Amendments dated 31 January 2019 made pursuant to the Order of Mr Justice Marcus Smith dated 22 January 2019

IN THE HIGH COURT OF JUSTICE **CLAIM No. FL-2017-000001**

CHANCERY DIVISION

B E T W E E N :

THE PERSONS IDENTIFIED IN SCHEDULE 1 TO THESE PARTICULARS OF CLAIM

Claimants

-and-

TESCO PLC

Defendant

AMENDED PARTICULARS OF CLAIM

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1. INTRODUCTION

1.1. Definitions, abbreviations and relevant individuals

1.1.1. In these Particulars of Claim, the following definitions and abbreviations will be used:

Person/Party	Abbreviation
The ~~111~~ 58 institutional investors identified in Schedule 1 to these Particulars of Claim	The "**Claimants**"
Tesco PLC, the Defendant	"**Tesco**"
Tesco Stores Limited	"**Tesco Stores**"
The Groceries Code Adjudicator	The "**GCA**"
The Groceries Code Adjudicator's Report dated 26 January 2016	The "**GCA Report**"
The Serious Fraud Office	The "**SFO**"
The investigation commenced by the Serious Fraud Office into Tesco announced on 30 October 2014, ongoing at the date of these Particulars of Claim.	The "**SFO Investigation**"

1.2. **Particulars of wrongdoing**

As set out in detail below, the Claimants contend that Tesco intentionally misled investors between (at least) 17 April 2013 and 22 October 2014 inclusive (the "**Relevant Period**"), by information published between 17 April 2013 and 29 August 2014. The Claimants' knowledge and understanding of the manner in which Tesco misled investors is, at present, predominantly based on published and available information. The Claimants' investigations are ongoing. The full nature of Tesco's practices will only fully be revealed as a result of complete disclosure by it in the course of these proceedings. The Claimants reserve their rights to apply to amend these Particulars of Claim in due course.

1.3. **The GCA Report**

These Particulars of Claim make reference to the contents of the GCA Report. On the date of the GCA Report's publication, 26 January 2016, Mr Lewis, the Chief Executive Officer ("**CEO**") for Tesco publicly confirmed that Tesco accepted the findings of the GCA Report, said they were consistent with Tesco's own investigation, and accepted and averred that the GCA Report's findings were applicable to a period from "*the middle of 2013 to the very beginning of 2015*". Where the Claimants refer to matters stated in the GCA Report, each such reference should be read as accompanied by an express averral that such matters are both true and known by Tesco to be true.

2. SUMMARY OF CLAIMS

2.1. On 22 September 2014, Tesco announced that it had identified an overstatement of its expected profit for the half-year of an estimated £250 million. On the same day it suspended four senior employees (three of whom have not only been dismissed, but now face criminal charges of fraud and false accounting brought by the SFO). Tesco's share price fell immediately.

2.2. On 23 October 2014, Tesco released its interim results for 2014/15, confirming that after an investigation by Deloitte it had concluded that the aggregate profit overstatement was £263 million. Tesco's share price fell again; between Friday 19 September and Friday 24 October 2014, it had fallen by more than 26%.

2.3. On 22 April 2015, in its preliminary results for 2014/15, Tesco again upwardly adjusted the aggregate profit overstatement originally announced in September 2014, implying that it was at least £326 million. At the same time it announced a pre-tax loss of £6.4 billion (compared to pre-tax profits of £2.26 billion for the preceding year and £2.0 billion for 2012/2013) - the biggest loss ever suffered by a UK retailer and one of the largest in UK corporate history.

2.4. It has become apparent that during that period, to the knowledge of its former management, Tesco deliberately communicated false and misleading statements to the market, designed to conceal a serious downturn in Tesco's UK business and provide false reassurance to investors that Tesco was capable of achieving the 5.2% profit margin target to which its management had only recently committed it.

