
Decision of the Office of Communications

Article 102 Treaty on the Functioning of the European Union and Section 18 of the Competition Act 1998

CW/01122/01/14

Discriminatory pricing in relation to the supply of bulk
mail delivery services in the UK

Non-confidential version

Redactions are indicated by [X]

Infringement decision

Issue date: 14 August 2018

Publication date: 26 October 2018

Contents

Section

1. Executive summary	1
2. Background	8
3. Royal Mail's Access arrangements and the Contract Change Notices of January 2014	23
4. Chronology of events	52
5. Legal framework	118
6. Market definition and dominance	150
7. Abuse of a dominant position: legal and economic analysis	176
8. Objective justification and Article 106(2) TFEU	267
9. Decision	278
10. Financial penalty	279

Annex

A1. Glossary and defined terms	318
A2. Arbitrage between price plans	321
A3. Ofcom's procedure	325

1. Executive summary

Introduction

- 1.1 This Decision of the Office of Communication's ("Ofcom") is addressed to Royal Mail plc ("Royal Mail").
- 1.2 In this Decision, Ofcom concludes that Royal Mail has infringed the prohibition imposed by section 18 (the "Chapter II prohibition") of the Competition Act 1998 (the "Act") and Article 102 of the Treaty on the Functioning of the European Union ("TFEU").
- 1.3 This Decision sets out Ofcom's finding that Royal Mail abused its dominant position in the market for bulk mail delivery services in the United Kingdom by issuing Contract Change Notices ("CCNs")¹ on 10 January 2014 which introduced discriminatory prices. We have concluded that this infringement lasted until at least 21 February 2014, being the date on which Ofcom opened an investigation meaning that the CCNs were suspended.
- 1.4 In accordance with the Competition Act 1998 (Competition and Markets Authority's Rules) Order 2014 (SI 2014/458) (the "CMA's Rules"), this Decision states the facts upon which we rely and our reasons for making this infringement decision.² The following part of this Section 1 is a summary of Ofcom's findings. Ofcom's full Decision is set out in Sections 2 to 10 and the Annexes to this document.

Executive summary

This Decision concerns a segment of the letters market known as 'bulk mail'

- 1.5 Royal Mail is the former state-owned statutory monopoly provider of postal services in the UK. In 2014, Royal Mail delivered approximately 13 billion letters and large letters. Of these, the vast majority (approximately 10 billion items) fell into a category known as 'bulk mail', which is the type of mail typically sent by large companies (such as utility companies and banks), government departments and advertisers. It includes such letters as bank statements and invoices, utility bills, council tax statements, as well as advertising mail and some magazine subscriptions. In the financial year 2013/14, bulk mail accounted for [X] of the broader letters market by revenue (approximately £[X]).
- 1.6 Many of the organisations that produce bulk mail fulfil their demand for the posting of large volumes of letters using companies known as 'access operators'. Access operators are postal operators who collect and sort bulk mailings on behalf of their customers before handing these letters over to Royal Mail for final delivery. Access operators make use of Royal Mail's wholesale bulk mail delivery services, known as 'access services'.

¹ The Contract Change Notices are explained in detail in section 3.

² CMA's Rules, rule 10(1).

- 1.7 There are a number of access operators active in the UK, of which the largest is Whistl UK Limited (“Whistl”). In 2014 Whistl handled nearly 4 billion letters, close to a third of all the letters then delivered by Royal Mail in the UK.

The relevant market as defined is the bulk mail delivery market

- 1.8 Ofcom has defined the relevant market as the market for bulk mail delivery in the United Kingdom, which consists of the activities of the inward sortation of bulk letters and large letters at Inward Mail Centres and onward delivery to the final recipient, with delivery on the second day after collection (D+2) or later. We refer to this market as the “bulk mail delivery market”.
- 1.9 Ofcom has determined that it is not necessary to formally define the associated retail market for bulk mail services. However, as the terms on which bulk mail delivery is provided (which, in turn, reflect competitive pressures on that product/service) affect the retail market for bulk mail services, we have considered the relationship between the bulk mail delivery market and the retail market where appropriate in this Decision. We refer to this associated market as “the retail market for bulk mail services”.
- 1.10 Our findings in relation to market definition are set out in Section 6, sub-section A.

Royal Mail was and remains dominant in the bulk mail delivery market

- 1.11 Ofcom has found that Royal Mail held a dominant position in the market for bulk mail delivery in the UK. At all relevant times Royal Mail had a very high market share in excess of 98% and its market power was sustained by high barriers to entry and weak competitive constraints.
- 1.12 Our findings in relation to dominance are set out in Section 6, sub-section B.

Whistl had started to compete with Royal Mail by undertaking its own ‘end-to-end’ deliveries of bulk mail

- 1.13 In 2012, Whistl started to expand its access business to undertake its own so called ‘end-to-end’ bulk mail delivery activities in certain parts of the UK in competition with Royal Mail. Whistl had announced long term plans to grow its delivery operation so that it would cover around 40% of all UK addresses by 2017. Whistl had also announced, in late 2013, that it had secured external investment from the private equity firm, LDC (Managers) Ltd (“LDC”), a wholly owned subsidiary of Lloyds Banking Group.
- 1.14 Whistl was the first ever delivery competitor to pose a serious challenge to Royal Mail’s effective monopoly in the delivery of letters. Under its plans, a growing proportion of Whistl’s mail - primarily in London and other major cities - would be delivered by its own postal workers. That mail would bypass Royal Mail’s delivery network completely. The remainder of its mail would continue to be delivered using Royal Mail’s ‘access services’. Whistl therefore remained economically dependent on Royal Mail to deliver the majority of its letters and to offer a nationwide bulk mail service to its retail customers.

Royal Mail responded to Whistl's entry by introducing changes to the prices of its access services

- 1.15 Royal Mail provides access services to customers like Whistl under a framework agreement known as the 'Access Letters Contract'. Under the Access Letters Contract, Royal Mail provided access services under several price plans. There were two national price plans, 'NPP1' and 'APP2', and a third 'zonal' price plan, 'ZPP3'.
- 1.16 Historically, prices on all three plans had been set by Royal Mail at an equivalent rate for the provision of the same delivery services.
- 1.17 However, on 10 January 2014, Royal Mail exercised a contractual power under the Access Letters Contract to change unilaterally (i.e. without the consent of access operators) the terms and conditions of access. As part of a package of changes, Royal Mail issued the CCNs which introduced for the first time a difference in pricing between the price plans. Specifically, Royal Mail's prices on 'APP2' and 'ZPP3' were to be increased by approximately 1.2%, or 0.25p per item relative to the prices available on 'NPP1'. Due to the applicable contractual rules and restrictions, NPP1 would in practice be unavailable to an entrant that rolled out delivery services of its own in competition with Royal Mail on any material scale (see Section 7C below). In the remainder of this Decision, we refer to the difference in price introduced by the CCNs between APP2/ZPP3 and NPP1 as the "price differential".
- 1.18 Section 3 describes in detail Royal Mail's access arrangements, the relevant price plans and the changes introduced by the CCNs. Section 4 outlines the relevant chronology of events leading up to and following the issue of the CCNs.

Whistl complained about the price changes and Ofcom took action using its competition law and regulatory powers

- 1.19 On 28 January 2014, Whistl submitted a complaint to Ofcom alleging that the package of price changes introduced by Royal Mail, including the price differential, was unlawful. Whistl complained among other matters that the price differential was discriminatory against it. It claimed that it would not be able to use NPP1 by reason of its end-to-end delivery operations, and that it would therefore have to pay higher prices than rival access operators for the same services. Whistl considered that the effect would be to inhibit its ability to compete with Royal Mail using its own delivery network. In order to use the lower-priced NPP1, Whistl told Ofcom that it would need to cease its own delivery operations.
- 1.20 In consequence, Whistl alleged that the introduction of the price differential: (a) involved a breach of certain regulatory conditions imposed on Royal Mail by Ofcom; and (b) amounted to an abuse of a dominant position by Royal Mail under competition law.
- 1.21 Having reviewed this submission, Ofcom considered that there were reasonable grounds to suspect that Royal Mail had infringed competition law and, accordingly, decided to open an investigation on that basis. At the same time, Ofcom launched a policy review using its powers under the Postal Services Act 2011 to examine Royal Mail's pricing on a forward-looking basis. As a consequence of Ofcom opening its investigation, Royal Mail suspended

the implementation of the price differential (as well as some of the other changes introduced by the CCNs).

Royal Mail's conduct amounted to an abuse of its dominant position

- 1.22 The Chapter II prohibition and Article 102 TFEU prohibit the abuse of a dominant position within the UK or the EU's internal market, respectively.
- 1.23 In investigating the allegations made by Whistl, Ofcom has considered whether the introduction of the price differential in January 2014 amounted to an abuse of Royal Mail's dominant position in the bulk mail delivery market. In accordance with the relevant case law, which is set out in Section 5, we have undertaken an in-the-round assessment of all the circumstances of the case to determine whether, at the time the price differential was introduced, Royal Mail's conduct was reasonably likely to give rise to a competitive disadvantage / restriction of competition. The conclusions that we have reached in light of that assessment are set out in Section 7.
- 1.24 By way of summary only:
- a) Having assessed the conditions of competition on the bulk mail delivery market as at early January 2014, we have found, in particular, that competition in the bulk mail delivery market was already very limited. Royal Mail was overwhelmingly dominant, enjoying unique structural advantages in a market for which there were high barriers to entry. Royal Mail was also an unavoidable trading partner for access operators, including those rolling out their own delivery network. The bulk mail delivery market was therefore vulnerable to exclusionary conduct on the part of Royal Mail.
 - b) We have found that the price differential amounted to discrimination against access operators that sought to compete with Royal Mail in the bulk mail delivery market. Due to the rules and restrictions Royal Mail applied to the different price plans, an access operator that sought to enter the bulk mail delivery market beyond a limited scale would have to move to, or remain on, APP2/ZPP3, and therefore pay the higher prices applicable under those price plans.
 - c) We have concluded that Royal Mail did not have a legitimate justification for discriminating in this way against its access customers which chose to compete with it in bulk mail delivery. Specifically, we have found that the difference in treatment applied by Royal Mail cannot, as Royal Mail has submitted, be explained or justified on the basis of: (i) differences between APP2/ZPP3 customers by comparison with NPP1 customers based on their geographic profile, total volumes or variability of volumes in a geographic area; or (ii) costs savings that are alleged to result from Royal Mail's introduction of a requirement for NPP1 customers alone to provide more detailed volume forecasts.
 - d) As part of our investigation, we obtained, using our statutory information gathering powers, Royal Mail's contemporaneous internal documents which were generated during its governance process leading to the CCNs. Having reviewed those documents in detail, we have concluded that Royal Mail's conduct reflected a deliberate strategy

to limit delivery competition from its first and only significant competitor, Whistl. The documents show that Royal Mail identified this nascent competition as a threat to its position. It then developed and introduced the price differential, alongside other measures in the CCNs, as a direct response to the threat of competition from Whistl. Section 4 sets out the documents as part of a chronology of events leading up to and following the issue of the CCNs.

- e) Based on our analysis of profitability, prices and costs, the price differential would have had a material impact on the profitability of an end-to-end entrant, both in absolute terms and also relative to its profits. The material effect of the price differential was particularly evident in the case of Whistl, which was the target of Royal Mail's pricing strategy and for whom the price differential was calibrated to deter further expansion of its end-to-end activities.
- f) In the context of the prevailing features and conditions of the bulk mail delivery market and the associated retail market for bulk mail markets at the time, such a material impact on profitability was likely to make entry or expansion in bulk mail delivery significantly more difficult. The introduction of the price differential increased the already high barriers to entry and expansion in the bulk mail delivery market, thereby reducing the incentives on an access operator to risk entry.
- g) By introducing the price differential in the CCNs, Royal Mail used its position as an unavoidable trading partner for access operators effectively to penalise those of its access customers who also sought to compete with it by undertaking end-to-end delivery activities. As a result, we conclude that the introduction of the price differential was reasonably likely to have a foreclosing effect because it made entry less likely to occur. This, in turn, would preserve and potentially enhance Royal Mail's dominant position in the bulk mail delivery market. Therefore, the introduction of the price differential was reasonably likely to give rise to a competitive disadvantage / lead to a restriction of competition from the point at which the CCNs were issued.
- h) To the extent that it is relevant that the price differential was suspended (on 21 February 2014) as a result of Ofcom opening this investigation, we have found that the suspension did not prevent the price differential from having continuing effects in the bulk mail delivery market. On the particular facts of this case, we have found that the introduction of the price differential was reasonably likely to distort competition from the point at which the CCNs were issued by Royal Mail.
- i) Our analysis of the restrictive effect of the price differential is supported by evidence of the immediate developments observed in the market following the introduction of the price differential in January 2014. We have concluded that the evidence shows that the introduction of the price differential materially contributed to: (i) LDC's decision not to complete its investment in Whistl in January 2014, and (ii) Whistl's decision to reduce and then suspend its roll out plans. This evidence also supports our conclusions on the continuing effects of the introduction of the price differential despite its suspension.

- j) We have not found it necessary in this case to determine whether the price differential was a material factor or not in Whistl's ultimate exit from the bulk mail delivery market in mid-2015.

Royal Mail's conduct was not objectively justified or otherwise necessary to secure its provision of the universal service

1.25 In Section 8, we examine Royal Mail's submission that the price differential did not amount to an unlawful abuse of dominant position because it was objectively justified and/or otherwise necessary to secure the provision of the universal service. The core argument made by Royal Mail in this regard is that roll-out in the bulk mail delivery market, in particular by Whistl, posed a threat to the financial sustainability of the universal postal service, which justified Royal Mail's actions. This core argument is advanced in two ways:

- a) first, the changes introduced through the CCNs, including the price differential, were objectively justified as a matter of Section 18 of the Act and Article 102 TFEU; and
- b) second, the CCNs would have been both objectively justified and necessary to secure economically acceptable conditions for the provision of the universal postal service (a service of general economic interest), and Royal Mail's conduct is therefore exempt from the application of competition law pursuant to Article 106(2) TFEU and paragraph 4 of Schedule 3 of the Act.

1.26 We have concluded that:

- a) It was not objectively necessary or proportionate for Royal Mail to engage in discriminatory conduct to address a perceived threat to the universal service. Securing the provision of the universal service was properly the role of Ofcom under the regulatory framework for postal services. In exercise of its regulatory powers, Ofcom assessed on a number of occasions (in 2012, 2013 and 2014) the impact of Whistl's proposed end-to-end delivery activities on the universal service and its repeated findings that there was no immediate threat to the universal service were not challenged by Royal Mail. Moreover, the objective of marginalising a competitor to preserve Royal Mail's market share and revenues in bulk mail delivery, even if those market share and revenues support the universal service, is not a legitimate objective that may be relied on to justify conduct that would otherwise amount to an abuse of a dominant position.
- b) Royal Mail has provided no evidence to substantiate an efficiencies defence, other than an assertion that it would otherwise have been required to raise its prices. In any event, we do not consider that an efficiencies defence would be applicable in this case given that Royal Mail's argument regarding the threat to the universal service is concerned with preserving its own market share and revenues and not about the creation of new efficiencies that would lead to consumer benefits.
- c) The exemption from competition law for 'services of general economic interest' is not applicable in this case. By issuing the CCNs, Royal Mail was not pursuing an objective of general interest. Moreover, it cannot be said that Article 102 was obstructing Royal

Mail's performance of the universal service given that the EU and UK legislative/regulatory rules for the postal sector established a regime in which the universal service would be protected, where necessary, in a manner consistent with the introduction of competition in the postal sector.

Decision to impose a financial penalty

1.27 Section 36 of the Act provides that Ofcom may impose a financial penalty on an undertaking which has intentionally or negligently committed an infringement of the Chapter II prohibition or Article 102. Ofcom has found that Royal Mail committed the infringement at least negligently and has decided to impose a financial penalty of £50 million. The level of the penalty reflects the seriousness of this infringement, the need to ensure Royal Mail, and other undertakings, are deterred from engaging in this kind of abusive conduct, and the need for a penalty to be proportionate. Section 10 sets out the detail of our Decision in relation to financial penalty.

Structure of the document

1.28 The remainder of this document is organised as follows:

- a) **Section 2** sets out the background and factual context to this decision;
- b) **Section 3** sets out a factual description of the relevant contractual arrangements for access;
- c) **Section 4** sets out the chronology of events associated with (i) Whistl's development as an end-to-end competitor (ii) Royal Mail's development of the CCNs and (iii) Whistl's (and its investors') response to the CCNs;
- d) **Section 5** sets out the legal framework that we have applied in this Decision;
- e) **Section 6** sets out Ofcom findings on market definition and dominance;
- f) **Section 7** sets out Ofcom's finding on the abuse;
- g) **Section 8** sets out Ofcom's findings that Royal Mail's conduct was not objectively justified and does not benefit from the exemption in Article 106(2) TFEU;
- h) **Section 9** sets out Ofcom's overall decision on the infringement; and
- i) **Section 10** set out Ofcom's decision to impose a financial penalty.

1.29 In addition, further information is included within the following annexes, which form an integral part of this Decision:

- a) **Annex 1:** Glossary and defined terms;
- b) **Annex 2:** Arbitrage between price plans; and
- c) **Annex 3:** Investigation procedure.

2. Background

Introduction

- 2.1 This section contains:
- a) a description of the relevant undertakings referred to in this Decision; and
 - b) an overview of the postal services sector in the UK, including relevant regulation.

The relevant undertakings

Royal Mail

- 2.2 Royal Mail plc is a public limited company (company number 08680755) listed on the London Stock Exchange. It is the holding company for an integrated postal services company operating in the UK and elsewhere. In the financial year to 2014, the financial year to which the conduct in this Decision relates, it had group revenues of £9,456 million.³
- 2.3 Royal Mail's operations are separated into two networks:
- a) UK Parcels, International & Letters operates Royal Mail's core postal services network in the UK, as well as its Parcelforce network. It had around 148,000 employees⁴ and reported revenue of £7,787 million⁵ in the financial year 2013-14. In the financial year to 2014 Royal Mail's core network delivered 13,342 million addressed letters, 3,143 million unaddressed letters and 1,068 million parcels.⁶
 - b) General Logistics Systems ("GLS") operates a postal services network throughout Europe. GLS had around 14,000 employees⁷ and reported revenue of £1,651 million⁸ in the financial year 2013-14.
- 2.4 Royal Mail was, and is, engaged in an economic activity and is, accordingly, an undertaking for the purposes of section 18 of the Act and Article 102 TFEU.
- 2.5 Ofcom has designated Royal Mail as the universal service provider and has imposed upon it regulatory conditions requiring it to provide a universal service (see further below at paragraphs 2.41 to 2.43).⁹

³ Royal Mail, *Annual Report and Financial Statements 2013-14*, 6 June 2014, page 2. (PD0040) In the most recent financial year to 2018, it had group revenues of £10,172 million (see Royal Mail, *Annual Report and Financial Statements 2017-18*, 15 June 2018, page 4.) (PD0071)

⁴ Royal Mail, *Annual Report and Financial Statements 2013-14*, 6 June 2014, page 3. (PD0040)

⁵ *Ibid.*, page 4. (PD0040)

⁶ *Ibid.*, page 20. (PD0040)

⁷ *Ibid.*, page 3. (PD0040)

⁸ *Ibid.*, page 4. (PD0040)

⁹ Ofcom, *Postal Regulation: Transition to the new regulatory framework*, 29 September 2011, Annex 1. (PD0020) This designates Royal Mail Group Limited (a wholly owned subsidiary of Royal Mail plc) as the Designated Universal Service Provider. Ofcom imposed a Designated USP condition on Royal Mail Group Limited on 27 March 2012, which has been modified on a number of occasions since.

Whistl

- 2.6 Whistl UK Limited (Whistl) is a limited liability company (company number 04417047), which until 15 September 2014 was called TNT Post UK Limited. Whistl is a postal services company that distributes addressed mail in various forms throughout the UK.
- 2.7 In 2013, Whistl was (and today remains) the largest access operator in the UK involved in the distribution of around 3.8 billion¹⁰ addressed letters in the UK, which is around a quarter of all inland addressed mail volumes.

PostNL

- 2.8 PostNL N.V. is a postal services company operating in the Netherlands and other parts of Europe. In the period referred to in this Decision, and until July 2015, Whistl was a wholly owned subsidiary of PostNL. In July 2015, Whistl's management agreed a management buyout with PostNL. PostNL retained a 17.5% shareholding of Whistl.¹¹

LDC

- 2.9 LDC (Managers) Limited (LDC) is a private equity investment company (company number 02495714) and a wholly owned subsidiary of Lloyds Banking Group. In December 2013, LDC agreed to a joint venture with PostNL and Whistl, as part of which it would provide investment to support Whistl's expansion in the letters delivery market. In April 2015, PostNL announced that LDC would not be completing this investment and that negotiations had ended.

The markets and products referred to in this Decision

The bulk mail letters market

- 2.10 The postal services sector in the UK is made up of a number of segments including addressed letters, unaddressed mail and parcels. This Decision is concerned with the first of these segments: addressed letters. These can be distinguished from other sectors by two key characteristics:
- a) As 'addressed' mail, these letters are directed towards specific individuals, business and households, whereas unaddressed mail is usually marketing mail directed to a certain area (for example, marketing material delivered to every household in an area local to a supermarket); and
 - b) As letters or large letters, there are weight, size and volumes constraints that apply to individual items (unlike parcel services which can serve larger or heavier items). There is a technical difference between a letter and a large letter (which is explained below in

¹⁰ Whistl, *Witness Statement of Nicholas Mark Wells*, 28 January 2014, page 5, paragraph 11. (WH0132)

¹¹ PostNL, *PostNL reaches agreement on management buy out of Whistl*, 30 July 2015. (PD0062)

paragraphs 3.32). However, throughout this document, where we refer to ‘letters’, this should be understood to include large letters unless otherwise stated.

2.11 In 2013-14 the total UK market for addressed letters was worth £4.3 billion with total volumes of 12.8 billion items. This can in turn be broken down into two further categories: ‘single-piece mail’ and ‘bulk mail’. Single-piece mail relates to ‘one-off’ letters sent by individuals or businesses, whereas bulk mail relates to large mailings of identical or similar letters and which, due to their volume, are generally discounted compared to single-piece letters. This Decision concerns bulk mail, which is described in more detail directly below.

Bulk mail

2.12 Bulk mail does not have a precise definition, but the term is used to refer to high volume mailings of often similar or identical mailing items being sent to addresses across the whole of UK or at least a substantial part of it.

2.13 This includes:

- a) business or transactional mail, such as statements and invoices, produced by financial services companies (most notably high street banks¹²), central and local government bodies,¹³ utility companies¹⁴ and other large retail companies (including supermarkets);
- b) advertising mail, including mail produced by direct mail companies; and
- c) fulfilment mail which involves the delivery of small items which can fit within letters and large letters, such as magazine subscriptions produced by publishers.

2.14 In 2013-14, bulk mail made up the majority of the letters market by volumes (approximately 10 billion items)¹⁵ and [§<] the letters market by revenue (approximately £[§<]).¹⁶

2.15 A feature of demand in the retail bulk mail market is that mail producers send letters to a wide area of the UK and in most cases to every part of the UK. For example, large high street banks have customers with whom they need to communicate by post in virtually every postcode in the UK. This applies similarly to other large-scale businesses.

¹² Including Barclays, HSBC and Lloyds.

¹³ Including HMRC, DVLA and DWP.

¹⁴ Including gas and electricity providers, communications providers and water and sewerage companies.

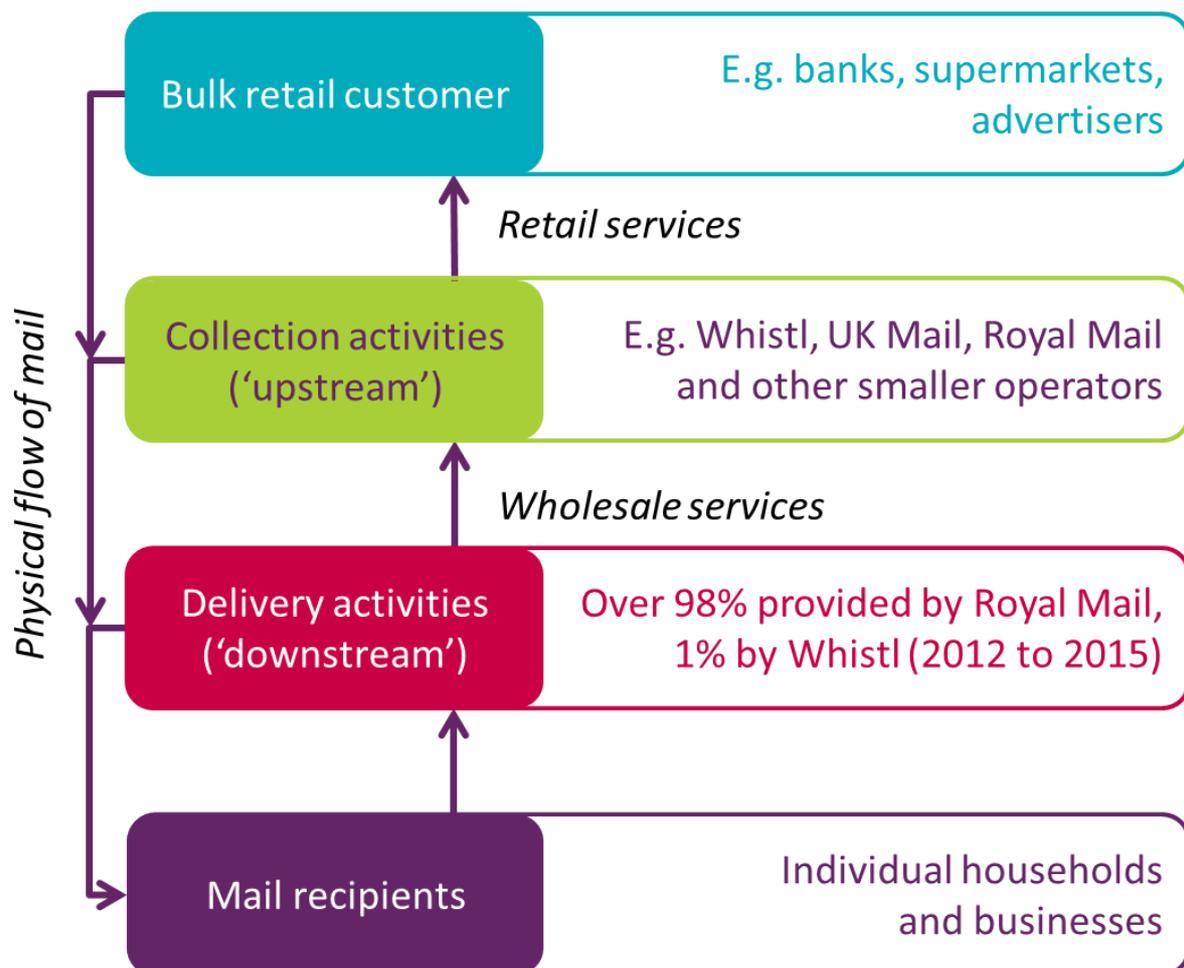
¹⁵ Royal Mail, *response to 5th section 26 Notice*, 31 October 2014, answers to questions 1 (access volumes) and 2c (Royal Mail bulk volumes). (RM0868) (RM0869)

¹⁶ See below, paragraphs 10.90 to 10.93.

The value chain for bulk mail services

- 2.16 In broad terms, the value chain for bulk mail services can be broken into two major components:
- Collection and initial sortation** activities (together ‘collection activities’) which involve collecting mail from customers/mail producers, geographically sorting the mail by delivery location and transportation to that area; and
 - Delivery** activities which involve further sortation and sequencing of mail for local distribution⁴ and final delivery to the addressee.
- 2.17 In the context of postal services, for historical reasons, collection activities are often known as ‘upstream activities’ and delivery activities as ‘downstream activities’. In this context, these terms follow the physical flow of a letter rather than the economic value, which flows in the opposite direction. In more standard terms, delivery services are wholesale services offered to operators providing collection services, who in turn offer retail services to bulk mail customers. This is set out in figure 2.1.

Figure 2.1: the high-level value chain for bulk mail services



- 2.18 The bulk mail sector is therefore divided into two main parts: (a) the retail market for bulk mail services (which comprises end-to-end services, incorporating collections as well as

delivery); and (b) the bulk mail (wholesale) delivery market (which provides delivery services to operators who undertake their own collection and inward sortation of mail).

- 2.19 As discussed in more detail below, the market for retail bulk mail services is generally considered to be competitive. As of 2014, the largest provider of bulk mail retail services was Whistl (handling approximately 3.8 billion items¹⁷), closely followed by UK Mail (handling approximately 3 billion items¹⁸) and Royal Mail (handling approximately [X]¹⁹).
- 2.20 While the provision of retail services to bulk mail customers is generally considered to be competitive, as outlined in more detail below, this is not the case for wholesale delivery services where Royal Mail is virtually the sole provider. In 2013-14, Royal Mail delivered over 98% of all bulk mail letters. This means that competitors to Royal Mail in the retail market rely heavily on access to Royal Mail's delivery network to provide services to retail customers.

Royal Mail's provision of wholesale services

Royal Mail's network

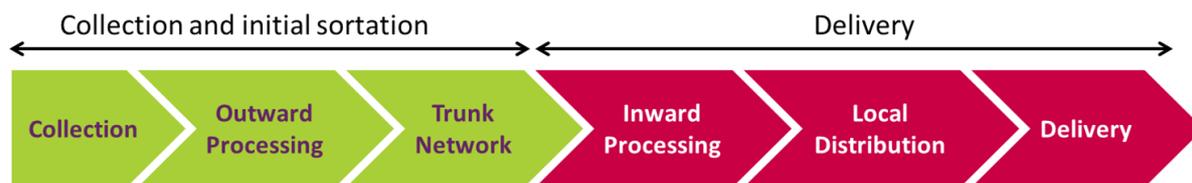
- 2.21 Royal Mail's core network (which it uses to convey letters and parcels) can be broken down into six key stages:
- a) **Collection:** Mail is collected from pillar boxes, post offices or, in the case of some business customers, the customer's premises and taken to an outward mail centre ("OMC");
 - b) **Outward Processing:** Most mail is then geographically sorted at an OMC to identify the relevant inward mail centre ("IMC") to which it should be conveyed (some mail misses this stage out as the sender arranges for it to be pre-sorted);
 - c) **Trunk Network:** Mail is then transported across the country as required to an IMC;
 - d) **Inward Processing:** Mail is then subject to further geographical sortation at the IMC to identify the relevant delivery office;
 - e) **Local Distribution:** Mail is then transported from the IMC to the appropriate local delivery offices, where it is sorted and sequenced into individual 'walks' for delivery; and
 - f) **Delivery:** Finally, mail is delivered to the recipient's address.
- 2.22 As set out above, we refer to the first three stages as 'collection and initial sortation' activities and the latter three as 'delivery' activities. Figure 2.2 shows these stages of the value chain (based on the flow of letters).

¹⁷ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 5, paragraph 11. (WH0132)

¹⁸ UK Mail, *Written Evidence from UK Mail Group plc (USO 27)*, October 2014, page 1. (PD0078)

¹⁹ Royal Mail, *response to 5th section 26 Notice*, 05 November 2014, answer to 2c (Royal Mail retail bulk volumes). (RM0869)

Figure 2.2: Royal Mail's domestic postal services pipeline



The development of regulated 'access'

- 2.23 Prior to the Postal Services Act 2000, Royal Mail held a statutory monopoly in relation to the handling and delivery of the considerable majority of letters.²⁰ The Postal Services Act 2000 introduced a licensing regime which enabled other operators to carry out certain postal activities, including activities that had been within Royal Mail's monopoly, subject to authorisation by Postcomm (the sectoral regulator at the time).²¹ From 1 January 2003, Postcomm permitted competitors to handle 'bulk mail' (then defined as individual mailings from a single producer of more than 4,000 items) or to consolidate smaller mailings, so long as these mailings were ultimately delivered through Royal Mail's delivery network. By 2006, the final restrictions on the activities of postal competitors were removed and the market was fully liberalised, i.e. postal competitors could deliver mail if they had the necessary network in place.²²
- 2.24 In practice, companies relying on access (known as 'access operators'), put in place their own networks to collect bulk mail²³ from retail customers, sort it (unless the mail has been pre-sorted by the customer) and then transport it to the relevant geographic part of Royal Mail's network for onward delivery at the IMC. As set out in Figure 2.1 a range of operators provide services in the bulk mail retail market. However, once at the IMC, the bulk mail is handed over to Royal Mail for processing, local distribution and final delivery to the addressee. Royal Mail charges the access operator an access charge for carrying out this delivery.²⁴
- 2.25 This access process is illustrated at Figure 2.3.

²⁰ Royal Mail's 'reserved area' applied to the conveyance and delivery of letters weighing less than 350g and costing less than £1. See the British Telecommunications Act 1981, section 66, and the Postal Privilege (Suspension) Order 1981.

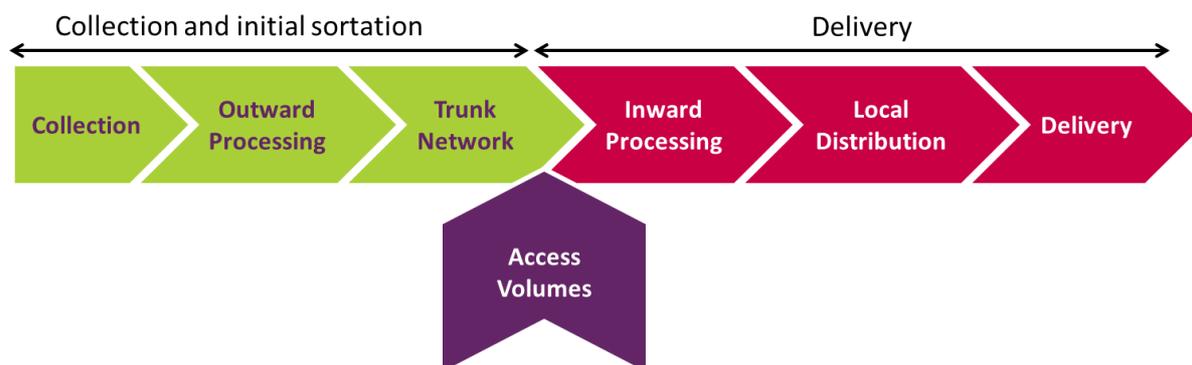
²¹ Pursuant to the Postal Services Act 2011, Ofcom replaced Postcomm as the regulatory authority for postal services on 1 October 2011.

²² See further paragraphs 2.49 to 2.54 below.

²³ Although in principle there is no restriction on access operators providing single piece mail products, the operational difficulties of arranging access and the economies of scale needed by an upstream operator mean that this type of mail is unlikely to be handled by an access operator.

²⁴ In this document, we use the term 'access charges' to refer to Royal Mail's wholesale charges. This distinguishes them from the retail price charged to the bulk mail sender.

Figure 2.3: Access to Royal Mail’s domestic postal services pipeline



D+2 Access

- 2.26 When access-based retail competition began in 2004, it was regulated by the terms of Royal Mail’s regulatory licence issued by Postcomm, which required Royal Mail to negotiate with postal operators and users in good faith with a view to agreeing terms for access to its network.²⁵ In 2004, Royal Mail agreed a set of terms and conditions with UK Mail which enabled UK Mail to access Royal Mail’s delivery network in such a way that UK Mail was able to provide services equivalent to Royal Mail’s second class bulk mail products. Royal Mail later agreed virtually identical terms and conditions with other access operators.
- 2.27 As a result of the change in regulatory framework in 2011, Royal Mail’s licence was replaced with a set of regulatory conditions.²⁶ One of these – the Universal Service Provider Access Condition (the “**USP Access Condition**”) – required Royal Mail to offer a specific form of access based on the existing arrangements that enabled operators to compete with Royal Mail’s second-class bulk mail products (see further paragraphs 2.44-2.48 below).
- 2.28 This form of access is known as D+2 Access. It is technically defined as “*access to [Royal Mail’s] postal network at the IMC for the purposes of providing D+2 and later than D+2 Letters and Large Letters services.*”²⁷ In practice, the implementation of the USP Access Condition means that access operators can inject mail into Royal Mail’s network for delivery the following working day. This enables competing postal operators to offer retail mail services for delivery within two days, or later than two days, of collection from the sender.

²⁵ This was Condition 9 of Royal Mail’s licence; accordingly, Royal Mail access arrangements became known as “C9 contracts”.

²⁶ Part 3 of the Postal Service Act 2011 provides for the abolition of postal licences and the creation of a general authorisation in which postal operators may be subject to certain regulatory conditions imposed by Ofcom. This transition took effect from 1 October 2011.

²⁷ Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012, Annex 9: *Statutory Notification: USP access condition*, condition 1.3 (f). (PD0024)

Retail competition for bulk mail services based on D+2 Access

- 2.29 Retail competition for bulk mail services based on D+2 Access began in 2004 and by 2013-14 access volumes made up the majority of the letters market (53%).²⁸ The two largest access operators by volume active in the UK are Whistl and UK Mail. Together, they account for the significant majority of all access volumes.
- 2.30 Competition amongst access operators is generally considered to be “*highly competitive*.”²⁹ Whistl’s CEO Nick Wells has stated that “[t]he fierce competition for upstream services (which saw both the German post office’s UK subsidiary, DHL, and La Poste’s UK subsidiary, Mail Plus, exit the sector) has meant that profit margins are low. Large contracts are won and lost on a fraction of one penny.”³⁰
- 2.31 These low margins are evidenced in the financial statements of the major access operators. For example, in 2014, UK Mail reported an operating profit of approximately £12.7 million on revenue of approximately £245 million in its mail business.³¹ Similarly, in 2014, Whistl reported an underlying operating profit of approximately £9.6 million on revenue of approximately £575 million.³²
- 2.32 For access operators, Royal Mail’s access charges make up the vast majority of their costs, as a consequence of which Royal Mail retains approximately 90% of all revenue generated by access operators. Figure 2.4 compares Royal Mail’s access revenue (from wholesale charges) with the revenue retained by access operators (from retail revenue).

