ 92 per case. If TEL reduced its CIF price to $ 91.67 it could position Sovereign in the mid price segment[169] and still make a positive margin of $ 20.84 per case, against a computed margin of $ 69.17.

9. In short Mr Goel's view is (i) that Dorchester and Sovereign, being Virginia blend, are not suitable for the market; (ii) the prices in Schedule 1 would put all three brands in the wrong price category; and (iii) in order to position Dorchester and State Line in the right place TEL would incur a loss.

10. Mr Goel's view that consumers would not pay a higher price for goods than that payable in the segment to which they belong and that TEL would not wish to sell its cigarettes at a loss in each case where his calculations show that they would do so applies throughout.

[168] This does not seem to me quite accurate. At $ 50 CIF the pack price, on Mr Goel's figures, would be $ 0.41. The value segment, on Mr Goel's figures, does not end until you get to $ 0.45.
[169] The pack price would be $0.53. which is as the lower end of the mid-price range, although some way above the peak of the value range.

Mr Gough's calculations

11. Mr Gough has included in his calculations a number of taxes but he appears to have excluded, for 2004/5 nearly $ 50 of taxes which are included in Mr Goel's calculations. He acted on the basis of unspecified information from Japan Tobacco International. I am left in considerable doubt as to whether he has included all relevant taxes. He has also eliminated a distributor (so that there were only three margins- Importer, wholesaler, and retailer) and excluded internal freight and documentation charges as being the responsibility of the in-market wholesaler. There was, however, a secondary wholesaler in Iran, a photograph of whom appears in the papers. Mr Gough calculated that it would be possible to sell Dorchester in 2004/5 at a price of $ 0.43 with a TEL margin of $ 10 a case. I do not regard this as likely.

IRAQ

12. The estimated market size is 25 billion sticks. 70% (Mr Gough says at least 70%) of the market is Virginia/30% American blend. The market is supplied solely by imported international brands. The key limiting factor is consumer affordability. Virtually all of the population lives under the poverty line of $ 2 per day.

13. The approximate price segments and market shares are

(a)	Premium	> $ 0.50	10%
(b)	Mid Price	> $ 0.35	70%
(c)	Value	> $ 0.20	29%

Dorchester

14. The sale prices of Dorchester Full Flavour and Lights implicit in Schedule 1 for 2004/5 namely $ 142.50 and $ 95 would position the brand just below the premium segment with pack prices of $ 0.43 and $ 0.40. In order to obtain a position at the appropriate price point in the market namely the low price segment TEL would need to sell at $ 50 CIF, at an average **loss** of about $ **37.47** per case, since the cost implicit in Schedule 1 is $87.48 for FF and $ 87.46 for Lights.

Mr Gough's calculations

15. Mr Gough would eliminate from Mr Goel's calculations (a) a figure of $ 2 per case for extra freight charges UAE – Iraq in the ground that a CIF price had been agreed which would include carriage and insurance to Iran; (b) $ 1 per case for port fees/clearing charges and $ 2 for internal freight on the ground that they form part of the margin of the in-market distributor as they are internal costs within

Iraq and should, therefore, be excluded from the duty paid landed costs ("DPLC"). I have my doubts about that. Mr Gough's calculations reduces the margin for the In-market distributor from Mr Goel's $ 19.94 figure to $ 12.97, and assumed that he bears the $ 2 and $ 1 charges, reducing his margin to $ 9.97. That is probably inadequate to cover the cost of security (about $10) and infrastructure, let alone any profit.

16. He also excluded, on instructions rather than on any personal expertise, one wholesale margin (out of 2) of $ 2, and one of $ 1. His calculations reduce the margin paid from (and including) regional wholesaler down to consumer from $ 7 to $ 3.46. I have no confidence in the validity of doing this. As a result Mr Gough thought it would be possible to sell Dorchester in the value segment at a price of $ 0.30 with TEL earning a margin of **$ 10** and Dorchester Lights at that price with a margin of **$ 7.54**.