2.5. At present it appears that Tesco's wrongful behaviour took two main forms. The first type of wrong was its use of inappropriate and unsustainable practices against its own suppliers, squeezing them in pursuit of ever-increasing levels of commercial income. The GCA Report confirms that Tesco had deliberately engaged in wrongful practices against its suppliers, including bullying behaviour and wrongful invoicing and payment practices. The GCA held that Tesco had breached the Groceries Supply Code of Practice (the "**Code**").

2.6. The second type of wrong was Tesco's deliberate and fraudulent accounting for its commercial income. In its announcement on 22 September 2014 Tesco confirmed that its financial reporting had been in breach of its own accounting standards, involving (in summary) both wrongfully accelerated recognition of commercial income and wrongfully deferred recognition of costs. The SFO's criminal charges against three senior members of Tesco's management further supports the Claimants' case that Tesco's accounting was fraudulent.

2.7. Following Tesco's public abandonment of its former wrongful practices, its trading profits and profit margins for 2014/15 and 2015/16 have displayed a material and structural decline (its group trading profit was £3.454 billion in 2012/13 and £3.315 billion in 2013/14, but only £1.39 billion in 2014/15 and £944 million in 2015/16 [1]; the corresponding profit margins likewise fell from 5.3% and 5.2% in 2012/13 and 2013/14, to only 2.2% in 2014/15 and only 1.7% in 2015/16); its dividend fell from 14.76p per share in each of 2012/13 and 2013/14, to only 1.16p per share in 2014/15 and zero in 2015/16; and its credit rating has fallen to "junk" status. Tesco shares are, in short, a very different investment proposition to how the market (in reliance on Tesco's false statements) regarded them prior to September 2014.

2.8. The Claimants are ~~111~~ 58 institutional investors who dealt in Tesco shares between 17 April 2013 and 23 October 2014, and suffered serious losses as a result of Tesco's false and misleading statements to the market and Tesco's dishonest omissions from those statements. The Claimants are entitled to compensation under the Financial Services and Markets Act 2000. The Claimants will in due course seek a Group Litigation Order or similar order, facilitating the effective case management of these proceedings, including in the event that other Tesco investors seek to join them.

3. PARTIES

3.1. The Defendant

3.1.1. Tesco is a well-known, publicly listed retailer. It is the ultimate 100% shareholder in Tesco Stores and the ultimate 100% shareholder in Tesco Food Sourcing Limited "**Tesco Food Sourcing**").

3.1.2. At all material times during the Relevant Period:

(1) Tesco was the issuer of ordinary shares trading on the Main Market of the London Stock Exchange ("**Tesco shares**"), constituting securities that were, with the consent of the issuer, admitted to trading on a securities market situated or operating in the United Kingdom within the meaning of paragraph 1 of Schedule 10A to the Financial Services and Markets Act 2000 ("**FSMA**"); and

[1] In 2015/16, Tesco stopped reporting "trading profit" and instead reported "operating profit before exceptional items".

(2) the United Kingdom was Tesco's home state, within the meaning of paragraph 1 of Schedule 10A to FSMA.

3.1.3. Employees or former employees of Tesco and/or other Tesco group companies relevant to the claim include the following:

Person	**Job title/role**
Mr Philip Clarke	CEO of Tesco from 3 March 2011 until 1 September 2014. Director of Tesco from 16 November 1998 until 1 September 2014.
Mr Laurie McIlwee	Chief Financial Officer ("**CFO**") of Tesco from 27 January 2009. His resignation was announced on 4 April 2014. Director of Tesco from 27 January 2009 to 4 April 2014.
Sir Richard Broadbent	Chairman and Director of Tesco from 2 July 2011. Resignation announced on 23 October 2014 and effective on 1 March 2015.
Mr Kenneth Hanna	Director of Tesco from 1 April 2009. Chairman of the Audit Committee. Resignation announced on 5 May 2015 and effective on 26 June 2015.
Mr Christopher Bush	UK Chief Operating Officer from March 2012 and UK Managing Director from January 2013. Member of Tesco's "Executive Committee". Director of Tesco Stores from 14 October 2013. Suspended 22 September 2014, later dismissed. Following the SFO Investigation, charged with false accounting and fraud; entered a "not guilty" plea on 22 September 2016.
Mr Carl Rogberg	Finance Director UK from around March 2013 to around late 2014 (and held a similar role from January 2007 to May 2010). Suspended 22 September 2014, later dismissed. Following the SFO Investigation, charged with false accounting and fraud; entered a "not guilty" plea on 22 September 2016.
Mr John Scouler	Food Commercial Director from January 2013. Director of Tesco Food Sourcing from 18 October 2011. Suspended 22 September 2014, later dismissed. Following the SFO Investigation, charged with false accounting and fraud; entered a "not guilty" plea on 22 September 2016.
Mr Matthew Simister	Head of Food Sourcing from April 2010. Suspended 22 September 2014, reinstated in December 2014.
Mr Kevin Grace	Group Executive Commercial and Supply Chain Director from 2011. Member of Tesco's "Executive Committee". Director at

