Financial Services Authority

FSA®

FINAL NOTICE

To: **Woolworths Group plc**

Of: **Woolworth House**
242/246 Marylebone Road
London
NW1 6JL

Date: **11 June 2008**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (the "FSA") gives you final notice about a requirement to pay a financial penalty:

1. THE PENALTY

1.1 The FSA gave Woolworths Group plc ("Woolworths") a Decision Notice dated 9 May 2008 which notified Woolworths that for the reasons set out below and pursuant to section 91 of the Financial Services and Markets Act 2000 (the "Act"), the FSA had decided to impose on Woolworths a financial penalty of £350,000 in respect of a breach of Disclosure Rule 2.2.1 and Listing Principle 4.

1.2 Woolworths has not referred the matter to the Financial Services and Markets Tribunal.

2. REASONS FOR THE PENALTY

Summary

2.1 The FSA has decided to impose a penalty as a result of the conduct of Woolworths in relation to its delay in disclosing a significant variation to the terms of a major supply contract of one of Woolworths subsidiaries, Entertainment UK Limited ("EUK"), and its impact on Woolworths' profits. In reaching its decision the FSA has had regard to

the written and oral representations made on behalf of Woolworths which are summarised below.

2.2 On 9 August 2004 Woolworths and EUK entered into an agreement (the "Agreement") with Tesco Stores Limited ("Tesco"), a subsidiary of Tesco plc for the wholesale provision of entertainment products. A variation to the Agreement was agreed by way of a Deed of Variation (the "Variation") dated 20 December 2005, but was not announced to the market until the scheduled Christmas trading update was made on 18 January 2006 (the "Announcement").

2.3 The Variation increased the amount of retrospective discount that would be paid by EUK to Tesco by an estimated £8 million for the 12 month period from 1 March 2006. The consequential reduction in profits represented over 10% of Woolworths' anticipated profits for the following financial year (2006/07), which were expected to be approximately £68 million.

2.4 On the basis of the facts and matters described below the FSA is satisfied that:

a) Due to the size of reduction in profit in comparison to Woolworths' anticipated group profits the information about the Variation constituted inside information and as a result a disclosure obligation arose under Disclosure Rule 2.2.1 when the Variation was signed on 20 December 2005. The failure to disclose until 18 January 2006 resulted in a breach of this rule.

b) The failure to disclose led to the creation of a false market in Woolworths' shares from 20 December 2005 to 18 January 2006. As a result there was also a breach of Listing Principle 4.

Relevant Statutory Provisions and Guidance

2.5 Pursuant to Part VI of the Act, the FSA makes the Listing, Prospectus and Disclosure Rules[1] and is responsible for the official listing of securities in the UK. Disclosure rules under Part VI must require an issuer to publish specified inside information (section 96A of the Act). Between 20 December 2005 and 18 January 2006 (the "material time"), these rules set out the requirements for the admission of securities to the Official List and the continuing obligations of companies whose securities are so admitted.

2.6 For these purposes "inside information" is defined in section 118C of the Act (and in the Disclosure Rules) as:

"*(2) … information of a precise nature which –*

(a) is not generally available,

(b) relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments, and

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[1] On 20 January 2007 the Disclosure Rules were supplemented with additional rules and became the Disclosure and Transparency Rules.

(c) *would, if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of related investments. …*

(5) Information is precise if it –

(a) *indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and*

(b) *is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.*

(6) Information would be likely to have a significant effect on price if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions."

2.7 The FSA is authorised under section 91(1) of the Act to exercise its power to impose a financial penalty where it is satisfied that an issuer has contravened any provision of the Part VI rules.

2.8 At the material time the Disclosure Rules ("DR") for listed companies were set out in the FSA's Handbook. DR 2.2.1 stated that: "*An issuer must notify a RIS [Regulatory Information Service] as soon as possible of any inside information which directly concerns the issuer unless DR 2.5.1 applies*."[2]

2.9 At the material time the FSA had, pursuant to section 157 of the Act, published guidance on Disclosure Rule obligations in the Handbook which would have been available to Woolworths. In deciding to take the action set out in this notice, the FSA has had regard to specific guidance on the identification of inside information set out from DR 2.2.3G to DR 2.2.8G.