LIBYA

17. Public data on the Libyan market is scarce. The market size is about 7 billion, of which about 2 billion is smuggled. 7% is assessed as Virginia blend preference. All cigarettes must be imported through the State Monopoly – GTC. The exporting manufacturer must register brands with GTC. GTC is given a dollar allocation each month with which to purchase imported brands. The allocation of funds can be erratic. Only GTC registered wholesalers can purchase from GTC dealers and only GTC registered retailers can purchase from GTC registered wholesalers.

18. There are high specific and additional duties applied to imports ($ 0.43 per pack) so that price competition is effectively confined to the premium sector above $ 0.80 per pack, compared to local product which sells at below $ 0.40 per pack (see below). Duty paid imports are therefore limited to an estimated 30% of the duty paid market, of which only 7% is Virginia product supplied by Rothmans. (7% is an agreed figure). But there is estimated to be a large smuggled market for Virginia brands (at a price not accessible to legal imports) and Virginia products represent 29% of the estimated total duty paid plus smuggled market.

19. The approximate price segments and market share are as follows:

(a)	Premium	> $ 1	7%
(b)	Mid	> $ 0.80	9% (7% smuggled of which 6% Virginia)
(c)	Value	> $ 0.45	20% (all smuggled)
(d)	Low	< $ 0.40	

20. Because of the high specific duty structure it is not possible to position legally imported brands at below $ 0.58 per case even if the manufacturer sold to GTC at a nominal $ 1 per case.

21. In order to position Sovereign or Dorchester in the mid price segment TEL would have to sell at a price which involved a **loss** of **$ 14.52** per case in 2003/4 and **over $ 17** in 2004/5[170].

2003/4

22. The figures implicit in Schedule I for Sovereign and Dorchester FF ($ 125 CIF price and $ 84.52 cost of sales per case) are such that they would produce a pack price at or just over $ 1. This is unlikely to tempt current Virginia consumers in the (smuggled) value segment. In order to position Sovereign (or Dorchester) in the mid price segment it would be necessary for TEL to sell the brand(s) at $ 70 per case, in which case it would **lose $ 14.52** per case.

2004/5

23. In respect of 2004/5 TEL claims even higher selling prices. The selling price of Dorchester derived from Schedule 1 is $ 150 per case with a cost of sales of $ 88.33. The sales price of Sovereign is $ 120 with a cost of sales of $ 88.33. Both brands would thus still retail in the premium segment. If Sovereign or Dorchester was positioned in the mid price segment the losses would be $ 16.66 and $ 14.99 per case.

24. TEL contends that, by using the tribal route it is possible to avoid the GTC margin of $ 25.56 (assuming a TEL CIF price of $ 70). That may be so; in which case brands could be sold at $ 70 a case (thus producing a pack price in the mid segment) with, on Mr Gough's figures, a margin of around $ 10 a case, provided that the tribal route does not involve other expenses.

Mr Gough's calculations

25. Mr Gough has assumed that TEL would uses the tribal routes to Libya, i.e. via Cotonou in Begin across Niger and possibly Chad to Libya which he describes as "*well known, widely used and treated as legitimate*", and so has eliminated the GTC margin and GTC dealer margin. He also excludes a semi-wholesaler margin and assumes, on instructions and from experience, that only one in-market wholesale margin would be applicable. Again I have doubts about that. He also excludes port charges and handling charges on the ground that the CIF price will include carriage and insurance to a named location in Libya. It is not at all clear to

[170] Paragraphs 152 and 154 of Mr Goel's report state that in order to place Dorchester in the lowest priced international segment TEL would lose $ 14.52 per case in 2003/4 and $ 16.66 per case in 2004/5.

me whether such charges can properly be eliminated, not least because what they covered was not explored in evidence. Mr Gough calculates that it would be possible to sell Dorchester and Sovereign at $ 0.82 per pack with a $ 20 or $ 22 margin for TEL.