Person	Job title/role
	various times of a number of Tesco subsidiaries. Suspended 14 October 2014, later dismissed.
Mr William Linnane	Director of Impulse Purchases. Suspended 14 October 2014, later reinstated but subsequently removed from post in Tesco's management restructure.
Mr Dan Jago	Group Wine Director from December 2012. Suspended 14 October 2014, later reinstated but subsequently removed from post in Tesco's management restructure.
Mr Sean McCurley	Director of Convenience Foods from March 1996. Suspended 14 October 2014, later reinstated but subsequently removed from post in Tesco's management restructure.
Mr Chris Robinson	Group Commercial Finance Director from January 2012. Suspended January 2015, later reinstated but subsequently removed from post in Tesco's management restructure.
Mr David Lewis	CEO and Director of Tesco from 1 September 2014.
Mr Alan Stewart	CFO and Director of Tesco from 23 September 2014.

3.1.4. Tesco is required to confirm whether any other individuals, in addition to those referred to above, have resigned or been dismissed or removed from post in circumstances which have any connection to Tesco's admitted profit overstatement (set out in detail at paragraph 8.5 below), Tesco's admitted wrongful practices which were the subject of the GCA Report, and/or any other matter(s) referred to in these Particulars of Claim.

3.2. **The Claimants**

3.2.1. The Claimants are ~~111~~ 58 institutional investors who dealt in Tesco shares during the Relevant Period. The Claimants are each identified at **Schedule 1** to these Particulars of Claim.

4. COMMERCIAL BACKGROUND

4.1. The importance of the UK market to Tesco

4.1.1. The UK market, and in particular the UK grocery market, is an extremely important one to Tesco's business. By way of example, as at February 2016 (when Tesco's financial year ends):

(1) Tesco had around a 28.4% share of the UK grocery market.

(2) Of Tesco's 6,665 stores worldwide, around 3,460 stores were in the UK.

(3) Around 79% of Tesco group revenue (excluding VAT, including fuel sales) and 53% of group operating profit before exceptional items (excluding Tesco Bank) came from the UK and the Republic of Ireland.

4.2. The importance of margin

4.2.1. Self-evidently, the difference between the amount for which a retailer can buy products and the amount for which it can sell them is critical to the retailer's business. Tesco's margins are of great importance to it (and its actual and potential shareholders). Amongst other things, Tesco's share price is related to its ability to maintain margins and accordingly to pay dividends. The importance to Tesco of nurturing and maintaining the confidence of the markets in its ability to protect margin is evidenced by, amongst other things, the following matters:

(1) Tesco's financial reporting consistently emphasised its trading margin, to the extent that in 2012 Tesco publicly committed itself to maintain a future trading margin of 5.2%. Tesco's Annual Report 2012/13, having stated (at page 21) a UK trading margin of 5.21%, referred back to the previous year's rebasing of trading margin to 5.2% and confirmed that "*the new base of 5.2% is appropriate for the foreseeable future*". In adopting this approach, Tesco effectively staked a material part of its reputation on achieving this trading margin figure for the foreseeable future.