2.10 Chapter 7 of the Listing Rules sets out the Listing Principles which apply to every listed company with a primary listing of equity securities. The purpose of the Listing Principles is to ensure that listed companies pay due regard to the fundamental role they play in maintaining market confidence and ensuring fair and orderly markets.

2.11 Listing Principle 4 provides that "*a listed company must communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed equity securities*."

2.12 The FSA regards the continuing obligation requirements of the Disclosure Rules and Listing Principles as a fundamental protection for shareholders. These requirements are designed to promote full disclosure to the market of all relevant information on a timely basis to ensure that all users of the market have simultaneous access to the same information. Observance of these continuing obligations is essential to the maintenance of an efficient, fair and orderly market in securities and to maintaining confidence in the financial system.

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[2] DR 2.5.1 is not relevant in this case.

3. FACTS AND MATTERS RELIED UPON IN THE WARNING NOTICE

Background

3.1 Woolworths is a listed issuer of securities on the London Stock Exchange Official List. Woolworths de-merged from Kingfisher plc in 2001 and was listed on the London Stock Exchange on 28 August 2001. At the material time its shares were included in the FTSE 250.

3.2 In the year ended 28 January 2006, Woolworths' principal activity was described as a general merchandise retailer operating through high street stores in small towns and city suburbs, targeted at meeting basic everyday shopping requirements, as well as larger stores located on prime shopping streets in major regional shopping centres. Woolworths had 821 stores (803 stores and 18 out-of-town stores). EUK is a wholly owned subsidiary of Woolworths and was the UK's largest wholesale distributor of home entertainment products (DVDs, CDs, videos, books and games software).

The Agreement with Tesco and the Ways of Working Discussions

3.3 EUK and Woolworths entered into the Agreement with Tesco on 9 August 2004 for the wholesale supply of entertainment products. The Agreement was envisaged to run for an initial period until 1 March 2007 although there was provision for early exit in specific circumstances.

3.4 In the financial year 2005/06 the Agreement generated operating profit of approximately £14 million which represented 45% of EUK's £31 million operating profit. This represented approximately 20% of Woolworths' adjusted operating profit of £73.5 million for that year. At the material time EUK was one of Tesco's five largest suppliers.

3.5 A condition of the Agreement was that the parties would work together in order to obtain supply chain efficiencies, which was a process known as the "Ways of Working". In the event that an agreement could not be reached under the Ways of Working, up until 21 December 2005, Tesco could terminate the contract on 6 months' notice. After that date a 12 month notice period would apply.

3.6 After a series of presentations under the Ways of Working initiative Tesco requested a meeting with EUK on 8 December 2005. During the meeting Tesco explained that, if EUK wished to work through the balance of the contract until 1 March 2007 and avoid being served with six months' notice on 21 December 2005, it required an increase in the retrospective discount paid by EUK to Tesco of £8 million.

3.7 At the same meeting Tesco also informed EUK that they were not their preferred supplier to continue the contract after 1 March 2007 and that, although it was not a final decision, it was unlikely that they would continue with EUK after that date.

3.8 The £8 million increase in the amount of retrospective discount paid to Tesco would reduce Woolworths' anticipated profits, which were expected to be approximately £68 million, by over 10% for the following financial year (2006/07).

3.9 Whilst the increased payment to Tesco would mean that the annual profit from the contract would reduce by nearly 60% it had the key benefit for EUK in that Tesco would then only be able to serve 12 months' notice. This would ensure that the business was retained for the important Christmas trading period in 2006 as well as giving EUK additional time to rebuild the business should Tesco ultimately decide not to renew the Agreement.

3.10 The details of the proposal by Tesco (including the likely impact on Woolworths' anticipated profits) were included in a presentation made to the Woolworths Board at a Group Directors Away Day on 12 and 13 December 2005. While the FSA accepts that the Woolworths Board might conclude that Woolworths did not need to disclose the Tesco proposal then, Woolworths did not consider (as it should have done) whether a disclosure obligation would arise if the Variation was executed.

Signing of the Deed of Variation

3.11 The proposal to increase the amount of retrospective discount paid by EUK to Tesco was accepted and documented in the Variation signed on 20 December 2005. A copy of the Variation was provided to senior company officers of Woolworths before the end of the following day. They did not however consider then (as they should have done) whether a disclosure obligation had now arisen.