26. It may be that a margin of between $ 10 and $ 20 per case could have been obtained on goods supplied by TEL to Syria. But whether that could be done legitimately appears to me extremely doubtful. It has all the hallmarks of a smuggling route. Even if it can Mr Gough's calculations seem dubious. He includes the non GTC taxation and duty payments on the ground that some duty or equivalent payments would need to be due to those in control of the tribal routes. What exactly those payments would be is unclear. Further his calculations do not seem to take into account the cost of using the route itself.

SYRIA

27. The total market was estimated by Mr Goel to be 22.8 billion, of which about 13.5 billion is duty paid. It is now agreed to be about 20 billion sticks (including smuggled product). 41% of the market is smuggled, a significant proportion of which is Lights. All legal imports must come through the Government owned manufacturer – GOTA – which accounts for 70% of the Duty Paid market. GOTA applies various duties and taxes and takes a margin, thereby effectively setting a minimum retail price which is double or nearly double the price of the locally manufactured product. Similar arrangements to those applicable in Libya apply in relation to registration with GOTA by manufacturers, wholesalers and retailers with similarly erratic US $ quotas for importation of foreign cigarettes. Legal imports are estimated at 30% of the duty paid market.

28. Mr Gough expressed the belief that there are officially sanctioned import routes into Syria apart from GOTA but Mr Goel's experience was that there are not.

29. There are no data supporting the existence of a Virginia segment, and no apparent records of GOTA ever importing Virginia brands. (Mr Gough accepts that the market is predominantly American blend). The duty paid market is, thus 100% American blend. Mr Goel notes that Adam Trading claims a Virginia market in Syria of 4,800 cases annually. He assumes that to be Adam Trading's estimate of Virginia brands available in the smuggled market. Optimistic sales projection of a 10% share of the smuggled Virginia segment might be made on the assumption that smokers of smuggled Virginia would trade up to officially imported product. If so, this would be the equivalent of 40 cases a month yielding a gross margin of $ 15,744 annually before distribution and marketing costs.

30. The approximate price segments and market shares are as follows:

(a)	Premium	> $ 1	5%
(b)	Mid	> $ 0.90	25%
(c)	Low	< $ 0.50	70%

The Low segment is inaccessible to imported blends.

31. The price for Dorchester implicit in Schedule 1 is $ 100 per case with a cost of sales of $ 69.72. This would produce a price per pack of $ 0.90. Since, in Mr Goel's view, there is no legitimate demand for Virginia cigarettes, he does not regard it as necessary to decide whether Dorchester should be positioned in the mid price segment as representing the lowest segment accessible to imported brands.

32. Mr Goel assumed that Adam Trading's claim that there was a Virginia market in Syria of 4,800 cases was an estimate of Virginia brands available in the smuggled market.

Mr Gough's calculations

33. Mr Gough assumed duty free sales until local production started in 2005/6 and then for duty paid sales through GOTA thereafter with margins of $ 27.93 and $ 34.14. In respect of duty paid sales Mr Gough appears to have omitted a substantial amount in the way of tax which Mr Goel has taken into account. I think that Mr Goel's tax calculations are likely to be more reliable.

SUDAN

34. The estimated market size is 2.6 billion. The market is 99% Virginia blend. 84% of the market is occupied by local manufacturers. Duties and taxes applied to imported and domestic cigarettes are high, with additional duties being applied to imported cigarettes. 80% of cigarette sales are made in 10 packs. A purchase of one imported pack of 20 cigarettes is 15% above the average daily income of 40% of the population.

35. The approximate price segments and market shares are as follows:

(a)	Premium	> $ 2.30	17%
(b)	Low Price	< $ 1.80	83%

36. The sale price of Sovereign implicit in Schedule 1 is $ 120 with costs of sales of $ 88.33. This would produce a price per pack of $ 2.10.That price would result in Sovereign being sold at 89% of the B & H price. So TEL could arguably create a

mid-price segment (unless there is some practical barrier to the creation of one, which the absence of such a segment might suggest). Mr Goel estimates that, on that footing, there is a potential of 1% of the whole market for Sovereign, being the estimated market size of the smallest established Virginia brand in the import segment – Karelia Royal. This would result in Sovereign sales of 2,600 cases per year yielding TEL, if trading took place at all, a gross margin of $ 82,342. In Mr Goel's opinion an annual volume below 4,800 cases would not be viable.