(2) Similarly, market analyses of Tesco consistently focused on its margin performance, and in particular its margin performance relative to its published trading margin target of 5.2%. For example, in a report dated 22 April 2013 (making a "buy" recommendation in respect of Tesco shares) Cantor Fitzgerald said "*If Tesco can sustain superior trading margins in the more competitive convenience store market then we still see value in the shares. Tesco has added several new higher margin service businesses to the UK to sustain the 5.2% UK trading margin*", and in an article published on 29 November 2013, *The Guardian* reported on Mr Clarke's emphasis on maintaining margin at 5.2% and growing City scepticism in respect of the same.

(3) The GCA Report stated at paragraph 24.1 that "*It was clear from the evidence that a major focus of the Tesco commercial team during this period was on hitting budgeted margin targets*".

(4) In his response to the GCA Report on the date of its publication (26 January 2016), Mr Lewis accepted that "*The absolute focus on operating margin had damaging consequences for the business and our relationship with suppliers*".

4.3. **Tesco's market position**

4.3.1. In the 1990s, Tesco became the UK supermarket leader, growing its UK sales at around 9% per annum until around 2009. By March 2011, when Philip Clarke took over as CEO from Sir Terry Leahy, Tesco had become one of the biggest retailers in the world. However, the onset of the global financial crisis and the failure of various international investments made by the Tesco group, together with increased competition from "discounters" such as Aldi Stores Limited and Lidl UK GmbH, produced serious and sustained challenges for Tesco.

4.3.2. The GCA Report stated at paragraphs 18.2 and 18.3 that, in summary:

(1) In April 2013, Tesco announced its first fall in profits in almost 20 years.[2] By October 2013, Tesco's profits had dropped by 23.5%, which it attributed to the challenging retail environment. Profits continued to fall in the third quarter, with Tesco also announcing a 1.5% drop in like-for-like UK sales, which Tesco again attributed to the financial climate and pressures on household finances.

(2) The year 2014 was also challenging for Tesco. It had a disappointing 2013/14 Christmas period, with like-for-like sales down 2.4%. It announced that at least 100 of its largest stores would be scaled down. By March 2014 Tesco's market share had fallen to the lowest level since 2005. A profit warning followed in April 2014, with Tesco reporting a 6% fall in full-year Group trading profits.

4.4. **<u>Tesco's wrongful practices</u>**

Against that adverse and challenging commercial background, Tesco deliberately engaged in wrongful practices in the Relevant Period in an attempt to maintain its reported margins and its share price. Those wrongful practices are pleaded below as follows:

(1) Section 5 sets out the relevant financial information published by Tesco during the Relevant Period;

(2) Section 6 sets out Tesco's wrongful acts to increase its commercial income (as defined below);

(3) Section 7 sets out Tesco's wrongful manipulation of its financial reporting;

(4) Section 8 sets out the untrue and misleading nature of the relevant financial information published by Tesco during the Relevant Period; and

(5) Section 9 sets out the knowledge and state of mind of Tesco personnel.

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[2] In fact, the fall had been announced at the same time as the Interim Results for the year 2012/13, published on 3 October 2012.

5. TESCO'S PUBLISHED INFORMATION DURING THE RELEVANT PERIOD

5.1. Preliminary Results for 2012/13

Tesco published its Preliminary Results for 2012/13 (the "**Preliminary Results 2012/13**") on 17 April 2013, containing the following statements:

(1) At pages 1, 2 and 6 (amongst others), it stated that UK trading profit was £2.272 billion;

(2) At pages 2 and 6, it stated that the UK trading margin was 5.21%. At page 6 it noted this was "*in line with the guidance given at our Preliminary Results in April last year*".

5.2. Annual Report 2013

5.2.1. Tesco published its Annual Report and Financial Statements 2013 (the "**Annual Report 2013**") on 23 May 2013, containing the following statements:

(1) At pages 20 and 21, it stated that UK trading profit was £2.272 billion;

(2) At page 21, it stated that UK trading margin was 5.21%.

5.2.2. Further or alternatively, the Annual Report 2013 expressly (alternatively, impliedly) represented that Tesco had complied (and/or believed it had complied) with the Code.