²⁸ Ofcom, *Annual monitoring update on the postal market - Financial year 2013-14*, 2 December 2014, page 15, figure 3.3. (PD0012)

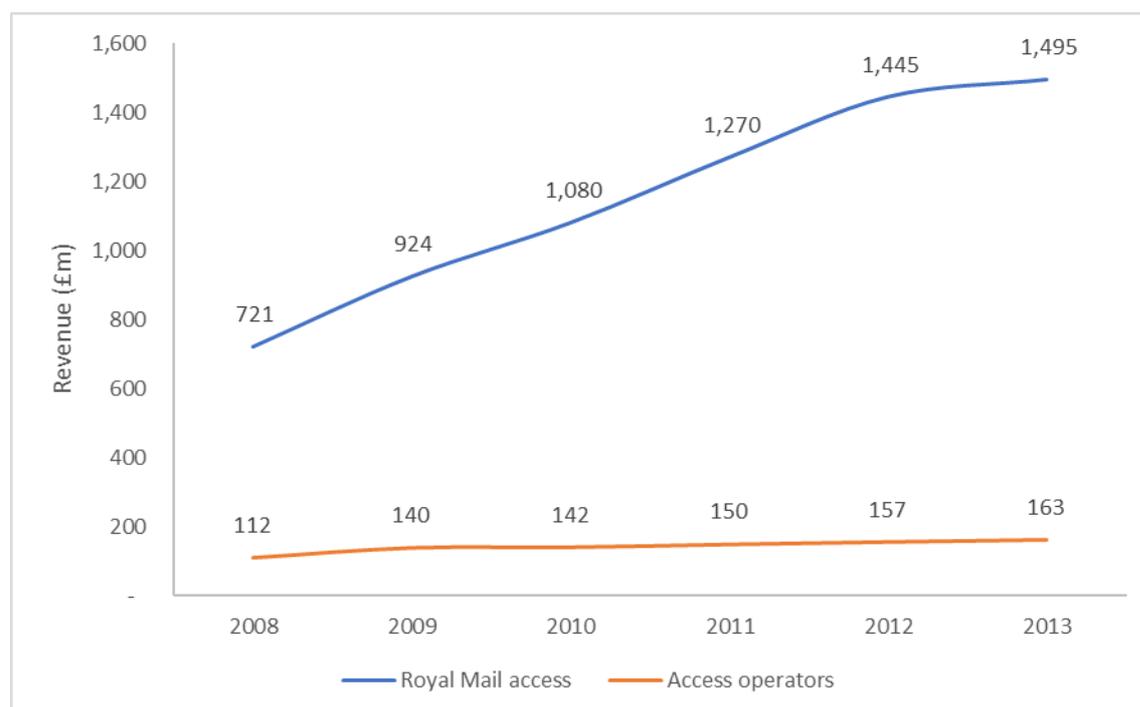
²⁹ See for example PwC, *Project Luke Draft Commercial Due Diligence Report*, 25 October 2013, page 41. (WH0710)

³⁰ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 8, paragraph 23. (WH0132)

³¹ UK Mail, *Report and accounts 2014*, page 16. (PD0049)

³² Whistl, *Whistl UK Limited – Annual report and consolidated financial statements for the year ended 31 December 2014*, page 2. (PD0051) It should be noted that this figure was calculated by eliminating certain start-up and one-off costs, most notably costs associated with the start-up of Whistl’s end-to-end business. On a statutory basis, Whistl recorded an operating loss of £3.7 million.

Figure 2.4: Royal Mail’s access revenue and revenue retained by access operators (2008-2013).



Source: Ofcom, *Communications Market Report: United Kingdom, 7 August 2014, page 380, figure 6.7.* (PD0015)

Customer Direct Access and agency customers

2.33 Royal Mail’s D+2 Access products are exempt from VAT (as a consequence of the regulatory condition requiring Royal Mail to provide these services). However, VAT does apply to access operators offering services on the retail market (using access to Royal Mail’s network). This has led to the creation of two variants to the basic access model (outlined above) which enable certain retail customers to contract directly with Royal Mail and receive VAT-exempt wholesale services. This is particularly important for retail customers who are themselves VAT-exempt, such as financial services businesses, and therefore are unable to reclaim VAT.

- a) **Customer Direct Access:** CDA customers³³ directly acquire (as wholesale customers) VAT-exempt access services from Royal Mail and then, separately, acquire collection and sortation services from an access operator who physically hands the mail over to Royal Mail on the customer’s behalf.
- b) **Agency access:** Agency access customers³⁴ appoint an access operator to provide collection and initial sortation services and to post items through Royal Mail as the

³³ To be eligible for this arrangement, customers must meet the minimum eligibility requirement of Royal Mail’s access agreement. This means that the customers must post more than 6 million items per year and 4,000 items per day.

³⁴ Schedule 17 of the Access Letters Contract sets out the terms on which Royal Mail will accept an agency arrangement. The customers must have an annual spend of at least £5,500 and be wholly or partially exempt from VAT (Royal Mail, *Access Letters Contract*, Schedule 17, paragraphs 3.2 and 4.1). (PD0037)

retail customer's agent. This has the same outcome to the CDA arrangement as it enables retail customers to be invoiced directly by Royal Mail for VAT-exempt services.

Liberalisation of the market

2.34 In 2006, the market for delivery of letters was liberalised and Royal Mail's remaining statutory monopoly on letters delivery was abolished.³⁵ Since that point, it has been possible for postal operators to establish their own delivery networks for letters. A postal operator with its own end-to-end delivery network could bypass³⁶ Royal Mail's network in areas where its own delivery network is rolled out and, in respect of the letter volumes delivered in this way, the postal operator could retain the entire revenue for each item, rather than having to pay Royal Mail's access charges.³⁷ In practice, however, as explained later in this Decision, any end-to-end operator active on the retail market across the UK would also need to rely in large part on access to Royal Mail's network.

Whistl's entry as a delivery competitor

2.35 In 2004, PostNL – one of the largest European postal operators and the incumbent provider in the Netherlands – entered the UK postal market through its wholly owned subsidiary, Whistl (then known as TNT Post UK). Although Whistl entered the market as an access operator, it intended to develop its own delivery capacity.³⁸ This is consistent with PostNL's other international activities in Germany and Italy where by 2012 it had developed active delivery networks with market shares of 7% and 11% respectively.³⁹ In the case of PostNL's Italian subsidiary, it had established a delivery network with a geographic coverage of 68%.

2.36 In 2008, Whistl carried out a small-scale trial of the operational viability of delivery in Liverpool. This enabled Whistl to develop a detailed business plan and secure investment from its parent company, PostNL.⁴⁰ A further trial of Whistl's delivery service was launched

³⁵ The Third Postal Services Directive (Directive 2008/6/EC which amended Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services) required the abolition of reserved areas by 31 December 2010 in most EU Member States, with a further two years allowed for certain other EU Member States. However, as noted above, this had been achieved in the UK by 2006.

³⁶ As explained below, in practice Royal Mail may still deliver some mail on behalf of an end-to-end operator even in the areas where that operator has deployed its own delivery network.

³⁷ As explained in Ofcom's 2013 guidance document, *End-to-end competition in the postal sector – Final guidance on Ofcom's approach to assessing the impact on the universal postal service*, on a like-for-like basis, the impact on Royal Mail's revenues of end-to-end competition is significantly greater than that of access competition, as Royal Mail retains 85% to 90% of the total revenue for access mail but is not involved in any part of the value chain for items processed and delivered directly to the receiving customer by another operator (Ofcom, *End-to-end competition in the postal sector – Final guidance on Ofcom's approach to assessing the impact on the universal postal service*, 27 March 2013, page 10, paragraph 3.17). (PD0018)

³⁸ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 7, paragraph 17. (WH0132)

³⁹ PostNL, *Q4 & FY 2012 Results - Presentation*, 25 February 2013, page 28. (PD0058)

⁴⁰ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 8, paragraph 20. (WH0132)

in April 2012 covering an area in West London. During the course of 2012, the service expanded to:

- a) Central South West London in September 2012; and
- b) the City of London in November 2012.

2.37 By 2013, Whistl had established a business model and developed a roll-out plan which were designed to enable it to develop its own delivery network. The key characteristics of Whistl’s business model and roll out plan were as follows:

- a) **Conversion of customers.** By 2013, Whistl had established a substantial retail customer base for which it handled around 3.8 billion letters. This enabled the delivery business to focus on ‘converting’ existing retail customers from a Royal Mail access-only arrangement to one in which Whistl would deliver in certain areas. Whistl’s retail customer base was split between what it referred to as: (a) ‘national’ accounts, which accounted for 75% of its volumes and related to financial services, public sector and large retail customer, and (b) ‘regional’ accounts which accounted for 25% of its volumes and related to SME, local government and mailing house customers.⁴¹ Whistl was able to automatically convert most volumes from its regional accounts, but it was required to seek consent from national customers to switch their volumes.⁴² As at May 2013, Whistl had converted around 50% of volumes in the areas where it was operating end-to-end.⁴³ Table 2.1 shows how Whistl forecast that its conversion rate would grow over time.

Table 2.1: Whistl’s annualised forecast conversion rate (2014 to 2018)

Year	2014	2015	2016	2017	2018
Conversion rate	56.6%	70.4%	79.8%	83.4%	84.9%

Source: Frontier Economics, *Exclusionary effects of Royal Mail’s pricing proposals*, 28 January 2014, page 17, table 3.

- b) **Alternating delivery days.** Unlike Royal Mail, which delivers bulk mail six days per week, Whistl’s business model was based on delivering to each postcode three times per week on alternating days. In practice, this meant its staff would deliver to half of an area on one day and then to the remaining half on the following day. This was intended to provide a “*cost efficient delivery solution*”.⁴⁴
- c) **Incremental roll out.** Whistl designed a phased ‘roll-out’ plan over a number of years which would enable it to enter the market and grow incrementally over time to the

⁴¹ Whistl, *Project Luke – Investment Memorandum*, May 2013, slides 24 and 29. (WH0709). Notwithstanding these descriptions of ‘national’ and ‘regional’s accounts, over 99% of Whistl’s volumes required national delivery. Frontier Economics, *Exclusionary effects of Royal Mail’s pricing proposals*, 28 January 2014, page 18 (WH0121)

⁴² Ibid., slides 31 and 37. (WH0709).

⁴³ Ibid., slide 53. (WH0709).

⁴⁴ Whistl, *E2E UK – Board of Management*, 26 August 2011, slide 11. (WH0267)

point where it would cover a substantial part of the market. In 2013, its business plan aimed, by 2018, to cover around 42% of UK postcodes⁴⁵ (mostly in suburban, London and urban delivery areas) and deliver nearly 1.5 billion letters per year.⁴⁶

- 2.38 From 2013 onwards, Whistl's entry into the bulk mail delivery market proceeded as follows:
- a) South West London in July 2013;
 - b) Manchester in November 2013;
 - c) Harrow in February 2014; and
 - d) Liverpool in March 2014.
- 2.39 This was the maximum extent of Whistl's delivery network. At this point, Whistl's network covered around 7% of UK addresses.⁴⁷

Regulation of the postal services sector

- 2.40 Ofcom has regulatory responsibility for the postal services sector pursuant to the Postal Services Act 2011. In this subsection, we describe the regulatory position (as of 2014 and to date) in relation to (i) the universal service obligations imposed on Royal Mail, (ii) the provision of access by Royal Mail, and (iii) end-to-end competition.

The universal service

- 2.41 Ofcom has designated Royal Mail as the UK's universal service provider and has imposed regulatory conditions requiring it to provide the universal service.⁴⁸ This means that Royal Mail is subject to a number of obligations which require it to deliver a minimum level of service. In its most basic form, the universal service obligation ("USO") requires Royal Mail to collect and deliver letters six days per week at uniform prices across the UK.
- 2.42 Royal Mail fulfils its USO by providing certain services, including First Class and Second Class mail up to 20kg, Special Delivery, Signed For and Services for the Blind.
- 2.43 The universal service, and hence Royal Mail's USO, does not extend to all types of mail. Royal Mail has (and, as at January 2014, had) no universal service obligations in relation to bulk mail, which is the subject of this Decision.

⁴⁵ Whistl, *Complaint submitted to Ofcom on behalf of TNT Post...*, 28 January 2014, page 4, paragraph 5 (WH0128); Whistl, *E2E Competition – [§<] TNT Post UK Ltd*, 30 September 2013, slide 35. (WH0082) Whistl noted that there is also "the prospect of extending the roll-out at a later date depending on the success of the plan." (Whistl, *Project Luke – Investment Memorandum*, May 2013, slide 52.) (WH0709).

⁴⁶ Whistl, *Project Luke – Investment Memorandum*, May 2013, slide 53. (WH0709).

⁴⁷ Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals*, 28 January 2014, page 16, figure 3. (WH0121)

⁴⁸ Ofcom, *Postal Regulation: Transition to the new regulatory framework*, 29 September 2011, Annex 1. (PD0020) Ofcom imposed a Designated USP condition on Royal Mail on 27 March 2012, which has been modified on a number of occasions since.

Regulation of access in the March 2012 Statement

- 2.44 On 27 March 2012, Ofcom published a statement making decisions on a new regulatory framework for the postal services sector following the transfer of regulatory responsibilities from Postcomm (the “**March 2012 Statement**”).⁴⁹ The March 2012 Statement introduced a new regulatory framework that moved away from the traditional approach to regulating Royal Mail based on price controls and provided Royal Mail with more freedom in relation to the pricing of most of its services. The March 2012 Statement provided Royal Mail with greater operational flexibility, by reducing the notification, publication and pre-approval requirements for product changes and new services.
- 2.45 At the heart of the new regulatory framework was a commitment to secure the provision of the universal postal service. The objectives of the March 2012 Statement were to grant Royal Mail sufficient pricing flexibility to ensure it could continue to provide the universal service on a sustainable basis and sufficient commercial flexibility to adapt to the changing market environment. The regulatory framework also aimed to maintain the benefits of competition in supporting the efficient provision of the universal service.⁵⁰
- 2.46 As we explain at paragraphs 2.27 to 2.28 above, as part of the new regulatory framework, Ofcom set the USP Access Condition.⁵¹ This Condition requires Royal Mail to grant access at its IMCs for the provision of retail D+2 and later than D+2 letters⁵² and large letters⁵³ on fair, reasonable and not unduly discriminatory terms.⁵⁴ In setting the USP Access Condition, Ofcom aimed to impose a form of control which would allow Royal Mail to charge prices to reflect its costs and investment in its network.⁵⁵ Therefore, Ofcom did not directly regulate access charges. Instead, Ofcom relied on an *ex ante* margin squeeze test to ensure effective competition between Royal Mail and access operators.⁵⁶ Royal Mail was required to maintain a minimum cost-based margin between its retail prices and its access charges.⁵⁷

⁴⁹ Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012. (PD0025)

⁵⁰ *Ibid.*, page 3, paragraph 1.16. (PD0025)

⁵¹ *Ibid.*, Annex 9: *Statutory Notification: USP access condition*. (PD0024)

⁵² A ‘letter’ is defined as a mail item up to 240mm in length, 165mm in width, 5mm in thickness and weighing no more than 100g. See USPA condition 1.3(l).

⁵³ A ‘large letter’ is defined as a mail item larger than a ‘letter’, up to 353mm in length, 250mm in width, 25mm in thickness and weighing no more than 750g. See USPA condition 1.3(m).

⁵⁴ Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework: Annex 9: Statutory Notification: USP access condition*, 27 March 2012, USPA conditions 3.1 and 5.1. (PD0024)

⁵⁵ Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012, page 239, paragraph 13.42. (PD0025)

⁵⁶ *Ibid.*, page 8, paragraph 1.50. (PD0025)

⁵⁷ *Ibid.*, Annex 9: *Statutory Notification: USP access condition*, USPA 6.1. (PD0024)

- 2.47 Ofcom also provided an indication of the issues it may have regard to when considering whether particular terms were fair and reasonable.⁵⁸ In this context, it said that Royal Mail should:

“take into account the alignment of zonal prices with Royal Mail’s costs. Furthermore, in moving geographic areas (e.g. postcode sectors, postcode areas) between zones, Royal Mail should take into account the alignment of prices and costs. Zonal costs should be derived in accordance with Royal Mail’s Regulatory Financial Reporting obligations;

seek to ensure that the weighted average of zonal access prices is broadly comparable to the national access price; and

take into account the frequency of implementing changes to the terms of zonal access (including moving geographic areas between zones and revising the zonal structure) as well as the transactional costs for access users (and customers) of implementing the changes. Regard should be given to minimising such transactional costs for access users.”⁵⁹

- 2.48 The new regime therefore allowed Royal Mail to exercise greater commercial freedom in setting and negotiating terms of access to its network. As is clear from the above text, Ofcom envisaged, for example, that Royal Mail could use appropriate forms of zonal pricing.⁶⁰ However, any such pricing terms would need to be fair and reasonable and comply with competition law.

Regulation of end-to-end competition

- 2.49 The EU has promoted the gradual liberalisation of postal services through three successive directives: Directive 97/67/EC of 1997, as amended by Directive 2002/39 and Directive 2008/6/EC. The directives seek to promote competition in this sector so as to help realise the EU internal market. However, the Directives also recognise that postal services fulfil a purpose of general interest, and they therefore provide for safeguards to preserve the continued full coverage and affordability of postal services.
- 2.50 Pursuant to the Third Postal Services Directive, national postal markets were fully liberalised in more than half of the EU by 31 December 2010 (including the UK which did so in 2006), with the remaining eleven Member States completing the process by the end of 2012.
- 2.51 As the UK postal services sector is fully liberalised, there are no statutory provisions preventing operators other than Royal Mail from delivering mail or offering other services to customers at any point of the postal value chain.
- 2.52 Following the commencement of the Postal Services Act 2011, operators were permitted to provide postal services without the need for any licence or prior regulatory

⁵⁸ Ibid., page 167, paragraph 10.153. (PD0025)

⁵⁹ Ibid., page 167, paragraph 10.153. (PD0025)

⁶⁰ For an explanation of what ‘zonal pricing’ is in this context, see Section 3.

authorisation from Ofcom. The previously applicable system of *ex ante* licensing was abolished and section 28 of the Postal Services Act 2011 provided Ofcom with powers to impose a defined list of regulatory conditions on postal operators in given circumstances.

2.53 Ofcom exercised its powers under section 41 of the Postal Services Act 2011 to impose a notification condition on every person providing, or intending to provide, a service within the scope of the universal service (which would include an operator intending to provide end-to-end delivery services for bulk mail).⁶¹ This condition requires such an operator to give Ofcom three months' advance notice if it is planning – in the quarter following the notification period – to: (a) enter the market and deliver more than 2.5 million letters in the UK, or (b) increase the volume of letters it is carrying by more than 2.5 million.⁶²

2.54 In Section 7, paragraphs 7.29 to 7.40, we explain how Ofcom exercised its functions in relation to securing the provision of the universal service and end-to-end competition following the commencement of Whistl's bulk mail delivery activities. As explained in those paragraphs, Ofcom was actively engaged in reviewing Whistl's planned roll-out of a delivery network, and its implications for the market generally.

⁶¹ Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012, Annex 12: *Statutory Notification: Notification Condition*. (PD0069)

⁶² The condition does not give Ofcom the power to accept or reject an operator's proposals. It is not akin to an authorisation process but simply a system of advance notification.

3. Royal Mail's Access arrangements and the Contract Change Notices of January 2014

Introduction

3.1 This Decision relates to the terms and conditions on which Royal Mail supplied D+2 Access services under its Access Letters Contract; in particular, whether Royal Mail abused its dominant position when it issued a set of Contract Changes Notices in January 2014 (referred to in this Decision as the "CCNs") which introduced a series of changes to those terms and conditions. Our assessment of whether Royal Mail's conduct amounted to an abuse of its dominant position relies upon a detailed understanding of the terms on which access services were offered, both before and after the CCNs were issued by Royal Mail in January 2014. In this Section, we therefore set out a factual description of the Access Letters Contract, including the key features of the price plans.

Access arrangements

- 3.2 At the time of the complaint, Royal Mail had in place three principal types of access agreements with its access customers. These were:
- a) D+2 Access arrangements, which are arrangements that enable access operators to use Royal Mail's network to offer D+2, or later than D+2, retail mail products;
 - b) D+1 Access or "premium access" arrangements, which are arrangements that enable access operators to use Royal Mail's network to offer D+1, or next day, retail mail products; and
 - c) Parcel access arrangements, which enable postal operators to use Royal Mail's network to offer retail parcel products.
- 3.3 The subject of this Decision is the D+2 Access arrangements which Royal Mail offers under the terms of the Access Letters Contract, which we refer to in the rest of this section as the "ALC".⁶³ The vast majority of access mail, around [38]% in the financial year to 2014, was delivered under the terms of the ALC.⁶⁴

Royal Mail administrative framework for Postcodes and Zones

3.4 Royal Mail organises its delivery network into geographically based administrative areas. These administrative areas form the basis for how Royal Mail sets up and manages its price plans under the ALC.

⁶³ Royal Mail also had in place a small number of legacy D+2 Access agreements known as 'Condition 9' contracts. These are no longer offered to new wholesale customers and we have not considered these further.

⁶⁴ Royal Mail's response of 18 June 2014 to question 1.1 of a Notice (under section 55 of the Postal Services Act) issued in connection with the Access Pricing Review on 2 June 2014). (RM0605) The remaining volumes relate to D+1 Access agreements and the legacy C9 agreements that are still in force.

- 3.5 Royal Mail's delivery network is organised around its postcode system. Postcodes are the alphanumeric codes attached to every UK delivery address that allow Royal Mail and other postal operators to sort and sequence mail accurately. The postcodes act as an abbreviated form of address which enables a group of delivery points, which include properties and post boxes, to be specifically identified. In 2014, there were approximately 1.8 million unique postcodes in the UK.⁶⁵
- 3.6 Postcodes are aggregated by Royal Mail into postcode groupings of different levels of granularity:
- a) Postcode Sectors, represented by the first part of the postcode and the first number of the second part, aggregate all postcodes into approximately 11,000 separate contiguous areas;
 - b) Five-digit Standard Selection Codes are used to aggregate Postcode Sectors into approximately 1,500 separate contiguous areas; and
 - c) Three-digit Standard Selection Codes, represented by the first three digits of the five-digit Standard Selection Codes, are used to aggregate five-digit Standard Selection Codes into 83 larger, separate contiguous areas.
- 3.7 Where we refer to a Standard Selection Code (or SSC) in this document, we are referring to the three-digit SSC unless otherwise stated.
- 3.8 Separate to its SSC organisational framework, Royal Mail also makes use of non-contiguous groupings of Postcode Sectors known as zones. Royal Mail allocates each Postcode Sector to one of the following four zones depending on the characteristics of that sector:⁶⁶
- a) London zone: includes Postcode Sectors falling within an SSC which has more than 50% of its postal delivery volume going to delivery points within the M25 boundary. Royal Mail has calculated that 14.6% of its access and bulk mail is delivered to the London zone.⁶⁷
 - b) Urban zone: includes Postcode Sectors meeting either of the following criteria (and not falling within the London zone);
 - i) business addresses make up more than 10% of total delivery points within the Postcode Sector and the Postcode Sector contains more than 500 delivery points; or
 - i) the Postcode Sector contains more than 1,000 delivery points.Royal Mail has calculated that 34.5% of its access and bulk mail is delivered to the urban zone.⁶⁸

⁶⁵ Ofcom, *Postcode Address File – Review*, 22 July 2013, page 2, paragraph 2.1. (PD0021)

⁶⁶ Royal Mail, *Access Letters User Guide for Inward Mail Centres (version 2)*, July 2013, page 146, figure 99. (PD0038)

⁶⁷ Royal Mail, *Access Letters Contract Change Notice 012*, 12 January 2015. (PD0036)

⁶⁸ *Ibid.* (PD0036)

- c) Suburban zone: includes Postcode Sectors that contain more than 100 delivery points (but fewer than 1,000 delivery points). Royal Mail has calculated that 30.7% of its access and bulk mail is delivered to the suburban zone.⁶⁹
- d) Rural zone: includes Postcode Sectors that contain fewer than 100 delivery points. Royal Mail has calculated that 20.3% of its access and bulk mail is delivered to the rural zone.⁷⁰

The historical development of different price plans for D+2 Access

The 2004 national pricing arrangements

3.9 In February 2004, Royal Mail and UK Mail entered into the first access arrangement in the UK.⁷¹ This was shortly followed in April 2004 by an identical agreement with Whistl.⁷² This first arrangement is the precursor to the NPP1 arrangement in place today. The agreement required the access operators to use all reasonable endeavours to ensure that its geographic profile – the geographic profile of items handed over to Royal Mail, known as ‘fall-to-earth’ – matched Royal Mail’s overall geographic profile. Royal Mail explained the purpose of this requirement:

“The rationale behind the geographic fall-to-earth requirements was that for Royal Mail to offer a uniform geographically averaged price, it had to have some assurance that an access customer would post mail with a similar profile to that of Royal Mail, in order to ensure that the profile of mail it received broadly matched the cost profile of Royal Mail’s network.”⁷³

3.10 The agreement itself confirms that it is based on the access operator’s “ability to provide Royal Mail geographically uniform postings reflecting a typical Royal Mail national mix of mail from a large business customer.”⁷⁴ It continues that “[c]onsequently, [the access operator’s] overall posting will reflect a typical Royal Mail national mix of mail – i.e. mail which has a profile equivalent to that currently received by Royal Mail for distribution throughout the UK and so does not have a disproportionate amount of mail for geographic areas with a high cost to serve, nor a disproportionate amount of mail being generated locally for local delivery.”⁷⁵

3.11 To achieve this, the agreement specifies the “Royal Mail National Geographic Posting Profile” which indicates the proportion of mail that UK Mail was expected to send to each

⁶⁹ Ibid. (PD0036)

⁷⁰ Ibid. (PD0036)

⁷¹ Royal Mail, *Condition 9 Access Agreement between Royal Mail Group plc and UK Mail Ltd*, 10 February 2004. (RM2326)

⁷² Royal Mail, *Condition 9 Access Agreement between Royal Mail Group plc and TGP Post UK Ltd*, 6 April 2004. (RM2328)

⁷³ Royal Mail, *Response to Statement of Objections*, 27 November 2015 page 26, paragraph 2.41. (RM2386)

⁷⁴ Royal Mail, *Condition 9 Access Agreement between Royal Mail Group plc and UK Mail Ltd*, 10 February 2004, page 3, recital (c). (RM2326)

⁷⁵ Ibid. (RM2326)

Postcode Area⁷⁶ of the UK.⁷⁷ This requirement could, in some circumstances, be enforced by Royal Mail, through a surcharge mechanism based on the extent to which UK Mail deviated from the required profile.⁷⁸ The aim of the requirement is, by normalising the profile of access operators to the national baseline, to remove the risk that access operators hand over postings that contain a disproportionate amount of high cost mail. This ensures the average price is reflective of average costs.⁷⁹

- 3.12 The agreement with UK Mail in 2004 was a commercial agreement reached between the parties. However, this agreement was reached in a context where UK Mail had applied to Postcomm to determine terms of access which Royal Mail was required to provide under its licence. Postcomm, commenting on the agreement in March 2004, noted that the reasoning behind the national profile requirement was that this would ensure *“UK Mail’s mail will mirror Royal Mail’s national fall-to-earth profile and significant variation from this profile might materially change the cost of the service provided.”*⁸⁰
- 3.13 Postcomm continued, however, that in its opinion, *“a national profile would not necessarily be a condition for a set of prices equalling those in the UK Mail agreement.”*⁸¹ It added that, while it had not considered an access request from an operator wanting to hand over mailings that do not reflect Royal Mail’s profile, if called upon to so, *“Postcomm will not necessarily include a similar condition if required to make a determination.”*⁸²

The 2004 zonal pricing arrangement

- 3.14 Following the announcement of these agreements, Royal Mail received requests from other potential access operators who were unable to meet the national profile requirements of the early 2004 arrangements. In October 2004, Royal Mail developed an alternative access arrangement under which the price of sending an item of mail was different depending on its destination. In practice, Royal Mail allocated each of its Postcode Sectors to one of five *“cost-based zones,”*⁸³ based on the delivery characteristics of that sector,⁸⁴ each of which was then associated with a different price.

⁷⁶ Postcode Areas are aggregations of Postcode Sectors based on the first (either one or two) letter(s) of a Postcode, which identify a geographic area for delivery of mail.

⁷⁷ Royal Mail, *Condition 9 Access Agreement between Royal Mail Group plc and UK Mail Ltd*, 10 February 2004. Schedule 4. (RM2326)

⁷⁸ *Ibid.*, see schedule 4. (RM2326)

⁷⁹ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 26, paragraph 2.41: *“The rationale behind the geographic fall-to-earth requirements was that for Royal Mail to offer a uniform geographically averaged price, it had to have some assurance that an access customer would post mail with a similar profile to that of Royal Mail, in order to ensure that the profile of mail it received broadly matched the cost profile of Royal Mail’s network.”* (RM2386)

⁸⁰ Postcomm, *Promoting effective competition in UK postal services through downstream access – observations on the agreement between Royal Mail and UK Mail Ltd on access to Royal Mail’s delivery network*, March 2004, page 36, para 4.27. (RM2327)

⁸¹ *Ibid.*, page 36, para 4.27. (RM2327)

⁸² *Ibid.*, page 37, para 4.28. (RM2327)

⁸³ *Ibid.*, page 27, para 2.44. (RM2327)

⁸⁴ Royal Mail, *Condition 9 Access User Guide V3.1*, 30 September 2005, appendix L. (RM2330)

3.15 Royal Mail explained that where the profile of mailing items was not expected to meet the national profile, the zonal arrangement could be used to establish a ‘dynamic’ price based on the zonal composition of a particular profile.⁸⁵ Compared to a national arrangement, Royal Mail later explained that the zonal arrangement was a *“more cost reflective access agreement developed subsequently [and which] offers the customer a non-uniform Access price based on the specific profile of each daily posting, whether that is to one postcode area or many.”*⁸⁶

3.16 In 2008, Royal Mail also set out its view of the relationship between these plans:

*“Balance in terms of pricing is ensured, since a customer who posts an average National Geographic Posting Profile on a Zonal Agreement would pay the same average price as using a National Agreement for the same traffic. The two options may be used in combination – providing that the terms of each Agreement are met - and allow postings to any part of the UK at prices that are cost reflective and commercially viable for both parties.”*⁸⁷

The 2011 averaged zonal pricing arrangement

3.17 In December 2006, Whistl complained to Postcomm about the *“combination of the national geographical posting profile provisions with the related surcharge mechanism and rights of termination which means that it is not possible, in practice, to use downstream access as a “launch pad” for moving into full end-to-end competition.”*⁸⁸ Whistl also stated that it did not consider the 2004 zonal pricing arrangement to be a commercially viable option for it.⁸⁹ Postcomm invited Whistl to attempt to seek resolution with Royal Mail before it would consider a formal investigation⁹⁰ and in January 2007 Whistl confirmed it would suspend its complaint while it did so.⁹¹ Whistl subsequently requested, in July 2007, a new form of access from Royal Mail which it considered would enable end-to-end competition. In November 2007, Royal Mail confirmed that it would not offer this form of access.⁹² As a result, in December 2007 Whistl requested that Postcomm determine appropriate terms of access based on Whistl’s previous request to Royal Mail.⁹³

⁸⁵ Ibid. (RM2330)

⁸⁶ Royal Mail, *Royal Mail's Response to Postcomm's Access Review Consultation*, March 2008, page 28, paragraph 3.24. (PD0076)

⁸⁷ Ibid. (PD0076)

⁸⁸ Whistl, *Letter to Sarah Chambers (Chief Executive, Postcomm)*, 6 December 2006. Page 1, paragraph 3. (WH0085)

⁸⁹ Ibid., pages 6 to 8, paragraphs 26 to 33. (WH0085)

⁹⁰ Whistl, *Letter to Sara Chambers (Chief Executive, Postcomm)*, 13 December 2007, page 2. (PD0079)

⁹¹ Postcomm, *Changes to zonal access pricing by Royal Mail – licence modification*, 14 May 2009, page 27, paragraph 2.66. (RM2331)

⁹² Whistl, *Letter to Sara Chambers (Chief Executive, Postcomm)*, 13 December 2007, pages 2 to 3. (PD0079)

⁹³ Ibid. (PD0079)

- 3.18 In August 2008, during Postcomm’s consideration of Whistl’s request, Royal Mail consulted on two changes to its access arrangements:
- a) in relation to the zonal pricing arrangement, Royal Mail proposed to change the structure of zones with a view to achieving a simpler and more cost-reflective structure;⁹⁴ and
 - b) in relation to the national pricing arrangement, Royal Mail proposed to change the basis for the national profile from a system based on the proportion of mail sent to each Postcode Area to a system based on the proportion of mail sent to each of the zones. Instead of requiring operators to send a certain proportion of their items to specific contiguous locations, the proposed arrangement would require a certain proportion to be sent to each zone (and not necessarily to any given location).⁹⁵
- 3.19 As a result of this consultation, Postcomm decided to delay issuing a direction in response to Whistl’s request of December 2007 in order to allow industry to try to reach a commercially acceptable solution.⁹⁶
- 3.20 Following its consultation, Royal Mail requested that Postcomm vary its licence to enable the changes it had proposed to the zonal structure and to enable it to align the national price to the weighted average of the new zonal structure.⁹⁷ Royal Mail also noted that its proposed change to the national pricing arrangement would have to be negotiated with contract holders (rather than being imposed as a result of regulatory intervention by Postcomm).⁹⁸ Postcomm consulted on these changes in February 2009⁹⁹ and issued a decision in May 2009 to vary Royal Mail’s licence to change the zonal structure.¹⁰⁰ Postcomm welcomed Royal Mail’s proposed changes to the national pricing arrangement and agreed that, given the contractual nature of the arrangements, it was appropriate for Royal Mail to seek to introduce the changes in accordance with the variation procedures set out in those contracts.¹⁰¹
- 3.21 In October 2009, Royal Mail consulted on changes to the national pricing arrangement and, following further consultation in April 2010, published its final proposals in February 2011.¹⁰² This confirmed that Royal Mail would, as originally proposed in 2008, seek to change the basis for the national profile from a system based on the proportion of mail

⁹⁴ Royal Mail, *Letter to customers*, 13 August 2008, pages 2 to 3. (RM2332)

⁹⁵ *Ibid.*, pages 3 to 4. (RM2332)

⁹⁶ Postcomm, *Downstream Access – Observations on Royal Mail Wholesale’s letter “Proposed changes to RMW Access Contracts (Zonal and National)”*, 29 August 2008, page 10, paragraphs 29 to 30. (RM2334)

⁹⁷ Royal Mail, *Application under the Postal Services Act Section 14 and licence condition 21(5b) for a determination of zonal access pricing*, 25 November 2008. (RM2333) Previously, the national price had been aligned to zone ‘c’ representing the mid-point of the five zones.

⁹⁸ *Ibid.*, page 9. (RM2333)

⁹⁹ Postcomm, *Changes to zonal access pricing – proposed licence modification*, 20 February 2009. (PD0070)

¹⁰⁰ Postcomm, *Changes to zonal access pricing by Royal Mail – licence modifications*, 14 May 2009. (RM2331)

¹⁰¹ *Ibid.*, page 25, paragraph 2.63. (RM2331)

¹⁰² Royal Mail, *Consultation on changes to the access national geographic posting profile definition – Final proposals from Royal Mail Wholesale*, 18 February 2011, page 3. (RM2335)

sent to each Postcode Area to a system based on the proportion of mail sent to each of the zones.¹⁰³

- 3.22 In February 2011 Royal Mail sought consent from access operators to vary their contracts to incorporate the new national pricing framework.¹⁰⁴ In the event, not all access operators agreed to the changes. In particular, UK Mail declined to accept the changes to its contract whereas Whistl accepted the new terms. Accordingly, Royal Mail noted in its representations:

“On 23 February 2011, Royal Mail wrote to access customers requesting consent to replace Schedule 4 of the national access contract (which contained the NGPP [National Geographic Posting Profile] requirements) with a new schedule, which reflected the amendments to the NGPP. Customers were asked to respond by 23 March 2011. In the event, only some customers decided to accept the amendments and therefore to move onto the new price plan in March 2011. As an unintended consequence, rather than a single national price plan as had been envisaged, Royal Mail ended up with two national price plans, in addition to the zonal price plan (now known as ZPP3).”¹⁰⁵

- 3.23 By late April 2011, a situation had therefore developed in which there were three access arrangements prevailing in the market:
- a) the legacy 2004 national pricing arrangement for those operators who had refused consent to implement Royal Mail’s proposed change;
 - b) the revised 2011 national pricing arrangement for those operators who had accepted the new terms; and
 - c) the continuing 2004 zonal pricing arrangements.

The Access Letters Contract

- 3.24 On 8 October 2012, Royal Mail began a process to replace the existing access agreements with a new form of contract based on its view that these were out of date and in need of fundamental reform.¹⁰⁶
- 3.25 Royal Mail consulted on a number of proposals, including proposals to replace the existing national pricing arrangements with a new set of arrangements which would involve customers giving a commitment to posting certain volumes over a defined period and a commitment to matching Royal Mail’s profile across SSCs and between zones, in return for lower prices for all committed volumes than would be charged under the zonal pricing plan.¹⁰⁷ However, in announcing its final terms on 21 January 2013, Royal Mail largely

¹⁰³ Ibid., page 8. (RM2335)

¹⁰⁴ Royal Mail, *Response to Statement of Objections*, 27 November 2015 page 29, paragraph 2.50. (RM2386)

¹⁰⁵ Ibid. 2.50. (RM2386)

¹⁰⁶ Royal Mail, *Proposals for the reform of the access contracts – A customer discussion document*, 8 October 2012. (WH0027)

¹⁰⁷ Ibid, pages 18 to 19, paragraphs 5.11 to 5.19. (WH0027)

retained the structure of the price plans that had developed over the preceding eight years. Those final terms were set out in the ALC, which remained in place as at January 2014. At the same time as it announced the final terms of the ALC in January 2013, Royal Mail also stated that:

“[Royal Mail] will maintain price equivalence between the different price plans. However, [Royal Mail] believe[s] that the value of the commitment given by these differential pricing plans to Royal Mail may well differ and we will review whether it is appropriate for these pricing plans to be set at the same level in the future.”¹⁰⁸

3.26 Royal Mail added that it *“believe[d] there is merit in the introduction of a price structure that allows customers greater stability in return for committing volume”* and would *“continue to work with the industry during 2013 with a view to introducing some form of volume commitment pricing (or other incentive connected to volume) into the new contracts.”¹⁰⁹*

Royal Mail’s expanded power to make unilateral changes to terms and conditions

3.27 The new Access Letters Contract structure enabled Royal Mail to make more unilateral variations to the terms of access than was possible under its previous contracts. Royal Mail was previously able to make only limited changes to its access contracts without the consent of the access operators. In its letter to access operators introducing the ALC, Royal Mail explained that this unilateral power to vary was subject to a number of limitations.