37. An annual volume below 4,800 cases is not viable both (a) intrinsically and (b) because the effect of clauses 4 (xv) and 4 (xvi) of TEL Agreement taken with Schedules III and IV is to prevent TEL from conducting a business of less than that number of cases per year. Under those provisions TEL is required to use its best endeavours to limit stock to not more than two months in market sales per Territory and to purchase in units of 40' containers, which hold about 8 million sticks. TEL would thus have to order at least 4 million sticks per month or 48 million sticks (4,800 cases) per annum.

AFGHANISTAN

38. There is very little data available on the Afghan market. Mr Goel estimates the market size at about 3.6 billion (derived from market sources) with an estimated 70% American and 30% Virginia blend. (Mr Gough regards the Virginia blend percentage as being higher than 30%). There is no local manufacture of cigarettes, The American blend is dominated with products from KT & GC., a Korean manufacturer. Mr Goel assumes that the border area with Pakistan is predominantly Virginia blend because Pakistan is predominantly Virginia and local blend.

39. It is thought that a quantity, perhaps even the majority, of imported Virginia products are in fact re-exported for sale elsewhere because, even at the full duty paid price the product is attractive to smugglers.

40. Because of the high levels of poverty price is the main driver in consumer selection of cigarettes. Most of the product is shipped under duty suspension from Bandar Abbas in Iran to the Iran/Afghanistan border near Mashar. This route is taken, rather than importation from Western Pakistan because products imported through Pakistan effectively pay local taxes and duties even if they are intended for re-export. Duties are paid once the goods enter Afghanistan (ad valorem based on declared CIF price – around 40%) and the goods are transported to Herat. From there they are then transported to Kandahar in the South East near the Pakistan border, which is the main base for distributors.

41. The approximate price segmentation and market share is as follows:

(a)	Premium	> $ 0.50	10%
(b)	Mid Price	< $ 0.45	20%
(c)	Low Price	< $ 0.35	70%

42. The price implicit in Schedule 1 for Sovereign and Dorchester is $ 120, with costs of sales of $ 88.33, producing a price per pack of $ 0.59 for Sovereign and $ 0.57 for Dorchester. Both Dorchester and Sovereign would thus fall within the premium segment. If Dorchester were to be sold in the low price section at $ 0.35 TEL would **lose $ 28.33** per case. If Sovereign were to be sold in the mid-price section at $ 0.45 per packet, TEL would make a **loss of $ 3.33** per case.

Mr Gough's calculations

43. Mr Gough has excluded two sets of transport costs on the basis that they would come out of the margin of the distributor or retailer and, on instructions, removed the semi-wholesaler margin. He calculates that it would be possible to sell Sovereign and Dorchester at $ 0.37 a pack with a TEL margin of $5. I regard this as highly dubious. In order to reach his figures Mr Gough assumes that $ 10 per case of transport costs will be borne by a distributor whose margin is $ 13.07, leaving him with $ 3.07 per case to cover infrastructure and profit.

PAKISTAN, YEMEN, EGYPT AND MOZAMBIQUE

44. **Pakistan** is predominantly Virginia and local blends preference. (Mr Gough and Mr Goel agree that 50% is Virginia blend). **Egypt**, which is agreed to have a market somewhere around 60 billion sticks, is predominantly American and local blends. (Mr Goel regards the Virginia segment as 2-3%; Mr Goel regards it as 0.7%). **Yemen** is mainly Virginia and local blends. (Messrs Gough and Goel agree that it is 95% Virginia). **Mozambique** is mainly (95%) Virginia and local blends. In each market international competition is established with local manufacture.