5.3. Interim Results for 2013/14

Tesco published its interim results for the first half of 2013/14 (the "**Interim Results 2013/14**") on 2 October 2013, containing the following statements:

(1) On pages 1, 2, and 6 (amongst others), it stated that there had been UK trading profit of £1.131 billion;

(2) On pages 2 and 6 (amongst others) it stated that the UK trading margin was

5.2%. At page 6, it further stated "*UK trading margin remained stable at 5.2% despite continued investment in our core food offer, helped by our progress so far on refocusing our general merchandise business on more profitable categories*".

5.4. **Preliminary Results for 2013/14**

Tesco published its Preliminary Results for 2013/14 (the "**Preliminary Results 2013/14**") on 16 April 2014, containing the following statements:

(1) At pages 1, 2 and 6 (amongst others) it stated that UK trading profit was £2.191 billion;

(2) At pages 2 and 6, (amongst others) it stated that UK trading margin was 5.03%.

5.5. **Annual Report 2013/14**

5.5.1. Tesco published its Annual Report and Financial Statements 2014 (the "**Annual Report 2014**") on 22 May 2014, containing the following statements:

(1) At pages 12 and 13 (amongst others), it stated that UK trading profit was £2.191 billion;

(2) At page 13, it stated that UK trading margin was 5.03%. At page 18, it stated that UK trading margin was 5.0%.

5.5.2. Further or alternatively, the Annual Report 2014 expressly (alternatively, impliedly) represented that Tesco had complied (and/or believed it had complied) with the Code.

5.6. **Trading Statement on 29 August 2014**

On 29 August 2014, Tesco issued a trading update saying "*We now expect trading profit for 2014/15 to be in the range of £2.4bn to £2.5bn. Trading profit for the six months ending 23 August 2014 is expected to be in the region of £1.1bn.*"

5.7. **Application of FSMA**

Each of the documents referred to in this Section 5 (the "**Published Information**") was published by "recognised means" and accordingly constituted "published information" within the meaning of Schedule 10A to FSMA.

6. WRONGFUL ACTS BY TESCO TO INCREASE COMMERCIAL INCOME

6.1. **Introduction**

This Section of these Particulars of Claim addresses the wrongful acts carried out by Tesco in its attempt to increase commercial income, and thereby disguise its falling trading profits and margins in respect of its UK grocery business.

6.2. **Definitions**

6.2.1. Commercial income is frequently sub-divided into "front margin" and "back margin". By paragraph 3(a) of a letter from its solicitors, Freshfields Bruckhaus Deringer ("**Freshfields**"), dated 13 July 2016, sent in response to the Claimants' letter before action dated 26 May 2016, Tesco contended that:

> "*Consistent with standard industry practice, Tesco had agreements with suppliers whereby volume related allowances, promotional and marketing allowances and various other fees and discounts were received in connection with the purchase of goods for resale from these suppliers. Most of the income received from suppliers relates to adjustments to the core price of a product, and as such is considered part of the purchase price of that product. Sometimes receipt of the income is conditional on Tesco performing specified actions or satisfying certain performance conditions associated with the purchase of the product. These include achieving agreed purchases or sales volumes targets and providing promotional or marketing materials and activities or promotional product positioning. Whilst there is no standard definition, all these amounts receivable from suppliers in connection with the purchase of goods for resale are generally termed commercial income. The difference between the sale price to the customer – the till price – and the purchase price from the supplier is referred to at Tesco as the "front margin". Payments received from suppliers (net of expenses) are referred to at Tesco as "back margin". Both front margin and back margin form part of Group Trading Profit in Tesco's published accounts.*"

6.2.2. Tesco is put to proof of the accuracy of the matters asserted in this paragraph, and of Tesco's custom and practice asserted in the final two sentences. Without prejudice to that burden of proof, the Claimants note in particular that Freshfields' definition of "front margin" in the sixth sentence of the extract above assimilates (a) the "normal" mark-up that would always exist between the price at which Tesco might purchase a single unit of a given item from its supplier (i.e. without any volume-related discount, or any promotional, marketing or any other allowance) and Tesco's till price, and (b) the allowances referred to in the first sentence of the extract above, some of which would go to reduce the purchase price paid by Tesco to its supplier. Accordingly, to assist ease of analysis these Particulars of Claim refer to the aggregate of (i) the allowances mentioned in (b) in the preceding sentence, and (ii) back margin (as defined above), as "**supplier allowances**".