- a) First, Royal Mail would be required to provide minimum periods of notice before it can implement the effects of a variation.¹¹⁰ The ALC sets out a detailed schedule of notice periods that must be provided before different categories of changes can be implemented. For example, price increases would require 70 days’ notice¹¹¹ whereas changes to the pricing structure require 190 days’ notice.¹¹²
- b) Second, the number of tariff changes that Royal Mail can carry out would be limited to twice in a financial year.¹¹³
- c) Third, any contract change notices that become the subject of an investigation by Ofcom or any other regulatory or competition authority would be suspended pending resolution.¹¹⁴ The ALC requires the suspension of relevant changes in the event that *“any Regulatory Body makes a formal public notification that it has opened an investigation”* and where *“the outcome of the investigation... is reasonably likely to affect [Royal Mail’s] right[s] to change [the] Contract or it would be reasonable to*

¹⁰⁸ Royal Mail, Letter to access customers (*‘Reform of Access Contracts’*), 21 January 2013, page 2. (WH0046)

¹⁰⁹ *Ibid.*, page 1. (WH0046)

¹¹⁰ *Ibid.*, page 2. (WH0046)

¹¹¹ Royal Mail, *Access Letters Contract (General Access Terms and Conditions)*, page 15, clause 13.2.3. (RM0026)

¹¹² *Ibid.*, clause 13.2.1. (RM0026)

¹¹³ Royal Mail, Letter to access customers (*‘Reform of Access Contracts’*), 21 January 2013, page 2 (WH0046); Royal Mail, *Access Letters Contract (General Access Terms and Conditions)*, page 15, clause 13.2.3. (RM0026)

¹¹⁴ Royal Mail, Letter to access customers (*‘Reform of Access Contracts’*), 21 January 2013, page 2. (WH0046)

expect [Royal Mail] to take that outcome into consideration in deciding whether [Royal Mail] [was] acting fairly and reasonably in changing [the] Contract.”¹¹⁵

- 3.28 Royal Mail said that it recognised “*that the new terms have real commercial value for Royal Mail*” and that it would therefore price the new contracts at 2.44% less than the existing agreements “*to provide customers with an appropriate incentive to switch.*”¹¹⁶ The vast majority of customers switched immediately and began to operate on the new terms from April 2013.

Access Letters Contract – general operational requirements

- 3.29 Under the ALC, Royal Mail offered to convey and deliver any mailing items handed over to Royal Mail at one of its inward mail centres that bear postcodes served by that particular inward mail centre.¹¹⁷ Operators were required to hand over mailing items between 7.30 am and 12.00 pm, with Royal Mail committing to deliver 95% of mail the next working day.¹¹⁸ In this way, access operators could use this wholesale service to provide a D+2 service for their retail customers.
- 3.30 Access operators had to meet certain operational requirements in order to use the ALC. For example, they had to meet a minimum posting requirement of at least 6 million mailing items per year.¹¹⁹ In addition, each daily posting or separately identified posting was also required to contain at least 4,000 mailing items.¹²⁰ Each posting was sampled by Royal Mail to ensure that the correct postage had been paid¹²¹ and that the mail met particular operational requirements, such as the way that it was been ‘presented’ (that is, the form of the address on the face of the letter or the container that had been used to handle the mail).
- 3.31 As a framework agreement, the ALC enabled a postal operator to select particular access products to use in its mailings. There was a wide range of different mailing specifications that could be used by access operators. Together we understand that these specifications combined to form in excess of 130,000 separate D+2 products.¹²²
- 3.32 In summary, D+2 Access products were differentiated by the following characteristics:
- a) Letter type: there are different products for Letters¹²³ and Large Letters¹²⁴;
 - b) Letter weight: Large Letters products are differentiated by weight;

¹¹⁵ Royal Mail, *Access Letters Contract (General Access Terms and Conditions)*, page 16, clauses 13.7(a) and (b). (RM0026)

¹¹⁶ Royal Mail, Letter to access customers (*‘Reform of Access Contracts’*), 21 January 2013, page 2. (WH0046)

¹¹⁷ Royal Mail, *Access Letters Contract (Schedule 2)*, page 36, clause 9. (RM0026)

¹¹⁸ *Ibid.*, pages 32 and 36, clauses 2.1 and 11.1. (RM0026)

¹¹⁹ *Ibid.*, page 36, clause 10.1. (RM0026)

¹²⁰ *Ibid.*, clause 10.2. (RM0026)

¹²¹ *Ibid.*, page 34, clause 3.1. (RM0026)

¹²² Letter from [redacted] (Royal Mail) to [redacted] (Ofcom), 29 May 2014. (RM0269)

¹²³ ‘Letters’ have a maximum size of 240mm x 165mm, a maximum thickness of 5mm and a maximum weight of 100g.

¹²⁴ ‘Large Letters’ must not be ‘Letters’ (as above) and have a maximum size of 353mm x 250mm, a maximum thickness of 25mm and a maximum weight of 750g.

- c) Address format: there were differentiated products for whether the delivery address is presented as a barcode, or otherwise in a machine-readable format;
- d) Presentation of mailing: there were different products for letters handed over in a tray rather than in a bag;
- e) Type of mail: there were differentiated products for different types of mail, including advertising mail, business mail or “responsible mail”, which is a subset of advertising mail that conformed to certain defined environmental specifications; and
- f) Level of sortation: there were differentiated products for mail that is sorted and sequenced to two levels of sortation: Access 70, which required mail to be divided into 86 geographic areas,¹²⁵ which are the three-digit SSCs referred to above, and Access 1400 which required mail to be divided into around 1,525 geographic areas, which are the five-digit SSCs referred to above.¹²⁶

3.33 Royal Mail published a full price list on its website that detailed each combination of these products and specified the relevant price.

Price plans of the Access Letters Contract

Overview of the price plans

3.34 As of January 2014, the ALC offered access operators a choice of three price plans:¹²⁷

- a) a uniform price plan called National Price Plan One (“NPP1”);
- b) a uniform price plan called Averaged Price Plan Two (Zones) (“APP2”),¹²⁸ and
- c) a price plan containing separate prices by delivery location called Zonal Price Plan (“ZPP3”).

3.35 Operators could use more than one plan at the same time by combining either NPP1 or APP2 with ZPP3. However, they could not operate on NPP1 and APP2 at the same time.¹²⁹ We outline below the way in which the pricing plans operated prior to the introduction of the CCNs.

National Price Plan 1 (NPP1)

3.36 Under NPP1, Royal Mail offered a nationally averaged and uniform price that did not vary with the delivery location of the item. To qualify for this plan, the access operator had to adhere to certain profile requirements. These requirements acted in effect as floors that

¹²⁵ This includes the three SSCs associated with the Channel Islands and the Isle of Man.

¹²⁶ Royal Mail, *Access Letters User Guide for Inward Mail Centres (version 2)*, July 2013, page 9. (PD0038)

¹²⁷ Since the investigation opened Royal Mail has introduced an additional price plan - the Regional Price Plan or RPP4. RPP4 is not relevant to this Decision and is not discussed further.

¹²⁸ Previously this price plan was known as “National Price Plan Two (Zones)”. In the interests of clarity, we refer to this price plan exclusively as APP2.

¹²⁹ Royal Mail, *Access Letters Contract (Contract Details)*, page 4, clause 3.2. (RM0026)

set minimum letters volumes that were to be sent to each SSC and, separately, to urban areas within each SSC. There were two profiles: the 'National Spread Benchmark' and the 'Urban Density Benchmark'.

- 3.37 The **National Spread Benchmark** required access operators to post a similar distribution of mail across the whole of the UK to the profile of all bulk mail delivered by Royal Mail (i.e. the totality of access volumes and Royal Mail's own bulk retail volumes).¹³⁰ It was based on Royal Mail's combined geographic delivery profile of bulk mail across each of the 83 three-digit SSCs (see paragraph 3.6).¹³¹ For example, if Royal Mail delivered 3% of its total access and bulk mail to a particular SSC, NPP1 operators would in principle also be required to send 3% of their total mail to that SSC. In practice, compliance with the National Spread Benchmark was measured across regions of the UK. For example, the benchmarks for SSCs within England and Wales were presented as a proportion of total volume across English and Welsh SSCs. Volumes sent in Scotland and Northern Ireland would not affect performance in those SSCs.
- 3.38 The **Urban Density Benchmark** required access operators to have a similar distribution of mail across the UK within the urban zone to the distribution of access and bulk mail delivered by Royal Mail in the urban zone.¹³² This applied to SSCs outside London and was based on the proportion of access and bulk mail delivered by Royal Mail to postcode sectors that had been allocated to the urban zone. For example, if Royal Mail delivered 3% of its access and bulk mail to urban sectors within a particular SSC, NPP1 customers would also be required to send 3% of their mail to urban sectors within that same SSC.
- 3.39 Both of these profiles were based on Royal Mail's SSCs. Figure 3.1 shows how the SSCs were distributed throughout the UK as contiguous regions.

¹³⁰ Ibid., clause 4.1. (RM0026)

¹³¹ There are a further three SSCs covering the Channel Islands and the Isle of Man. These SSCs are used for the purpose of sorting and for charging but are not included within the National Spread Benchmark (that is, NPP1 does not require mail to be sent to these SSCs but does allow NPP1 operators to send a certain number of letters within the uniform pricing arrangement).

¹³² Royal Mail, *Access Letters Contract (Schedule 3)*, page 40, clause 6.1. (RM0026)

Figure 3.1: Map of SSCs



Source: Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 15. (RM0960)

3.40 The practical result of these two benchmarks was that, in order to qualify for NPP1 prices, operators were required to send mail to almost every part of the UK. Access operators were only eligible to use NPP1 if they could prove to Royal Mail’s reasonable satisfaction that they had a reasonable likelihood of meeting these benchmarks.

3.41 Customers that used NPP1 were required to “agree to use all reasonable endeavours” to meet both of the National Spread and Urban Density Benchmarks.¹³³ If an NPP1 operator failed to meet either of the benchmarks by more than a specified amount, and also failed to use all reasonable endeavours to attempt to meet the benchmarks, Royal Mail was entitled to impose a surcharge.¹³⁴

Averaged price plan 2 (APP2) and Zonal price plan 3 (ZPP3)

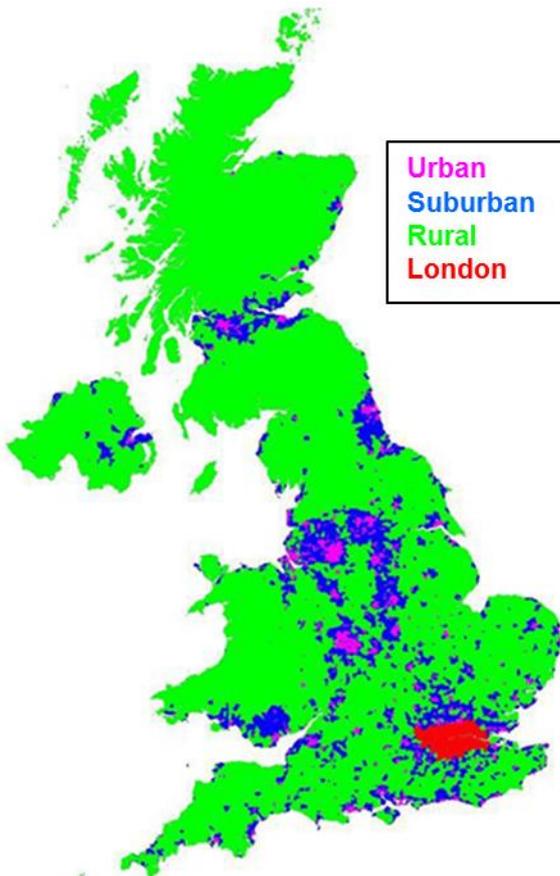
3.42 Under APP2, Royal Mail offered a nationally averaged and uniform price that did not vary with the delivery location of the item. To use this price plan, the access operator had to

¹³³ Ibid., page 39, clause 3.1. (RM0026)

¹³⁴ Royal Mail, Access Letters Contract (Schedule 3), page 39, clause 3.2. (RM0026)

meet a zonal profile requirement.¹³⁵ For the purposes of this plan, Royal Mail allocated postcodes to one of four zones based on the cost of delivery in that location and required access operators to have a similar distribution of mail across the four zones to the profile of bulk mail delivered by Royal Mail. The zonal arrangement is depicted in figure 3.2.

Figure 3.2: Map of zones



Source: Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 16. (RM0960)

3.43 An access operator was eligible to use APP2 if it could prove to Royal Mail's "reasonable satisfaction that it is reasonably likely" that it would meet the 'Zonal Posting Profile' – this was the proportion of Royal Mail's access and bulk mail that it delivered to each of the four zones.¹³⁶ As this profile measured volumes in four non-contiguous zones, APP2 did not require operators to send mail across the whole of the UK. This was a key difference with NPP1, which has the National Spread Benchmark requirement.

3.44 Unlike the NPP1 profile requirements, APP2 operators were subject to an absolute requirement to comply with the Zonal Posting Profile benchmark rather a requirement to

¹³⁵ Since 2004, Royal Mail has changed the structure of zones and under the present arrangements there are four zones: Urban, Suburban, Rural, London.

¹³⁶ Royal Mail, *Access Letters Contract (Schedule 3)*, page 39, clause 2.1. (RM0026)

use all reasonable endeavours to do so. If they failed to meet the profile by more than a specified amount, Royal Mail was entitled to impose a surcharge.¹³⁷

- 3.45 Under ZPP3, Royal Mail offered a separate price for each zone. ZPP3 did not have any specific eligibility criteria or any requirement to meet specific mailing profiles. It did not therefore contain any profile surcharging measures.

Comparison of the price plans in place before the introduction of the CCNs

- 3.46 The key difference between the uniform price plans (NPP1 and APP2) and the 'pay as you go' price plan (ZPP3) was the way in which the price was applied. In the case of ZPP3, prices were applied on an ongoing per item basis (referred to as 'pay as you go'), with the level of charge dependent on the zone in which the item was to be delivered. In contrast, NPP1 and APP2 both offered a single price per item that did not vary with the geographic destination of the mail.
- 3.47 Prior to Royal Mail issuing the CCNs in January 2014, the prices it charged under the NPP1 plan were identical to the prices it charged under the APP2 plan. This equivalence was also a feature of the pricing plans which existed before the ALC was introduced.
- 3.48 A feature of the relationship between APP2 and the zonal prices of ZPP3 was that the weighted average of zonal prices was equivalent to the uniform APP2 price. In this context, 'weighted average' meant weighted according to the zonal profile that APP2 customers were expected to comply with. Put another way, if an operator on ZPP3 sent letters to each zone in the same proportions as the zonal profile of APP2, it would pay an average price that was the same as APP2. It was for this the reason that APP2 was named averaged price plan 2.
- 3.49 Prior to Royal Mail issuing the CCNs in January 2014, the prices applied under ZPP3 were designed to be effectively equivalent to NPP1 prices. The basis on which this occurred was that, if a ZPP3 user matched Royal Mail's overall zonal profile (i.e. it sent letters in the same proportion to each of the four zones as Royal Mail's benchmark profile¹³⁸), it would in fact pay an average price that was the same as NPP1.¹³⁹
- 3.50 Thus, historically all access arrangements, whether under NPP1, APP2 or ZPP3, have been priced at an equivalent rate. Table 3.1 shows that the prices were identical.

¹³⁷ Royal Mail, *Access Letters Contract (Schedule 3)*, page 39, clause 3.2. (RM0026); Royal Mail, *Royal Mail Wholesale – Quick Guide to the Pricing Plans (April 2013)*, April 2013, page 3. (WH0054)

¹³⁸ This is the Royal Mail Zonal Posting Profile explained below at paragraphs 3.102 to 3.103.

¹³⁹ In 2008, Royal Mail stated that there was "balance in terms of pricing" between the zonal and national price plans, "since a customer who posts an average National Geographic Posting Profile on a Zonal Agreement would pay the same average price as using a National Agreement for the same traffic." (Royal Mail, *Royal Mail's Response to Postcomm's Access Review Consultation*, March 2008, page 28, paragraph 3.24) (PD0076)

Table 3.1: Comparison of NPP1 and APP2/ZPP3 prices for key access services (2013-14).

Service (Based on tray prices)	NPP1 2013-14 (Pence per item)	APP2/weighted average of ZPP3 2013-14 (Pence per item)
70 CBC Letters (100g)	19.470	19.470
70 Letters (100g)	22.509	22.509
70 CBC Advertising Letters (100g)	15.97	15.97
70 Advertising Letters (100g)	19.009	19.009
1400 Large Letters Advertising Mail (100g)	21.538	21.538
1400 Large Letters Advertising Mail (250g)	29.256	29.256
1400 Large Letters (100g)	26.538	26.538
1400 Large Letters (250g)	34.256	34.256

Source: Royal Mail data sheets and Ofcom calculations

3.51 However, in January 2014, Royal Mail used its contractual right to unilaterally change the terms and conditions of access and introduced, in particular, a differential between the APP2/ZPP3 and NPP1 price plans.

Pricing structure set out in the CCNs

3.52 Royal Mail published detailed schedules of prices that list the price under each price plan for all D+2 Access products. In this section, we explain how the prices under each price plan related to each other and how this relationship would have been altered by the changes introduced by Royal Mail in January 2014.

3.53 In January 2014, Royal Mail notified customer of a number of changes it was making to access prices. There were two distinct price changes:

- a) A “normal, inflation related price update”¹⁴⁰ which increased access prices on NPP1, APP2 and ZPP3 by the same amount; and
- b) A further price increase which applied only to APP2 and ZPP3, which accordingly increased these prices relative to NPP1 (i.e. the price differential).

¹⁴⁰ Royal Mail, *Letter to access customers*, 4 March 2013, page 1. (RM0072)

3.54 This Decision is concerned with the introduction of the price differential which increased prices for APP2 and ZPP3 customers compared to NPP1 customers. In this section, we also explain how that price differential was manifested in APP2 and ZPP3 prices.

Price differential between NPP1 prices and APP2 prices

3.55 As explained in paragraphs 3.46 to 3.50, prior to January 2014, Royal Mail had maintained a complete equivalence between the uniform NPP1 and APP2 prices.

3.56 By virtue of the CCNs, Royal Mail notified access customers that APP2 prices were to be fixed at around 1.2% (or about 0.25p) above NPP1 prices. In practice, prices for letters appear to have been set at around 1.2% above NPP1 prices, whereas prices for large letters appear to have been fixed at around 1.4% above NPP1 prices.

3.57 Table 3.2 compares the prices for certain key access services offered under NPP1 and APP2 once the price differential is incorporated.¹⁴¹

¹⁴¹ We have identified these key services based on Access Letters Contract Change Notice 002. (RM0030)

Table 3.2: Comparison of NPP1 and APP2 prices for key access services (as specified by CCN 002).

Service (Based on tray prices)	NPP1 2014-15 (Pence per item)	APP2 2014-15 (Pence per item)	Price differential (%)	Price differential (Pence per item)
70 CBC Letters (100g)	20.07	20.31	1.21%	0.24
70 Letters (100g)	23.23	23.51	1.21%	0.28
70 CBC Advertising Letters (100g)	16.05	16.29	1.51%	0.24
70 Advertising Letters (100g)	19.21	19.49	1.46%	0.28
1400 Large Letters Advertising Mail (100g)	21.57	21.91	1.57%	0.34
1400 Large Letters Advertising Mail (250g)	29.80	30.24	1.46%	0.44
1400 Large Letters Business Mail (100g)	27.99	28.33	1.21%	0.34
1400 Large Letters Business Mail (250g)	36.22	36.65	1.20%	0.44
1400 Large Letters (100g)	31.55	31.93	1.20%	0.38
1400 Large Letters (150g)	40.81	41.30	1.20%	0.49

Source: Royal Mail data sheets and Ofcom calculations

3.58 As ZPP3 prices were derived from APP2, each zonal price incorporated the price differential as adjusted for the zonal tilt. Table 3.5 below shows how the price differential fed through to zonal prices.

The changes to the ZPP3 pricing: changes to zonal tilts and the introduction of the price differential between NPP1 prices and ZPP3 prices

3.59 As explained above, Royal Mail had in place a system of ‘zones’ which aggregate together different areas based on common characteristics associated with differing delivery costs. Under the January 2014 CCNs, zonal prices were calculated by reference to NPP1 and APP2 prices through the following method:

- a) NPP1 prices were determined by Royal Mail;

- b) APP2 prices were derived from NPP1 prices by applying an increase of 1.2%; and then
- c) zonal prices, which were used principally as ZPP3 prices (but are also of relevance in both NPP1 and APP2 surcharge arrangements), were derived by applying a ‘zonal tilt’ to the APP2 prices.

3.60 The ‘zonal tilt’ describes a set of percentage-based adjustments that were applied to the uniform APP2 prices to produce different prices for each of the four Royal Mail zones. In January 2014, Royal Mail notified customers of a significant change to these prices.

3.61 Table 3.3 shows the zonal tilts that applied during the preceding financial year (2013-14).

Table 3.3: 2013-14 zonal tilts

2013-14 Zonal Tilt	Urban	Suburban	Rural	London
Percentage variance for letters	-12.9%	+0.3%	+13.9%	+9.9%
Percentage variance for large letters	-13.1%	-0.6%	+15.0%	+10.9%

Source: Royal Mail, Letter to customers – 2013 Access Prices, undated. (RM0062)

3.62 By virtue of Contract Change Notices 002 and 005 Royal Mail notified its access customers that it was changing the zonal tilts and that, during the financial year 2014-15, the variances set out in table 3.4 would apply.

Table 3.4: 2014-15 zonal tilts

2014-15 Zonal Tilt	Urban	Suburban	Rural	London
Percentage variance for letters	-25%	+10.4%	+44.1%	-25%
Percentage variance for large letters	-25%	+10.4%	+44.1%	-25%

Source: Royal Mail, Letter to customers containing Contract Change Notices 003 - 005, 10 January 2014. (RM0031)

3.63 Under the price plans in place up to the introduction of the CCNs, the application of the zonal tilts for 2013-2014 resulted in urban prices which were significantly lower than the uniform prices available under NPP1 and APP2, while rural and London prices were significantly higher. Suburban prices were very similar to the uniform prices available on NPP1 and APP2.

3.64 Under the changes to the zonal tilts introduced by the CCNs, the notified 2014-15 ZPP3 prices for urban and London zones were significantly reduced compared to 2013-14 prices, while the 2014-15 prices for suburban and rural zones were significantly increased. Royal Mail explained that it was making “[c]hanges to the zonal price differential between [its]

four zones (London, Urban, Suburban and Rural), so they are more reflective of relevant costs and market conditions.”¹⁴²

3.65 As the zonal prices were derived from APP2 prices, they were also increased as a result of the price differential between NPP1 and APP2. The impact of the price differential varies depending on the zonal tilt adjustment. Table 3.5 below illustrates this by applying the zonal tilt to an illustrative NPP1 price of 20 pence per item and comparing this to the price that results from applying the zonal tilt to the higher priced APP2.

Table 3.5: illustration of the impact of the price differential on zonal prices

	Urban	Suburban	Rural	London
NPP1 price (pence)	20	20	20	20
APP2 price (pence)	20.24	20.24	20.24	20.24
<i>Price differential</i>	<i>0.24</i>	<i>0.24</i>	<i>0.24</i>	<i>0.24</i>
Zonal tilt (2014-15)	-25%	10.40%	44.10%	-25%
NPP1 based zonal prices (pence)	15	22.08	28.82	15
APP2 based zonal prices (pence)	15.18	22.34	29.17	15.18
Impact of price differential on zonal prices (pence)	0.18	0.26	0.35	0.18

Source: Ofcom calculations.

3.66 It can be seen from the table above that the CCNs therefore also introduced a price differential as between NPP1 and ZPP3 prices.

3.67 The relevant Contract Change Notices are discussed in more detail in the following subsection.

¹⁴² Royal Mail, *Royal Mail response to Ofcom’s statement on Access contract changes*, 21 February 2014. (RM0018)

The January 2014 Contract Change Notices

- 3.68 In this section we explain in detail the changes introduced by the CCNs issued by Royal Mail in January 2014. These CCNs unilaterally altered the terms and conditions upon which access was provided.¹⁴³
- 3.69 Following our decision to open an investigation, Royal Mail suspended the implementation of a number of the notified price changes, pursuant to clause 13.8 of the ALC, which requires suspension of contract changes in the event of, and for the duration of, any regulatory investigation. However, Royal Mail announced that it had not suspended some changes which it believed were “*not the subject of the Ofcom investigation.*”¹⁴⁴ This included its general “*annual RPI-related price increase*” and its reallocation of some postcode sectors between zones.¹⁴⁵ The CCNs were eventually withdrawn by Royal Mail in March 2015.

Contract Change Notice 001

- 3.70 Royal Mail issued Contract Change Notice 001 on 15 November 2013.¹⁴⁶ It introduced three changes to APP2:
- a) It reduced the tolerance applied to the zonal posting profile from 7.5% to 2% (see paragraph 3.106).
 - b) It reduced the automatic transfer threshold from 15% to 10% (see paragraph 3.110).
 - c) It renamed the plan from “National Price Plan Two (Zones)” to “Averaged Price Plan Two (Zones).”
- 3.71 The notice period for these changes would have concluded on 31 March 2014. However, due to the opening of our investigation, the implementation of the changes was suspended on 21 February 2014.

Contract Change Notice 002

- 3.72 Royal Mail issued Contract Change Notice 002 on 10 January 2014.¹⁴⁷ It introduced price changes to the access prices for all three price plans. The notice refers to full details of the unilateral changes on the Royal Mail Wholesale Website and includes, in an annex, details of the prices for “key services” under the NPP1 contract.
- 3.73 The pricing details listed on Royal Mail’s website between 10 January 2014 and 4 March 2014 showed the combined effect of a number of price changes (some of which were introduced in Contract Change Notice 005):

¹⁴³ Subsequent to the changes notified in January 2014, Royal Mail has issued a number of further contract change notices. None of these subsequent changes are the subject of the investigation and we do not describe them in detail.

¹⁴⁴ Royal Mail, Letter to access customers, 4 March 2013, page 1. (RM0072)

¹⁴⁵ Ibid. (RM0072)

¹⁴⁶ Royal Mail, *Access Letters Contract Change Notice 001*, 15 November 2013. (RM0027)

¹⁴⁷ Royal Mail, *Access Letters Contract Change Notice 002*, 10 January 2014. (RM0030)

- a) A general price increase across all price plans, which Royal Mail described as RPI-linked price increases.
 - b) A change to the large letter products that split these into two different categories: a 'Business Mail' product for specified types of large letters and a higher priced General Large Letters product.
 - c) Price changes resulting from the price differential and revised zonal tilt (see paragraphs 3.52 to 3.66).
- 3.74 The notice period for these changes was to conclude on 31 March 2014. However, Royal Mail suspended them on 4 March 2014 and reissued the spreadsheets on its website to include only the general RPI-related price increase and the new large letters products (i.e. it removed the effect of the price differential and the revised zonal tilt).
- 3.75 Royal Mail's decision to suspend part of this notice and implement the remainder was questioned by Whistl. As a result, on 4 March 2014, Royal Mail issued a further version of Contract Change Notice 002 which notified only the unsuspended aspects of the original notice. Royal Mail described this as a protective notice that was issued without prejudice to the validity of the original notice. This protective notice took effect from 15 May 2014.

Contract Change Notice 003

- 3.76 Royal Mail issued Contract Change Notice 003 on 10 January 2014 (this notice was issued in a single letter together with Contract Change Notices 004 and 005).¹⁴⁸ It unilaterally introduced three changes to NPP1:
- a) A requirement to provide a two-year notification of reductions of volumes in any SSC (beyond a specified threshold) and the introduction of a surcharge regime for non-compliance (see paragraphs 3.97 to 3.100).
 - b) A requirement to provide a two-year forecast of total volumes on a monthly basis and the introduction of a right for Royal Mail to terminate an operator's NPP1 agreement if that operator's total volume was less than forecast by more than a specified amount (see paragraphs 3.95 to 3.96).
 - c) Changes to the structure of the tolerances related to the National Spread Benchmark so that Scotland and Northern Ireland would be measured as separate regions rather than a single region¹⁴⁹ (see paragraph 3.87).
- 3.77 The notice period for these changes would have concluded on 4 August 2014. However, due to the opening of our investigation, the implementation of these changes was

¹⁴⁸ Royal Mail, *Access Letters Contract Change Notices 003 - 005*, 10 January 2014. (RM0031)

¹⁴⁹ In the 2013 contract the permitted variance for National Spread Benchmark performance allows NPP1 customers to fail the benchmark in up to three SSCs in Scotland and Northern Ireland. This notice separates these areas and, read in conjunction with contract change notice 004, changes the permitted variance spread across the SSCs in Scotland and Northern Ireland.

suspended on 21 February 2014. This Notice was withdrawn in its entirety on 11 March 2015.

Contract Change Notice 004

- 3.78 Royal Mail issued Contract Change Notice 004 on 10 January 2014.¹⁵⁰ It unilaterally introduced four changes to NPP1:
- a) It reduced the tolerance for National Spread Benchmark compliance from six failed SSCs in England and Wales to five failed SSCs (see below paragraph 3.87).
 - b) Following on from Notice 003, it reduced the tolerance for National Spread Benchmark compliance from three SSCs in Scotland and Northern Ireland to one SSC in Scotland and none in Northern Ireland (see paragraph 3.87).
 - c) Following on from Notice 003, it specified the level of volume decline in SSCs that would trigger the requirement to provide a forecast (see paragraph 3.98).
 - d) Following on from Notice 003, it specified the level of allowed divergence from a contract volume forecast before Royal Mail would enter discussions with the customer about its forecasting (see paragraph 3.95).
- 3.79 The notice period for these changes would have concluded on 31 March 2014 in respect of (a), and 4 August 2014 for (b) to (d). However, again the implementation of these changes was suspended due to the opening of our investigation on 21 February 2014. This Notice was withdrawn in its entirety on 11 March 2015.

Contract Change Notice 005

- 3.80 Royal Mail issued Contract Change Notice 005 on 10 January 2014.¹⁵¹ It unilaterally introduced two main changes, one to APP2 and one to ZPP3:
- a) It introduced a price differential between NPP1 and APP2 prices, under which APP2 prices were set to be approximately 1.2% higher than NPP1 prices (see paragraphs 3.55 to 3.58). As explained above, as the zonal prices were derived from the APP2 prices, the ZPP3 prices also increased as a result of the price differential (see paragraph 3.65).
 - b) It changed the zonal tilts on the basis of which ZPP3 prices were set (see above paragraphs 3.59 to 3.64).
- 3.81 The notice period for these changes would have concluded on 31 March 2014. However, due to the opening of our investigation, the implementation of these changes was suspended on 21 February 2014. This Notice was withdrawn in its entirety on 11 March 2015.

¹⁵⁰ Royal Mail, *Access Letters Contract Change Notices 003 - 005*, 10 January 2014. (RM0031)

¹⁵¹ *Ibid.* (RM0031)

Detailed description of the price plans

3.82 In this section we provide a detailed description of the operation of the price plans, incorporating the changes introduced by the January 2014 CCNs. As noted above, some of the features were suspended and later withdrawn. This means that they did not become part of the contractual framework. However, in this section we describe the prices plans as they would have operated upon the implementation of all of the changes set out in the January 2014 CCNs.

NPP1

NPP1 eligibility

3.83 Access operators were eligible to use NPP1 if they could prove to Royal Mail's reasonable satisfaction that they had a reasonable likelihood of meeting the 'National Spread Benchmark' and 'Urban Density Benchmark'.¹⁵² As described above, the practical result of these benchmarks was that they required NPP1 operators to send mail to almost every part of the UK.

NPP1 surcharges and tolerances

3.84 Customers were required to "*agree to use all reasonable endeavours*" to meet both of the National Spread and Urban Density Benchmarks.¹⁵³ If an NPP1 operator failed to meet either of the benchmarks by more than a specified amount, and also failed to use all reasonable endeavours to attempt to meet the benchmarks, Royal Mail was entitled to impose a surcharge.¹⁵⁴

3.85 Royal Mail specified the amount by which NPP1 operators were allowed to miss either of the benchmarks and not be subject to the imposition of a surcharge. Royal Mail referred to these as "permitted tolerances".

3.86 In the case of the National Spread Benchmark, there were two permitted tolerances. The first permitted tolerance was that an NPP1 operator's actual proportion of mail to each SSC was not required to perfectly match the benchmark proportions (which was set by reference to Royal Mail's overall pattern of deliveries). This meant that an NPP1 operator would only fail to meet the benchmark in a particular SSC if the proportion of its mail volumes that it sent to that SSC was less than 70% of the proportion delivered by Royal Mail to that SSC.¹⁵⁵ For example, if Royal Mail sent 3% of its access and bulk mail to a particular SSC, an NPP1 operator was required to post at least c.2.1% of its mail to that SSC (being 70% of 3%).

¹⁵² Royal Mail, *Access Letters Contract (Schedule 3)*, page 39, clause 2.1. (RM0026)

¹⁵³ *Ibid.*, page 39, clause 3.1. (RM0026)

¹⁵⁴ Royal Mail, *Access Letters Contract (Schedule 3)*, page 39, clause 3.2. (RM0026)

¹⁵⁵ Royal Mail, *Spreadsheet Royal Mail National Spread and Urban Density Benchmarks – Letters* (RM0055); Royal Mail, *Royal Mail Wholesale – Quick Guide to the Pricing Plans (April 2013)*, April 2013, page 1. (WH0054)

- 3.87 The second permitted tolerance was that NPP1 operators were allowed to fail to meet the National Spread Benchmark in a certain number of SSCs. This applied where operators had posted less than the 70% threshold described above. Prior to January 2014, NPP1 operators were allowed to fail to meet the National Spread Benchmark in up to six SSCs in England and Wales and three SSCs in Scotland and Northern Ireland.¹⁵⁶ As part of its notified price changes, Royal Mail reduced this permitted tolerance to five SSCs in England and Wales, one in Scotland and none in Northern Ireland.¹⁵⁷
- 3.88 In the case of the Urban Density Benchmark, the permitted tolerance specified a range around the benchmark within which an NPP1 operator would be treated as having met the benchmark. This meant that the NPP1 operator's proportion of urban mail to a particular SSC may vary from the Urban Density Benchmark by up to 30 basis points (or, in absolute terms, 0.3%).¹⁵⁸ For example, if Royal Mail sent 3% of its access and bulk mail to urban sectors within a particular SSC, an NPP1 operator would meet the Urban Density Benchmark if it sent between 2.7% and 3.3% of its mail to urban sectors within that SSC.
- 3.89 A further feature of the NPP1 surcharge regime was that *"surcharges will not apply if customers are using all reasonable endeavours to meet the Royal Mail profile."*¹⁵⁹ Royal Mail had not set out a full description of what it would regard as 'using all reasonable endeavours', but in its guidance on ALC terms and processes it provided examples of where a profile is not achieved as a result of a *"change in company ownership (e.g. mergers, acquisitions) or company structure"* or as a result of *"unplanned/exceptional mailings."*¹⁶⁰
- 3.90 Royal Mail stated that it is *"aware that there can be many other circumstances that could constitute reasonable endeavours and we encourage customers to discuss these with us during the quarterly reviews to avoid surprises at year end"*.¹⁶¹ It added that it *"will examine each circumstance on its own facts and explain the reasons for any decision that [it] make[s]."*¹⁶²

Level of surcharges on NPP1

- 3.91 In relation to the National Spread Benchmark, surcharges would be levied where an operator failed to meet the benchmark in the relevant number of SSCs. The surcharge was calculated as the total price the operator would have paid, based on the average price it has paid, for the additional mailing items that would be required to achieve the benchmarks in those SSCs.¹⁶³ Operators were permitted to fail a certain number of SSCs

¹⁵⁶ Ibid. (RM0055)

¹⁵⁷ Royal Mail, *Access Letters Contract Change Notices Numbers 003 - 005*, 10 January 2014. (RM0031)

¹⁵⁸ Royal Mail, *Spreadsheet Royal Mail National Spread and Urban Density Benchmarks – Letters* (RM0055); Royal Mail, *Royal Mail Wholesale – Quick Guide to the Pricing Plans (April 2013)*, April 2013, page 2. (WH0054)

¹⁵⁹ Royal Mail, *New Access Contracts – Guidelines on key terms and processes*, 18 February 2013, page 4. (WH0031) See also Royal Mail, *Access Letters Contract (Schedule 3)*, page 39, clause 3.1. (RM0026)

¹⁶⁰ Ibid. (WH0031)

¹⁶¹ Ibid. (WH0031)

¹⁶² Ibid. (WH0031)

¹⁶³ Royal Mail, *Royal Mail Wholesale – Quick Guide to the Pricing Plans (April 2013)*, April 2013, pages 1 and 2. (WH0054)

and this tolerance was applied to the largest failures (i.e. those SSCs where the gap between the operator's actual volume and the volume that would be required to meet the benchmark is greatest).