3.12 The £8 million loss of profit arising from the Variation was, in the context of Woolworths' financial performance, inside information within the terms of DR 2.2.1 and should have been disclosed to the market immediately. Woolworths did not however do so.

Drafting of the Announcement

3.13 Woolworths were due to issue a scheduled Christmas trading update on 18 January 2006, this was considered by Woolworths to be the appropriate point to update the market in relation to the overall status of the EUK relationship with Tesco.

3.14 The drafting of the Announcement commenced on 10 January 2006 in conjunction with senior management and Woolworths' advisers. The advisers were not explicitly asked to comment on whether the Variation would constitute inside information and require a separate disclosure. At the time of drafting the advisers were not aware that the Variation had been entered into on 20 December 2005. In fact they were under the impression that the negotiations in relation to this matter were still ongoing with a target date for their completion being immediately prior to the scheduled announcement on 18 January 2006. On the basis of this one of the advisers did note that the profit effect of the Variation (i.e. the estimated £8 million) should be included within the Announcement.

The Announcement

3.15 On 18 January 2006 Woolworths issued a scheduled Christmas trading update announcement. Following the Announcement on that day, the share price fell from 36.75p to 32.25p, a fall of 12.24%. It is the view of the FSA that information documented in the Variation was a significant contributor to the fall in share price.

3.16 Amongst other information, the Announcement detailed that EUK had agreed new trading terms with Tesco and that this, together with other factors, would lead to reduced profits for EUK in the following financial year of approximately £10 million (of which £8m constituted the loss of profit from the Variation). The Announcement also noted that it was currently uncertain whether the contract would be renewed after 28 February 2007.

4. SUMMARY OF WOOLWORTHS' REPRESENTATIONS

4.1 Woolworths made written representations in a document dated 20 March 2008 and made oral representations on 29 April 2008. This section summarises the key representations made by Woolworths.

4.2 In Woolworths' view there has been no breach of Listing Principle 4 or DR 2.2.1. The central question is whether the (estimated) £8 million cost to EUK of the Variation constituted "inside information". Woolworths' position has always been (and remains) that it did not. The question turns on whether the information "*would, if generally available, be likely to have a significant effect*" on the price of the Woolworths' shares. Woolworths accept that the other criteria for determining whether the Variation was "inside information" are met.

4.3 Woolworths accept that the question has to be asked by the issuer (and its advisers) at the time and without the benefit of hindsight – for the purpose of reaching a decision whether to make an announcement. Woolworths argue that section 118C is to be viewed as a set of factors to take into account at that time, and is not the exclusive test to apply in identifying whether there has been a breach of the rules. Woolworths submit that the need to consider and analyse what caused the share price movement should be central to the determination of whether a piece of information is "inside information" for that latter purpose. That determination will, by the nature of things, take place after the event. Woolworths also suggest that this was in fact the approach adopted by the FSA through its investigation process.

4.4 Directors do not have the luxury of conducting such an *ex post facto* analysis. A company and its advisors have to make what are often fine judgments at the time in the midst of commercial pressures. In those circumstances, Woolworths contend that the facts should point very clearly to the information in question being "inside information" and having had a significant effect on the issuer's share price, before a finding of market abuse is made.

4.5 There is no set percentage or other figure which determines whether or not there is a "significant effect" on the share price and it will vary from issuer to issuer. Whether the price movement in Woolworths' shares of 12.24% amounts to a "*significant effect on the price*" should be considered against the backdrop of (a) the various factors in the Announcement which could have had an adverse impact on the price of Woolworths' shares and (b) the fact that Woolworths' share price fall is much lower than in other cases where action has been taken against issuers.

4.6 Woolworths do not consider that the FSA has taken proper account of the implications of the other factors in the Announcement. In particular, the uncertainty surrounding the renewal of the Tesco/EUK Supply Contract is given wholly insufficient weight. Woolworths' view is that the risk of the total loss of the Supply Contract was more significant than the Variation payment of £8m. The time available to rebuild the EUK

business to mitigate such a loss also applies to the time available to mitigate the impact of the Variation. The reaction of the analysts at the time and the views expressed by Woolworths and its advisors do not support the FSA's case.