45. Mr Goel's assessment of these markets has been conducted on a general level using ERC data in the main. This is either because he does not have direct experience of these markets (Pakistan, Egypt and Yemen) and/or because the data sources to which he has had access are not adequate to develop a detailed market report. The basis and assumptions upon which Mr Goel's assessment is based are contained in Schedule 7 to his report. They include assuming, in the case of Pakistan, that the TEL sales prices as identified in Schedule 1 would enable each identified TEL brand to be sold at the appropriate competitive price segment; and

assuming that where it appears possible for TEL to enter into a market (because it is selling appropriate blends at apparently appropriate prices) and no clear indication is available of existing market shares TEL will achieve an equal share with any competitors identified ("the equal share assumption").

46. This is a highly favourable assumption since, if there are, say, already three established competitors in the market, it will in practice be extremely unlikely that TEL would achieve a 25% share.

47. The upshot of Mr Goel's assessment is that, using the prices and costs inherent in Schedule 1, in respect of 2004/5 and 2005/6

(a) In *Pakistan*, which is Virginia or local blend preference, but with a small imported market, TEL would achieve in 2004/5 and 2005/6 minimal sales of Sovereign and Dorchester (355 cases in all) with minimal TEL gross margin (around $ 11,250) - a negligible amount;

(b) In *Egypt*, where the market is 0.7% Virginia, 29.3% American and 70% local blend, if TEL sold at a CIF prices of $ 120 per case (as Schedule 1 assumes) the resultant retail price of Dorchester and State Line would be $ 0.76 assuming no distributor, wholesaler or retailer margins at all. If an aggregate margin of no more than 10% is (favourably to TEL) allowed for these, the price would be $ 0.83. This compares unfavourably with the $ 0.65.and $ 0.79 at which L& M, a mid-price brand, sold in 2003 and 2005, and is equivalent to the $ 0.84 at which Kent, a premium brand, sells.

(c) If TEL chose to sell at its average cost of sale price of $ 62.07 the resultant retail price of Dorchester and State Line would be $ 0.54 (assuming no trade margins whatever and no profit for TEL) which compares unfavourably with Boston, a low price international brand, which retails at $ 0.44 per pack. If an aggregate 10% margin is allowed the retail price would be $ 0.59.

(d) If Stateline, TEL's American blend, was sold at $ 0.44, so as to be comparable to Boston TEL would incur a loss of $ 37.03 per case.

(e) In respect of the *Yemen*, which is 95% Virginia blend, *TEL* would need to sell at $ 7.49 per case below their cost of sales (derived from Schedule 1) for Sovereign Full Flavour and $ 8.33 per case below their cost of Sales for Sovereign Lights in order to compete against a mid priced international brand (Aspen) sold in Yemen at $ 80 per case. That calculation assumes, favourably to TEL, that Aspen had the same CIF price in 2004/5 as in 2005/6.

(f) In respect of *Mozambique,* which is 95% Virginia blend, TEL would need to sell at $ 4.99 per case below the cost of sales for Dorchester Full Flavour and $ 8.33 below their costs of sales for Dorchester Lights (as computed from Schedule 1), if TEL was to compete with Bond Street, a mid priced band, selling at $ 80 per case. It would lose even more in order to position Dorchester in the international low price segment (if that exists).

(g) Since Mr Goel assumes that customers would not be prepared to pay a premium or mid prices for low price brands, and that TEL would not wish to sell at a loss, Mr Goel estimates that, at the prices implied by Schedule 1 there was no business potential in Egypt, Yemen and Mozambique.

48. In relation to the above, Mr Gough has nothing to contribute in relation to *Pakistan*. He treats all sales into *Egypt* as duty free and, therefore, excludes, probably rightly, any sales tax. On that footing he produces a retail selling price of $ 0.45 for Dorchester and $ 0.41 for Stateline with margins of $ 47.93 and $ 37.93 respectively. Whether the volumes in Schedule 1 (60,000 cases) could ever be attributable to duty free shoppers seems to me highly doubtful. He produced a calculation for *Yemen* which showed a price per pack of $ 0.73 with a TEL margin of $20. But this was based on no expertise or experience.