6.3. **Tesco's increased reliance on commercial income**

6.3.1. Shortly prior to the Relevant Period, Tesco reported a fall in its incremental annual UK sales, as follows:

(1) incremental annual sales by Tesco Stores (excluding VAT, including fuel sales) in 2010/11 and 2011/12 were around £1.4 billion and £1.8 billion respectively, representing 3.6% and 4.6% year-on-year growth;

(2) but had fallen to £681m by 2012/13 (1.6% growth);

(3) and were negative in 2013/14, with £115m in lower revenues (-0.3% growth).

A similar trend occurred over the same time period in respect of the incremental sales and sales growth reported by Tesco in its consolidated group accounts in relation to the UK.

6.3.2. Moreover, in respect of costs:

(1) For the financial years 2012/13 and 2013/14 the staff and net rental costs reported by Tesco Stores as a percentage of total sales increased, to 11.9% in 2012/13 and 12.2% in 2013/14 (compared to the stable levels of 10.9% in each of 2011/12 and 2010/11, 10.7% in 2009/10 and 10.6% in 2008/09).

(2) For the financial years 2012/13 and 2013/14, the year on year growth of rental costs reported by Tesco Stores was 13.2% and 10.5% respectively (at a time when, as set out in paragraph 6.3.1 incremental sales were falling).

6.3.3. In respect of Tesco's market share, Tesco's annual reports for 2006/07, 2007/08, 2008/09 and 2009/10 reported its market share (as 21%, 21.8%, 22.2% and 22.5% respectively). However, Tesco's annual reports no longer did so from the financial year 2010/11 onwards. It is to be inferred that this was because Tesco's market share was (to its knowledge) falling. Further, the Claimants rely on data reported by Kantar Worldpanel which showed a decline in market share from 2008 through 2012 to 2014.

6.3.4. The decline in Tesco's UK incremental sales and market share (both on its own, and in particular when viewed against the expansion of Tesco's UK retail space) and the annual rate of increase in its UK costs would ordinarily imply falling levels of profitability and margin. In support of that contention the Claimants rely, amongst other things, on the financial reports of <u>Tesco Stores</u> for the years 2012/13 and 2013/14:

Financial Year	**Revenue (exc. VAT) (£m)**	**Operating Profit (£m)**	**Operating Profit Margin**
2011/2012	41,981	2,220	5.29%
2012/2013	42,662	1,746	4.09%
2013/2014	42,547	1,765	4.15%

6.3.5. However, the same decline did not appear in the Tesco (i.e. <u>group</u>) reported revenue, trading profit and trading profit margins:

Financial Year	**Revenue (exc. VAT) (£m)**	**Trading Profit (£m)**	**Trading Profit Margin**
2011/2012	64,539	3,761	5.77%
2012/2013	64,826	3,453	5.28%
2013/2014	63,557	3,315	5.17%

6.3.6. Nor (apparently inconsistently with the financial reporting of Tesco Stores for the UK set out at paragraph 6.3.4 above) did the UK segment of the Tesco (i.e. group) reported revenue, trading profit and trading profit margins show the same decline:

Financial Year	Revenue (exc. VAT) (£m)	Trading Profit (£m)	Trading Profit Margin
2011/2012	42,248	2,480	5.87%
2012/2013 [3]	43,088	2,272	5.27%
2013/2014	43,057	2,191	5.09%