4.7 Woolworths does not accept that there was no hint that there were any problems with the Tesco contract or that Tesco were going to change the terms. Information was known to the market at the time. Woolworths explained the "Ways of Working" process (WOW) and the fact that it was a condition of the Supply Contract continuing for the initial period (i.e. until March 2007) when it announced the signing of the Supply Contract on 9 August 2004. It was explained in similar terms in Woolworths' interim results presentation to analysts in September 2005. Woolworths continued to keep the market apprised of the WOW process and the challenges inherent in the Tesco relationship.

4.8 Woolworths does not dispute that, until the Announcement, the information regarding the (approximate) £8 million payment to Tesco pursuant to the Variation was not known within the market. However, this was simply because it formed part of a confidential process appropriate for a commercial negotiation.

4.9 Woolworths consider that the FSA places undue weight on the level of the £8m payment agreed by the Variation. Against the backdrop of a Group with a turnover in 2005/06 of £2.6 billion, there were plenty of ways in which Woolworths could look to mitigate the loss of that sum. The success of EUK in the succeeding years shows that, as Woolworths' management expressed at the time, being free of the Tesco contract opened up new opportunities for the company to develop elsewhere.

4.10 Woolworths does not accept that EUK was perceived by the market to be the "major" and/or "fastest" "growth area" for Woolworths prior to the Announcement. In Woolworths' view, its non-retail operations (which included 2Entertain as well as EUK) were not fully understood by the market at this stage. Rather, the focus of the market and the analysts' attention was on the turnaround of the main-chain retail business (i.e. Woolworths).

4.11 Indeed, all of the analyst reports in evidence in this case refer also to the uncertainty regarding renewal of the Supply Contract. In particular, analyst reports also refer to the uncertainty around renewal of the Tesco/EUK contract and (where they give profit expectations for the 2007/8 year) downgrade such expectations accordingly. Further one report only refers to the likelihood of the Tesco/EUK contract not being renewed and not to the Variation.

4.12 Woolworths contends that a proper and careful analysis of the factors which were at play (giving appropriate weight to the non-renewal of the Tesco/EUK contract and recognising some impact attributable to both the £11m International Financial Reporting Standards accounting adjustment and the 2005/06 Profit Before Tax downgrade), points, on a conservative approach, to a share price fall attributable to the Variation of less than 5%. It is not uncommon for a share price movement of this size to happen during the course of a normal trading day.

4.13 The FSA's expert's view is that a significant share price movement is one of 10%. To be precise about the percentage figure relating to the Variation is impossible, as the exercise is, inevitably speculative to some extent. However, not to engage in such an analysis at all amounts to turning a blind eye to the obvious.

4.14 A finding that a single figure share price fall satisfies the test of having a "significant effect on the price" of qualifying investments sets a dangerous precedent. In Woolworths' submission, the FSA as the UK financial markets regulator should be slow to set the bar in a case of this nature at such a low level. The approach taken in other cases where action has followed significant share price movements, in the range of 36% to 67%, is the correct one. To do otherwise in this case, would not be the well-judged consistency of action expected of a leading financial markets regulator.

4.15 Woolworths does not consider that the proposed sanction is justified. It contends that the FSA has not made out the case of a failure to disclose inside information. Further, Woolworths considers that a financial penalty at the level proposed in the Warning Notice is an inappropriate and disproportionate response. If there was a breach it was not deliberate and Woolworths has no previous disciplinary record. It has in each of 2004/05 and 2006/07 made RNS announcements around its Christmas trading period in compliance with its disclosure obligations. It has also co-operated fully with the investigation, at considerable cost, through an extended period of over two years. It has also accepted (in the course of its oral representations) that it may have overlooked the need to consider the signing of the Variation in isolation.

5. CONCLUSIONS

5.1 The key question is for the FSA to decide whether it is satisfied that, as at 20 December 2005, the signing of the Variation and its financial consequences amounted to "inside information". Woolworths accept that this is the crux of the matter.

5.2 The FSA is satisfied that the Act specifies a single definition of "inside information", and this is the one set out above. Section 118C is set out in the Act as a key part of that definition – it is not included merely as a set of factors to take into account. The FSA is also satisfied that "likely to have a significant effect on price" must be assessed against the test in section 118C(6) only. An analysis of actual price movements and the matters contributing to it can be relevant to the question of penalty, and is inevitably likely to be the starting point for an investigation. However, it is the wrong approach to seek to analyse the amount of an actual fall that might be attributed to a particular piece of information in order to determine whether it was "inside information". Indeed it is an unworkable test if the relevant piece of information was not in fact disclosed. This is entirely consistent with the guidance in the Disclosure Rules to the effect that there is no set percentage or other figure to determine whether there is a "significant effect on price".