3.92 The Urban Density Benchmark is about maintaining minimum volumes of urban mail (which is relatively less costly to deliver than suburban or rural mail). Urban Density Surcharges were based on the net volume of letters that fell *below* the benchmark in any SSC (by more than the tolerance) having offset any volumes above the benchmark in any SSC. If there was an overall deficit of urban mail, a surcharge could be levied on that volume which would reflect the additional price the customer would have paid to send that volume, through the zonal plan, to the rural zone.¹⁶⁴

NPP1 eligibility – new forecasting requirements

3.93 Contract Change Notice 003 notified access operators of the introduction of new forecasting requirements in order to use NPP1.¹⁶⁵ Prior to this change, there were no requirements on operators to provide long term forecasts of mail volumes. Instead, under the terms of the ALC, operators on all of the price plans were required to provide short term operational forecasts about anticipated volumes at particular inward mail centres.¹⁶⁶

3.94 NPP1 operators were required to provide two types of forecast.

3.95 The first type of forecast was a 'contract volume forecast' which set out the operator's expected total mailing volumes in each month for the following two years.¹⁶⁷ If this forecast proved to be incorrect by more than a specified amount (set at 10% under Contract Change Notice 004),¹⁶⁸ the customer would be required to discuss this with Royal Mail and make arrangements to improve its forecasting.

3.96 NPP1 operators were not contractually required to meet their total volume forecasts. However, failure to improve forecasting to within the specified amount would entitle Royal Mail to remove the customer from NPP1.¹⁶⁹

3.97 The second forecast was known as an 'SSC forecast'. This required an operator to identify any particular SSC in which it expected its volume to decrease by more than a specified amount over a forecast period of two years.¹⁷⁰ This was a requirement to forecast local or relative drops in volume rather than general or widespread changes in volumes.

¹⁶⁴ Royal Mail, *Access Letters Contract Change Notices 003 - 005*, 10 January 2014, Annex B, clause 10.1. (RM0031)

¹⁶⁵ *Ibid.*, Annex B, clause 1.1.3. (RM0031)

¹⁶⁶ Royal Mail, *Access Letters Contract (Schedule 2)*, page 37, clause 12. (RM0026)

¹⁶⁷ Royal Mail, *Access Letters Contract Change Notices 003 - 005*, 10 January 2014, clause 2.1(b). (RM0031)

¹⁶⁸ *Ibid.*, clause 3.1 (as defined under the term 'Normal Contract Volume Variance'). (RM0031)

¹⁶⁹ Royal Mail, *Access Letters Contract Change Notices 003 - 005*, 10 January 2014, Annex B, clause 5. (RM0031) Under clauses 5.2 and 5.3 if Royal Mail believes the operator's volume may fall more than 10% below its forecast it can require the operator to submit a plan to improve its forecasting methods. If the operator's forecasting does not fall within the 10% variance in the three months after this, Royal Mail can then terminate the operator's right to use NPP1.

¹⁷⁰ *Ibid.*, clause 2.1(a). (RM0031)

- 3.98 In particular, the forecast required operators to identify SSCs in which their performance against the National Spread Benchmark (calculated as the ratio of the operator's proportion of mail in an SSC divided by the National Spread Benchmark) was expected to decline by a factor of more than 0.4 compared to the previous year's ratio.¹⁷¹ For example, if an operator matched the benchmark, holding a ratio of 1, a 40% drop in volume would result in a decline of 0.4 (assuming all remaining volumes remained constant).
- 3.99 If the operator failed to identify a decline in advance, this would have entitled Royal Mail to impose a surcharge:
- a) if an unreported decline occurred in an SSC in the first year of a forecast, Royal Mail could levy a surcharge of 0.1% of the operator's total annual postage in that SSC; or
 - b) if an unreported decline occurred in an SSC in the second year of a forecast, Royal Mail could levy a surcharge of 0.05% of the operator's total annual postage in that SSC.¹⁷²
- 3.100 Royal Mail could also levy a surcharge of 0.05% of the operator's total annual postage in an SSC if a decline was reported but did not in fact occur.¹⁷³

Automatic transfer

- 3.101 If an NPP1 operator was subject to a total surcharge related to either benchmark that was equivalent to more than 15% of its total mailing volume under NPP1, the operator's right to post under NPP1 would be terminated on 30 days' notice and the operator would then have to use ZPP3.¹⁷⁴

APP2

APP2 eligibility

- 3.102 Access operators were eligible to use APP2 if they could prove to Royal Mail's "*reasonable satisfaction that it is reasonably likely*" that the geographic spread of the operator's deliveries would meet the 'Royal Mail Zonal Posting Profile'.¹⁷⁵ The Royal Mail Zonal Posting Profile was the proportion of Royal Mail's access and bulk mail that it delivered to each of the four zones.¹⁷⁶
- 3.103 In effect, this price plan required APP2 operators to balance the total level of mail they sent to each of the four zones such that the proportions going to each zone reflected Royal Mail's Zonal Posting Profile (as set out in table 3.6). Unlike NPP1, APP2 did not necessarily require operators to send mail across the whole of the UK.

¹⁷¹ The factor of 0.4 is set under Contract Change Notice 004 as defined under the term 'SSC Variance' – see Royal Mail, *Access Letters Contract Change Notices 003 - 005*, 10 January 2014, clause 3.1. (RM0031)

¹⁷² *Ibid.*, Annex B, clauses 4.2.1 and 4.2.2(a). (RM0031)

¹⁷³ *Ibid.*, Annex B, clause 4.2.2(b). (RM0031)

¹⁷⁴ *Ibid.*, Annex B, clause 14.1. (RM0031)

¹⁷⁵ Royal Mail, *Access Letters Contract (Schedule 3)*, page 39, clause 2.1. (RM0026)

¹⁷⁶ *Ibid.*, (Schedule 1), page 28. (RM0026)

Table 3.6: 2014-15 Zonal Posting Profile

Royal Mail Zonal Posting Profile (weighted average) ¹⁷⁷	Urban	Suburban	Rural	London
2014-15 ¹⁷⁸	33.98%	30.82%	20.55%	14.65%

Source: Royal Mail, Letter to access customers, 7 March 2014 (updating Contract Change Notice 006, 17 January 2014)

APP2 surcharges and tolerances

- 3.104 APP2 operators were required to conform to the Zonal Posting Profile. If they failed to meet the profile by more than a specified amount, Royal Mail could impose a surcharge.¹⁷⁹ Unlike the NPP1 profile requirements, APP2 operators were subject to an absolute requirement to comply with the benchmark rather than a requirement to use all reasonable endeavours to do so.
- 3.105 The APP2 surcharge regime was complex, but in effect it allowed for the imposition of a surcharge in circumstances where an operator’s volume of mail within a zone exceeded the permitted variance applied to the Royal Mail profile for that particular zone.¹⁸⁰ APP2 surcharges only applied, however, to excess volumes in those zones where the ZPP3 price was above the average national price. We outlined how ZPP3 prices are set in paragraphs 3.60 to 3.63 above).
- 3.106 The CCNs introduced substantial changes to the APP2 surcharge regime. We set out below the position that applied in 2013-14 as well as the position following the CCNs. The starting point for each of those time periods is as follows:
- a) During 2013-14, APP2 operators were liable to be surcharged if the proportion of letters they posted to suburban and rural zones exceeded the Zonal Posting Profile by more than 7.5%.¹⁸¹ This is an effective allowance of suburban volumes of c.33.1% and rural volumes of c.22.1%.
 - b) Under the terms of the CCNs, APP2 operators were liable to be surcharged if the proportion of letters they posted to suburban, rural and London zones exceeded Royal Mail’s profile by more than 2%.¹⁸² This is an effective allowance of suburban volumes of c.31.4%, rural volumes of c.21.0% and London volumes of c.14.9%.

¹⁷⁷ Ibid., (Schedule 3), Annex A, page 44, paragraph 1. (RM0026) The benchmark is the weighted average of zonal price variances (see table 3.2 above) across Letters and Large Letters. In 2014-15, the Letters and Large letters variances were identical.

¹⁷⁸ Royal Mail, *Access Letters Contract Change Notice 006*, 17 January 2014 (updated by letter 7 March 2014). (RM0056)

¹⁷⁹ Royal Mail, *Access Letters Contract (Schedule 3)*, page 39, clause 3.2 (RM0026); Royal Mail, *Royal Mail Wholesale – Quick Guide to the Pricing Plans (April 2013)*, April 2013, page 3. (WH0054)

¹⁸⁰ Ibid., Annex A. (RM0026)

¹⁸¹ Royal Mail, *Royal Mail Wholesale – Quick Guide to the Pricing Plans (April 2013)*, April 2013, page 3. (WH0054)

¹⁸² Royal Mail, *Access Letters Contract Change Notice 001*, 15 November 2013, Annex 1, paragraph 1.1. (RM0027)

Level of surcharges on APP2

- 3.107 In broad terms, Royal Mail calculated the level of surcharges which applied by reference to the amount that the access operator would have paid had it been charged on the basis of the zonal prices in ZPP3 instead of the uniform prices in APP2. Royal Mail would do this by calculating the ‘allowed invoice amount’, which is the maximum approximate amount the customer *could have been* charged on the basis of separate zonal charges while still fitting within the zonal posting profile (as adjusted for tolerance) required by APP2.¹⁸³
- 3.108 Royal Mail would then calculate the ‘implied invoice amount’, which is the amount the customer *would have been* charged under ZPP3 based on its actual posting profile. If the customer’s ‘implied invoice amount’ exceeds the ‘allowed invoice amount’, then Royal Mail would be able to impose a surcharge equal to the difference.¹⁸⁴ APP2 surcharges were therefore comparable to the difference in total price that an operator would have paid if it had used ZPP3 instead of APP2.
- 3.109 For this calculation excess volumes in any expensive zones increase the likelihood of a surcharge, whereas lower volumes (than Royal Mail’s zonal profile) in any expensive zones decrease the likelihood of a surcharge. This meant, for example, that an operator who had excess volumes in the suburban zone may not have in fact incurred a surcharge if it had lesser volumes in the rural zone.

Transfer

- 3.110 If the total volume of mailing items in relation to which surcharges were levied exceeded 10%¹⁸⁵ of the operator’s total annual mailing volume, the customer could be required to transfer to ZPP3.¹⁸⁶ In practice, this situation would arise where the operator’s combined proportion of mail to suburban and rural zones (under the notified terms of 2014-15) exceeds the maximum allowed amount by more than 10%.

ZPP3

ZPP3 eligibility

- 3.111 ZPP3 did not have any specific eligibility criteria or any requirement to meet specific mailing profiles. This price plan did not therefore contain any profile surcharging measures. A key distinction between ZPP3 and the other plans was a requirement to include on every

¹⁸³ The test simplifies the zonal pricing arrangement, particularly under the 2013-14 zonal tilt in which actual zonal pricing variances, as used by ZPP3, differed between Letters and Large Letters, whereas under APP2 a weighted average pricing variance is used.

¹⁸⁴ Royal Mail, *Access Letters Contract (Schedule 3)*, page 42, clause 4 and page 44, Annex A. (RM0026)

¹⁸⁵ Royal Mail, *Access Letters Contract Change Notice 001*, 15 November 2013, Annex, clause 1.2 (prior to Contract Change Notice 001, this threshold was set at 15%). (RM0027)

¹⁸⁶ Royal Mail, *Access Letters Contract (Schedule 3)*, page 43, clause 8.1. (RM0026)

letter the zonal indicia (i.e. an external indication of the zone in which the delivery address is located).¹⁸⁷

¹⁸⁷ Royal Mail, *Access Letters Contract (Schedule 3)*, page 45, clause 3.1. (RM0026) These requirements are set out in Appendix F of *Access Letters User Guide for Inward Mail Centres (version 2)*, July 2013. (PD0038)

4. Chronology of events

Introduction

- 4.1 In this section, we provide an overview of the relevant events leading up to the introduction of the price differential in January 2014 as part of the CCNs, and the consequences of that conduct. In summary:
- a) First, in sub-section A, we outline the background to Whistl's launch of its own delivery network, starting with a pilot service in 2012, and then the steps it took to secure external investment in order to expand its activities as an end-to-end competitor to Royal Mail.
 - b) Second, in sub-section B, we describe the development by Royal Mail of the CCNs, and, specifically, the price differential. This sub-section is based, in particular, on the contents of Royal Mail's internal contemporaneous documents, which we have obtained using our statutory information gathering powers.
 - c) Third, in sub-section C, we set out how Whistl, and its investors LDC and PostNL, responded to the CCNs in the immediate period after they were introduced and suspended. This sub-section is based, in particular, on the contents of LDC's and Whistl's internal contemporaneous documents, which we have obtained using our statutory information gathering powers.
 - d) Fourth, in sub-section D, we outline the proposals which Ofcom consulted on in December 2014, the subsequent decisions by Royal Mail to withdraw the CCNs and the decision by Whistl to exit the bulk mail delivery market.

A. 2012 to 2013, Whistl's initial entry into the bulk mail delivery market and negotiations with LDC

- 4.2 In a witness statement provided to Ofcom with Whistl's complaint in January 2014, Nick Wells (CEO, Whistl) explained that Whistl, as a wholly owned subsidiary of PostNL, which was active in other end-to-end markets in Germany and Italy, had entered the UK's access market in 2004 with the intention of developing its own end-to-end capability.¹⁸⁸
- 4.3 As explained at paragraph 2.36 above, in 2008, Whistl carried out a small-scale trial of the operational viability of delivery in Liverpool. This enabled Whistl to develop a detailed business plan and secure investment from its parent company, PostNL.¹⁸⁹
- 4.4 In April 2012, Whistl launched a pilot bulk mail delivery service in West London.¹⁹⁰ The service was expanded to Central South West London and the City of London in September

¹⁸⁸ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 7, paragraph 17. (WH0132)

¹⁸⁹ *Ibid.*, page 8, paragraph 20. (WH0132)

¹⁹⁰ *Ibid.*, page 8, paragraph 20. (WH0132)

and November 2012 respectively.¹⁹¹ On 25 February 2013, PostNL announced that the pilot had been successful and that it would be seeking to launch a full service.¹⁹² It noted that PostNL had “*absolute cash constraints within PostNL in the years ahead*”¹⁹³ and that, accordingly, it was receptive to an investment partner to contribute to an overall investment of “*€50 to €80 million.*”¹⁹⁴

4.5 In May 2013, Whistl produced an Investment Memorandum to support PostNL’s aim of securing a funding partner. This Investment Memorandum set out in significant detail the commercial opportunity presented by Whistl’s entry into the end-to-end delivery market. It sought an overall investment of circa £52 million to fund capex and start-up losses and incremental working capital,¹⁹⁵ and projected “*growth in EBIT from £10 million in [financial year 2012] to £67 million in [financial year 2018]*”.¹⁹⁶

4.6 In the Investment Memorandum, Royal Mail’s pricing was recognised as a regulatory risk:

*“Regulatory Risks... Further change in pricing metrics to make NPP One – a plan that [Whistl] cannot access – cheaper than NPP Two...”*¹⁹⁷

*“Risk Response... Possible that this may happen in April 2014 repricing, but would be seen as discriminatory against the nascent E2E service from [Whistl] – unlikely that Ofcom would be supportive of differential pricing until competitive force established”.*¹⁹⁸

4.7 In an analyst presentation on 7 May 2013, PostNL said “*[w]e have started preparations for the expansion of our E2E pilot into the Southwest of London. As announced in our Q4 presentation, we are looking for a co-investor and we will update you when we have more news on this.*”¹⁹⁹ Whistl expanded into South-West London in July 2013.²⁰⁰

4.8 On 5 August 2013, PostNL repeated in a further analyst presentation that it was “*not able to find enough cash to invest in this end-to-end and that means that last May we started a process to find a co-investor and at this moment in time we can say we are well underway, which means that there is interest and that we are talking to several parties.*”²⁰¹ During this period PostNL was negotiating with LDC, the private equity arm of Lloyds Banking Group.

4.9 In October 2013, LDC appointed PwC to carry out due diligence activities on the proposed deal. The resulting due diligence report noted: “*in future Royal Mail could try make [sic] alterations to the plans in order to protect the profitability of the group and complete the*

¹⁹¹ See figure 4.2 below.

¹⁹² In this period, and for all events covered in this chapter, Whistl was a wholly owned subsidiary of PostNL.

¹⁹³ PostNL, *Transcript of Press Conference*, 25 February 2013, page 6. (PD0061)

¹⁹⁴ PostNL, *Q4 & FY 2012 Results Update 2013 – Sustainable delivery*, 25 February 2013, slide 29. (PD0058)

¹⁹⁵ Whistl, *Project Luke – Investment Memorandum*, May 2013, slide 5. (WH0709)

¹⁹⁶ *Ibid.*, slide 6. (WH0709). Whistl noted that this assumed resolution of VAT inequality between it and Royal Mail and projected a 2018 EBIT of £55m million without VAT resolution (see slide 11).

¹⁹⁷ *Ibid.*, slide 60. (WH0709)

¹⁹⁸ *Ibid.*, slide 60. (WH0709)

¹⁹⁹ PostNL, *Transcript of Analyst presentation*, 7 May 2013, page 2. (PD0054)

²⁰⁰ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 8, paragraph 20. (WH0132)

²⁰¹ PostNL, *Transcript of Analyst presentation*, 5 August 2013, page 9. (PD0055)

universal service obligation [including through a...] change in the pricing metrics to make NPP One cheaper...".²⁰² PwC found that "[w]hile changes would be subject to review, the regulator has indicated that there is unlikely to be... a divergence of the price plans."²⁰³ Ultimately it reached the view that "the pricing structure (price plans / surcharges) is unlikely to change [and that] "Extreme" pricing policies will not be allowed by Ofcom."²⁰⁴

- 4.10 Whistl and PostNL continued to negotiate with LDC in the following months and, by December 2013, had reached a position where the parties expected to sign a Share Purchase and Sale agreement on 9 or 10 of December 2013 to formalise LDC's investment in Whistl.²⁰⁵ This was to be followed by a merger filing to the European Commission with completion expected in late January 2014 (conditional on merger clearance and there being no material adverse changes).

B. 2013-2014, Royal Mail's development of the January 2014 Contract Change Notices

Royal Mail governance boards and committees

- 4.11 This section explains the governance process applied by Royal Mail in deciding to issue the CCNs which introduced a price differential. This involved a number of bodies within Royal Mail:
- a) The Royal Mail plc Board ("Board"), and its predecessor Royal Mail Group Board, which, during the period relevant for this assessment, consisted of the Chairman, seven non-executive directors and three executive directors: CEO, [X]; CFO, [X]; and Managing Director Operations and Modernisation, [X].
 - b) The Chief Executive's Committee ("CEC"), which according to Royal Mail is "*[r]esponsible for all the key areas of commercial activity within the Group, including management of the overall framework of financial risk and business controls and assignment of key accountabilities for business performance.*"²⁰⁶ During the period relevant for this assessment, the CEC consisted of the CEO, [X], CFO, [X], Managing Director Operations and Modernisation, [X], and ten senior Royal Mail executives.
 - c) The Disclosure Committee is a sub-committee of the CEC,²⁰⁷ with which it shares many members. According to Royal Mail, the Disclosure Committee "*serves to assist in meeting Royal Mail's statutory and regulatory disclosure obligations, including those arising from a stock exchange listing.*"²⁰⁸ During the period relevant for this assessment, the Disclosure Committee consisted of the CEO, [X], CFO, [X], six senior

²⁰² PwC, *Project Luke – Draft Commercial Due Diligence Report*, 25 October 2013, slide 79. (WH0710)

²⁰³ *Ibid.*, slide 79. (WH0710)

²⁰⁴ *Ibid.*, slide 8. (WH0710)

²⁰⁵ See investment timetable described in Whistl, *Presentation to Ofcom*, 9 December 2013, slide 16. (WH0717)

²⁰⁶ See Royal Mail, *Management and committees*, accessed on 22 April 2015. (PD0044)

²⁰⁷ Royal Mail, *Minutes of the meeting of the Disclosure Committee (being a Sub-Committee of the Chief Executive's Committee)*, 6 January 2014 (RM0122); Royal Mail, *Minutes of the meeting of the Disclosure Committee (being a Sub-Committee of the Chief Executive's Committee)*, 8 January 2014. (RM0131)

²⁰⁸ Letter from [X] (Royal Mail) to [X] (Ofcom), 8 April 2014. (RM0152)

Royal Mail executives and CEC members, as well as a number of additional Royal Mail directors.

- d) The Pricing Strategy Board (“PSB”), which is an operational committee that coordinates retail, wholesale and international pricing decisions across Royal Mail. It contains many of the members of the CEC. During the period relevant for this assessment, the PSB consisted of CEO, [redacted], CFO, [redacted], four senior Royal Mail executives and CEC members, as well as a number of additional Royal Mail directors.

Royal Mail’s “Letters Strategy” and “Letters Pricing Strategy”

- 4.12 Royal Mail made significant changes to the contractual framework for D+2 Access in January 2013. This is described in Section 3 above. As noted at paragraph 3.25, Royal Mail did not implement some of the price changes it had consulted on at that time, but it did state that it would continue to review pricing under the Access Letters Contract.
- 4.13 Royal Mail started working towards introducing new price changes in the spring of 2013, when Royal Mail launched a project that would ultimately lead to the introduction of a price differential in the CCNs of January 2014.
- 4.14 The early stage of this project involved the preparation of presentations to the CEC (in May 2013) and to the Board (in June 2013) that set out Royal Mail’s overall strategy in the letters markets (referred to below as the ‘Letters Strategy’), which identified possible risks to Royal Mail’s position in letters, including direct delivery competition, and started to identify possible actions to address these risks.
- 4.15 At the same time, a project was initiated, by way of a proposal to the PSB in May 2013, to develop the detailed pricing proposals that would be used to implement the ‘Letters Strategy’ (referred to below as the ‘Letters Pricing Strategy’). This included seeking to identify a possible pricing strategy to respond to the perceived threat of direct delivery competition. Over the next few months to September 2013, the PSB was presented with several updates on the letters pricing project which involved the development of options for pricing changes, which included a proposal to introduce a price differential between NPP1 and APP2/ZPP3.

May 2013 to June 2013 – The Letters Strategy as presented to the CEC and the Board

- 4.16 On 15 May 2013, the CEC reviewed a presentation on the ‘Letters Strategy’ which was then taken to the Board on 26 June 2013.²⁰⁹ The ‘Letters Strategy’ presentation “*describes the approach and initiatives [Royal Mail] will deploy in order to deliver the core Letters*

²⁰⁹ Royal Mail told us that there were no minutes from the CEC meeting of 15 May 2013. However, the relevant material appears to have been approved as it was subsequently included in the version of the presentation submitted to Board on 26 June 2013 (see Letter from [redacted] (Royal Mail) to [redacted] (Ofcom), 20 January 2015). (RM1269)

revenues for the Business Plan”²¹⁰ and seeks approval for the “Strategic Intent” for the Letters Strategy. This was to:²¹¹

“Successfully manage the Letters decline. Secure value from Letters over the medium term in line with the Business Plan. Mitigate the risk of greater than forecast decline [; and]

*Remain the carrier of choice for delivery of Letters in the UK.”*²¹²

- 4.17 The document explained that “Letters are crucial to achieving the required revenues to drive our overall business plan EBIT.”²¹³ It identified four risks to letters revenue, including “further consolidation in the Wholesale market which triggers direct delivery competition”,²¹⁴ “Direct Delivery grows without regulatory intervention”²¹⁵.
- 4.18 The presentation also considered: “Potential market evolution – scenarios and potential influence on Direct Delivery risk to Business Plan”, charting possible developments influencing direct delivery competition starting from a description of the market structure in 2013/14 up to 2016/17 and outlining the risk that these developments were said to pose to the Royal Mail Business Plan.²¹⁶ The relevant slide, Slide 19, is shown below in Figure 4.1. As shown in Figure 4.1, the slide described the market situation at the time and then identified a range of possible outcomes which were depicted along an arrow ranging from those outcomes that represented a “Reduced risk to the plan”, to those outcomes that represented an “Increased risk to the plan”. Of the possible outcomes considered, “[Whistl] remains focussed on upstream only (as is)” was positioned as a “[r]educed risk to plan” (the least risk), while “Direct Delivery risk increases”, was positioned as an “increased risk to plan” (the most risk).²¹⁷

²¹⁰ Royal Mail, Presentation entitled *Letters Strategy – Royal Mail Group Board*, 26 June 2013, slide 4. (RM1033)

²¹¹ *Ibid.*, slide 2. (RM1033)

²¹² *Ibid.*, slide 5. (RM1033)

²¹³ *Ibid.*, slide 4. (RM1033)

²¹⁴ *Ibid.*, slide 4. (RM1033)

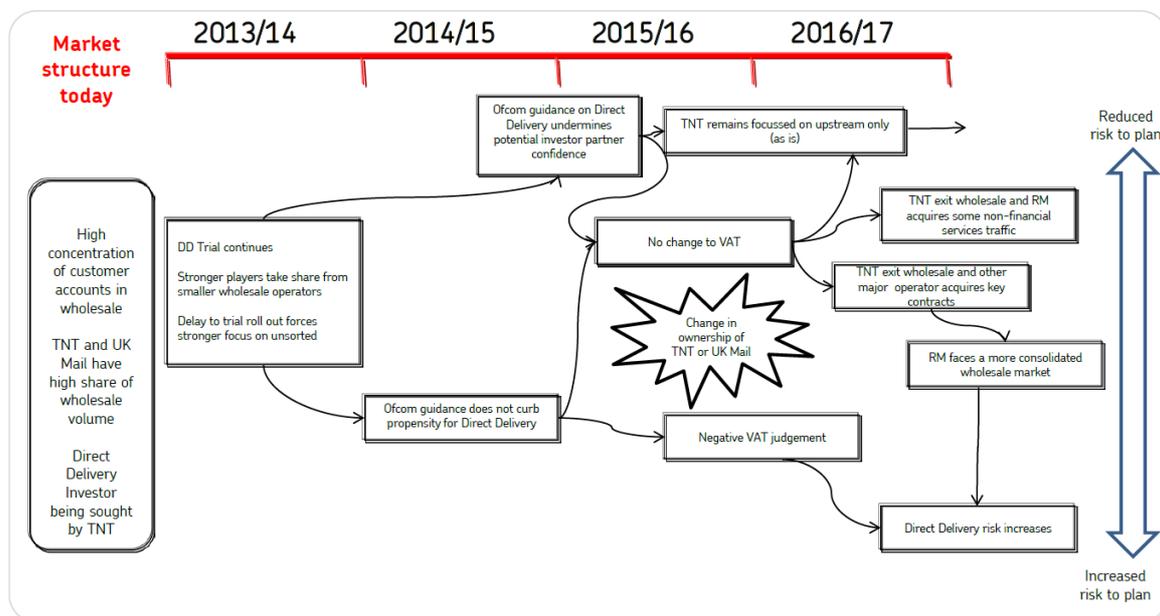
²¹⁵ *Ibid.*, slide 18 (RM1033)

²¹⁶ *Ibid.*, slide 19. (RM1033)

²¹⁷ *Ibid.*, slide 19. (RM1033)

Figure 4.1 Slide 19 from Royal Mail's *Letters Strategy Board* presentation

Potential market evolution - scenarios and potential influence on Direct Delivery risk to Business Plan



Royal Mail, Presentation entitled *Letters Strategy – Royal Mail Group Board*, 26 June 2013, slide 19. (RM1033)

4.19 The presentation went on to explain that Royal Mail had already completed a number of mitigating actions. These include:

“2) Modified access contracts... Introduced new access contract (which over 80% of wholesale volumes are now on) that enable Royal Mail to modify price levels and price structure more easily, in response to market developments.”²¹⁸

“3) Assessed impact on business plan... Completed work to assess the likely pace of TNT roll out will be and implications for plan overlay – included Direct Delivery as a risk to the business plan but not in the mainline forecast.”²¹⁹

4.20 The presentation also set out a number of areas which Royal Mail considered might further mitigate the risk of end-to-end entry, including an assessment of price changes. The presentation states that [S].” The presentation notes that this option was considered to be “[r]eactive” and a “[l]ast resort”.²²⁰ At this stage, Royal Mail was however considering as a “pre-emptive” response, “[g]eographically focussed changes” such as a change to “Tilt

²¹⁸ Ibid., slide 33. (RM1033)

²¹⁹ Ibid. (RM1033)

²²⁰ Ibid., slide 34. (RM1033)

zonal pricing” (which was described as “*cost neutral*”) in combination with “*Zonal disaggregation*”, such as splitting the London zone into “*inner London/inside M25*”.²²¹

May 2013 to September 2013 – the Letters Pricing strategy as presented to the PSB

May 2013

- 4.21 On 15 May 2013, a paper was presented to the Pricing Strategy Board proposing a project “*for taking [a] strategic look at access price structures across Access services.*”²²² The proposal explained that “*new access contracts introduced in April provide an opportunity to review our pricing structure and unlock greater pricing flexibility.*”²²³ It added that “[*t*]here are also a number of threats and challenges, including... *direct delivery.*”²²⁴ The PSB was asked to “*review the commercial objectives of the work and to determine their prioritisation.*”²²⁵
- 4.22 The proposal reported that “[*Whistl*] announced plans in the last week to extend their direct delivery operation to cover all of the SW postcodes, which is likely to increase their weekly volumes from 600k to 1 million. [*Whistl*] remain on a national access contract (rather than a zonal contract.)”²²⁶ The proposal noted that: “*Various zonal pricing options, for access contracts in general, are still under consideration. These options are partially constrained by the Retail price structure and therefore we need to take a cross business view.*”²²⁷
- 4.23 The proposal then explained that the “*commercial strategy*”²²⁸ involved looking at the following objective and opportunity:
- “Conclude preliminary work on zonal access pricing to ensure we charge a fair price to customers who do not present us a national profile of mail, and to optimise the price differential between the national plans.”*²²⁹

July 2013

- 4.24 On 23 July 2013, a paper was presented to the PSB on the letters pricing project addressing the “*business objectives and initial view of pricing options.*”²³⁰

²²¹ Ibid. (RM1033)

²²² Royal Mail, *Pricing architecture options and opportunities across Access and Retail - Project proposal*, 10 May 2013, page 1. (RM0971)

²²³ Ibid., page 1, paragraph 1.1. (RM0971)

²²⁴ Ibid. (RM0971)

²²⁵ Ibid, page 1, paragraph 1.2. (RM0971)

²²⁶ Ibid., page 1, paragraph 2.3. (RM0971)

²²⁷ Ibid., page 1, paragraph 2.4. (RM0971)

²²⁸ Ibid., page 1, paragraph 3. (RM0971)

²²⁹ Ibid., page 1, paragraph 3.2. (RM0971)

²³⁰ Royal Mail, Presentation entitled *Letter Pricing Strategy: Business objectives and initial view of pricing options*, 23 July 2013, title slide. (RM0976)

- 4.25 The presentation noted that a “[k]ey business objective”²³¹ of the wholesale Letters Strategy was to “[p]rotect the USO”²³² by “[d]efend[ing] downstream mail volumes against the threats of Direct Delivery...” This included “[e]nsur[ing] operators pay a fair cost reflective price for cream skimming Direct Delivery and that the USO is not put at risk from stranded legacy costs.”²³³
- 4.26 The presentation then set out a number of pricing options. ‘Option 1’ was to “[i]ntroduce a price differential between the 2 national price plans”²³⁴ which would “[c]reate [a] financial incentive for providing a national mail distribution.”²³⁵ The presentation noted that “[i]t is difficult to cost justify a price difference.”²³⁶

August 2013

- 4.27 On 21 August 2013, an updated set of initial options was presented to the PSB for discussion.²³⁷ This included a “[p]roposition” to “[c]reate a price/financial incentive for committing to a national distribution of mail to all postcodes.”²³⁸ The presentation noted that the value of this proposition “[d]epends on the price difference between each type of Access contract and whether this can be cost justified” and that the “[p]roposition needs to be objectively justified to ensure regulatory cooperation.”²³⁹ The presentation noted that “Oxera [Royal Mail’s economic advisers] are looking at this”²⁴⁰ (we discuss Oxera’s involvement further below).

September 2013

- 4.28 By September 2013, the letters pricing project appears to have advanced to the stage of preparing a set of preferred options, including proposed price changes. On 17 September 2013, the letters pricing project reported to the PSB with a more developed set of options. The presentation identified a ‘business problem’ and a ‘business question’:

“Business Problem... An operator on wholesale National Price Plan 2 (Zones) [referred to hereafter as NPP2 (Zones)] would currently be able to roll out a Direct Delivery (DD) network on a scale that could jeopardise the economics of the USO while still remaining within PP2 (Zones) tolerances and paying the average uniform national access price.”²⁴¹

“Business Question... How do we ensure that DD operators pay a cost reflective price for their use of our network? Whereby Royal Mail, as the downstream provider of

²³¹ Ibid., slide 8. (RM0976)

²³² Ibid. (RM0976)

²³³ Ibid. (RM0976)

²³⁴ Ibid., slide 9. (RM0976)

²³⁵ Ibid. (RM0976)

²³⁶ Ibid. (RM0976)

²³⁷ Royal Mail, Presentation entitled *Letters Pricing Strategy: Business objectives and initial view of pricing options – for discussion*, 21 August 2013. (RM0978)

²³⁸ Ibid., slide 6. (RM0978)

²³⁹ Ibid. (RM0978)

²⁴⁰ Ibid. (RM0978)

²⁴¹ Royal Mail, *Protecting USO Option Overview*, 17 September 2013, slide 1. (RM0754)

last resort, does not need to maintain a full network in future to manage the unpredictability of volumes, putting it at a cost disadvantage.”²⁴²

- 4.29 The presentation outlined a number of options for addressing this question. ‘Option A’ was to “[i]ntroduce a price discount on NPP1 (SSC), without a volume commitment”²⁴³ by which Royal Mail would “[k]eep NPP2 (Zones) but price it higher than NPP1 (SSC) to incentivise migration.”²⁴⁴ The paper noted that the “[r]ationale is to move national/non-DD operators onto a price plan which is better at protecting the USO, whilst ensuring that a DD operator is paying a higher price reflective of the lower predictability of volumes.”²⁴⁵
- 4.30 The paper stated that this option “[w]ill address [the] problem if the price differential is meaningful, e.g. 0.5p”²⁴⁶ but that “[t]he price differential needs to be objectively justified, probably in terms of cost, and this is not straightforward.”²⁴⁷
- 4.31 The minutes of the PSB meeting record that “[t]here was extensive discussion on this topic with five options were considered, It was decided, [sic] however, that further discussions outside of the PSB were required to formulate the strategy.”²⁴⁸

The recommendation on access pricing changes

- 4.32 In November 2013 a paper, ‘Regulatory Strategy’, which set out in more detail the overall objectives of the price changes, was presented to the CEC and the Board. Around the same time the CEC also reviewed a detailed presentation, ‘Options for protecting the USO’, that set out the proposed price changes in detail, including the proposals and rationale for introducing a price differential between NPP1 and APP2.

November 2013 – Regulatory Strategy approved by the CEC and the Board

- 4.33 The options developed in the letters pricing project were included in a presentation of Royal Mail’s ‘regulatory strategy’ to the Chief Executive’s Committee on 1 November 2013²⁴⁹ and subsequently to the Royal Mail Board on 15 November 2013.²⁵⁰
- 4.34 The minutes of the CEC meeting record that it “agreed the regulatory strategy as presented for progression to the Board on 15 November, 2013.”²⁵¹ [Original emphasis]

²⁴² Ibid. (RM0754)

²⁴³ Ibid. (RM0754) Other options included increasing tolerances (and increasing penalties) on APP2 push end-to-end operators onto ZPP3, removing APP2, introduced discounts for volumes commitments and discounting by SSC.

²⁴⁴ Ibid. (RM0754)

²⁴⁵ Ibid. (RM0754)

²⁴⁶ Ibid. (RM0754)

²⁴⁷ Ibid. (RM0754)

²⁴⁸ Royal Mail, *Minutes of the meeting of the Pricing Strategy Board*, 17 September 2013, page 5. (RM0979)

²⁴⁹ Royal Mail, Presentation entitled *Royal Mail Group – Regulatory Strategy*, 1 November 2013. (RM0958)

²⁵⁰ Royal Mail, Presentation entitled *Royal Mail Group – Regulatory Strategy*, 15 November 2013. (RM0952)

²⁵¹ Royal Mail, *Chief Executive’s Committee – Minutes of meeting held on 1st November 2013*, 1 November 2013, page 5. (RM0957)

- 4.35 In the regulatory strategy presentation to the Royal Mail Board on 15 November 2013, Royal Mail identified six key objectives of its regulatory strategy.²⁵² The first objective was to “[s]afeguard the USO in the face of increasing delivery competition”.²⁵³ The presentation went on to outline Royal Mail’s intention to “[p]rotect and exploit” its “current position” during the final two quarters of 2013/14 by “[s]upport[ing] the commercial pricing response to Direct Delivery in the face of likely regulatory challenge.”²⁵⁴
- 4.36 In its detailed summary of the objective to “[s]afeguard the USO in the face of increasing competition”²⁵⁵ the presentation outlined a number of key features of the current and anticipated market picture. In particular, the presentation:
- a) explained that the current position as at November 2013 was one in which Whistl “forecasts 40% UK delivery point coverage by 2017;”²⁵⁶
 - b) outlined Royal Mail’s view that “Ofcom will review by end 2015 if it has not already done so, however may not intervene at that stage dependent on circumstances – the delays inherent in the current approach are likely to mean that any intervention would be too late to be effective”;²⁵⁷
 - c) acknowledged that there were: “Significant legal and competition law risks should Royal Mail take commercial action to respond to the threat”;²⁵⁸
 - d) explained that Royal Mail’s key initiative in this area would involve “[d]evelop[ing] a “best case” commercial response which does not reduce revenues e.g. zonal tilting and price plan differentials;”²⁵⁹
 - e) stated that Royal Mail would “[d]evelop [a] clear objective justification for different access price plans, for example based on benefits of volume certainty”;²⁶⁰ and
 - f) concluded that the “[s]hort term” outcome is to “[s]upport the commercial pricing response to Direct Delivery in the face of likely regulatory challenge”.²⁶¹
- 4.37 The minutes of the Board meeting of 15 November 2013 record its discussion as follows:
- “[X A Royal Mail Executive] reported that the Company was seeking to introduce a set of subtle commercial responses into the market in January in relation to access prices. There would also be a change to the zonal prices which Ofcom had challenged*

²⁵² The objectives were as follows: “1. Safeguard the USO in the face of increasing delivery competition”; [X]. Royal Mail, Presentation entitled *Royal Mail Group – Regulatory Strategy*, 15 November 2013, slide 2. (RM0952)

²⁵³ Ibid. (RM0952)

²⁵⁴ Ibid., slide 8. (RM0952)

²⁵⁵ Ibid., slide 10. (RM0952)

²⁵⁶ Ibid. (RM0952)

²⁵⁷ Ibid. (RM0952)

²⁵⁸ Ibid. (RM0952)

²⁵⁹ Ibid. (RM0952)

²⁶⁰ Ibid. (RM0952)

²⁶¹ Ibid. (RM0952)

the Company to undertake. The Board was advised that these measures were not without risk...