49. In relation to *Mozambique*, about which Mr Gough professed to have no experience, Mr Gough understood that Gallaher was selling to OTI for $ 100 and $ 110 a case and produced a calculation showing that at a price of $ 90 CIF Mozambique, the pack could be sold at $ 0.67 a case, with a $ 1.67 to margin. He accepted that this calculation was not based on any expertise or experience; and I decline to regard it as reliable.

LATIN AMERICA

50. Because Mr Goel has no direct experience of these markets (being, relevantly, Argentina, Brazil, Chile, Paraguay, and Uruguay) he has assessed them only through ERC data. The assumptions upon which his assessment is based are set out in Schedule 8 to his first report.

51. The Latin American markets, with a total of over 150 billion sticks, are all predominantly (per Mr Gough – mainly) American blend markets characterised by firmly entrenched and long established competitors with significant investment in local manufacture and direct store delivery systems. The ERC reports do not support the existence of a Virginia segment. So only Stateline might penetrate the market. In respect of 2003 TEL's claim is only in respect of Dorchester, a Virginian blend, of which, Mr Goel concludes, no sale would be made.

52. There is a preference for soft cup packs (Argentina 72.2% and Brazil 75.8%). There is also some preference for lengths other than standard King Size. In Argentina, Brazil and Chile listing fees are common at retail level – which would add significant cost to marketing expenditure.

53. In making his market assessment Mr Goel made a number of assumptions favourable to TEL including the equal share assumption.

54. Mr Goel's market assessment includes the following:

(a) *Argentina:* In 2003 the import market was 100 cases, and in 2004 200 cases. Even if TEL managed to gain 100% of that market the volumes would be small. Applying the market cigarette length preference (82.2% King Size) and the pack format preference (soft cup 72.2%) would leave TEL with a total import market potential in 2003 of 22.85 cases and in 2004 of 46 cases. These are negligible amounts.

(b) *Brazil*: In 2003 the import market was 24,400 cases and 18,600 in 2004. Applying the market cigarette length preference and the pack format preference would leave TEL with a total import market potential; in 2003 of 4,983 cases and in 2004 of 3,799 cases. Even if TEL captured all of this the volume would not be viable. If the equal share assumption is applied it would capture 1,266 in 2004.

(c) *Chile*: The import market in 2003 was 25,000 cases and in 2004 23,200 cases, but in 2004 19,800 cases were of PMI brands leaving a total potential imported market available to TEL of 3,400. But in 2003 and 2004 only .4% of the total market (3,400) cases) was not accounted for by either BAT or PMI sales. If these shares are reflected in the import market TEL would have an import potential of 93 cases.

(d) *Paraguay*: The market is 50% imported products but in 2003 only 1.8% of volume is not accounted for by specific brands. In 2004 the percentage was 0.2%. If the total market is reflected in the imported sector then the total import volume not accounted for by specified brands is 5,850 cases in 2003 and 600 in 2004. Even if TEL through Stateline commanded the whole of this

unaccounted for volume, the volume is not viable in 2003 and negligible in 2004. If the equal share assumption is applied TEL would have an import potential of 150 cases.

(e) *Uruguay:* In 2003 2,920 cases were imported into Uruguay. Even if TEL gained 100% of that volume it would not be viable. If the equal share assumption is applied TEL would sell 730 cases. In 2005/6 imports rose to 30,000 as a result of BAT closing its local manufacturing base and importing from neighbouring countries. BAT's volume is stated to be 30,000 cases in 2004 so that the whole of the imported market is accounted for.