5.3 It follows that the FSA does not accept Woolworths' suggestion that a share price fall of 10% or more attributable to the particular piece of information is needed for there to have been a "significant effect on price" from that piece of information. The materials available to the FSA, including the views of an appropriate market professional, do not support Woolworths' suggestion. The FSA is satisfied that the Variation resulted in a profit reduction of more than 10% and that this is, on any view, information of a type that a reasonable investor would be likely to use as part of his investment decisions.

5.4 The FSA is therefore satisfied that no later than 20 December 2005 (the date on which the Variation was executed, and therefore became a legally binding commitment) the £8m reduction in profit resulting from the Variation was inside information as defined under section 118C of the Act – that is precise information, not generally available,

relating directly to Woolworths, and information (if generally available) likely to have a significant effect on the price of Woolworths' shares. This information is of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions.

5.5 A disclosure obligation therefore arose under DR 2.2.1 on 20 December 2005. Failure to disclose this information was a breach of this rule, continuing until 18 January 2006 when it was announced. In addition, the failure to disclose this information led to the creation of a false market in Woolworths' shares from 20 December 2005 to 18 January 2006. As a result there was also a breach of Listing Principle 4.

6. SANCTION

6.1 The FSA's policy on the imposition of financial penalties and public censures is set out in Decision Procedure & Penalties and Enforcement Guide at DEPP 6. As this matter relates to events prior to the introduction of DEPP (28 August 2007), the FSA has also had regard to the relevant policies set out in the Enforcement Manual (which preceded DEPP) at ENF 21.7. The principal purpose of financial penalties is to promote high standards of market conduct by deterring those who have committed breaches from committing further breaches, helping to deter others from committing similar breaches and demonstrating generally the benefits of compliant behaviour.

6.2 The FSA considers that the seriousness of Woolworths' breach of DR 2.2.1 and Listing Principle 4 merits a financial penalty. The factors which have been taken into account in determining the financial penalty to be imposed on Woolworths include:

(a) at the material time Woolworths' shares formed part of the FTSE 250 and contravention of DR 2.2.1 and Listing Principle 4 impacted on the orderliness of the capital markets and public confidence in those markets;

(b) the delay in announcing the Variation was extensive, i.e. from 20 December 2005 to 18 January 2006, a period of 29 days, during which time there was a false market in Woolworths' shares;

(c) Woolworths failed adequately to take professional advice in relation to its disclosure obligations;

(d) Woolworths' internal processes failed to identify in a timely fashion the need to consider itself whether the effect of the Variation was inside information, even though its Board was made aware of the potential impact shortly before the Variation was executed, and senior company officers received a copy of it on the day it was signed; Woolworths have acknowledged that this was so;

(e) the breach was not deliberate;

(f) Woolworths has co-operated with the FSA's investigation; and

(g) no previous disciplinary action has been taken against Woolworths.

6.3 In determining the financial penalty the FSA has considered the need to deter Woolworths and others from engaging in this type of activity. The FSA has also had

regard to penalties in other similar cases. The FSA considers that a financial penalty of £350,000 is appropriate.

7. DECISION MAKER

7.1 The decision which gave rise to the obligation to give this Final Notice was made by the Regulatory Decisions Committee.

8. IMPORTANT

8.1 This Final Notice is given to Woolworths in accordance with section 390 of the Act.

Manner of and time for Payment

8.2 The financial penalty must be paid in full by Woolworths to the FSA by no later than 25 June 2008, 14 days from the date of the Final Notice.

If the financial penalty is not paid

8.3 If all or any of the financial penalty is outstanding on 26 June 2008, the FSA may recover the outstanding amount as a debt owed by Woolworths and due to the FSA.

Publicity

8.4 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

8.5 The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

8.6 For more information concerning this matter generally, you should contact Helena Varney on 020 7066 1294 or Jeremy Parkinson on 0207 066 0224 of the Enforcement Division of the FSA.

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Tracey McDermott
Head of Department
FSA Enforcement Division