*The Board approved the Regulatory Strategy and agreed the priority initiatives.”²⁶²
[Original emphasis]*

November 2013 – Options for ‘protecting’ the USO in response to direct delivery competition

4.38 Detailed recommendations resulting from the Letters Pricing Strategy were taken to the CEC on 13 November 2013.

4.39 In a presentation entitled ‘*Options for protecting the USO*’, Royal Mail reiterated its concerns about end-to-end competition. The “Management summary” stated the following:

- *“Direct delivery competition has the potential to deliver c10% of addressed mail volumes within 5 years. Mail volumes are also under threat from e-substitution both at a national level and also at a local level where there are pockets of accelerated decline.*
- *Volume decline of this scale would damage Royal Mail’s ability to deliver the USO, which Ofcom has an obligation to protect.*
- *Ofcom has stated that they would expect Royal Mail to take commercial steps and cost reduction actions to protect the USO before they take regulatory steps.*
- *This presentation includes an immediate set of commercial actions which recognise the value of customers who commit to a national profile of mail without damaging current revenues. We would look to implement these actions in April 2014 alongside the new Tariff...”²⁶³*

4.40 In a slide headed: ‘*What is the Direct Delivery threat in London and Beyond?*’ (included below as figure 4.2) the presentation described Whistl’s roll-out in some detail, including a review of its roll-out to that stage. This review showed Whistl’s end-to-end business operating in five SSCs (four SSCs in London and one SSC in Manchester) and estimated that Royal Mail was losing around £20 million per annum in lost access revenue.²⁶⁴ The paper also described Whistl’s “*stated ambition: 42% delivery points (31 SSCs) accounting for 10% of UK land mass; 8.5% market share (national) by 2017.*”²⁶⁵

²⁶² Royal Mail, *Royal Mail PLC – Minutes of the meeting of the Board of Directors*, 15 November 2013, page 55. (RM0951)

²⁶³ Royal Mail, *Options for protecting the USO – Draft discussion document, October 2013*, 13 November 2013, slide 2.

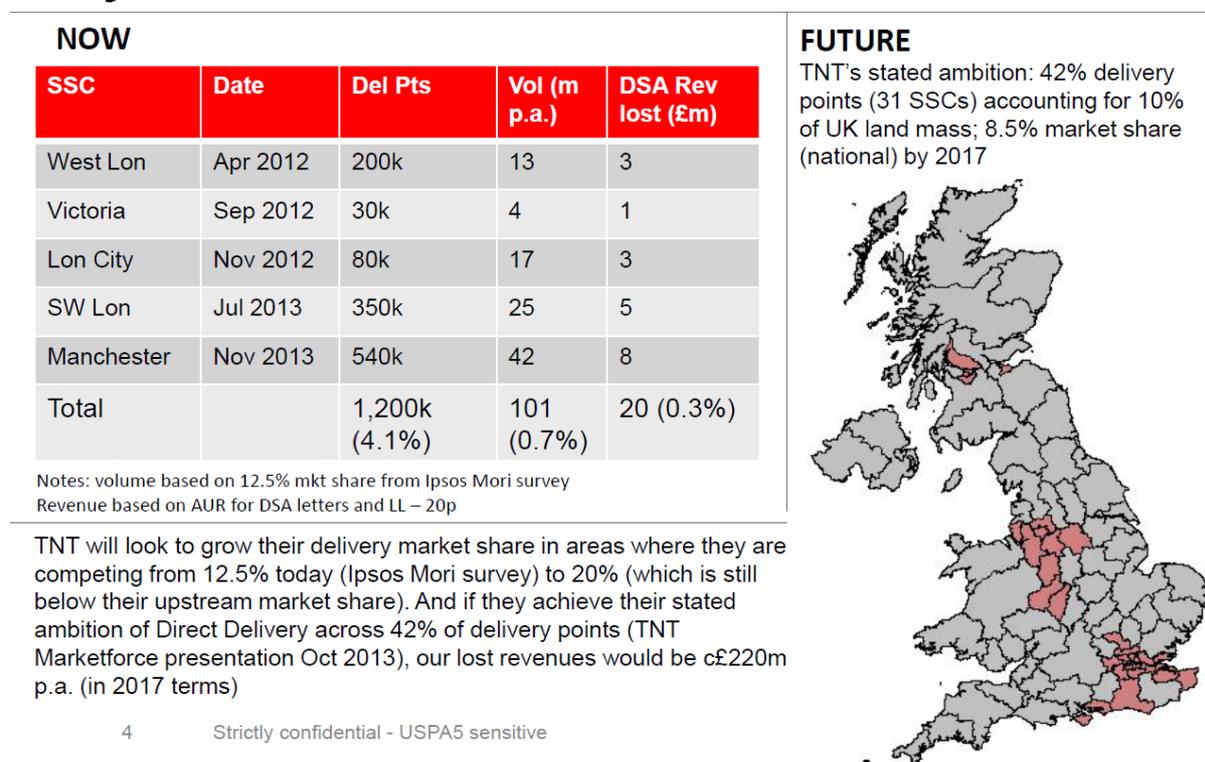
Although the document was entitled a “draft discussion document” and dated as “October 2013” we understand that in fact these slides were the version presented to the CEC on 13 November 2013. (RM0960)

²⁶⁴ *Ibid.*, slide 4. (RM0960)

²⁶⁵ *Ibid.* (RM0960)

Figure 4.2: slide 4 from presentation ‘Options for protecting the USO’

What is the Direct Delivery threat in London and Beyond?



Source: Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 4. (RM0960)

- 4.41 The presentation stated that “[Whistl] will look to grow their delivery market share in areas where they are competing from 12.5% today (Ipsos Mori survey) to 20% (which is still below their upstream market share)”, and estimated that “if [Whistl] achieve their stated ambition of Direct Delivery across 42% of delivery points (TNT Marketforce presentation Oct 2013), our [Royal Mail’s] lost revenues would be c£220m p.a.”²⁶⁶
- 4.42 In a slide headed, “Which problems need to be addressed and why is this important for the USO?”, the presentation then identified the problems that Royal Mail considered needed to be addressed. This included the problem that “[t]he value of a national profile of access mail is not currently reflected in RM’s access pricing.”²⁶⁷ Royal Mail stated that “[s]hould the profile of access mail change significantly this would affect our unit costs as our network is configured to deal with volumes according to a certain national profile.”²⁶⁸ A further problem identified was that “Royal Mail is delivery provider of last resort to be

²⁶⁶ Ibid. (RM0960)

²⁶⁷ Ibid., slide 5. (RM0960)

²⁶⁸ Ibid. (RM0960)

*“dumped” on” and states that “[d]elivery operators can “cherry pick” leaving Royal Mail to deliver more costly and difficult mail, but only pay a national average price”.*²⁶⁹

4.43 The paper presented five strategic options. The preferred option was to “[l]aunch [a] package of initiatives without reducing average prices.”²⁷⁰ This option was described as follows: *“Introduce revised PP1 T&Cs and price recognition for a national profile. Revised zonal prices”.*²⁷¹ The option was described as being contingent on Royal Mail believing that, as a result, *“DD operators will move to PP1 to avoid surcharges”.*²⁷² The proposed changes under the preferred option were: (i) to tighten tolerances in NPP1 (including reducing SSC exemptions from nine to six and a 2-year forecast requirement); (ii) to *“[r]ecognise the benefit to Royal Mail of a national posting profile by creating up to a 0.3 pence differential for [NPP1] customers compared with zonal price plan customers [APP2/ZPP3];”*²⁷³ and (iii) to change the zonal tilt for APP2 and ZPP3, reducing the London price whilst increasing rural prices to maintain the same national average.

4.44 The *“business rationale”* for the introduction of the price differential was described in the following terms:

- *“The price differential is very small at just 1.5% but it could be argued as being material in terms of margins in the upstream market.*
- *[N]PP1 provides greater certainty to Royal Mail in terms of medium/long term volume forecasting although this is difficult to quantify in terms of cost benefits*
- *The price differential can also be justified in terms of the additional value which customers receive from the zonal price plans. [A]PP2 and [Z]PP3 give customers much greater flexibility (compared with the tight controls on [N]PP1). For example, a direct delivery operator might expect to pay an additional 0.3pence in surcharges if was [sic] on PP1 instead of a zonal plan.*
- *This option does not prevent Direct Delivery competition although a roll out beyond 6 SSCs would attract surcharges”.*²⁷⁴

4.45 In a slide headed *“Evaluation of [the] proposed solution”*, the paper explained the following:

- *“Our proposal is to combine a series of actions, each of which has a rational commercial and business justification. Taken together, the combined package of actions will address most of the immediate problems with access contracts and send a clear signal to the market that we will compete effectively to protect the USO.*
- *Introducing a small price incentive (less than 1.5%) for customers committing to a national profile of mail is likely to be attractive to almost all customers and will not exclude Direct Delivery competition. The market share (in delivery) we might expect to*

²⁶⁹ Ibid. (RM0960)

²⁷⁰ Ibid., slide 7. (RM0960)

²⁷¹ Ibid. (RM0960)

²⁷² Ibid. (RM0960)

²⁷³ Ibid., slide 8. (RM0960)

²⁷⁴ Ibid. (RM0960)

lose within the permitted tolerances of Price Plan 1 is 1.4% representing £30-40million revenue.

- A larger scale Direct Delivery operator would need to move to a zonal Price Plan to minimise surcharges. This would involve a trade-off between short term losses to achieve longer term profits. Our zonal pricing “tilt” has an impact on how a DD operation might develop...
- A separate legal and regulation assessment of the proposed solution is provided.²⁷⁵

4.46 To develop a specific recommendation on the level of the price differential, the paper presented a number of scenarios with differently configured price differentials and zonal tilts and illustrated the impact of the changes by reference to the likely impact on end-to-end competitors, market share loss for Royal Mail and revenue loss for Royal Mail. The relevant slide presenting this analysis is reproduced here as Figure 4.3.

Figure 4.3: Slide 10 from presentation ‘Options for protecting the USO’

The best combination of actions is to apply a moderate price incentive on PP1 and make a significant change to the zonal tilt which improves our competitiveness in London

Description	Scenario					
	0	1	2	3	4	5
Do nothing and wait for market to develop without defending USO	Do nothing and wait for market to develop without defending USO	Apply moderate "value" justified incentive on PP1 and moderate zonal tilt	Apply moderate "value" justified incentive on PP1 and significant zonal tilt	No changes to zonal tilt which allows stretched "value" justified PP1 incentive	Apply moderate "value" justified incentive on PP1 and stretched zonal tilt	Do not offer PP1 incentive and just change the zonal tilt
Price incentive for the National Price plan	None	0.3p	0.2p	0.5p	0.1p	None
Zonal price difference (tilt) vs national average price (0%)	Urban: -12% Suburb: 0% Rural: 14% London: 10%	Urban: -25% Suburb: -1% Rural: 44% London: 0%	Urban: -25% Suburb: 10% Rural: 44% London: -25%	Urban: -12% Suburb: 0% Rural: 14% London: 10%	Urban: -25% Suburb: 23% Rural: 44% London: -50%	Urban: -25% Suburb: 10% Rural: 44% London: -25%
Likely outcome for Direct Delivery operator (#)	Stay on PP2 and grow to 20+ SSCs	End on PP2 and grow to 20+ SSCs	Switch to PP1 and stay there *	End on PP2 and grow to 20+ SSCs	End on PP2 and grow to 20+ SSCs	End on PP2 and grow to 20+ SSCs
Market share loss	9.4% By 2017	5.9% By 2017	1.4% By 2014	7.3% By 2017	9.4% By 2017	6.5% By 2017
RM revenue loss	£240m	£160m	£40m	£190m	£240m	£170m

(#) A DD operator would switch to PP1 to start with for all scenarios 1-4
 (*) It is not profitable for DD operator to switch back to PP2 at any point
 All of these assume no major investment is available to the entrant and that the entrant needs 10% profits in any expansion



Source: Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 10. (RM0960)

4.47 Royal Mail considered what would be the best combination of actions to achieve its goals by reference to their combined impact on direct-delivery (i.e. end-to-end) operators and, consequently, on Royal Mail’s market share / revenue loss. The highlighted Scenario

²⁷⁵ Ibid. (RM0960)

(Scenario 2) was the preferred option. This option broadly matches the price changes introduced by the CCNs of January 2014 (the zonal tilt is the same and the magnitude of the price differential is lower than that introduced). Scenario 2 shows that Royal Mail identified that a price differential of 0.2p, together with an adjustment to the zonal prices, would be likely to lead to end-to-end competitors switching to NPP1 and ‘staying there’ because it would “*not [be] profitable for DD operator to switch back to PP2 at any point*”.²⁷⁶ This was expected to limit Royal Mail market share loss to 1.4% or £40m revenue. A number of points on the analysis in Figure 4.2 should be noted:

- a) One of the rejected Scenarios, Scenario 5, was to apply significant changes to the zonal tilt, and not apply a price differential in conjunction with those changes. However, the application of this Scenario would still allow the direct delivery competitor to “*end on [APP2] and grow to 20+ SSCs*”. The zonal tilt changes alone were not expected to achieve the desired outcome.
- b) The notes to the analysis observe that for all of scenarios 1 to 4 the direct delivery operator would have to switch to NPP1 to start with. However, Scenarios 1, 3 and 4 would not require the operator to end on NPP1. It was only Scenario 2 (marked with an asterisk), which involved the application of the price differential on top of the significant zonal tilt changes, that would require direct delivery operators to switch and “*stay there*”, i.e. the desired outcome.

4.48 During the course of our investigation, Royal Mail explained that the “*models used to produce the “market share loss” and “RM revenue loss” row at slide 10 of the draft discussion document were early versions of Royal Mail’s Entrant Cost Model and Entrant Strategy Model.*”²⁷⁷ Royal Mail advised Ofcom that the Entrant Cost Model “*is a bottom-up calculation of the likely recurring costs that would be incurred by an entrant into the downstream UK letters delivery market.*”²⁷⁸

- a) In relation to volumes, the model “*[a]s a starting point... has been calibrated using [Whistl]’s observed local market shares in areas where entry has occurred already, namely London SW, W and City.*”²⁷⁹
- b) In relation to establishing the likely location of delivery units (“DUs”), the model is “*predominantly based on observations of [Whistl]’s delivery office locations in London and Manchester (and the publically presented catchments areas for the Manchester DUs).*”²⁸⁰

²⁷⁶ Ibid., slide 10. (RM0960)

²⁷⁷ Royal Mail, *Letter from [Royal Mail] to [Ofcom]*, 12 September 2014, page 1, response to question 1. (RM0764)

²⁷⁸ Royal Mail, *Entrant Cost Model*, 10 March 2014, page 1, Executive Summary. (RM0086)

²⁷⁹ Ibid., page 2, paragraph 3. (RM0086)

²⁸⁰ Ibid., page 2, paragraph 6. (RM0086)

- c) In relation to staff costs, “[Royal Mail] use the Living Wage specifications as [Whistl] have quoted that this is their base salary.”²⁸¹
- d) In relation to local distribution, the model uses geographic mapping data to generate the distance between each DU and the nearest Mail Centre (“MC”) which is “based on the location of the 6 known [Whistl] MCs.”²⁸²
- 4.49 Royal Mail’s working notes, which contain outputs from the Entrant Strategy Model, show the underlying assumptions and methodology used in each of the scenarios presented in figure 4.3.²⁸³
- 4.50 A key assumption used in each Scenario was that Royal Mail would “[a]ssume that they won’t do any DD unless they can make a 10% profit (after all surcharges knocked off).”²⁸⁴ With respect to the Scenarios that involved the introduction of a price differential, the working notes state that the direct delivery operator would “switch to PP1 to avoid differential.”²⁸⁵ The author of the working notes then calculate the effective cost of the differential together with surcharges under APP2 and the potential profit that might be available from direct delivery. This is used to indicate whether a direct delivery operator would switch back to APP2 or remain on NPP1. Scenario 2 (shaded green in figure 4.3) was identified as the preferred option.²⁸⁶
- 4.51 The working notes outlined the finding that, in relation to Scenario 2, the “[d]ecision to move back to PP2 would require enough profitable [direct delivery] to offset differential of £5.8m +£4.0m surcharges for current DD = £9.8m.”²⁸⁷
- 4.52 However, the notes also explained that
- “[u]nder customer scenario 2, there is only £7m of profit to be had”²⁸⁸ and that “[t]hey would need to move up to customers scenario 3 (27% market share) which at this point (only 6 SSCs covered²⁸⁹) would seem unlikely.”²⁹⁰*
- 4.53 In Royal Mail’s presentation, the results for Scenario 2 showed the least market share loss (1.4%) and revenue loss (£40m) for Royal Mail compared to the other Scenarios considered, which predicted larger market share (5.9% to 9.4%) and revenue losses

²⁸¹ Ibid., page 3, paragraph 12. (RM0086)

²⁸² Ibid., page 4, paragraph 15. (RM0086)

²⁸³ Royal Mail, Spreadsheet *Working notes*, 4 October 2013 (RM0839) and Royal Mail, Spreadsheet *Working notes*, 17 October 2013. (RM0840)

²⁸⁴ Royal Mail, Spreadsheet *Working notes*, 17 October 2013. (RM0840)

²⁸⁵ Ibid., scenarios 1, 2, 3 and 6. (RM0840)

²⁸⁶ Royal Mail, *Options for protecting the USO – Draft discussion document*, October 2013, 13 November 2013, slide 10. (RM0960)

²⁸⁷ Royal Mail, Spreadsheet *Working notes*, 17 October 2013, scenario 2 (RM0840)

²⁸⁸ Ibid. (RM0840)

²⁸⁹ Please note that Royal Mail later advised this was a typographical error that should have read “only 8 SSCs covered.” (RM0770)

²⁹⁰ Royal Mail, Spreadsheet *Working notes*, 17 October 2013, scenario 2. (RM0840)

(£160m to £240m).²⁹¹ The presentation indicates that it was anticipated that a delivery competitor would be limited to a 1.4% market share under Scenario 2.²⁹²

- 4.54 The presentation then analyses the impact of Scenario 2 on “[Whistl]’s published expansion plans from Q3 2014”²⁹³ and found that the price changes would stop Whistl’s roll-out at 1.4% (representing £30-40 million revenue loss) unless “[Whistl] forgoes [a] reasonable rate of return for 2-3 years to build economies of scale”,²⁹⁴ in which case Royal Mail projected Whistl could reach around 9% market share.²⁹⁵ The working notes show that one version of Scenario 2, which was considered by Royal Mail, was generated by “assum[ing] that they [Whistl] do not need to make a profit”²⁹⁶ in the short term in order to continue with their end-to-end expansion. On that assumption, the working notes record that the modelling showed that for Whistl to find it profitable to move back to APP2, it would need to have sufficient direct delivery scale to “offset” the differential and surcharges by entering “38 SSCs (only one of which is London)”.²⁹⁷
- 4.55 Royal Mail set out its expectation for different formulations of Scenario 2 in the graphs reproduced at Figure 4.4.

²⁹¹ Royal Mail, *Options for protecting the USO – Draft discussion document, October 2013*, 13 November 2013, slide 10. This compares scenario 2 with other the projected outcome for other scenarios. (RM0960)

²⁹² Ibid. (RM0960)

²⁹³ Ibid., slide 11. (RM0960)

²⁹⁴ Ibid. (RM0960)

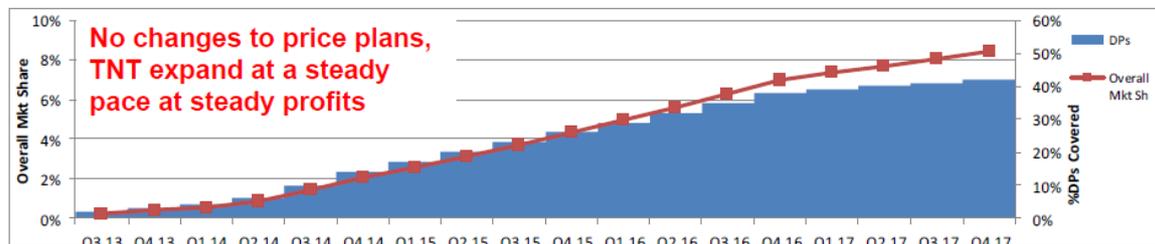
²⁹⁵ Ibid. (RM0960)

²⁹⁶ Royal Mail, *Spreadsheet Working notes, 17 October 2013*, scenario 2 0%. (RM0840) In this context, what Royal Mail meant was that they were not assuming that Whistl would only continue with direct delivery expansion if they could make at least a 10% profit, as in the version of Scenario 2 discussed at paragraph 4.50 above.

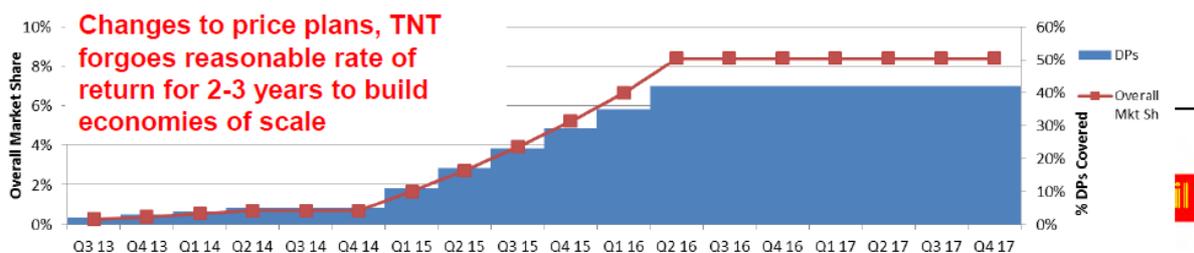
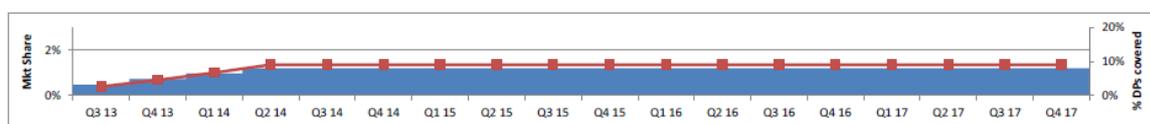
²⁹⁷ Ibid. (RM0840)

Figure 4.4: Slide 11 from presentation 'Options for protecting the USO'

The proposed actions of scenario 2 impact TNT's published expansion plans from Q3 2014



Changes to price plans, TNT funds expansion through profits and require a reasonable rate of return in each year



Source: Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 11. (RM0960)

- 4.56 In reviewing the impact of price changes on its access customers the presentation observed that “[Whistl] might choose to switch to PP1 to avoid a £6 million impact of the new price differential on PP2.”²⁹⁸ Whistl and [X] (a CDA customer of Whistl) are also presented as being a “[h]igh risk of complaint”.²⁹⁹ [X The CDA customer] was regarded as “no worse-off under the proposals” but were considered to be likely to “follow” Whistl; all other customers are shown to be less affected and a “[l]ow risk of complaint”³⁰⁰ or “[l]ow/medium risk of complaint.”³⁰¹
- 4.57 The minutes from the Chief Executive’s Committee meeting record that it “discussed the matter in detail” and although “[a] decision was not required at this stage... the CEC

²⁹⁸ Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 12. (RM0960)

²⁹⁹ Ibid. (RM0960)

³⁰⁰ Ibid. (RM0960)

³⁰¹ Ibid. (RM0960)

supported the progression of the strategy as presented.”³⁰² The CEC agreed “that the Board would also need to be appraised of this.”³⁰³

Development of Royal Mail’s justification for the price differential

Royal Mail sought external economic advice on the impact of price changes

- 4.58 Royal Mail engaged the economic consultancy Oxera to advise on a range of potential pricing options for the Access Letters Contract which Royal Mail was considering, including an option relating to the introduction of a price differential between NPP1 and APP2.³⁰⁴ This advice considered how various proposals might be justified and discussed potential competition and regulatory issues.
- 4.59 During the development of the price differential Royal Mail observed (see, for example paragraph 4.36(e)) that it needed an objective justification to support a price differential between NPP1 and APP2. Royal Mail engaged with its economic advisors to develop this justification.

September 2013 - Initial work to identify possible justifications

- 4.60 Following a meeting on 27 August 2013, on 3 September 2013 Oxera provided its “initial thoughts on how to justify and quantify a price differential between NPP1 and [APP2]”, which it said it understood was “currently the leading or preferred option that Royal Mail is considering in order to respond to the threat of direct delivery (DD) competition”.³⁰⁵ Oxera’s note identified two potential justifications:
- a) a cost-based justification; and
 - b) a value-based justification.
- 4.61 Oxera outlined that the cost-based justification would be predicated on the following principle:

“NPP1 (where measurement and compliance with the national fall-to-earth profile are done at the level of SSCs, combined with Urban/Rural ratios) would provide considerably greater planning and operational benefits to Royal Mail than NPP2 (where measurement and compliance with the national fall-to-earth profile are done at a more aggregate ‘zonal’ level) or, indeed, PP3 (the ‘pay-as-you-go’ zonal price plan).”³⁰⁶

³⁰² Royal Mail, *Chief Executive’s Committee – Minutes of meeting held on 13th November 2013*, 13 November 2013, page 4. (RM0959)

³⁰³ Ibid. (RM0959)

³⁰⁴ See E-mail from [Oxera] to various (Royal Mail), 6 September 2013 (RM1063); Royal Mail, *Options for protecting the USO*, 5 September 2013 (versions 2 and 3). (RM1064) (RM1065)

³⁰⁵ Oxera, *Thoughts on how to justify and quantify a price differential between NPP1 and NPP2 – Note prepared for Royal Mail*, 3 September 2013, page 1. (RM1051)

³⁰⁶ Ibid. (RM1051)

- 4.62 Oxera's note explained that the main reason for these benefits "*would be the greater certainty and forecasting accuracy that NPP1 would provide relative to NPP2 or PP3 as a result of the reduced variance in the distribution of volumes relative to the national fall-to-earth profile.*"³⁰⁷ It continues that "[t]his greater certainty would allow Royal Mail to allocate resource across its network more efficiently, building in less excess capacity in delivery offices than would be the case if all access operators were under NPP2... [h]ence, if all access customers signed up to NPP1, this would lead to lower overall unit costs than in the current situation..."³⁰⁸
- 4.63 Oxera explained that for this argument to hold Royal Mail would need to demonstrate these benefits. It suggests that it could do so by showing that if APP2 customers were to switch to NPP1 "*and were able to replicate the greater forecasting accuracy of existing customers on NPP1, Royal Mail would be able to reorganise the operations of the delivery network in such a way that it would save £x per item.*"³⁰⁹ Oxera considered that "[o]btaining the value of 'x' would require working closely with the Operations team to articulate and quantify this cost saving."³¹⁰
- 4.64 Oxera also considered that it may be possible to demonstrate these benefits by calculating "*the greater theoretical or potential volume distribution variance that is inherent in NPP2 relative to NPP1.*"³¹¹ Oxera added that "*even under this approach, an articulation of the benefit to Royal Mail from an Operational perspective would be required in order to argue that this difference in potential outcomes translates into an expected lower cost reduction under NPP1.*"³¹²
- 4.65 The value-based justification was described as the argument that "*an operator that is on NPP2 has considerably greater flexibility in meeting the fall-to-earth national profile because measurement and compliance are done at a very aggregate 'zonal' level, rather than the much more accurate measurement implicit in NPP1.*"³¹³
- 4.66 Oxera added that "[a]n operator such as TNT could exercise this flexibility in many ways – such as by... engaging in more DD than would be possible under NPP1 without incurring substantial financial penalties"³¹⁴ and that "[t]he ability to exercise this flexibility has a 'value' for these operators which ought to be reflected in a 'premium' that should be paid over and above the price of NPP1."³¹⁵
- 4.67 Following this advice, it appears that Royal Mail undertook some further modelling. In an email exchange with Oxera on 6 September 2013, it was noted that the "*[c]urrent view is that the modelling is only likely to support the 'value based justification' approach (as set*

³⁰⁷ Ibid. (RM1051)

³⁰⁸ Ibid. (RM1051)

³⁰⁹ Ibid., page 2. (RM1051)

³¹⁰ Ibid. (RM1051)

³¹¹ Ibid. (RM1051)

³¹² Ibid., page 3. (RM1051)

³¹³ Ibid. (RM1051)

³¹⁴ Ibid., page 2. (RM1051)

³¹⁵ Ibid. (RM1051)

*out in the OXERA note). Modelling to set out surcharges which would be applied if an operator on NPP2 who was operating at the tolerance level (set at 2% based on new approach from April 2014) was moved onto NPP1”.*³¹⁶

- 4.68 On 30 September 2013 Royal Mail shared with Oxera a presentation that assessed how access customers would be affected by the access pricing changes it was considering implementing. This presentation identified a number of actions that Royal Mail proposed to implement in April 2014.³¹⁷
- 4.69 The first proposed action was to “[c]learly differentiate PP1 as a national price plan by introducing additional requirements and tighter tolerances”³¹⁸ The presentation noted that this action “is partly done to provide a more solid justification for Action 2, which introduces a price differential between PP1 and the zonal price plan.”³¹⁹ The objective justification for this proposal was noted as being the following:

*“Access is not a USO product. However access mail now represents 54% of inland addressed mail (USO, Bulk Retail and Access Mail) and therefore the profile of access mail is critical to the finances of the USO. Should the profile of access mail change significantly this would affect our unit costs as our network is configured to deal with volumes according to a certain profile. The number of mail centres and delivery offices we have and where these are located reflects the profile of our mail. Should the profile of mail change we would need to invest to change our network.”*³²⁰

- 4.70 The second proposed action was to “[i]ntroduce up to a 0.3pence differential between PP1 and the other two price plans which will be more clearly described as zonal (non-national).”³²¹ The presentation noted that this would mean that “[c]ustomers on the new USPA5 contracts will pay up to an additional 0.3pence per item (on average if they have a national profile) if they are on a zonal price plan (PP2 or PP3) compared with PP1, representing an average surcharge of 1.5%”,³²² adding that “Royal Mail might choose to start with a lower differential to minimise the risk of complaint.”³²³

- 4.71 In relation to Royal Mail’s proposed justification for this action, in a section headed “Objective justification”, the presentation stated that:

“PP1 provides value to Royal mail [sic] because we receive greater certainty in terms of medium and long term volume forecasting but it is difficult to quantify in terms of a costing benefit. There are some minor cost differences because the zonal price plans are more complex to administer.

³¹⁶ Email from [redacted] (Royal Mail) to various, 6 September 2013. (RM1063)

³¹⁷ Royal Mail, Presentation entitled *Proposed actions on Access contracts to protect the USO*, 30 September 2013. (RM1126)

³¹⁸ *Ibid.*, page 1. (RM1126)

³¹⁹ *Ibid.*, page 2. (RM1126)

³²⁰ *Ibid.* (RM1126)

³²¹ *Ibid.*, page 1. (RM1126)

³²² *Ibid.*, page 4. (RM1126)

³²³ *Ibid.* (RM1126)

The price differential can also be justified in terms of the additional value which customers receive from the zonal price plans. PP2 and PP3 give customers much greater flexibility (compared with the tight controls on PP1). For example, a direct delivery operator might expect to pay an additional 0.3p in surcharges if was [sic] on PP1 instead of a zonal plan".³²⁴

- 4.72 It was also suggested that: *"Royal Mail might argue that a 0.3 pence price differential (1.5%) is immaterial as far as direct competition is concerned (compared with their cost advantages against the access price). A small scale DD operation (5 or less SSCs) could be supported on [NPP1] and any wider roll-out would be sure to trigger Ofcom intervention in any case."*³²⁵ The presentation noted that: *"A regional operator could always switch to a national consolidator to access the lowest prices".*³²⁶
- 4.73 The presentation also considered the impact of these proposed changes on each of Royal Mail's access customers. In relation to Whistl, the impact of the price differential is estimated to be *"£9,064,394"* whereas for other operators using an Access Letters Contract the impact was estimated to range, depending on the customer, between *"£6,874"* for [one access operator] and *"£765,127"* for [another access operator].³²⁷
- 4.74 The presentation observed that *"[i]f [Whistl] stay on PP2 then they will have a price disadvantage vs UKM [UK Mail], if they move on to PP1 this will limit their direct delivery ambitions."*³²⁸ The presentation added that there was a high likelihood of Whistl complaining about the changes as *"they would need to switch to PP1 to continue to compete with UK Mail but that would then dent their direct delivery ambitions."*³²⁹ It also anticipated that Whistl would probably switch to NPP1 in the short term as *"they wouldn't incur any surcharges on PP1 now."*³³⁰

October 2013 - Further development of a cost-based justification

- 4.75 Oxera prepared a note of advice for Royal Mail dated 3 October 2013 entitled *'Economic assessment of the proposed actions on access contracts'*. In this note, Oxera considered the further work that appears to have been undertaken by Royal Mail to develop a justification for the differential. Oxera explained that:

"Royal Mail is planning to introduce a price differential between PP1 and the zonal variants (PP2 and PP3). This would take the form of a price discount applied to the PP1 price. The current proposal is for the differential to be at 0.3p per item.

³²⁴ Ibid. (RM1126)

³²⁵ Ibid. (RM1126)

³²⁶ Ibid. (RM1126)

³²⁷ Ibid., page 11 (RM1126)

³²⁸ Ibid. (RM1126)

³²⁹ Ibid., page 25. (RM1126)

³³⁰ Ibid. (RM1126)

The rationale/objective justification for this price differential has been articulated by Royal Mail on the basis of both cost differences (from a Royal Mail perspective) and value-based differences (from an access customer perspective).

In relation to cost, PP1 is said to provide greater medium and long-term volume stability relative to PP2 and PP3 (due to the need to post mail across the whole of the UK), which allows Royal Mail to plan the delivery network more efficiently.

In relation to value, PP1 requires greater commitment from access customers to post mail across the whole of the UK...whereas PP2 and PP3 provides greater flexibility for customers to post mail according to their own individual profiles. This flexibility has a 'value' which access customers ought to be prepared to pay for; alternatively, by committing to the requirements of PP1, access customers are giving up this value and should therefore be rewarded through a price discount."³³¹

4.76 In relation to the cost-based justification, Oxera observed that:

"It would have been ideal to have a cost justification for this price differential, as this would provide a compelling and a more 'mainstream' objective justification (in a competition law sense) for an action that can have potential anti-competitive effects....

However, we understand that it has not been possible to articulate and quantify a 'pure' cost differential on the basis of the planning benefits that Royal Mail would derive if all access customers were on PP1 rather than PP2 or PP3. The discussions with operations staff suggest that if Royal Mail could have sufficiently early indication from its customers about its posting profiles Royal Mail could derive considerable planning benefits. This, however, appears to provide support for profile commitment of any kind, but not exclusively linked to the national fall-to-earth profile of PP1. For example, if TNT shared its plans in advance with Royal Mail and committed to this profile, Royal Mail would in theory derive considerable value from this information."³³²

4.77 Oxera also outlined that:

"Ultimately, it is understood the greatest commercial risk and therefore cost that Royal Mail faces is the potentially higher risk of volume loss/stranded costs that would materialise if TNT remains on PP2 at current price levels and tolerances, and is therefore able to roll-out its direct delivery more widely. However, this cost argument is unlikely to be a valid objective justification in a competition law case for conduct [that] can have the effect of restricting efficient competition."³³³

³³¹ Oxera, *Economic assessment of the proposed actions on Access contracts – Note prepared for Royal Mail*, 3 October 2013, page 8. (RM1134)

³³² *Ibid.*, pages 8 and 9. (RM1134)

³³³ *Ibid.* (RM1134)

- 4.78 In relation to the value-based justification, Oxera's assessment was that: *"The rationale for this price differential, when articulated as a discount offered in return for a commitment from customers to post in every single SSC of the UK according to the national fall-to-earth profile is clear, simple to articulate and intuitively appealing"*.³³⁴ However, they also note that *"this would be a novel justification for which to our knowledge there are no competition law precedents."*³³⁵ Oxera explained that despite this it *"consider[ed] that the modelling approach is sound and that the 'value' that is derived from it is real, as it based on current parameters and T&Cs as written in the contracts."*³³⁶
- 4.79 However, Oxera went on to say that *"because the value obtained is dependent on the T&Cs and parameters of each individual contracts, it can be perceived as being highly subjective and 'circular', in the sense that it is within Royal Mail's gift to alter the T&Cs of the contracts and either increase or reduce the perceived value-based differential between the different plans."*³³⁷
- 4.80 Oxera also assted that *"it could be argued the value the model is deriving is a conservative estimate given that it is 'diluted' by the inclusion in the average of customers such as UK Mail who do not have plans to roll-out or to use direct delivery networks and therefore attach little or no value on PP2 or PP3."*³³⁸ This, Oxera notes, *"illustrates an aspect of the model which Ofcom may take issue with, which is that the value calculated by the model is derived exclusively from actions taken as result of TNT's direct deliver [sic] roll-out plans."*³³⁹
- 4.81 Oxera later summarised its view: as follows *"the value based justification, whilst having a good grounding on economics, may not on its own be viewed by Ofcom as sufficiently 'objective' as it is dependent on parameters that Royal Mail controls."*³⁴⁰
- 4.82 Although Oxera's note focused on the rationale and justification for the price differential, it also stated that:

"...we understand that whilst small relative to the overall access price (1.5%), 0.3p is a substantial proportion of the upstream margin that access operators compete on (between 15% and 60%, depending on whether it is measured on the basis of Royal Mail's upstream costs or the margins available for some individual customers).