6.3.7. Therefore, contrary to what would have been expected, Tesco's consolidated financial reporting appeared to show that it had effectively maintained a stable level of trading profit margin, and that it was meeting or effectively meeting the group trading margin target of 5.2% on which it had publicly staked a material part of its reputation. The disparity in the figures set out above for the Tesco group and for Tesco Stores in respect of the financial years 2012/13 and 2013/14 has not satisfactorily been explained by Tesco (and the Claimants rely, amongst other things, on the fact that the same conclusion was reached by JPMorgan Cazenove in its research note dated 17 December 2014). The disparity gives rise to an inference that Tesco inappropriately and wrongfully manipulated its group financial reporting in those financial years in order to achieve its group trading margin target of 5.2%. Tesco is required to particularise and prove the reasons for the disparity.

6.3.8. Following (amongst other things) Tesco's admission of wrongdoing on 22 September 2014 and the conclusions of the GCA Report, it has now become clear that, during the Relevant Period, Tesco aggressively and wrongfully attempted to increase the level of commercial income it received from its UK suppliers, in an attempt to achieve its published trading margin targets.

6.3.9. Tesco has stated to the Claimants, by the letter from Freshfields dated 13 July 2016 (paragraph 13), that Tesco's UK commercial income was £1.9 billion in 2012/13 and £2.1 billion in 2013/14. The Claimants estimate that in 2013/14, this figure

[3] Revenue figure is as originally reported; it was subsequently re-stated to £43.091 million.

represented 65% of Tesco's total commercial income, estimated to be approximately £3.2 billion.

6.3.10. Accordingly, in each of the financial years 2012/13 and 2013/14:

(1) Tesco's group commercial income accounted for the vast majority of Tesco group trading profit and, it is to be inferred, trading profit margin;

(2) Tesco's UK commercial income accounted for an even larger proportion of Tesco's UK segment trading profit (around 84% in 2012/13 and 96% in 2013/14) and, it is to be inferred, trading profit margin; and

(3) Tesco's UK commercial income accounted for (more than) the entirety of the operating profit reported by Tesco Stores (around 109% in 2012/13 and 119% in 2013/14) and, it is to be inferred, trading profit margin.

6.3.11. As set out below at paragraphs 6.5 to 6.8 and in Section 7, this level of reported commercial income (on which Tesco was dependent in order to meet its published 5.2% trading margin target) was only achieved by the adoption of wrongful practices in respect of commercial income and Tesco's financial reporting in respect thereof.

6.4. **The relative proportions of "front margin" to "back margin"**

6.4.1. For a typical retailer, back margin would be expected to be relatively small compared to front margin. It is relevant to know whether this is not the case, because that situation is unlikely to be sustainable.

6.4.2. However, during the Relevant Period Tesco was forced to seek increased levels of commercial income (and, in particular, supplier allowances which were not dependent on the volume of product purchased by Tesco) from Tesco's suppliers. In support of their case that during the Relevant Period Tesco's level of commercial income (and, in particular, supplier allowances which were not dependent on the volume of product purchased by Tesco) increased dramatically, the Claimants will rely amongst other things on the following:

(1) The PowerPoint presentation of a Tesco Trade Briefing delivered in May 2015 which gave (at pages 39 to 41) an example of how, against a background of negative like-for-like sales in a given product, back margin had increased in each of 2011, 2012 and 2013 to become several multiples higher than its level in 2010. The presentation also stated Tesco's intention to reduce dramatically the proportion of back margin relative to front margin.

(2) The PowerPoint presentation of a Tesco Trade Briefing delivered in May 2015 which referred at page 8 to Tesco's former "*imbalanced Front to Back margin ratio*".

(3) Tesco's statement in a presentation of its half-year results for 2016/17 on 5 October 2016 that "*over two years, we've moved 91% of that back margin into the front*".

6.4.3. Tesco is required to particularise its absolute and relative levels of back margin from 2010 to the present date.

6.5. **<u>Specific ways in which Tesco wrongfully sought to increase its commercial income</u>**

Pending complete disclosure by Tesco in these proceedings, the Claimants' understanding of the ways in which Tesco attempted to increase the level of supplier allowances it received (and, in particular, the level of supplier allowances which were not dependent on the volume of product purchased by Tesco) is necessarily incomplete. However, some of Tesco's wrongful actions have now become public, and are set out below at paragraphs 6.6 to 6.8.