55. The upshot of Mr Goel's assessment is that, on the basis explained in Schedule 8, TEL's total gross annual margins would be as follows:

COUNTRY	**2004/5**	**2005/6**
Argentina	$ 2,454	$ 2,454
Brazil	$ 67,546	$ 67,546
Chile	$ 4,950	$ 4,971
Paraguay	$ 8,001	$ 8,001
Uruguay	$ 38,938	-

Mr Gough's views

56. Mr Gough was unable to analyse any individual breakdown for duty paid sales in Latin America as there was no such breakdown in Schedule 1. He reckoned that since sales were, at least initially, to be on a duty free basis the projected volumes were conservative. This was not, however, based on any expertise or experience. He produced no reasoning or analysis to contradict Mr Goel.

57. TEL put forward a series of alternative calculations based on tobacco manufacture in Poland or elsewhere outside the UK. I do not propose to address these. No suggestion was made in the pleadings that damages should be calculated by

reference to non UK manufacture. The calculations surfaced only in Mr Gough's third report, which came forward two weeks after the conclusion of Gallaher's factual evidence. The question as to whether Gallaher would have undertaken Polish manufacture (provided for by the July 2004 Heads of Agreement but not by way of contract) and what the ramifications of that would be was not addressed to any substantial extent in evidence. TEL had no entitlement to non UK manufacture or to any price reduction on that account.

SUB-APPENDIX B.3.

DUTY FREE SALES

1. Iran

Cigarette labelling was from May/June 2003 the same as for the domestic market. All cigarettes in duty free shops therefore require a Farsi health warning. A company called Shaheed was the exclusive duty free operator in Iran, including licensed outlets in duty free zones. The total legitimate sales through duty free shops of all brands is estimated to be 5 containers annually because that is what Shahed is understood to sell. Duty free allowances are only available to Iranian nationals in a free zone if they leave the country with the product purchased. If cigarettes are purchased in a duty free zone and taken into Iran they are subject to all applicable duties, taxes and regulations. The legitimate import of duty free goods into Iran would have been limited because only foreign visitors could do so and then only in limited quantities.

2. Argentina

Goods to be sold in duty free outlets have to have a label identifying them as such ("*For duty free only*") and require a specific health warning mandated by Argentine law ("*Fumar es prejudicial para la salud*"). Mr Goel thought that the goods sold to TEL would not have complied with these requirements; but that will depend on the content of the "Latin American health clause" with which one consignment of 40,000 cases was labelled. Travellers are allowed to bring into Argentina a maximum of 20 packs of cigarettes without paying duty.

*3. Brazi*l

Travellers are allowed to bring into Brazil a maximum of 20 packs duty free. Global health warnings appear to be permitted.

4. Chile

There are various packaging and labelling requirements, which have changed over time, applicable to sales of cigarettes in duty free shops, with which the goods supplied to TEL would not have complied. The maximum of 20 packs applies.

5. Paraguay

A Spanish health warning is required ("*Fumar dana la salud*"). The goods sold to TEL may not have complied with this. Travellers can bring in $ 5000 worth of

good free of duty. If this was totally expended on cigarettes this would amount to about 360 packs of 20 cigarettes.

6. *Uruguay*

There are various packaging and labelling requirements, although these do not appear to have been enforced to date in respect of foreign cigarettes. The allowance was 20 packs until 26th August 2005 per trip and 40 thereafter.

7. *Egypt*

Percentages of tar and nicotine have to be identified on the pack and there has to be a health warning covering one third of the packaging area. There was one shipment of goods intended to comply with the specific Egyptian duty free packaging requirements during the TEL era. The personal allowance for import into Egypt was 10 packs.

8. *Syria and Libya*

All cigarettes have to be supplied through GOTA and GTC respectively and required the same pack markings as the domestic product.

Sudan, Afghanistan, Pakistan, Iran, Mozambique and Yemen.

9. Mr Goel was not aware of the labelling requirements for duty free zones or outlets in these countries. But he discovered that the personal allowances were as follows: Sudan, Pakistan, Syria, and Libya - 200 cigarettes; Mozambique – 400 and Afghanistan "a reasonable quantity of tobacco products".