...we have been told by Royal Mail that [Whistl] would migrate to PP1 to avoid being placed at a competitive disadvantage. This would allow them to continue their current level of roll-out and re-assess whether they would be prepared to make the step-change in their roll-out required to compensate for the additional 0.3p per item that it would have to pay for the mail it would continue to send via Royal Mail. Hence, an argument could be made that while the price difference might have some

³³⁴ Ibid. (RM1134)

³³⁵ Ibid. (RM1134)

³³⁶ Ibid., page 10. (RM1134)

³³⁷ Ibid. (RM1134)

³³⁸ Ibid. (RM1134)

³³⁹ Ibid. (RM1134)

³⁴⁰ E-mail from [X] (Oxera) to [X] (Royal Mail), 11 October 2013, page 1. (RM1162)

impact on [Whistl's] decision-making process, in the short-run [Whistl] would suffer no financial impact; whereas in the medium to long-term, if [Whistl] decide to roll-out on a large scale (as originally announced), profit margins earned would more than compensate the 0.3p difference..."³⁴¹

4.83 Oxera said that it considered that *"Royal Mail has a fighting chance of successfully arguing to Ofcom that a price differential of this magnitude would not have the effect of restricting genuine end-to-end competition"* but noted that *"Ofcom may take a different view faced with similar facts"*.³⁴²

4.84 Oxera's assessment concluded that:

*"Work and evidence demonstrating that the price differential will not have an exclusionary effect is therefore of paramount importance (although we appreciate this is somewhat counterintuitive from a commercial perspective, as ideally you would want to show the opposite)."*³⁴³

4.85 On 4 October 2013, a note was prepared by Royal Mail staff regarding the different relationships between Royal Mail and its NPP1 customers and APP2/ZPP3 customers and how differences in the relationships affect Royal Mail's operations planning.³⁴⁴ This appears to have been based on research carried out with Royal Mail's operations teams.³⁴⁵

4.86 The note records that because of the profile requirements applying to NPP1 it is *"more likely that customers posting on NPP1 will not have very significant volume swings by SSC nor that their volumes will decrease significantly as otherwise there would be a risk to them achieving their SSC profile... If customers were planning a significant change by SSC or in overall volume they would be unlikely to sign up to NPP1 or if they are NPP1 customers they are encouraged to discuss these changes with us."*³⁴⁶

4.87 The note continued that *"[i]n this way NPP1 is an enabler for operational efficiency and therefore cost reduction."*³⁴⁷ Royal Mail illustrated this finding with a number of examples of discussions with NPP1 customers:

- a) discussions with [X] a financial services company regarding structural changes to its business] to help it assess the impact this would have on its compliance with NPP1,³⁴⁸

³⁴¹ Oxera, *Economic assessment of the proposed actions on Access contracts – Note prepared for Royal Mail*, 3 October 2013, page 9. (RM1134)

³⁴² *Ibid.*, page 10. (RM1134)

³⁴³ *Ibid.*, 3 October 2013, page 10. (RM1134)

³⁴⁴ Royal Mail, *Notes from meetings and conference calls with Operations on planning and forecasting and insight into changes in customer behaviour*, 4 October 2013

³⁴⁵ E-mail from [X] (Royal Mail) to various (Royal Mail and Oxera), 4 October 2013. (RM1144)

³⁴⁶ Royal Mail, *Notes from meetings and conference calls with Operations on planning and forecasting and insight into changes in customer behaviour*, 4 October 2013, page 1. (RM1145)

³⁴⁷ *Ibid.* (RM1145)

³⁴⁸ *Ibid.* (RM1145)

- b) discussions with [X a financial services company regarding demergers of part of its business] as a result of which Royal Mail agreed to allow [X multiple financial services companies] to continue to post on one account;³⁴⁹ and
- c) discussions with [X a major retail company] about the possibility of it setting up a NPP1 account for its financial services business.³⁵⁰

4.88 The evidence collected from Royal Mail's operations division appears to describe the planning efficiencies that may be achieved from forecast information. This shows that advance information would help to manage a greater than 10% decline in local volumes and that volume forecasts at 3% certainty would enable Royal Mail to plan differently.³⁵¹

4.89 In considering this material, Oxera advised by e-mail on 10 October 2013 that although "[t]he 'value' for Royal Mail resides in getting advance knowledge of volume profiles... these profiles do not necessarily have to be in accordance with NPP1."³⁵² The e-mail outlined that:

"A common theme across both documents coming out of the detailed discussion with Ops, is that Royal Mail derives considerably more value from the receipt of timely information on the volume profile of access customers (whatever this profile is), rather than from any intrinsic benefit from an Ops perspective that a national profile by SSC (NPP1) has over other profiles that are possible under NPP2/ PP3.

In other words, if Royal Mail customers on NPP2 or PP3 were able to commit to post mail according to pre-specified profile of mail and shared this information with Royal Mail 1-2 years in advance, the value for Royal Mail from a planning perspective would be very large. For a very large customer, such as [Whistl], the value of this information could be the same, if not greater, than the value coming from the implicit commitment made by most customers on NPP1.

Put differently, the value is in the information and commitment to a particular volume profile that customers would be willing to provide, rather than on the fact they happen to post mail on the basis of national or other profile. What is helpful here is that given the requirements of NPP1, this is acting as a catalyst for customers to provide detailed information and, in time, will allow Royal Mail to act on this information to plan the operations of the network (in particular, the activities involved in provide [sic] Downstream Access) more efficiently. What is less helpful is that the justification provided means that customers who are on NPP1 but are not able to meet the criteria and tolerances of this price plan, should still be able to receive a discount if they are able and willing to tell Royal Mail with sufficient advance notice and a sufficiently high level of precision (eg, which SCCs [sic], when)

³⁴⁹ Ibid., pages 1 and 2. (RM1145)

³⁵⁰ Ibid., page 2. (RM1145)

³⁵¹ Ibid., pages 3 and 4. (RM1145)

³⁵² E-mail from [X] (Oxera) to [X] (Royal Mail), 10 October 2013, page 1. (RM1154)

*that they are unlikely to meet the criteria of PP1 but are willing to commit to another profile.”*³⁵³

- 4.90 Oxera suggested that Royal Mail consider introducing the “*concept of profile commitment discount within NPP1*”³⁵⁴ which would mean that “*the rationale for the discount provided on NPP1 would now be much more closely tied with the internal evidence that these documents have uncovered.*”³⁵⁵
- 4.91 Oxera also observed that such a concept would mean that “[Whistl] *will now be able to benefit from the discount if they too are willing [to] provide information to Royal Mail on volume profiles that will help it plan the network more efficiently, and crucially, they would not necessarily have to commit to the national fall-to-earth profile by SSC.*”³⁵⁶
- 4.92 Oxera provided further advice to Royal Mail over the following weeks. In an e-mail of 11 October 2013 about a draft of the presentation ‘Options for protecting the USO’ (see above from paragraph 4.38), Oxera made a number of observations about the price differential:
- “(a) this does have the potential to give rise to an exclusionary effect by making it harder for an operator like TNT to rollout direct delivery, given that the differential is a large proportion of the upstream margin. The bigger the differential the larger the effect, and it is difficult to judge a priori what size of differential will Ofcom consider [sic] to be sufficient to determine that an exclusionary effect is likely; (b) further work is required to develop a cost justification that Ofcom would accept as an objective justification.”*³⁵⁷
- 4.93 Oxera also noted that: “*Scenario/Option 2 (0.2p price difference and an ‘semi-aggressive’ zonal tilt) appears to have the greatest commercial benefit for RM. This suggests the price difference and the tilt are very effective...However, when we look at Scenarios/ Options 1 and 3, which have even greater price differentials (0.3p and 0.5p, respectively) and no or small change to the zonal tilts, the commercial benefit to Royal Mail appears to be very small.*”³⁵⁸ Oxera then stated that:
- “There is an apparent inconsistency here which I think is explained by the fact that there is another assumption driving the results – whether [Whistl] switch to PP1 and stay there, or whether they will switch back to PP2 and continue to rollout their DD network”.*³⁵⁹
- 4.94 As a result, Oxera observed that: “*What is therefore missing from the analysis seems to be an assessment of the extent to which the different Options affect the incentives of a DD operator to be on PP1 or PP2, and therefore the likelihood that the commercial benefits are*

³⁵³ Ibid. (RM1154)

³⁵⁴ Ibid., page 2. (RM1154)

³⁵⁵ Ibid. (RM1154)

³⁵⁶ Ibid. (RM1154)

³⁵⁷ E-mail from [redacted] (Oxera) to [redacted] (Royal Mail), 11 October 2013, page 1. (RM1162)

³⁵⁸ Ibid, pages 2 and 3. (RM1162)

³⁵⁹ Ibid, page 3. (RM1162)

maximised (which we understand arises if the DD operator decides to switch and stay on PP1)”.³⁶⁰

4.95 Oxera later observed that:

*“it is probable (at least conceptually), that the price differential triggers a permanent migration from all customers in PP2 towards PP1. Indeed, we understand this would be the ideal scenario from Royal Mail’s perspective.”*³⁶¹

November – December 2013 – Final stages of work on the cost justification

4.96 By November 2013, Royal Mail had further developed its analysis of the *“cost savings it could obtain from having advance knowledge of volumes profiles by SSC”*³⁶² which Oxera understood to be based *“on an estimate of the FTE savings that will be achieved in Manchester (following entry by TNT), extrapolated to the rest of the UK consistent with Royal Mail’s best estimates of the likely scale of direct delivery entry.”*³⁶³

4.97 By 25 November 2013 Royal Mail appears to have decided to *“introduce a formal requirement into PP1 for customers to provide forecasts of their volume profile.”*³⁶⁴ Oxera noted that *“the cost justification is predicated on the fact that the information Royal Mail receives from customers in PP1 is accurate, reliable, sufficiently timely and of a sufficiently large scale, in order for Royal Mail Operations to make critical forward-looking planning decision on the basis of it.”*³⁶⁵

4.98 Oxera added that it was not clear how Royal Mail intended to ensure that the forecasting information it received from NPP1 customers met these criteria, and noted that *“it would be important that Royal Mail develops a clear approach and mechanism (eg, penalties or rewards) that ensures customers have the incentive to provide reliable forecast [sic] that Royal Mail operations can act on”*.³⁶⁶

4.99 On 12 December 2013 Royal Mail appears to have agreed it needed to make a *“decision on structure and quantum of penalties for customers who miss forecasts.”*³⁶⁷ It would appear that on 18 December 2013 Royal Mail circulated a draft of the *“Forecasting proposal”*.³⁶⁸ On the same day, an internal Royal Mail email summarised the cost justification:

“The cost justification for the differential is rooted in the fact that increases in direct delivery will lead to sudden volume reductions of +10% in a number of SSCs which, if we do not know about them, leaves RM exposed to additional costs [redacted] as we then

³⁶⁰ Ibid, page 3. (RM1162)

³⁶¹ E-mail from [redacted] (Oxera) to [redacted] (Royal Mail), 19 December 2013, page 1. (RM1205)

³⁶² E-mail from [redacted] (Oxera) to [redacted] (Royal Mail), 25 November 2013, page 1. (RM1185)

³⁶³ Ibid. (RM1185)

³⁶⁴ Ibid. (RM1185)

³⁶⁵ Ibid., page 2. (RM1185)

³⁶⁶ Ibid. (RM1185)

³⁶⁷ Royal Mail, *Check list of actions to complete before confirming price change proposals*, 12 December 2013, page 1. (RM1197)

³⁶⁸ E-mail from [redacted] (Royal Mail) to various (Royal Mail and Oxera), 18 December 2013. (RM1208)

*seek to resize the network to an appropriate level for the lower volumes we will be handling. Conversely, if we know in advance about such volume reductions, we can plan for them and avoid those costs. That is what justifies a discount for customers on PP1 over customers on PP2. Therefore, the scale of the differential in costs will depend on the extent to which changes in Direct Delivery volumes occur on PP1 as opposed to PP2. To the extent they occur on PP1, we will know in advance and can reduce costs accordingly (i.e. there will be no additional cost to recover). The extent they occur on PP2, the additional cost will arise and we cannot take action to avoid it".*³⁶⁹

- 4.100 On the basis of this cost justification, approval was sought in December 2013 and January 2014 from Royal Mail's senior management and Board to implement the price changes. By this point in the development of its proposals, Royal Mail had dropped the value-based justification stating that the "*justification of the price differential is solely based*"³⁷⁰ on the calculations of the cost saving benefits due to advance volume information and "*not the value to customers of the additional flexibility*".³⁷¹

Royal Mail's decision to introduce a price differential

- 4.101 As Royal Mail finalised its work on developing a cost justification it also completed its final decision-making process in December 2013 and January 2014, which involved scrutiny of the proposals from Royal Mail's most senior executive committees and its Board. Overall Board approval for the proposals was given in mid-December 2013, but determination of the final details of the changes was delegated to the executive. The executive decision making process involved two steps: (a) general approval by the Chief Executive's Committee (Royal Mail's most senior executive committee) in late December 2013; and (b) in early January 2014, the decision of the Disclosure Committee (a sub-committee of the Chief Executive's Committee which serves to assist Royal Mail in meeting its statutory and regulatory disclosure obligations) to approve the specific prices and levels to be introduced.
- 4.102 The papers presented as part of this process indicate that Royal Mail appreciated the risk that the introduction of the price differential could raise competition law and regulatory concerns. They also explained to the decision-makers that Royal Mail had sought external legal and economic advice which had fed into the development of the cost justification for the price differential in order to mitigate that risk.

December 2013 – finalising the price differential

- 4.103 In December 2013, Royal Mail's project team went through the final stages of selecting the level of price differential that would be presented to its senior governance bodies. Ahead

³⁶⁹ E-mail from [redacted] (Royal Mail) to [redacted] (Royal Mail) and [redacted] (Oxera), 18 December 2013, page 1. (RM1205)

³⁷⁰ Royal Mail, *Disclosure Committee 6 January 2014 – Changes to Access Pricing Plans: explanation and justification of Royal Mail's approach*, 6 January 2014, page 3, paragraph 2.10. (RM0124)

³⁷¹ *Ibid.* (RM0124)

of these meetings, [redacted a Royal Mail Executive] and member of the Royal Mail plc Board, provided a steer on this work:

“[redacted a Royal Mail Executive] approached me on Friday and made it very clear that he expected the PSB to be presented with an option which was more assertive than the 0.2p price differential which is the current recommended option. Something more like 05p [sic]. He was fairly relaxed about the legal risks provided what we were doing was reasonable and arguable. He was very keen for us to give the market a very assertive signal. He suggested that [redacted a Royal Mail Executive]’s risk appetite had changed in recent days and [redacted] was willing to be bolder.”³⁷²

4.104 In early December 2013, before Royal Mail had decided on the precise detail, and basis for, the price differential, which it continued to work on through the remainder of December and early January (as set out in paragraphs 4.112 to 4.133 below), Royal Mail publicly confirmed its commitment to introducing a price differential. On 6 December 2013, Royal Mail e-mailed access operators and published a notice on its website in which it set out its plan to introduce a price differential:

“We are aware that there has been recent speculation in the market concerning whether or not Royal Mail will be introducing a pricing differential between National Price Plan 1 and National Price Plan 2 next April as we recently received a letter from one customer asking us to confirm what our position is.

Although the final details of the Access tariff changes have not yet been finalised, we have confirmed to that customer that we have made a decision in principle to introduce a price difference between National Price Plan 1 and National Price Plan 2 / the Zonal Price Plan from next April.

The final price difference has not yet been finally decided. Of course, we will contact you as soon as possible after the Tariff 2014 details have been published in January to work with you on assessing the most suitable price plan for your company.

We aim to publish our new Access tariff on the 7th January 2014.”³⁷³

4.105 On the same day, Royal Mail wrote to Whistl and confirmed that it had made a “decision in principle” to introduce a price differential, adding that “[t]he price difference has not yet been finally decided. Other potential changes to Access terms and conditions are also being considered. Of course, any customer who is using National Price Plan 2 (Zones) or Zonal Pricing will be free to migrate to National Price Plan 1 (SSC) should they wish to do so, providing their posting profile meets the eligibility criteria.”³⁷⁴

December 2013 – Royal Mail presents its plans to Ofcom

4.106 On 10 December 2013, Royal Mail presented its planned pricing changes to Ofcom.

³⁷² E-mail from [redacted] (Royal Mail) to [redacted] (Royal Mail), 2 December 2013. (RM0372)

³⁷³ Royal Mail, E-mail from [redacted] (Royal Mail) to various, 6 December 2013. (WH0103)

³⁷⁴ Royal Mail, E-mail from [redacted] (Royal Mail) to [redacted] (Whistl), 6 December 2013. (WH0102)

- 4.107 In the first of two presentations, Royal Mail set out its view that Whistl could be able to grow its market share rapidly, such that this “*may have a material impact on the financial sustainability of the Reported Business as early as 2015.*”³⁷⁵ It said it was concerned that “[m]aterial damage to USO finances could occur before regulatory intervention could be implemented due to the long lead times” and, for this reason, it urged Ofcom to take immediate action.³⁷⁶
- 4.108 In response Ofcom explained that it was “*continually monitoring both [Royal Mail] and [Whistl], and analysing the potential impact of [Whistl’s] roll-out. Therefore, as we had said in July 2012 (update on end-to-end competition), March 2013 (the final end-to-end guidance) and most recently in the annual monitoring report November 2013, currently we saw [no] need to intervene in the foreseeable future.*”³⁷⁷
- 4.109 In its second presentation, Royal Mail outlined the changes it intended to introduce to access pricing setting out both the price differential between NPP1 and APP2/ZPP3 and the change to the zonal tilt.³⁷⁸ Royal Mail explained that these “*reflect the most appropriate response to developing competition...*”³⁷⁹ As part of its presentation on the price differential Royal Mail set out:
- a) a cost-based justification associated with forecasts that would be provided by NPP1 customers;³⁸⁰
 - b) a value-based justification associated with the greater flexibility offered to APP2/ZPP3 customers to deviate from a national profile without incurring surcharges on NPP1;³⁸¹ and
 - c) its view that APP2 customers have options to avoid the increased price by switching to NPP1 or, in the case of certain customers, by taking an agency agreement with UK Mail.³⁸²
- 4.110 Royal Mail’s minutes of this meeting record that Ofcom raised two points in response to the presentation:
- a) First, “*Ofcom queried what [Royal Mail] would do if [it] received the forecasts at SSC level on [APP2]. Royal Mail explained that this was not a feature of the [APP2] contracts and therefore it would be very odd to receive this type of information but [if] this eventuality arose [Royal Mail] would reflect on the appropriate treatment.*”³⁸³

³⁷⁵ Royal Mail, Direct Delivery Modelling Update: Why Regulatory Action is Necessary Now to Protect the USO, 10 December 2013, slide 12. (RM2363)

³⁷⁶ Ibid., slide 13. (RM2363)

³⁷⁷ Ofcom, email from [redacted] (Ofcom) to various re meeting with Royal Mail on 10 December 2013, 8 January 2014, page 1. (RM2618). See also Royal Mail, Note of meeting with Ofcom, 10 December 2013. (RM2324)

³⁷⁸ Royal Mail, April 2014 Access Pricing, 10 December 2013. (RM2349)

³⁷⁹ Ibid., slide 10. (RM2349)

³⁸⁰ Ibid., slide 6. (RM2349)

³⁸¹ Ibid., slide 7. (RM2349)

³⁸² Ibid., slide 9. (RM2349)

³⁸³ Royal Mail, Note of meeting with Ofcom, 10 December 2013, page 2, paragraph 8. (RM2324) See also Ofcom, email from [redacted] (Ofcom) to various re meeting with Royal Mail on 10 December 2013, 8 January 2014, page 1: “I asked whether an

- b) Second, “Ofcom queried whether the proposed differential [between] plans was consistent with the March 2012 access regime.”³⁸⁴ On this point, Royal Mail included a comment in its minutes that it had “reviewed the wording of the March 2012 [Statement³⁸⁵] subsequent to the meeting and believes the proposals are consistent with the decision document.”³⁸⁶

4.111 Royal Mail’s note of the meeting sets out Ofcom’s concluding remarks:

“Ofcom set out that they did not have a view on the proposals. [Whistl] has already contacted Ofcom setting out that they believed Royal Mail’s proposals were likely to be exclusionary behaviour. Ofcom emphasised that Royal Mail must undertake its own due diligence on the price proposals and that this was not just a regulatory issue but also likely to be a competition issue.”³⁸⁷

December 2013 – Board and Chief Executive’s Committee approval

4.112 On 11 December 2013, a paper was submitted to the Royal Mail Board seeking its approval to implement the price changes.

4.113 In the paper entitled ‘Chief Executive’s update to RMG Board in protecting the USO and direct delivery’ the Board was advised that “direct delivery has the potential to undermine the financial sustainability of the universal postal service.”³⁸⁸ This was supported by evidence Royal Mail had gathered on Whistl’s progress as an end-to-end operator, in particular as a result of surveys it had commissioned from Ipsos MORI. The paper explained:

“Based on evidence from an Ipsos Mori survey (commissioned by Royal Mail), we believe that TNT UK is gaining market share at a local level more quickly than we originally predicted. Survey evidence in July suggested it had gained a 12% market share in areas in London in which TNT is delivering. It may be higher: TNT announced in [half year results] numbers which suggested that its market share was 15%.

Based on the survey data, we believe that TNT could achieve a market share of c.24% in areas in which it is operating fairly easily. This could be achieved by banks and

operator on price plan 2 could also provide forecasts which would presumably generate the same cost saving benefits. RM said that this wasn’t how the price plan 2 worked.” (RM2618).

³⁸⁴ Royal Mail, *Note of meeting with Ofcom*, 10 December 2013, page 2, paragraph 7. (RM2324) See also Ofcom, *email from [X] (Ofcom) to various re meeting with Royal Mail on 10 December 2013*, 8 January 2014, page 1: “I also asked RM how this was consistent with the Ofcom’s March 2012 statement on the new regulatory framework which said that the weighted average of zonal access prices should be broadly comparable to the national access price. RM said that things had changed.” (RM2618).

³⁸⁵ Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012. (PD0025)

³⁸⁶ Royal Mail, *Note of meeting with Ofcom*, 10 December 2013, page 2, paragraph 7. (RM2324)

³⁸⁷ See Royal Mail, *Note of meeting with Ofcom*, 10 December 2013, page 2. (RM2324) See also Ofcom, *email from [X] (Ofcom) to various re meeting with Royal Mail on 10 December 2013*, 8 January 2014, page 2: “[X] (Ofcom) thanked RM for the presentation and said it was important that they had satisfied themselves they were fully compliant with their obligations.” (RM2618).

³⁸⁸ Royal Mail, *Chief Executive’s update to RMG Board on protecting the USO and direct delivery*, 11 December 2013, page 1. (RM0137)

large customers who currently use the TNT upstream service [X] switching to the TNT direct delivery network.”³⁸⁹

4.114 The Board was also advised that Whistl was believed to have “*now received financial backing for expanding End to End operations beyond the current zone.*”³⁹⁰

4.115 The update described “*Royal Mail’s commercial response*”.³⁹¹

“We have investigated a number of price responses. Given the need for the USO to be sustainable and affordable and earn a commercial rate of return, any response that involves significant revenue dilution (e.g. an across the board access price cut) is not realistic. ... We are proposing to introduce a price differential reflecting a cost benefit to Royal Mail. Under NPP1 we receive detailed customer forecasts at a local level which will allow us to plan better at a local level. In addition we are proposing to increase the zonal price differentials to better reflect competitive conditions between zones.”³⁹²

4.116 The minutes record that “[t]he Board also discussed the risks of the proposed actions and resolved to support the proposal. The Board approved the pricing strategy and delegated execution to the Executive Team.”³⁹³

4.117 On 16 December the PSB discussed the proposed price changes for April 2014, including consideration of the price differential.³⁹⁴ The paper that was submitted to the PSB was later submitted in substantially the same form to the CEC on 18 December 2013.³⁹⁵

4.118 On 18 December the CEC approved the proposed price changes for April 2014. This included the proposal to:

“[i]ntroduce a price differential between the prices that customers are charged under national price plan 1 (NPP1) and the national and ‘pay as you go’ zonal price plans (NPP2 and ZPP3). Customers can post under NPP1 if they post items throughout the UK in accordance with geographic areas. The price difference will reflect cost benefits to Royal Mail and value to customers and we are considering a range between 0.2 and 0.5pence. The costing analysis is currently under review and the final price difference will be ratified by a disclosure committee arranged for January 6th (one day before notification).”³⁹⁶

³⁸⁹ Ibid. (RM0137)

³⁹⁰ Royal Mail, *Minutes of the meeting of the Board of Directors*, 11 December, page 3. (RM1230)

³⁹¹ Royal Mail, *Chief executive’s Update to RMG Board on protecting the USO and direct delivery*, 11 December 2013, page 2. (RM0137)

³⁹² Ibid. (RM0137)

³⁹³ Royal Mail, *Minutes of the meeting of the Board of Directors*, 11 December, page 3. (RM1230)

³⁹⁴ Royal Mail, *Minutes of the meeting of the Pricing Strategy Board*, 16 December 2013. (RM0983)

³⁹⁵ Royal Mail, *Pricing Strategy Board – Access, International Retail and Door to Door price changes for April 2014*, 16 December 2013. (RM0984)

³⁹⁶ Royal Mail, *Chief Executive Committee – Access, International Retail and Door to Door price changes for April 2014*, 18 December 2013, pages 1 and 2. (RM0964)

4.119 The minutes of the meeting record that:

"[X A Royal Mail Executive] pointed out that introducing a price differential between the two different price plan may result in competitors seeking an injunction to prevent it. However, this pricing was now more cost reflective and would result in national mail (which was cheaper and had a good mix) being cheaper than zonal. The legal justification for this was from the information that the business would obtain. [X A Royal Mail Executive] would write to Oxora [sic] to obtain written confirmation that they were in agreement with this..."³⁹⁷

"The CEC noted the risks outlined in the paper. After some further discussion the CEC approved the Access, International Retail and Door to Door price changes for April 2014."³⁹⁸ [Original emphasis]

January 2014 – First Disclosure Committee

4.120 The Chief Executive's Committee delegated approval of the level of the differential to the Disclosure Committee. On 3 January 2014, a paper was circulated to members of the Disclosure Committee in advance of its meeting on 6 January 2014.³⁹⁹ That paper proposed that Royal Mail implement a 0.3 pence differential between NPP1 and APP2/ZPP3.

4.121 On 5 January 2014 there was an e-mail exchange with [X a Royal Mail Executive in] Royal Mail's Operations division. On receipt of the paper submitted to members of the Disclosure Committee ahead of its meeting on 6 January 2014, he said:

"I will attend but cannot support the financials based on what I have seen.

With good and accurate notice Ops should be able to plan more effectively and pull some costs earlier however I attended [a] meeting on this on Friday where the teams understanding of the notice period from the customers for SSC's was at best unclear, at worst there is no notice.

Regardless of notice, we have only recently been given the model on the numbers which we are now reviewing, but that won't be complete for Monday [6 January 2014]."⁴⁰⁰

4.122 At its meeting on 6 January 2014 the Disclosure Committee did not approve the 0.3 pence differential, noting that "[f]urther work would be undertaken internally to finalise the proposals."⁴⁰¹ The paper contained however a detailed set of justifications for the introduction of the price differential.⁴⁰²

³⁹⁷ Royal Mail, *Chief Executive's Committee – Minutes of meeting held on 18th December 2013*, 18 December 2013, page 10. (RM0963) Ofcom was not provided with any such written confirmation on the part of Oxera either in its responses to Ofcom's information requests or in its written representations.

³⁹⁸ *Ibid.*, page 11. (RM0963)

³⁹⁹ E-mail from [X] (Royal Mail) to various (Royal Mail), 3 January 2014. (RM1220)

⁴⁰⁰ E-mail from [X] (Royal Mail) to [X] (Royal Mail) and [X] (Royal Mail), 5 January 2014. (RM0416)

⁴⁰¹ Royal Mail, *Minutes of the meeting of the Disclosure Committee (being a Sub-Committee of the Chief Executive's Committee)*, 6 January 2014, page 2. (RM0122)

⁴⁰² Royal Mail, *Disclosure Committee 6 January 2014 – Changes to Access Pricing Plans: explanation and justification of Royal Mail's approach*, 6 January 2014, page 2, paragraphs 2.2-2.10 and pages 5-26, Annex A, B and C. (RM0124)

- 4.123 The paper included an analysis of potential competition and regulatory issues relating to the proposals. This was summarised in the following terms:

“As Royal Mail is likely to be considered to be dominant in the wholesale market for letters and large letters, we have carefully considered the competition law position and have sought to reduce the risk that these price changes in access pricing, both between NPP1 and NPP2 and the Zonal Tilt would result in an abuse of a dominant position.

... We have taken advice from external legal and economic advisers. We believe that there are strong arguments that our pricing changes are fair and reasonable and do not constitute an abuse of dominance...

Notwithstanding our analysis of the soundness of our position, there is a high likelihood of a complaint under either or both of the Competition Act or Ofcom’s regulatory provisions and some risk that regulators could take a different approach and find in favour of a complainant.”⁴⁰³

- 4.124 Annex A to the paper, entitled ‘Economic analysis of competition and regulation issues’ provided a summary of the economic advice received by Royal Mail. It stated:

“The access pricing proposals involve price discrimination, i.e. RM is choosing to charge different customers different prices for the same services. Even for a firm deemed to be dominant in a market, price discrimination is allowable under competition law if it can be objectively justified.

There is a risk that Ofcom (or another regulator) could consider this to be “abusive of a dominant market position” under competition law...We expect a complaint, most likely to OFCOM, to follow the announcement of the introduction of these access price changes.”⁴⁰⁴

- 4.125 It continued:

*“While we would argue that the proposals would not result in any competitor or direct delivery entrant being excluded from the market, the key defence against any complaint will be to prove that there is an **objective justification for the price changes** that Royal Mail is introducing.”⁴⁰⁵ [Original emphasis]*

- 4.126 The paper then outlined both the cost-based and value-based justifications; however, it sought to rely solely on the cost-based justification.⁴⁰⁶ The paper set out the range for the possible price differential which Royal Mail considered could be justified according to its cost modelling. It then explained that Royal Mail has “adopted a conservative approach in identifying the appropriate price differential for use in Tariff 2014 [by] proposing a price

⁴⁰³ Ibid., page 4, paragraphs 4.1, 4.3 and 4.4. (RM0124)

⁴⁰⁴ Ibid., page 5, paragraph 1.1. (RM0124)

⁴⁰⁵ Ibid., page 5, paragraph 1.4. (RM0124)

⁴⁰⁶ Ibid., page 3, paragraph 2.10. (RM0124)

*differential of 0.3 pence per item, which is at the bottom end of the modelled range of potential cost differences.”*⁴⁰⁷

- 4.127 In addition to these papers, the Disclosure Committee also considered two documents which Royal Mail has not provided to Ofcom on the basis that they benefit from legal professional privilege. These were:
- a) a presentation by Royal Mail Group Legal on protecting the USO: access pricing, legal risks and scenario planning dated 3 January 2014; and
 - b) revised advice from [redacted] (Royal Mail’s external legal advisors) on access options dated 31 December 2013.⁴⁰⁸

January 2014 – Second Disclosure Committee

- 4.128 On 8 January 2014, Royal Mail held a second Disclosure Committee meeting in which a revised price differential of 0.25 pence was presented. The Committee was *“given an update on the work that had been carried out since the 6 January Committee meeting at their request. This had included a meeting between [redacted a Royal Mail Executive], senior colleagues and the external legal and economic advisors ([redacted], and Oxera) on the morning of 8 January.”*⁴⁰⁹
- 4.129 The Disclosure Committee was advised that *“all relevant stakeholders internally and externally are now aligned behind the view that there is a good justification for the proposed differential.”*⁴¹⁰
- 4.130 The Disclosure Committee was also advised that *“following further discussions including with the Chief Executive and our [Royal Mail’s] external legal and economic advisers, it was decided to reduce the differential from 0.3p to 0.25p in order to minimise the likelihood of an adverse finding and further demonstrate that this is a measured and reasonable level at which to set the differential.”*⁴¹¹
- 4.131 The update added that:
- “As we move into a scenario where we have more advance information available to us, we are beginning work now to ensure that the forecasting information and customer data is more fully embedded in our operational planning in the future.”*⁴¹²
- 4.132 The Committee *“discussed the legal and economic risks of the proposals and also of pursuing the proposals... [and] concluded that it would proceed with the proposals.”*⁴¹³ The

⁴⁰⁷ Ibid., Annex B, page 11, paragraph 10. (RM0124)

⁴⁰⁸ Royal Mail, *Letter from [redacted] (Royal Mail) to [redacted] (Ofcom)*, 8 April 2014, page 4. (RM0152)

⁴⁰⁹ Royal Mail, *Minutes of the meeting of the Disclosure Committee (being a Sub-Committee of the Chief Executive’s Committee)*, 8 January 2014, page 1. (RM0131)

⁴¹⁰ Royal Mail, *Disclosure Committee 8 January 2014 – Changes to Access Pricing Plans: update since 6 January*, 8 January 2014, page 2, paragraph 2.3. (RM0132)

⁴¹¹ Ibid. (RM0132)

⁴¹² Ibid., paragraph 2.5. (RM0132)

⁴¹³ Royal Mail, *Minutes of the meeting of the Disclosure Committee (being a Sub-Committee of the Chief Executive’s Committee)*, 8 January 2014, page 2. (RM0131)

Committee “*agreed that the proposals would be announced to the market via an RNS announcement at 12 noon on the 9th January*”.⁴¹⁴ [Original emphasis]

- 4.133 In addition to these papers, the Disclosure Committee also considered five documents which Royal Mail has not provided to Ofcom on the basis that they benefit from legal professional privilege. These were:
- a) a high level summary of [redacted Royal Mail's external legal advisors'] advice on Royal Mail's access reform proposals;
 - b) [redacted Royal Mail's external legal advisors'] advice on Royal Mail's access reform proposals;
 - c) summary commercial legal advice on USPA Letters Access Contract for Disclosure Committee;
 - d) the Royal Mail Group Legal Presentation on protecting the USO: access pricing, legal risks and scenario planning; and
 - e) a skeleton draft of hypothetical Ofcom decisions in relation to likely complaint prepared by Royal Mail Group Legal, Group Regulation and [redacted Royal Mail's external legal advisors].⁴¹⁵

January 2014 – Royal Mail issued Contract Change Notices

- 4.134 On 9 January 2014, [redacted a Royal Mail Executive] provided a briefing to the Royal Mail Board about the content of the CCNs and the likely reaction from Royal Mail's customers. The Board was told that: “*We believe that our proposals are proportionate, reasonable and necessary to support the sustainable provision of the USO in light of changes in market conditions, including the growth of direct delivery competition.*” The Board was also told that: “*We believe the measures...are the only commercial measures that we can sensibly take. They do however carry some legal and regulatory risks...*”⁴¹⁶
- 4.135 The Board was provided with a copy of Whistl's letter of 8 January 2014 outlining its concerns about the introduction of the price differential (see paragraph 4.159 below).⁴¹⁷ The Board was also informed that Whistl was expected to complain and that Ofcom was likely to investigate, leading to a suspension of the CCNs. The Board was advised about whether these events, flowing from issuing the CCNs, could affect Whistl:

“We think [Whistl's] claims about the harm they will suffer are exaggerated, but it is possible that they may find it difficult to attract new customers given the market uncertainty that may be created by their complaint. It is also possible that [Whistl's]

⁴¹⁴ Ibid. (RM0131)

⁴¹⁵ Royal Mail, *Letter from [redacted] (Royal Mail) to [redacted] (Ofcom)*, 8 April 2014, page 4. (RM0152). See also Royal Mail, *Disclosure Committee 8 January 2014 – Changes to Access Pricing Plans: update since 6 January*, 8 January 2014, page 3, paragraph 2.12. (RM0132)

⁴¹⁶ Royal Mail, *email from [redacted] (Royal Mail) to the Royal Mail Board re legally privileged and confidential*, 9 January 2014 (RM0138)

⁴¹⁷ Whistl, *Letter from [redacted] (Whistl) to [redacted] (Royal Mail)*, 8 January 2014, page 1. (WH0108)

financing may be conditional on there being no regulatory or competition law dispute ongoing.”⁴¹⁸

4.136 On 10 January 2014, Royal Mail published Contract Changes Notices 002, 003, 004 and 005 (see section 3 for description of these CCNs). In summary, the CCNs introduced two key pricing changes:

- a) a differential in pricing between NPP1 and APP2/ZPP3 of approximately 1.2%; and
- b) new zonal prices based on a revised ‘zonal tilt’ which increased rural prices while decreasing London and urban prices.⁴¹⁹

4.137 Royal Mail explained:

“the introduction of a price differential of 1.2% between National Price Plan One (NPP1) and the national Averaged Price Plan Two (APP2)/ the Zonal Price Plan (ZPP3). This reflects the cost benefits to Royal Mail of receiving advance information about posting volumes at the local level, which NPP1 customers provide but APP2 and ZPP3 customers do not, as well as the value to customers of the greater flexibility they enjoy under APP2 and ZPP3.”⁴²⁰

4.138 Royal Mail added:

“These changes are part of a longer term policy to adjust Access contracts so that they better reflect the way the Universal Service Obligation delivery network is structured and operated and the costs of maintaining that network, against the backdrop of a continuing decline in letter volumes.”⁴²¹

4.139 Royal Mail confirmed that these *“changes to the Access prices which will come into effect on 31st March 2014.”⁴²²* It said it was *“changing the price plans of the Access Letters Contract to respond to changes in the market and reflect up-to-date information on costs”* and informed customers that *“your Account Director will contact you to discuss the changes in detail and how they affect your business”*.⁴²³