6.6. **<u>Unwarranted demands for commercial income</u>**

6.6.1. During the Relevant Period, Tesco frequently and regularly demanded additional commercial income from suppliers, regardless of whether Tesco had performed its own commitments under the Joint Business Plan ("**JBP**") it had with its suppliers. This is supported by the findings of the GCA Report at paragraph 24.5.

6.6.2. Further, paragraph 46.1 of the GCA Report said, "*There was evidence on a number of occasions of Tesco asking for "investment" from suppliers in exchange for benefits to be agreed with the supplier or as part of wider negotiations about meeting margin targets at the end of trading periods. The amounts involved in these negotiations varied but were often for significant sums of money, sometimes amounting to millions of pounds.*" The purpose of these demands was to allow Tesco artificially to inflate the amount of commercial income that could be recorded in a given reporting period, particularly supplier allowances which were not dependent on the volume of product purchased by Tesco.

6.7. **<u>Other indications as to the existence and scale of Tesco's demands for commercial income</u>**

In late November 2013, Cantor Fitzgerald reported that Tesco had recently been in contact with hundreds of manufacturers, either demanding additional payments purportedly due to lower commodity prices, or deducting money from supplier trading accounts before they were paid to suppliers. It is to be inferred (in particular, given the admitted findings of the GCA Report) that Cantor Fitzgerald's report was true.

6.8. **<u>Attempting to hold suppliers to aspirational margin targets in JBPs</u>**

Margin targets in JBPs were aspirational and were not legally binding, and Tesco employees received training to that effect so far as Tesco's own obligations to its suppliers were concerned. However, in respect of Tesco's position on its suppliers' obligations, Tesco employees were encouraged to pressurise suppliers and attempt to hold them to the JBP margin targets. The GCA concluded that Tesco adopted this practice at paragraph 24.2 of the GCA Report.

7. <u>WRONGFUL MANIPULATION OF TESCO'S FINANCIAL REPORTING</u>

7.1. <u>Introduction</u>

This Section of the Particulars of Claim sets out further wrongful acts by Tesco in respect of its financial reporting in relation to commercial income. In respect of the particular ways that Tesco carried out this manipulation, at the present time the Claimants are only able to plead and particularise Tesco's publicly admitted wrongful practices, which are set out below at paragraphs 7.2 to 7.5.

7.2. **Duplicate invoicing**

7.2.1. During the Relevant Period, Tesco employed the practice of issuing duplicate invoices to suppliers, generally in respect of promotional activity. The duplicate invoices were often issued together with other incorrect invoices or unilateral deductions. Tesco would sometimes deduct both of the duplicated invoiced amounts from the sums that it subsequently paid to those suppliers. These matters were set out at paragraphs 23.1 and 23.3 of the GCA Report.

7.2.2. It is to be inferred that Tesco's practice of duplicate invoicing was adopted in order to inflate artificially the amount of commercial income it could record in a given period. During the Relevant Period, Tesco's practice was to include in its published financial information amounts of commercial income which had been invoiced but not paid by suppliers, which would have included commercial income invoiced in wrongful duplicate invoices.

7.3. **Unwarranted demands for commercial income designed to inflate artificially Tesco's performance in a given financial reporting period**

Having reviewed evidence in respect of Tesco's unwarranted demands for commercial income in order to satisfy Tesco's own margin targets, the GCA concluded at paragraph 24.5 that "*In particular, requests for payments to meet margin targets appeared to be more prevalent at the end of trading periods. Some suppliers reported that what set Tesco apart from other of the Retailers was the pressure it put on suppliers at the end of a financial quarter, half-year or full-year to close a JBP to the margin projected in that JBP. I have seen internal Tesco documentation which suggests that Tesco purposely over-estimated the margin gap on one supplier's account in order to meet a wider category target, and the supplier was told that this gap needed to be closed*".