4.140 In February 2014, Royal Mail also stated that the price differential *“reflects the cost benefit Royal Mail would gain by being able to plan more accurately at a local level and deliver greater efficiencies.”⁴²⁴* It added that the differential reflects a new feature of the NPP1 pricing plan which *“requires customers to provide monthly volume forecasts including significant changes for up to 2 years ahead, based on a national mail profile across 86 local districts”*,⁴²⁵ whereas APP2 does *“not require that forecast information, therefore providing additional flexibility for customers.”⁴²⁶*

⁴¹⁸ Ibid, 9 January 2014 (RM0138)

⁴¹⁹ Royal Mail, *Access Letters Contract Change Notices 003 - 005*, 10 January 2014. (RM0031)

⁴²⁰ Royal Mail, *Letter to access operators*, 10 January 2014, page 1. (WH0056)

⁴²¹ Ibid. (WH0056)

⁴²² Ibid. (WH0056)

⁴²³ Ibid. (WH0056)

⁴²⁴ Royal Mail, *Royal Mail response to Ofcom’s statement on Access contract changes*, 21 February 2014. (RM0018)

⁴²⁵ Ibid. (RM0018)

⁴²⁶ Ibid. (RM0018)

C. Whistl's and its investors' response to the CCNs

December 2013: Announcement by Royal Mail of its intention to introduce a price differential and the initial response of Whistl and LDC

- 4.141 On 27 November 2013, Whistl wrote to Royal Mail expressing concerns that its customers were being approached by one of its competitors who were *"stating that there will be a differential price come April 14 in the above contract rates [NPP1/APP2]."*⁴²⁷ Whistl requested confirmation that Royal Mail *"will not introduce differential pricing between NPP1 and NPP2 in April 14."*⁴²⁸ [Original emphasis].
- 4.142 On 6 December 2013, Royal Mail responded to Whistl and confirmed that it had made a *"decision in principle"* to introduce a price differential, noting that *"[w]e have made no secret of the fact that we have actively considered introducing such a differential and we raised the prospect of such a change last year."*⁴²⁹

December 2013: The inclusion of the Material Adverse Effect clause in the LDC agreement

Whistl and PostNL's immediate reaction to the 6 December 2013 announcement

- 4.143 Contemporaneous documentary evidence demonstrates that Whistl recognised that a price differential could have a material detrimental impact on its end-to-end business. In an email to Whistl's legal advisers on 8 December 2013, [X a Whistl Executive] explained that *"[w]hat has happened is that Royal Mail has (as expected) announced to the market that it intends to charge less to those who use it on an exclusive basis (like UK Mail) than those who dare to compete (ie TNT Post). Naturally, they have muddied the waters and will come up with some sort of purported cost-justification but that is the effect of their statement."*⁴³⁰ He noted that *"[e]ven a small differential (which would need to be matched commercially) could turn the business (10 million profit 2012) into a loss-making one within a year and, effectively, halt our end-to-end roll-out."*⁴³¹ His view was that Royal Mail's *"timing is no doubt deliberate"*.⁴³²
- 4.144 It was also noted that the expected publication date of the CCNs would, in relation to the LDC agreement, fall *"right in the middle of 'exchange to completion' [material adverse change] territory."*⁴³³ On 7 December 2013, [X a Whistl Executive] wrote to PostNL noting *"[w]hilst the attempt to derail E2E is predictable the timing is awful. We all really want to*

⁴²⁷ Royal Mail, *E-mail from [X] (Whistl) to [X] (Royal Mail)*, 27 November 2013. (RM0381)

⁴²⁸ *Ibid.* (RM0381)

⁴²⁹ Royal Mail, *E-mail from [X] (Royal Mail) to [X] (Whistl)*, 6 December 2013. (WH0102)

⁴³⁰ Whistl, *Email from [X] (Whistl) to [X] Whistl's external legal advisors re: Luke – management issue list*, 8 December 2013. (WH0714)

⁴³¹ *Ibid.*, (WH0714)

⁴³² *Ibid.*, (WH0714)

⁴³³ *Ibid.*, (WH0714)

complete the deal. I want to obviously discuss how we approach this with LDC but unable to speak to you [X a PostNL Executive] since we found out about this friday [sic] evening.”⁴³⁴

On 8 December 2013, Whistl’s legal advisors, [X], said “[i]nitial response is it is obviously a disclosure issue pre signing both for [Whistl] as seller and you as managers.”⁴³⁵

4.145 Whistl immediately (7 and 8 December 2013) began to explore regulatory and enforcement options.⁴³⁶ On 9 December 2013, [X a Whistl Executive] explained to LDC and PostNL the options available for it to seek intervention from Ofcom: “I have tried to summarise what could happen if there were a pricing differential between the price plans. I will then leave it to you, the investors to decide what to do.”⁴³⁷ [X a Whistl Executive] noted that the options for seeking regulatory intervention would be through an access dispute, a competition complaint or a regulatory complaint (or a combination), and explains that “[t]he trigger in this case would be if the downstream access pricing published in January 2014 by Royal Mail on the National Price Plan One (NPP1) **is not** equivalent to the pricing on Averaged Price Plan Two (Zonal)”⁴³⁸ (original emphasis). The email further explained the possible outcomes, noting that, if Ofcom were to accept the complaint or access dispute, the price change would be suspended: “the price change is suspended under the terms of the access contract until Ofcom issues its decision.”⁴³⁹ The email also notes that: “Unfortunately, none of the standard processes takes less than 20 weeks”.⁴⁴⁰

4.146 On 8 December 2013, senior executives from PostNL and Whistl discussed “the ‘announcement’ of Royal Mail regarding their planned prices differentiation between [NPP1] and [APP2].”⁴⁴¹ Following this, [X a PostNL Executive] emailed Whistl personnel: “We al [sic] realize [Royal Mail’s announcement] could seriously harm our E2E case and therefore would urgently need an overview which postpones some of the commitments and at the same time does not immediately impact the roll out plan.”⁴⁴² In response to this, Whistl developed plans to postpone further property investment in its end-to-end operations, including by delaying three of the seven proposed expansion areas scheduled for 2014 – Birmingham, North London and Central South East London – to early 2015,⁴⁴³

⁴³⁴ Whistl, Email from [X] (Whistl) to [X] (PostNL) and [X] (PostNL) re: Price differential - encouraging OFCOM discussion, 7 December 2013. (WH0711)

⁴³⁵ Whistl, Email from [X Whistl’s external legal advisors] to [X] (Whistl) re: Luke – management issue list, 8 December 2013. (WH0715)

⁴³⁶ Whistl, Email from [X] (Whistl) to [X] (Whistl) re: Price differential - encouraging OFCOM discussion, 7 December 2013. (WH0711). Whistl, Email from [X] (Whistl) to [X Whistl’s external legal advisors] re: Luke – management issue list, 8 December 2013. (WH0714)

⁴³⁷ Whistl, Email from [X] (Whistl) to [X] (LDC) and [X] (PostNL) re: MAC clause – differential pricing, 9 December 2013. (WH0729)

⁴³⁸ Ibid. (WH0729)

⁴³⁹ Ibid. (WH0729)

⁴⁴⁰ Ibid. (WH0729)

⁴⁴¹ Phone call described in: PostNL, Email from [X] (PostNL) to [X] (Whistl) and [X] (Whistl) re: FW: Updated Commitment overview, 9 December 2013. (WH0720)

⁴⁴² Ibid. (WH0720)

⁴⁴³ Whistl, Email from [X] (Whistl) to [X] (PostNL) re: commitments HY1 2014, 10 December 2013. (WH0732). See attachment. (WH0733)

and to delay sign-off of approximately £3.8 million of financial commitments from December 2013 until 15 January 2014.⁴⁴⁴

- 4.147 On 9 December 2013, Whistl presented its concerns about Royal Mail's announcement to Ofcom. Whistl explained that the announcement was having an immediate market impact and that it was having to "underwrite the differential in upstream price."⁴⁴⁵ Whistl also observed that its "access business would be loss-making with only minor differential of c.1.2%."⁴⁴⁶

Inclusion of an MAE Condition in the investment agreement

- 4.148 After Royal Mail's announcement in December 2013, an additional 'Material Adverse Effect' condition ("**MAE Condition**") was included in the investment agreement. Nick Wells (CEO, Whistl) explained in a witness statement submitted to Ofcom in January 2014 that: "*LDC is a sophisticated investor and, having learnt that Royal Mail planned to introduce price changes for downstream access, including potentially a price differential, included a specific clause, alongside other more general 'material adverse change' (or 'MAC') clauses, to protect itself in relation to that risk*".⁴⁴⁷
- 4.149 This was confirmed by LDC, who explained to Ofcom that "*LDC therefore supported the inclusion of the [MAE Condition] in the Agreement because LDC believed, on the basis of the information provided to it by both [Whistl] and PostNL, that the proposed prices changes notified to [Whistl] could have an adverse impact on the viability of [Whistl's] roll-out plans and consequently have an adverse impact on the value of LDC's proposed investment*".⁴⁴⁸
- 4.150 LDC explained to Ofcom that it had instructed its lawyers, verbally, to draft a material adverse change clause and they received a first draft of this on 10 December 2013.⁴⁴⁹ On 11 December 2013, PostNL's legal advisors circulated a revised draft of the MAE Condition which was eventually incorporated into the agreement.⁴⁵⁰ LDC explained to Ofcom in response to a formal request for information that "*LDC then agreed with PostNL, verbally, the inclusion of the additional [MAE Condition] that it needed confirmation of no adverse pricing differential prior to its investment and also that LDC would negotiate in good faith with PostNL to reach a commercial agreement as to the terms on which it will elect to proceed to Completion*".⁴⁵¹
- 4.151 On 12 December 2013, [redacted a Whistl Executive] wrote to [redacted a Whistl Executive]:

⁴⁴⁴ Whistl, *Email from [redacted] (Whistl) to [redacted] (PostNL) re updated commitment overview*, 9 December 2013. (WH0726)

⁴⁴⁵ Whistl, *Presentation to Ofcom*, 9 December 2013, slide 10. (WH0717)

⁴⁴⁶ *Ibid.* (WH0717) In later correspondence Whistl explained that "*Absorbing the differential for all customers would cost TNT Post around £9.9 million in 2014/15. This is a massive impact on our business which, in 2012, made an annual profit of £9.8 million*." Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 16, paragraph 47. (WH0132)

⁴⁴⁷ Whistl, *Witness Statement of Nick Wells*, page 19, paragraph 58. (WH0132)

⁴⁴⁸ LDC, *Letter from [redacted] (LDC) to [redacted] (Ofcom) - appendix 1*, 21 April 2017, page 2. (LDC126)

⁴⁴⁹ *Ibid.*, page 2. (LDC126).

⁴⁵⁰ PostNL, *Email from [redacted] (PostNL's legal advisors) to [redacted] LDC's external legal advisors] re: Royal Mail rider*, 11 December 2013. (LDC025)

⁴⁵¹ LDC, *Letter from [redacted] (LDC) to [redacted] (Ofcom)- appendix 1*, 21 April 2017, page 2. (LDC126)

“From a MAC perspective,⁴⁵² it looks like LDC’s ability to walk / talk on publication of prices will be too early a trigger. The more relevant date is at the end of any access dispute process (20 weeks i.e. May – would they wait around that long?) and not just on publication. This, though, delays the investment but would we expect LDC to invest / RBS to lend when an access dispute / complaint was pending?”

Royal Mail have played a very clever tactical game. They would love to see the deal fall at the first hurdle and so they have a very low risk in publishing, knowing that we have to challenge it (and may well do so successfully) and that the prices can be suspended under the contract. I would understand if LDC want the ability to pull the plug following publication but as we no [sic] know it is going to happen, we do need to persuade them to hold their nerve and either complete OR at least hang around until the regulatory process has run its course. This will give them an idea of what lies ahead.”⁴⁵³

- 4.152 On 13 December 2013, Whistl’s management provided a disclosure letter to LDC which included the following disclosure:

“On 6 December 2013, Royal Mail notified [Whistl] and its other access customers that it intends to publish its prices on 7th January 2014. They stated that they intend to introduce a price differential between the contract used by, among others, [Whistl] (National Price Plan 2 (Zones) / the average of Zonal Pricing) under which postal services would be more highly priced than those provided to customers on a National Price Plan 1 (SSC) contract. If permitted, the price changes would come into effect in April 2014. [Whistl] is not eligible to sign a National Price Plan 1 (SSC) contract, due to its delivery activities. [Whistl] is taking steps to prepare for a regulatory / legal challenge in anticipation of Royal Mail publishing differential prices. If such pricing were introduced and not removed, the Group’s business could be materially and adversely impacted.”⁴⁵⁴

The LDC Agreement of 13 December 2013

- 4.153 On 16 December 2013, LDC and PostNL announced that they had reached an agreement (the “LDC Agreement”) “to establish a joint venture, which will allow [Whistl] to roll out its end-to-end (E2E) postal delivery service.”⁴⁵⁵ Connected to the LDC Agreement, the parties had also entered into an agreement with the Royal Bank of Scotland for working capital and term facilities (the “RBS Agreement”).⁴⁵⁶ The bank had the right to withdraw these funds in the event that there was a material change to Whistl’s business.⁴⁵⁷

⁴⁵² This means “material adverse change” which is used, in this case, synonymously with the MAE Condition.

⁴⁵³ Whistl, *Email from [redacted] (Whistl) to [redacted] (Whistl) re NPP1 price differential - ###OFCOM UPDATE### URGENT*, 12 December 2013. (WH0734)

⁴⁵⁴ PostNL, *Disclosure Letter*, 13 December 2013, Page 7. (LDC030)

⁴⁵⁵ LDC, *LDC and PostNL to form joint venture to roll out E2E delivery in the UK*, 16 December 2013. (PD0007)

⁴⁵⁶ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 8, paragraph 23. (WH0132)

⁴⁵⁷ *Ibid.*, page 9, paragraph 23. (WH0132)

- 4.154 Completion of the LDC Agreement was conditional on two events. First, there was a requirement that the acquisition achieved anti-trust clearance from relevant authorities. Second, there was the MAE Condition which anticipated the introduction of price changes by Royal Mail. In addition, there were a number of other, standard specified events which enabled LDC to terminate the deed.
- 4.155 In the final agreement of 13 December 2013, the MAE Condition (clause 4.2) provided that completion of the LDC Agreement was conditional on the following:
- “Royal Mail shall have communicated, not later than 31 March 2014, to a Group Company the principal changes which it proposes to introduce to the charges it makes to Group Companies for the supply of delivery services or that it does not intend to introduce any such changes or intends only to implement changes which will not give rise to a Material Adverse Effect.”*⁴⁵⁸
- 4.156 Clause 4.3 set out that if clause 4.2 was not satisfied by the long stop date, 13 June 2014, *“then each of LDC or the Seller may, by notice in writing to each other party, terminate the rights and obligations of all parties to this Deed.”*⁴⁵⁹
- 4.157 Similarly, clause 5.6 stated that *“[i]f any of the following events has occurred, then LDC may, by notice in writing or by email to the Seller and the Buyer (a “Termination Notice”), terminate this Deed (other than in respect of the Surviving Provisions).”*⁴⁶⁰ This list included clause 5.6.6:
- “If:*
- (a) Royal Mail has communicated in writing to the Company the changes it proposes to introduce to the charges it makes for the supply of delivery services to Group Companies;*
- (b) such changes, if introduced, will have a Material Adverse Effect; and*
- (c) before 31 March 2014:*
- (i) such changes become binding; or*
- (ii) such proposals are not withdrawn or modified so that, if implemented, they will not give rise to a Material Adverse Effect.”*⁴⁶¹

⁴⁵⁸ Whistl, *Share Sale and Purchase Agreement relating to the acquisition of TNT NN1 Limited*, 13 December 2013, page 25. (WH0061)

⁴⁵⁹ *Ibid.*, page 25. (WH0061)

⁴⁶⁰ *Ibid.*, page 32. (WH0061)

⁴⁶¹ *Ibid.*, page 33. (WH0061). Clause 5.6.5. explains that a ‘Material Adverse Effect’ is *“any event... which causes a material change in the business, operations, assets, position (financial, trading or otherwise), profits of the Group, taken as a whole.”*

January 2014: Formal introduction of the CCNs, delay of Whistl’s external investment, Whistl submits a complaint to Ofcom

January 2014: Formal notification of Contract Changes by Royal Mail

- 4.158 On 17 December 2013, Whistl met with Royal Mail. According to Whistl’s note of this meeting, Whistl “asked if RM had considered the impact on TNT Post” and noted that “it was blindingly obvious what happens to TNT Post if they were to stay on National Price Plan 2 (NPP2).”⁴⁶² [§< a Royal Mail Executive] is recorded to have said that “the prices would be cost-reflective and that TNT Post ‘has options’ to mitigate the effect.” The note also recorded that “[§< a Royal Mail Executive] said that TNT Post currently satisfied the conditions of NPP1.”⁴⁶³
- 4.159 On 8 January 2014, Whistl wrote to Royal Mail to “set out [its] position clearly in writing so it is beyond doubt that you and your colleagues were fully aware of the facts and risks when you make your decision.”⁴⁶⁴ Whistl explained that Royal Mail’s plan to include a price differential “could render expansion of [its] end-to-end delivery business unviable and necessitate the closure of our existing end-to-end business” and that its “existing and potential future investors – namely Post NL and Lloyds Development Capital – would be likely to pull out of the project.”⁴⁶⁵ Whistl expressed the view that “launching the Plans would constitute an abuse of Royal Mail’s dominant position and would contravene relevant law and regulatory rules.”⁴⁶⁶
- 4.160 As set out above, on 10 January 2014, Royal Mail published Contract Changes Notices 002, 003, 004 and 005.
- 4.161 In addition, on the same day, Royal Mail responded to Whistl’s letter of 8 January 2014 stating: “[y]ou will be aware of the announcement which we made this morning. It will be apparent to you that we do not agree with what you say in your letter.”⁴⁶⁷

Whistl complains to Ofcom

- 4.162 Whistl immediately began to analyse the impact of the changes contained within the CCNs. PostNL, Whistl and LDC scheduled a catch up call on 13 January 2014 to see “where we are on Royal Mail – pricing information came in on Friday so think management are cranking the calculations over the weekend.”⁴⁶⁸
- 4.163 On 13 January 2014, Whistl prepared a proactive statement to its customers regarding the price differential introduced by the CCNs. This was not a public communication but was to

⁴⁶² Whistl, *Note of a meeting on 17 December 2013 at 10am at Royal Mail*, 17 December 2013, page 2. (WH0107)

⁴⁶³ Ibid. (WH0107)

⁴⁶⁴ Whistl, *Letter from [§<] (Whistl) to [§<] (Royal Mail)*, 8 January 2014, page 1. (WH0108)

⁴⁶⁵ Ibid. (WH0108)

⁴⁶⁶ Ibid., page 2. (WH0108)

⁴⁶⁷ Royal Mail, *Letter from [§<] (Royal Mail) to [§<] (Whistl)*, 10 January 2014. (WH0109)

⁴⁶⁸ LDC, *Email from [§<] (LDC) to [§<] (PostNL) re: Hope you are well*, 12 January 2014. (LDC031)

be used in communications with customers who Whistl staff felt would benefit from clarity around Whistl's position and to reassure them in their decision to work with Whistl:

"Customer Announcement

In light of the recent Access pricing announcement you may have some concerns about the price you pay going forward due to the differential in pricing plans.

Please be reassured that [Whistl] will not disadvantage their customers in terms of pricing. We will do what is right for our customers: delivering choice and cost efficiencies as we demonstrated last year.

*[Whistl] have always looked to innovate the postal industry and we recently made one of the most significant changes in the last 300 years of postal history by introducing an alternative delivery service to Royal Mail. We will continue to bring innovation, be competitively priced and above all maintain our integrity and deliver on our promises."*⁴⁶⁹

- 4.164 On 14 January 2014, Whistl prepared an internal strategy presentation regarding the impact of Royal Mail's pricing announcements. This analysed the impact of the price differential and changes to the zonal tilt in the context of its use of APP2 as well as the implications of it attempting to operate on NPP1.⁴⁷⁰ The outcome of this internal assessment is set out below at figure 4.5.
- 4.165 In relation to the price differential, Whistl assessed the level of additional costs associated with the higher price on APP2. It considered two scenarios: first where these additional costs applied in relation to all its customers and second where they would only apply in relation to its national customers.⁴⁷¹ There appears to be a sensitivity analysis to consider the range of impact the differential could have.
- 4.166 In relation to the zonal tilt, Whistl assessed how the change in zonal prices would have led to it incurring substantial surcharges during the course of its end-to-end roll out.⁴⁷² This is because the reduction in the London zonal price from a high-price zone to a low-price zone meant that Whistl's roll out in London (which was an early focus in the plan) would have removed low-price items rather than high-price items. As explained above in section 3, under APP2 operators are liable to be surcharged in a situation where they fail to hand over sufficient quantities of low-price mail.⁴⁷³

⁴⁶⁹ Whistl, *Email from [redacted] (Whistl) to Whistl staff re Access Pricing Customer Announcement*, 13 January 2014. (WH0115)

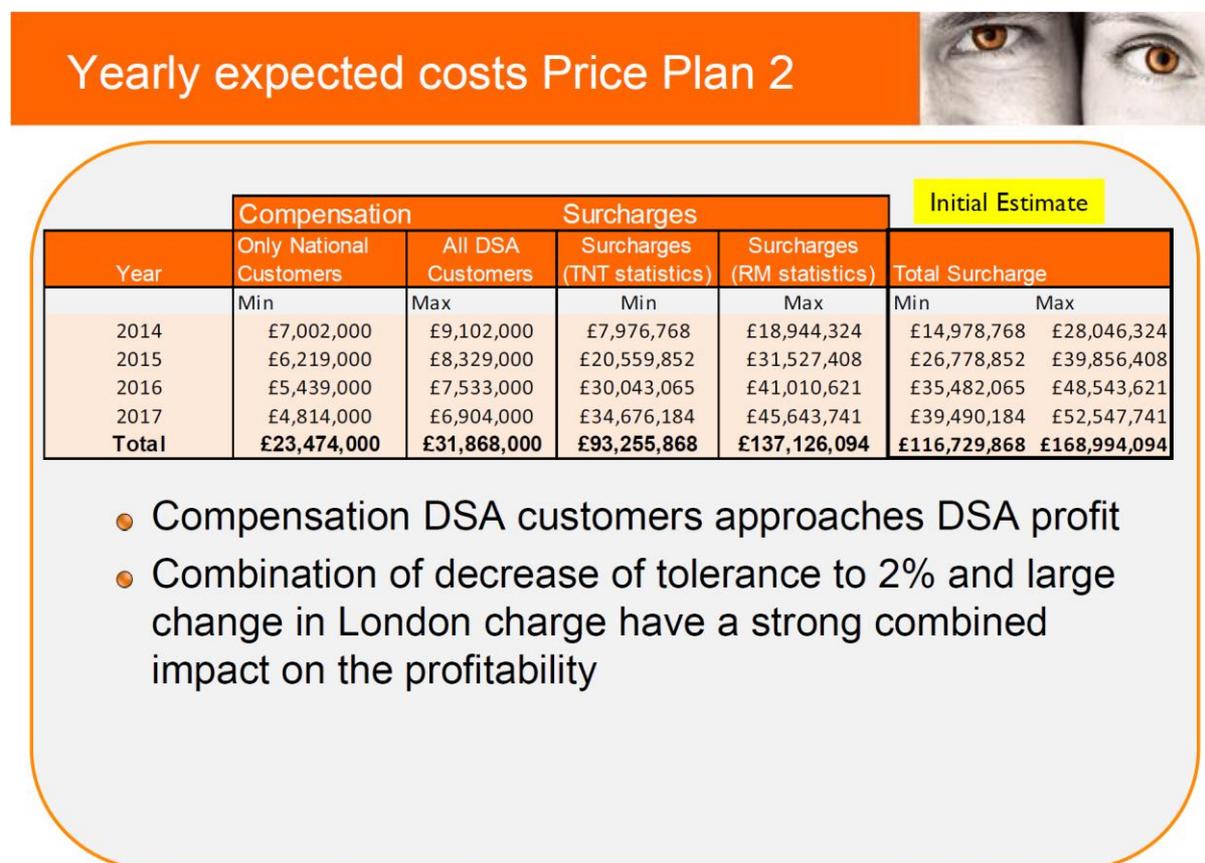
⁴⁷⁰ Whistl, *Impact of Price plan proposal Royal Mail*, 14 January 2014. (WH0739)

⁴⁷¹ *Ibid*, slide 11. (WH0739)

⁴⁷² *Ibid.*, slides 12 to 13. (WH0739)

⁴⁷³ In assessing this impact Whistl considered two different breakdowns of its volume by zone: first, the breakdown reported by Royal Mail sampling of its mail (which it relied on to monitor operator's compliance with the zonal profile of APP2) and, second, the breakdown reported by Whistl internal monitoring of volumes.

Figure 4.5 sets out Whistl's estimate of a substantial financial impact associated with both changes.



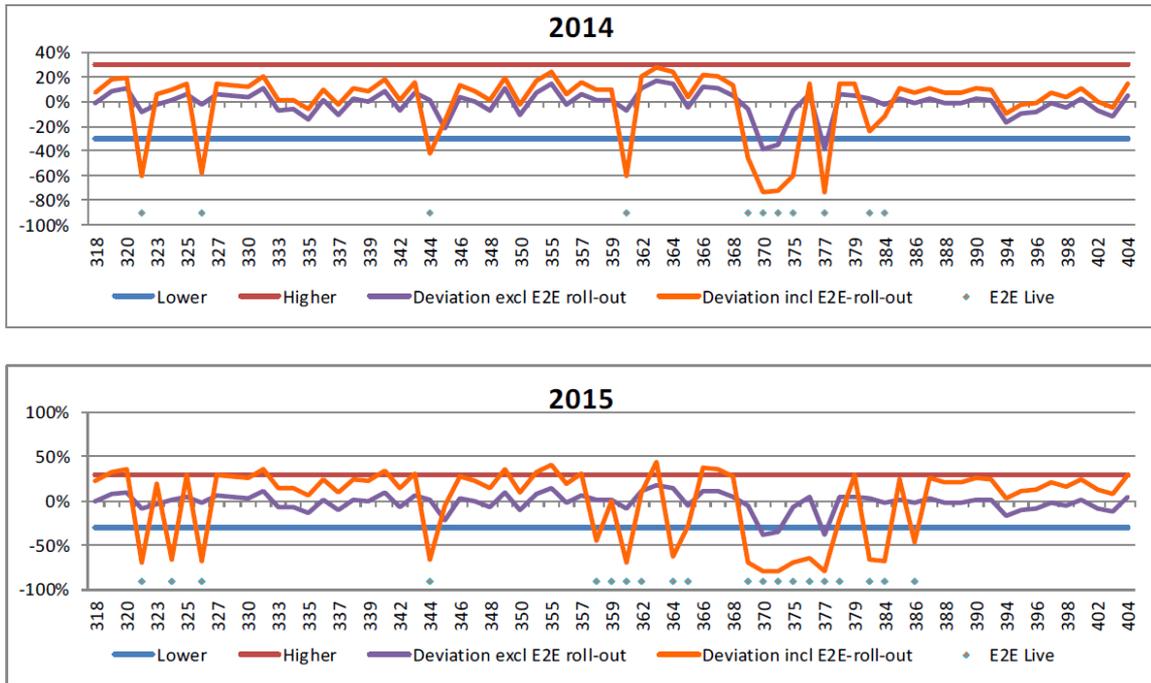
14

Whistl: Whistl, Impact of Price plan proposal Royal Mail, 14 January 2014, slide 14. (WH0739)

4.167 In addition to considering the financial impact resulting from its use of APP2, Whistl also assessed its ability to comply with the NPP1 benchmarks. The results of this assessment are set out below in figures 4.6 and 4.7. This shows that over time, Whistl's geographic profile would substantially deviate from the National Spread Benchmark exposing Whistl to substantial surcharges of £9.4 million (in 2014), £34.2 million (in 2015), £56.9 million (in 2016) and £65 million (in 2017).⁴⁷⁴

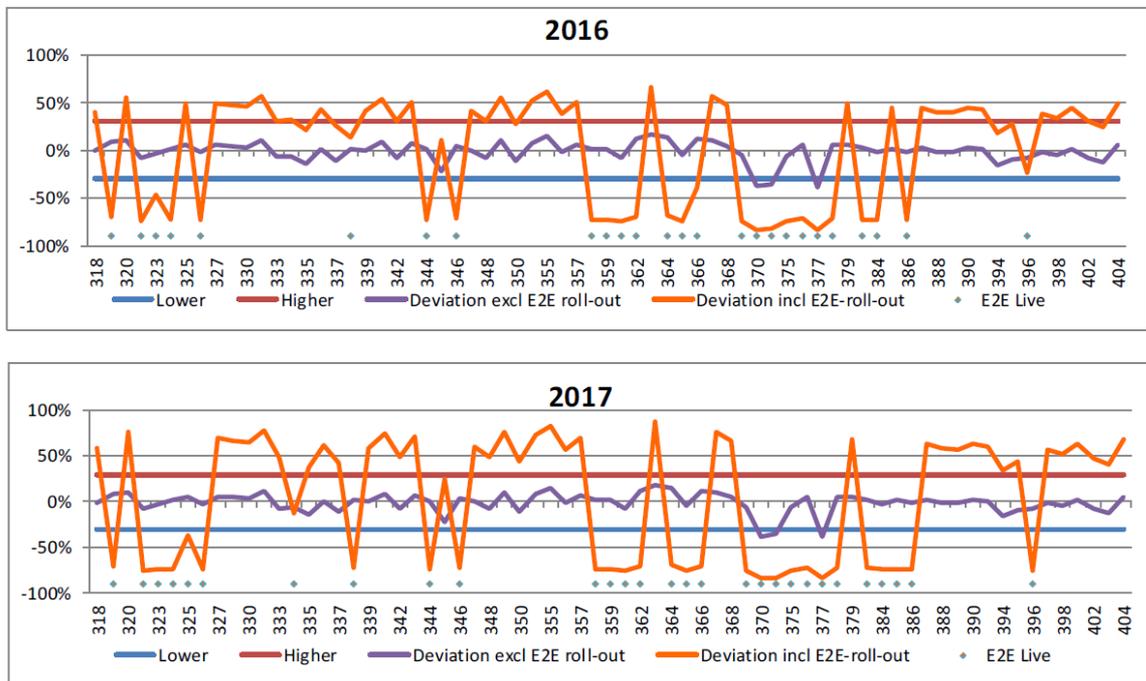
⁴⁷⁴ Whistl, Impact of Price plan proposal Royal Mail, 14 January 2014, slide 6. (WH0739)

Figure 4.6: Whistl's assessment of its national spread profile during roll out (2014/2015)



Whistl: Whistl, Impact of Price plan proposal Royal Mail, 14 January 2014, slide 8. (WH0739)

Figure 4.7: Whistl's assessment of its national spread profile during roll out (2016/2017)



Whistl: Whistl, Impact of Price plan proposal Royal Mail, 14 January 2014, slide 9. (WH0739)

4.168 On 28 January 2014, Whistl submitted a complaint to Ofcom alleging that the prices, terms and conditions on which Royal Mail was offering to provide D+2 Access, following the

publication of the CCNs, would unfairly disadvantage Whistl, and certain of Whistl's delivery customers, by subjecting them to higher prices and/or surcharges.

4.169 Whistl alleged that Royal Mail's revised terms following the notified price changes had been "*designed precisely to target [Whistl's] decision to enter and expand in the market for downstream letter delivery and it is, in any event, uniquely damaging to [Whistl] by reason of its downstream activities.*"⁴⁷⁵

4.170 Whistl added:

*"The [revised offer] is plainly discriminatory, requiring [Whistl] (which is Royal Mail's largest customer for downstream access) to incur higher overall charges (including surcharges) for downstream access than will be payable both by its competitors (such as UK Mail), and by customers under CDA contracts with Royal Mail (unless those customers choose to meet any part of their downstream delivery requirements by buying from TNT Post). The [revised offer] will force [Whistl] to abandon its plans to compete with Royal Mail in the downstream delivery market, because it will be uneconomic to do so."*⁴⁷⁶

4.171 Whistl identified five features of the revised D+2 Access terms that it considered would have a harmful effect on Whistl:

- a) the introduction of a price differential between the two national access price plans, which it said would result in the prices paid by Whistl being around 1.2% higher than those paid by its principal competitor (UK Mail);⁴⁷⁷
- b) the surcharges which applied to NPP1, the lower cost price plan, including surcharges for not meeting the geographic coverage requirement, which "*operate as a powerful disincentive against any user of [the lower cost price plan] switching part of its total mail volumes away from Royal Mail to an alternative downstream letter delivery operation.*"⁴⁷⁸
- c) Royal Mail's adjustment of the zonal tilt, which it said would have the effect of increasing the prices Whistl faced from Royal Mail for deliveries to rural and suburban areas;⁴⁷⁹
- d) Royal Mail's reduction of the tolerances for meeting targets, which would apply to APP2, the price plan under which Whistl principally operated, which it said would result in Whistl facing higher surcharges and hence higher costs;⁴⁸⁰ and
- e) Royal Mail's introduction of a requirement under NPP1, the lower cost price plan, to provide certain forecasts of volumes, which Whistl considered would effectively

⁴⁷⁵ Whistl, *Complaint submitted to Ofcom on behalf of TNT Post...*, 28 January 2014, page 3, paragraph 2. (WH0128)

⁴⁷⁶ *Ibid.*, page 3, paragraph 2. (WH0128)

⁴⁷⁷ *Ibid.*, page 12, paragraph 24a. (WH0128)

⁴⁷⁸ *Ibid.*, page 13, paragraph 24b. (WH0128)

⁴⁷⁹ *Ibid.*, page 13, paragraph 24c. (WH0128)

⁴⁸⁰ *Ibid.*, page 14, paragraph 24d. (WH0128)

compel the provision of commercially sensitive information from competitors to Royal Mail.⁴⁸¹

- 4.172 Whistl claimed that it would incur higher charges because it would be unable to meet the eligibility criteria for NPP1.⁴⁸² It argued that these eligibility criteria, in effect, prevented end-to-end operators from accessing the lower prices. Whistl alleged that Royal Mail's changes meant that such an operator would be penalised for carrying out delivery activities in competition with Royal Mail.⁴⁸³
- 4.173 In a witness statement to support the complaint, Nick Wells (CEO, Whistl) said that, as a result of the price differential increasing APP2/ZPP3 prices to a level 1.2% above NPP1 prices, "*[Whistl] will therefore be excluded from a discount that those of its competitors that use only Royal Mail for downstream delivery (e.g. UK Mail) receive, meaning that [Whistl] will be at a significant cost disadvantage in competing in the upstream market, at least unless and until [Whistl] abandons competing with Royal Mail in downstream delivery.*"⁴⁸⁴ Nick Wells added that, while the price differential "*sounds small...due to volumes, fractions of a penny are the difference between winning and losing contracts. We therefore either exit the market or somehow fund this discount ourselves, from somewhere else. Funding from somewhere else is simply not part of the business plan we have provided to our investors nor is it rational or viable.*"⁴⁸⁵
- 4.174 Nick Wells further explained that because the provision of upstream services was "*fiercely competitive*" it was necessary for it to commit to its customers that they would not be disadvantaged by the price differential.⁴⁸⁶

⁴⁸¹ Ibid., page 14, paragraph 24e. (WH0128)

⁴⁸² See above paragraphs 3.83.

⁴⁸³ Whistl, *Complaint submitted to Ofcom on behalf of TNT Post...*, 28 January 2014, page 17, paragraph 32. (WH0128)

⁴⁸⁴ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 13, paragraph 37. (WH0132)

⁴⁸⁵ Ibid. page 17, paragraph 50. (WH0132)

⁴⁸⁶ Ibid., page 13, paragraph 38, see above paragraph 4.163 for Whistl's proactive statement to its customers. (WH0132)

4.175 In this context, Nick Wells observed:

*“Our business made an annual profit in 2012 of £9.8 million. We calculate that, if we have to absorb the price differential for all of our customers in order to retain them, it will cost us the following amounts:”*⁴⁸⁷

NPP1 – APP2 Differential	
2014	£ 9,887,104
2015	£ 8,862,005
2016	£ 7,854,668
2017	£ 6,987,450
2018	£ 6,747,329

4.176 Whistl complained that Royal Mail’s revised offer following the notified price changes would have *“the effect of foreclosing the market for the provision of downstream letter delivery...from new entry or expansion by competitors.”*⁴⁸⁸ Whistl claimed this would affect both Whistl and *“the notional ‘as efficient competitor’ to Royal Mail.”*⁴⁸⁹

4.177 Whistl also argued that Royal Mail’s notified price changes appeared to be *“targeted at (i) undermining the viability of [Whistl]’s existing downstream letter delivery operation and (ii) preventing [Whistl]’s planned geographical expansion of its downstream letter delivery operation.”*⁴⁹⁰

4.178 In his witness statement in support of the complaint, Nick Wells (CEO, Whistl) said that Royal Mail’s conduct had prompted LDC to include the MAE Condition which allowed *“LDC to withdraw from the investment if the price changes would have a material adverse effect on the business.”*⁴⁹¹ He added that Whistl and its parent company PostNL were *“doing everything we can to persuade LDC to be patient and await the outcome of Ofcom’s investigation into the Notifications”* but that there was a *“very real risk that LDC will simply walk away from the deal.”*⁴⁹² He concluded that *“the likelihood is that loss of the LDC investment would, in effect, spell the end of postal delivery competition in the UK.”*⁴⁹³

4.179 Whistl’s complaint was supported by an economic paper prepared by Frontier Economics⁴⁹⁴ in which it had:

“carried out an initial analysis of the materiality of the new access pricing proposals on the profitability of [Whistl’s] entry into downstream delivery, using its business

⁴⁸⁷ Ibid., pages 13 to 14, paragraph 38. (WH0132)

⁴⁸⁸ Whistl, *Complaint submitted to Ofcom on behalf of TNT Post...*, 28 January 2014, page 11, paragraph 23a. (WH0128)

⁴⁸⁹ Ibid., page 11, paragraph 23b. (WH0128)

⁴⁹⁰ Ibid., page 11, paragraph 23c. (WH0128)

⁴⁹¹ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 19, paragraph 58. (WH0132)

⁴⁹² Ibid., page 19, paragraph 60. (WH0132)

⁴⁹³ Ibid., page 20, page 20, paragraph 61. (WH0132)

⁴⁹⁴ Frontier Economics, *Exclusionary effects of Royal Mail’s pricing proposals*, 28 January 2014. (WH0121)

*plan and costing model. On the basis of the current plans, [Whistl] expected to make a profit on its downstream delivery operations over the period 2014-2018, which is the (forward-looking) period over which its entry and investment decisions will be made. Under any of Royal Mail's proposed pricing plans, [Whistl's] downstream delivery operations will make a considerable loss over this period. The likely response of [Whistl], if these plans were introduced, is therefore to withdraw from its downstream delivery operations. Royal Mail's proposed pricing plans are also likely to deter any further downstream delivery entrants."*⁴⁹⁵

- 4.180 Frontier explained that it had carried out this analysis on the basis of Whistl's business plan and on an (upwardly) adjusted basis that took account of "*Royal Mail's less competitive wage rates and lower operational flexibility,*" which it referred to as a 'reasonably efficient competitor' approach.⁴⁹⁶ Based on this analysis, Frontier concluded that under any price plan following the CCNs Whistl's entry would be substantially loss-making, whereas before the CCNs it would make a clear profit.⁴⁹⁷

January to February 2014: Without investment as a result of the CCNs, Whistl develops reduced roll out scenarios

Whistl develops reduced roll out scenarios for 2014

- 4.181 In his witness statement of 28 January 2014, Nick Wells (CEO, Whistl) set out the issue facing Whistl at that time:

*"As matters now stand, [Whistl] faces a difficult dilemma as to whether or not to take decisions to proceed with purchases and other contracts required for carrying out our expansion plans. The relevant contracts include, for example, taking leases for larger depots, ordering sorting machines and labelling machines (with eight month lead times for delivery), entering into property leases on tens of delivery units, and ordering bicycles, uniforms and scanners. Failing to proceed with these commitments would, at the very least, delay our expansion plans, and might contribute to the loss of the LDC investment (because our rollout of delivery operations cannot be proceeded with as planned). On the other hand, there are great financial risks to TNT Post if we proceed with these commitments and they subsequently have to be written off."*⁴⁹⁸

- 4.182 In January 2014, Whistl developed several scenarios for delayed or cancelled roll outs. On 17 January, in an email to LDC from PostNL it was explained that PostNL "*would be in contact again end of the week to review the scenarios which are being worked out as a reaction towards RM price differentiation.*"⁴⁹⁹

⁴⁹⁵ Ibid., page 4. (WH0121)

⁴⁹⁶ Ibid., page 4. (WH0121)

⁴⁹⁷ Ibid., pages 4 and 5. (WH0121)

⁴⁹⁸ Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 19, paragraph 66. (WH0132)

⁴⁹⁹ PostNL, *Email from [redacted] (PostNL) to [redacted] (LDC) and [redacted] (LDC) re: Review effects of RM price differentiation*, 17 January 2014. (LDC034)

4.183 By late January the following scenarios had been developed with the assistance of business advisors, HMT:

Scenario	Description of roll out
Scenario 0	Base case as of November 2013
Scenario 0.a	Base case as of November 2013 updated E2E FY14 budget
Scenario 1	Stop E2E in January 2014
Scenario 2	Stop E2E February 2014 (if Ofcom rejects complaint)
Scenario 3a	Freeze E2E Spend (overhead growth and commitments) until decision Ofcom in August, then stop
Scenario 3b	Freeze E2E Spend (overhead growth and commitments) until decision Ofcom in August, then continue roll-out
Scenario 4a	Continue with roll-out of Harrow and Liverpool in Feb/March, and stop in August after negative Ofcom decision
Scenario 4b	Continue with roll-out of Harrow and Liverpool in Feb/March, and resume roll-out starting in August after positive Ofcom decision (i.e. 8 - 9 month lead time post Aug)
Scenario 5a	Continue with roll-out of Harrow and Liverpool in Feb/March, prepare for Edinburgh in Q4 2014 stop in August after negative Ofcom decision
Scenario 5b	Continue with roll-out of Harrow and Liverpool in Feb/March, and resume with Edinburgh in Q4 2014 after positive Ofcom decision in August
Scenario 6a	Continue with roll-out of Harrow, Liverpool in Feb/March, and East London and Edinburgh in 2014, stop in August
Scenario 6b	Continue with roll-out of Harrow, Liverpool in Feb/March, and East London and Edinburgh in 2014

Source: Email from HMT (business advisors to Whistl) to Whistl, 30 January 2014⁵⁰⁰

4.184 These scenarios were discussed with LDC on 31 January 2014 and it was agreed that the parties would focus on scenario 4b and scenario 5b.⁵⁰¹ [Redacted A PostNL Executive] sought feedback from LDC on these scenarios and asked “whether [LDC] are willing to complete immediately following Ofcom’s ruling (expected mid-August) under the same conditions as agreed in the agreement signed December 13,2013, if PostNL proceeds with either scenario 4 or 5.”⁵⁰²

⁵⁰⁰ Whistl, Email from HMT to [Redacted] (Whistl) re: update on the scenarios, 30 January 2014. (WH0741) See attachment. (WH0742)

⁵⁰¹ Whistl, Email from [Redacted] (PostNL) to [Redacted] (LDC) and [Redacted] (LDC) re: Luke scenario's as per our discussion last Friday, 4 February 2014. (WH0298)

⁵⁰² Ibid. (WH0298)

- 4.185 On 7 February 2014, [redacted] an LDC Executive] said that LDC's "*strong preference is for Scenario 5B of your two presented scenarios which is the closer case to what we envisaged from the original model.*"⁵⁰³ Whistl, PostNL and LDC agreed to scenario 5b, which was to "*[c]ontinue with roll-out of Harrow and Liverpool in Feb/March, and resume with Edinburgh in Q4 2014 after positive Ofcom decision in August.*"⁵⁰⁴ In this context, the positive Ofcom decision referred to a completed investigation which upheld Whistl's complaint; in agreeing to this scenario the parties noted that "*any decision from Ofcom that did not fully uphold the complaint would need to [be] financially assessed.*"⁵⁰⁵ This meant that the East London operation would now be postponed to 2015 (along with postponement of launches in Birmingham, North London and Central South East London).
- 4.186 In line with this strategy, Whistl continued its roll out to Harrow in February 2014 and Liverpool in March 2014. In its response to a statutory information request, Whistl noted this limited roll out was necessary "*[g]iven the lead times for ordering the letter-sequencing machines, which meant that some orders had already been placed; the need for PostNL to demonstrate its confidence in E2E to the would-be external investors; and Whistl's commercial need to demonstrate to the customers that it intended to continue its rollout of end-to-end, some further, limited rollout took place between January 2013 [sic – January 2014] and April 2014.*"⁵⁰⁶
- 4.187 On 24 February 2014, PostNL said to analysts: "*[w]e also will continue with the roll out of E2E. What you also probably heard, is that Royal Mail did a proposal to differentiate their tariffs in the UK. That proposal to differentiate tariffs can have a negative impact on the roll out of E2E and that is the reason why we put in a complaint with Ofcom, the UK regulator, which they have taken into investigation.*"⁵⁰⁷

LDC considers the MAE Condition to be engaged and does not invest in early 2014 as scheduled

- 4.188 On 30 January 2014 anti-trust clearance from the EU Commission was received.⁵⁰⁸ Therefore, subject to the MAE Condition (discussed below), at this point in time the LDC investment could have been completed.
- 4.189 On 2 February 2014 [redacted] an LDC Executive] confirmed in an internal email that the CCNs as notified by Royal Mail engaged the MAE Condition, even in circumstances where the prices were suspended due to Ofcom's investigation: "*It is acknowledged by management and PostNL this falls within our MAC. Currently we can completely walk away on 31 March 2014 if not resolved and complete up to 13 June 2014 (longstop date) should we choose.*"⁵⁰⁹ He

⁵⁰³ LDC, *Email from [redacted] (LDC) to [redacted] (PostNL) re: Luke scenario's as per our discussion last Friday, 7 February 2014.* (LDC060)

⁵⁰⁴ Whistl, *Email from [redacted] (PostNL) to [redacted] (LDC) and [redacted] (LDC) re: Luke scenario's as per our discussion last Friday, 4 February 2014.* (WH0298)

⁵⁰⁵ Whistl, *Minutes of Meeting (Whistl, PostNL and LDC) held in Marlow on 11 March 2014, 11 March 2014, page 1.* (WH0295)

⁵⁰⁶ Whistl, *Response to 2nd section 26 Notice – request 3, 20 March 2017, page 2.* (WH0834)

⁵⁰⁷ PostNL, *Transcript of Analyst presentation, 24 February 2014, page 5.* (PD0057)

⁵⁰⁸ LDC, *Letter from [redacted] (LDC) to [redacted] (Ofcom)- appendix 1, 21 April 2017, page 2.* (LDC126)

⁵⁰⁹ LDC, *Email from [redacted] (LDC) to [redacted] (LDC) re: Complaint – legally privileged, 2 February 2014.* (LDC047)

also noted that “PostNL want to continue to support the roll-out (at their risk if complaint does not go our way), albeit slightly more slowly on the basis we will stick to the original deal and complete once resolved with OfCom [sic].”⁵¹⁰

- 4.190 A subsequent internal LDC update paper prepared by [X an LDC Executive] and circulated on 24 March 2014 reiterated LDC’s position. The paper noted that Royal Mail had announced a price rise in January 2014 but “they also announced a gerrymandering of the pricing methodology which to summarise the complicated proposal would render the end of E2E competition in the UK by [Whistl].” The paper added that “[i]f accepted this would result in [Whistl] (or any other new entrant) being on a price plan where the differential means they could not be profitable competing with RMG.”⁵¹¹
- 4.191 The LDC paper noted that Whistl and PostNL were confident that Whistl’s complaint to Ofcom would be successful. It noted that PostNL “are continuing to support the ongoing roll-out, albeit on a slightly slower basis than before. This still however involves them and at their risk making long term additional commitments in the order of £10m + prior to 31 August 2014. In exchange for the ongoing commitment PostNL wants to still do the deal with LDC on the same terms on the basis OfCom rules appropriately.”⁵¹²
- 4.192 The paper concluded that “LDC is effectively seeking to have an option of whether to complete this transaction, subject to our opinion, that the RMG pricing proposals have been resolved. Management and the Business is performing extremely well given the circumstances and PostNL have been supportive. We continue to have the benefit of effectively ongoing due diligence on the opportunity and apart from the time investment we see little downside risk to our position at this time.”⁵¹³
- 4.193 On 10 June 2014, shortly before the longstop date in the LDC Agreement, [X an LDC Executive] in an email to PostNL and Whistl directors summarised the position:

“... Royal Mail has obviously communicated the changes it proposes to make to the charges for the supply of delivery services. Therefore, the position that we currently find ourselves in, namely that the changes proposed by Royal Mail will have a Material Adverse Effect on the group, requires that we look at the termination provisions in clause 5.6.

...

The current commercial position is, of course, that Royal Mail has not withdrawn or modified its proposed changes, such that they would not give rise to removing a Material Adverse Effect.”⁵¹⁴

⁵¹⁰ Ibid. (LDC047)

⁵¹¹ LDC, *TNT Update Paper*, 22 March 2014, page 1. (LDC076)

⁵¹² Ibid., pages 1 to 2. (LDC076)

⁵¹³ Ibid., pages 2. (LDC076)

⁵¹⁴ LDC, *Email from [X] (LDC) to [X] (PostNL)*, 10 June 2014. (LDC104)

February 2014 to April 2014: Ofcom's decision to open an investigation and Royal Mail's response

Ofcom announces that it will investigate Whistl's complaint

4.194 On 21 February 2014, Ofcom announced:

*"Following a complaint from TNT, Ofcom has decided to open an investigation in relation to certain prices, terms and conditions offered by Royal Mail for access to certain letter delivery services (known as "D + 2 access"). This follows announcements from Royal Mail in November 2013 and January 2014 of changes to these prices, terms and conditions."*⁵¹⁵

4.195 Ofcom explained to Whistl that it was considering whether it was more appropriate to use its regulatory enforcement powers or its Competition Act enforcement powers to handle the investigation.⁵¹⁶

February 2014: Royal Mail suspends the CCNs

4.196 On 21 February 2014, Royal Mail issued an RNS statement in response to Ofcom's announcement that it would investigate the issues raised by Whistl's complaint. Royal Mail said that it had *"considered carefully [its] legal and regulatory obligations before notifying Access customers of the changes"* and that it believed the changes *"are fair, reasonable and proportionate."*⁵¹⁷ Royal Mail said that it wished to *"see this matter resolved as quickly as possible so that these planned changes can be put into effect to help secure the sustainability of the Universal Service."*⁵¹⁸

4.197 In that statement, Royal Mail also stated that *"[u]nder the terms of our Access contracts, the price changes subject to Ofcom's investigation are suspended until the outcome of that investigation."*⁵¹⁹ Royal Mail identified the introduction of the price differential and the changes to zonal tilt as changes that were suspended. In a letter to Ofcom of 27 February 2014, Royal Mail also confirmed that *"Ofcom's announcement of an investigation that is reasonably likely to affect Royal Mail's rights to change its Access Letters Contracts triggers the suspensory provisions of clause 13.8."*⁵²⁰

4.198 On 4 March 2014, Royal Mail wrote to access customers to confirm *"how Ofcom's decision to open an investigation impacts your Access agreement with [Royal Mail]."*⁵²¹ Royal Mail said that it was *"suspending the notice periods for Change Notices **001, 003, 004 and 005** for all Access customers."*⁵²² [Original emphasis]

⁵¹⁵ Ofcom, *CCEB entry – Whistl complaint*, 21 February 2014. (PD0053)

⁵¹⁶ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Whistl)*, 21 February 2014. (WH0153)

⁵¹⁷ Royal Mail, *RNS Statement*, 21 February 2014. (RM0018)

⁵¹⁸ *Ibid.* (RM0018)

⁵¹⁹ *Ibid.* (RM0018)

⁵²⁰ Royal Mail, *Letter from [redacted] (Royal Mail) to [redacted] (Ofcom)*, 27 February 2014. (RM0039)

⁵²¹ Royal Mail, *Letter to access customers*, 4 March 2014, page 1. (RM0072)

⁵²² *Ibid.* (RM0072)

April 2014: Ofcom (i) opens a Competition Act investigation and (ii) launches a policy review

- 4.199 In its January 2014 complaint, Whistl requested that Ofcom open an investigation to determine whether Royal Mail had complied with its regulatory obligations, using Ofcom's powers under Schedule 7 of the Postal Services Act 2011.⁵²³ Royal Mail, in its initial comments, also expressed a preference for Ofcom using these sectoral powers instead of its powers under the Competition Act 1998.⁵²⁴
- 4.200 Ofcom considered the question of whether we should use our powers under the Competition Act or under the Postal Services Act 2011. Having taken account of submissions from the parties, we formed the view that there were reasonable grounds for suspecting that Royal Mail had abused a dominant position, contrary to the Chapter II prohibition and/or the prohibition in Article 102 of the TFEU.
- 4.201 Accordingly, on 9 April 2014 we announced that we would be using our powers under the Competition Act to investigate the issues raised by Whistl.
- 4.202 On the same day, Ofcom announced a review of the regulatory framework for access pricing:

“Since the introduction of the new regulatory framework in March 2012, new access prices have been proposed in 2013 and 2014, and a new contract for access services was introduced in 2013. In both 2013 and 2014 stakeholders have raised concerns about the interpretation of the conditions and the guidance. Stakeholders have suggested that this uncertainty has had an impact on both day to day commercial negotiations with end-users and, importantly, on medium and long term strategic planning and investment. Therefore, we consider it timely to review these requirements to ensure that they remain fit for purpose and that all stakeholders have clarity and certainty with regard to their interpretation.

We plan to issue a consultation document this summer setting out our initial views on whether the existing regulation and guidance are sufficiently clear and effective and any proposals for change. We aim to complete the review this year.”⁵²⁵

- 4.203 Whistl wrote to LDC on 9 April 2014 to provide its view on the implications of Ofcom's actions. In an update to [redacted] an LDC Executive] and [redacted] an LDC Executive], [redacted] a Whistl Executive] explained that Ofcom had launched two processes, noting that “[b]y de-coupling the process, this allows [Ofcom] to alter the Access Condition and give us market and regulatory certainty this calendar year while pursuing the competition law breaches.”⁵²⁶

⁵²³ Whistl, *Complaint submitted to Ofcom on behalf of TNT Post...*, 28 January 2014, page 5, paragraph 7. (WH0128)

⁵²⁴ Royal Mail, *Enquiry in relation to proposed changes to the prices, terms and conditions on which Royal Mail plc (“Royal Mail”) offers D+2 Access – Initial Comments of Royal Mail*, 10 February 2014, page 12, paragraph 4. (RM0011)

⁵²⁵ Ofcom, *Review of the pricing requirements of the universal service provider access (USPA) condition*, 9 April 2014. (PD0052)

⁵²⁶ Whistl, *Email from [redacted] (Whistl) to Whistl and PostNL Directors re: Ofcom investigation and Access Conditions Review*, 9 April 2014. (LDC085)

April 2014 to November 2014: Royal Mail's reiterates intention to implement CCNs

4.204 On 9 April 2014, Royal Mail issued an RNS statement in response to Ofcom's decision to open a Competition Act investigation on the basis that it had reasonable grounds to suspect that Royal Mail had infringed competition law. Royal Mail noted that its "[a]ccess contracts require it to suspend Access changes that are the subject of an Ofcom investigation and in February [it] wrote to customers notifying them of those changes that are suspended."⁵²⁷ It also stated that:

*"We wish to see these matters resolved as quickly as possible so that our planned Access changes can be put into effect to help secure the sustainability of the Universal Service. Royal Mail will cooperate fully with Ofcom in both these matters and will share with it the comprehensive and robust rationale for our proposals."*⁵²⁸

4.205 On 6 June 2014, Royal Mail published its Annual Report, in which it noted that "[t]he price changes subject to Ofcom's investigation are suspended until the outcome of this investigation."⁵²⁹ It added that it was "cooperating fully with Ofcom to ensure the investigation is completed as quickly as possible, so that our planned changes can be put into effect."⁵³⁰

4.206 On 24 June 2014, Royal Mail published a submission to Ofcom setting out its view of the threat to the universal postal service posed by bulk mail delivery competition. In its submission, Royal Mail addressed its use of the powers afforded to it by the Access Letters Contract to address this threat:

*"Royal Mail has attempted to use the commercial freedoms afforded under the current regulatory regime to respond to the direct impact of increased competition and support the finances of the Universal Service. However, these proposed changes are now under investigation due to a complaint by TNT Post and are suspended pending a decision by Ofcom. Royal Mail has thus been unable to implement an effective commercial response..."*⁵³¹

*"... the submission explains the impact of Ofcom's competition investigation into Royal Mail's proposed access price reform, which in Royal Mail's view is an appropriate commercial response to changing market circumstances, using its commercial freedoms. Royal Mail's proposed price changes are now suspended until the conclusion of Ofcom's investigation. This could permanently defer or delay their implementation for a long period."*⁵³²

⁵²⁷ Royal Mail, *RNS Statement*, 9 April 2014. (PD0046)

⁵²⁸ *Ibid.* (PD0046)

⁵²⁹ Royal Mail, *Annual Report and Financial Statements 2013-14*, 30 March 2014, page 7. (PD0040)

⁵³⁰ *Ibid.*, page 10. (PD0040)

⁵³¹ Royal Mail, *Direct Delivery: A Threat to the Universal Postal Service Regulatory Submission to Ofcom*, 20 June 2014, page 39. (PD0043)

⁵³² *Ibid.*, page 64. (PD0043)

4.207 In November 2014, as part of an analyst briefing, [X a Royal Mail Executive], referring to the CCNs said “we thought we were acting completely in line with, and we still continue to believe that those prices are completely in line with the guidance that we were given in 2012. So that needs to get resolved one way or the other and the sooner the better on that as well.”⁵³³

June 2014: Whistl and LDC agree to a revised MAE Condition

4.208 On 10 June 2014, [X an LDC Executive] in an email to PostNL and Whistl directors noted they had discussed options for proceeding with the LDC Agreement:

*“...our understanding is that commercially all sides wish to see this transaction through, and are optimistic that the Royal Mail position will be amended so as to create a commercial environment upon which this transaction can flourish. To that end there has been much discussion between parties as to how a Deed of Variation would operate given the myriad of possible scenarios.”*⁵³⁴

4.209 The email further explained that, in effect, the amended condition (“Revised MAE Condition”) was an open clause that enabled the parties to proceed with the investment while providing wide scope for renegotiation or withdrawal:

*“one can easily argue from a sensible commercial position, given the length of time that has progressed since exchange, the attitude of Royal Mail and the continued investigation by Ofcom, that to prescribe the criteria for a fixed completion now is not appropriate for all parties. In our view and, as at December 13th 2014 any successful conclusion to this transaction will require the willing collaboration of all parties.”*⁵³⁵

4.210 In its comments on the draft deed of variation on 13 June 2014, Whistl noted that it “looks like default position is we have a MAC and both parties have to agree if we don’t have a MAC and therefore proceed to a deal, which I think is the intention.”⁵³⁶

4.211 Accordingly, on 17 June 2014, clause 4.2 of the LDC Agreement was replaced with the following:

“4.2 The obligations of the Seller and the Buyer and LDC to proceed to Completion are also conditional upon:

4.2.1 Ofcom publishing guidance on the application of the USP Access Condition and the Seller, LDC and the Buyer agreeing that the result of such final guidance does not and will not, if adhered by [sic] Royal Mail, give rise to a Material Adverse Effect; and

4.2.2 Royal Mail only implementing or seeking to implement changes to the charges it makes for the supply of delivery services to Group Companies which the Seller, LDC

⁵³³ Royal Mail, *Half Year 2014-15 Results - Management presentation and Q&A transcript*, 19 November 2014, page 22. (PD0063)

⁵³⁴ LDC, *Email from [X] (LDC) to [X] (PostNL)*, 10 June 2014. (LDC104)

⁵³⁵ *Ibid.* (LDC104)

⁵³⁶ Whistl, *Email from [X] (Whistl) to [X] (LDC) re Project Luke – deed of variation*, 13 June 2014, page 1, (LDC108)

and the Buyer agree would not, if introduced, have or give rise to a Material Adverse Effect; and

4.2.3 The Buyer, LDC and the Seller agreeing to such changes to the terms of the Transaction as either party believes is reasonably necessary as a result of the delay in Completion from that which was anticipated on signing to be 31 January 2014; and

4.2.4 LDC and the Seller being satisfied that at Completion the Transaction will still be commercially sound and worthwhile, given the delay in Completion mentioned at clause 4.2.3. Whether the condition in this clause 4.2.4 has been met will be a matter for LDC and the Seller in their individual capacities to determine.”⁵³⁷

4.212 Clause 4.3 was varied to state that if “any of the conditions set out in clause 4.2 is not satisfied by the Longstop Date or if, prior to the Longstop Date, any of the conditions set out in clause 4.2 becomes incapable of being satisfied by the Longstop Date, then each of LDC or the Seller may, subject to clause 5.7, by notice in writing to each other party, terminate the rights and obligations of all parties to this Deed.”⁵³⁸

4.213 The Deed of Variation defined the “Longstop Date” as “30 November 2014 (or such later date as may be agreed in writing between the Seller and LDC).”⁵³⁹ The longstop date was eventually extended to 19 December 2014.⁵⁴⁰

April 2014 to October 2014: Further delays in Whistl’s roll out progress, followed by its decision to suspend entry

4.214 Following its expansion to Liverpool in March, Whistl’s final planned step for 2014 was to expand end-to-end operations to Edinburgh.⁵⁴¹ In June 2014, Whistl adjusted its plan to delay expansion to Edinburgh to Q2 2015 (i.e. a total delay of 12 months) and bring forward the Oldham/Bolton/Stockport expansion by 6 months to Q4 2014.⁵⁴² In June 2014, Whistl summarised the position regarding its roll out plan (see Figure 4.8).

⁵³⁷ Whistl, *Deed of Variation*, 17 June 2014, page 2. (WH0289)

⁵³⁸ Ibid. (WH0289)

⁵³⁹ Ibid., page 1. (WH0289)

⁵⁴⁰ LDC, *Letter from [X] (LDC) to [X] (Ofcom) - appendix 1*, 21 April 2017, page 4. (LDC126)

⁵⁴¹ See above, paragraph 4.185 relating to ‘scenario 5B.’

⁵⁴² Whistl, *LE2 2014 presentation*, slide 2 – Strategic & Other, 23 June 2014, (WH0753)

Figure 4.8: Whistl’s roll out assumptions based on Scenario 5b

SSC Area	Scenario 5		delay vs base case (months)
	Year	Quarter	
I79 West London	2012	Q2	0
I85 Central SW London	2012	Q3	0
I78 East London	2012	Q4	0
I86 South West London	2013	Q2	0
I22 Manchester	2013	Q3	0
I82 Harrow	2014	Q1	0
I26 Liverpool	2014	Q1	0
I24 Oldham, Bolton, Stockport	2014	Q4	-6
I13 Central Edinburgh	2015	Q2	12
I67 East London	2015	Q2	12
I48 Birmingham	2015	Q2	9
I77 North London	2015	Q2	9
I84 Central SE London	2015	Q2	6
I05 Glasgow Central	2015	Q3	6
I87 Croydon, Bromley	2015	Q3	6
I72 Southend	2015	Q4	6
I83 Slough, Uxbridge	2015	Q4	6

Source: Whistl, LE2 2014 presentation, 23 June 2014, slide 29. (WH0750)

4.215 By October 2014 the Oldham/Bolton/Stockport expansion had been postponed until Q3 2015.⁵⁴³

4.216 On 3 November 2014, PostNL, in a briefing for analysts, commented that “we will continue end-to-end in all the cities where we are delivering end-to-end at this moment in time, but we will stop the further roll out as long as we have an outcome of Ofcom.”⁵⁴⁴

D: Ofcom consultation on a revised regulatory framework, the withdrawal of the CCNs and Whistl’s exit from the bulk mail delivery market

December 2014: Ofcom’s consultation on a revised regulatory framework

4.217 On 2 December 2014, Ofcom consulted on a revised USP access condition which would have regulated Royal Mail’s provision of access services. Ofcom explained that this review arose from concerns that “Royal Mail’s current behaviour could discourage or even prevent

⁵⁴³ Whistl, Roll out plan E2E, 14 October 2014. (WH0769)

⁵⁴⁴ PostNL, Transcript Q3 2014 results – Analysts’ call, 3 November 2014, page 11. (PD0034)

competition in bulk mail delivery, leading to reduced pressure on Royal Mail to deliver efficiency improvements and a risk of excessive pricing.”⁵⁴⁵

- 4.218 The consultation contained proposals for two major changes related to the prices introduced in the January 2014 CCNs. Although Ofcom did not ultimately proceed with these proposals because of Whistl’s decision to terminate its end-to-end delivery business, these changes would, once implemented, have prevented Royal Mail from maintaining both the changes to the zonal tilt and the price differential as set out in the January 2014 CCNs.⁵⁴⁶

Addressing concerns associated with the zonal tilt

- 4.219 In relation to changes to zonal prices (the ‘zonal tilt’), Ofcom explained that it was concerned that Royal Mail “*could potentially set its zonal access charges in a way that undermines confidence in investment and deters or potentially prevents beneficial localised entry without delivering any benefit to consumers.*”⁵⁴⁷ In particular Ofcom identified the risk that Royal Mail could increase zonal prices (relative to its own costs) in areas where a delivery competitor had not entered and reduce zonal prices (relative to its own costs) in areas where a delivery competitor had entered.⁵⁴⁸
- 4.220 Ofcom explained that by doing this Royal Mail could discourage entry into delivery even by an entrant who was as efficient as Royal Mail in the area of entry. Ofcom explained “[s]uch an operator would not gain any cost advantage through self-supply in this scenario but would incur significant fixed costs of rolling-out and operating a delivery network in entry areas. It would therefore be financially better off remaining reliant on Royal Mail for all of its delivery requirements rather than incurring these fixed costs (i.e. remaining an access operator rather than entering bulk mail delivery).”⁵⁴⁹
- 4.221 To address this, Ofcom proposed a substantial change to the regulatory framework for access:
- a) First, it would set, within regulation, a framework to aggregate areas with similar delivery costs which in practice involved embedding Royal Mail’s zonal framework within the regulatory condition.⁵⁵⁰

⁵⁴⁵ Ofcom, *Royal Mail Access Price Review – Proposed amendments to the regulatory framework*, 2 December 2014, page 4, paragraph 1.5. (PD0009)

⁵⁴⁶ Ofcom did not implement the proposals because, following Whistl’s exit from the delivery market in June 2015, it determined that it would not be proportionate to do so. Ofcom explained that the “*proposals were intended to address particular concerns associated with competition in end-to-end letter delivery*” but, because it did not consider “*there is likely to be another end-to-end entrant of sufficient scale and scope to provide a significant level of letter delivery competition to Royal Mail in the foreseeable future,*” “*it would not be appropriate and proportionate to implement the 2014 proposals.*” Ofcom, *Review of the Regulation of Royal Mail - Statement*, 1 March 2017, page 63, paragraph 5.12. (PD0067)

⁵⁴⁷ Ofcom, *Royal Mail Access Price Review – Proposed amendments to the regulatory framework*, 2 December 2014, page 5, paragraph 1.11. (PD0009)

⁵⁴⁸ *Ibid.*, page 37, paragraph 4.36. (PD0009)

⁵⁴⁹ *Ibid.*, page 37, paragraph 4.37. (PD0009)

⁵⁵⁰ *Ibid.*, pages 53 to 55, paragraphs 5.9 to 5.20. (PD0009)

b) Second, it would require “Royal Mail to link its charges across different Zones in a way that reflects differences in the underlying cost of delivery.”⁵⁵¹ This in effect would have required Royal Mail to identify the fully allocated delivery cost for each zone and then to ensure zonal prices reflected those differences in cost. In setting zonal prices, Royal Mail would have flexibility to determine the total level of mark up above cost but would have to apply a similar approach in each zone.⁵⁵²

4.222 Ofcom considered that as a result of the proposed change “[t]he relative difference in access charges across Zones would thus reflect the relative difference in FAC. This means Royal Mail would not be able to selectively reduce charges in some Zones while setting high charges in others.”⁵⁵³ This would, in effect, have prevented Royal Mail from maintaining the particular ‘zonal tilt’ contained within the January 2014 CCNs.

Addressing concerns associated with differential pricing between plans

4.223 In relation to the price differential, Ofcom noted that Royal Mail could seek to use differences between access operators to justify offering differential pricing arrangements between operators on different contracts.⁵⁵⁴ It then explained that it was “concerned that such differentiation could place end-to-end operators at a disadvantage in relation to access operators. This concern is plausible in light of Royal Mail’s incentives and observed behaviour.”⁵⁵⁵

4.224 To address this concern, Ofcom proposed to require that “the national charge must equate to the volume weighted average of the zonal charges for the mailing item”⁵⁵⁶ Ofcom considered that this “intervention will substantially reduce the risk that Royal Mail could design its contracts to discriminate in its charges between different types of operator.”⁵⁵⁷

4.225 This proposal would, in effect, have prevented Royal Mail from maintaining the price differential between NPP1 and APP2/ZPP3 contained with the January 2014 CCNs.

Whistl’s response to the access pricing review consultation

4.226 Whistl reported to LDC on 14 January 2015 that “Ofcom review of Access pricing assumed no price differential or excessive surcharges from Royal Mail. Access review proposals published 2 December with decision expected summer 2015. Overall, a very positive outcome.”⁵⁵⁸

⁵⁵¹ Ibid, page 56, paragraph 5.21. (PD0009)

⁵⁵² Ibid, pages 56 to 58, paragraphs 5.21 to 5.31. (PD0009)

⁵⁵³ Ibid, pages 75, paragraph 7.10. (PD0009)

⁵⁵⁴ Ibid., page 6, paragraph 1.16. (PD0009)

⁵⁵⁵ Ibid., page 6, paragraph 1.17. (PD0009)

⁵⁵⁶ Ibid., page 6, para 1.19. (PD0009)

⁵⁵⁷ Ibid., page 77, paragraph 7.17. (PD0009)

⁵⁵⁸ Whistl, *Business Performance Review UK Q4 2014*, 14 January 2015, slide 2. (WH0779)

4.227 On 23 February 2015, [X a PostNL Executive], said in the context of an analyst briefing:

“We also further rolled out our end-to-end and stopped that in the summer of 2014. Reason for that it is, it took Ofcom the regulator, a little bit longer then [sic] they firstly expected to come out with their final view on postal markets in the UK. By the end of 2014 Ofcom, the UK regulator, came out with their view and that had enough positive points to of course start discussions with LDC again and we are now at this moment in time working on the joint venture agreement, again after having clarity around how the regulator in the UK thinks the market will develop.”⁵⁵⁹

“We had to wait for quite a long time on the final view of the British regulator, how they look into the postal market. That came in December 2014. We do think there are very positive angles on that report and that is enough basis to have the discussion with LDC.”⁵⁶⁰

“First your question on, do we have to wait for decision on the access mail from Ofcom. No, in our view not, so the discussions and talks with LDC are at this moment in time, we do have them and we hope to come up with the decision on the joint [venture] before summer this year, so no need for us to wait for a final decision from Ofcom on the access mail.”⁵⁶¹

March 2015: Royal Mail withdraws the CCNs

4.228 On 11 March 2015, Royal Mail announced that it had decided to withdraw the CCNs that it had announced it was suspending on 21 February 2014. Royal Mail said that it continued to believe that its *“proposals in the Suspended Change Notices comply with applicable law and our regulatory obligations and that the complaint about them is unfounded.”*⁵⁶²

4.229 Royal Mail set out its reasons for withdrawing the notices:

“We are of the view that the appropriate framework for Access pricing can be achieved through the exercise of Ofcom’s regulatory powers under the Postal Services Act 2011. We do not believe that a competition law investigation can adequately address these issues.

***We are therefore now withdrawing the Suspended Change Notices.** This will help us focus on engaging with Ofcom in a constructive dialogue about the appropriate regulatory framework for Access pricing, something we highlighted in our response to Ofcom’s Access Pricing Review consultation.”⁵⁶³ [Original emphasis]*

4.230 Royal Mail also announced the withdrawal on its website on that same day. Adding to the statements in its letter, Royal Mail said:

⁵⁵⁹ PostNL, *Transcript Q4/FY 2014 results – Analysts’ call*, 23 February 2015, page 5. (PD0059)

⁵⁶⁰ *Ibid.*, page 10. (PD0059)

⁵⁶¹ *Ibid.*, page 14. (PD0059)

⁵⁶² Royal Mail, *Letter to access customers*, 11 March 2015, page 1. (RM1811)

⁵⁶³ *Ibid.*, page 2. (RM1811)

“We also are mindful of our regulatory and contractual obligations to our Access customers. Because of the time that has now elapsed since Royal Mail first served its notice suspending the change notices, we would want to re-issue the change notices to allow customers a fair and reasonable notice period.”⁵⁶⁴

April 2015: LDC withdraws its offer of investment

- 4.231 In October 2014, Whistl provided a report to LDC setting out a comparison of the “Luke case” (i.e. the financials associated with the business plan as agreed in December 2013) with the “Base case” (i.e. the financials associated with the business plan as then scheduled in late 2014). The effect of the roll out delay is noted in a comparison of EBITDA from the Luke and Base cases: *“E2E causes the largest variance due to delay of breakeven point from 2015 to 2017.”* For example, the Luke case had forecast EBITDA in 2018 of £56.8m whereas the new Base case forecast £13.6m.⁵⁶⁵
- 4.232 Whistl explained to Ofcom that from this point onwards it was:
- “undertaking a substantial amount of work remodelling its E2E plans and engaging with LDC to demonstrate that Whistl’s E2E business was commercially operational and would be financially viable.”⁵⁶⁶*
- 4.233 The revised business plans took account of a number of factors which had changed since the business plan agreed with LDC in December 2013, including the financial impact of having suspended Whistl’s end-to-end roll out at the beginning of 2014, changes in costs, customer volumes and market strategy.
- 4.234 LDC explained to Ofcom in its response to a formal request for information that *“[a]s at the initial longstop date under the Agreement and the extended longstop date of 19 December 2014, there was insufficient information to accurately determine the outcome of the Ofcom access conditions regulatory framework review and what the impact would be on the ultimate price paid by [Whistl] to access Royal Mail’s network.”⁵⁶⁷* It added that *“ten months after [Whistl’s] complaint (Feb-14) about Royal Mail only a consultation had been launched (Dec-14) on the rules which was unlikely to be concluded until summer 2015, with then the prospect of a further lengthy drawn out appeal by Royal Mail. This effectively gave no regulatory certainty to the business plan and, although investment decisions are made based on many different factors, this influenced the assessment by LDC of any business plan provided by [Whistl] management.”⁵⁶⁸*
- 4.235 LDC explained to Ofcom that the *“amended strategic plan provided by [Whistl]/PostNL in October 2014 required greater funding due to a longer period of E2E losses and higher*

⁵⁶⁴ Royal Mail, *Website announcement: Suspended contract change notices are withdrawn*, 11 March 2015. (PD0047)

⁵⁶⁵ Whistl, *Strategic Plan 2014*, 20 October 2014, slide 23. (WH0771)

⁵⁶⁶ Whistl, *Response to 2nd section 26 Notice – request 3*, 20 March 2017, page 2. (WH0834). See Whistl, *E2E Scenarios*, 14 January 2015. (WH0778)

⁵⁶⁷ LDC, *Letter from [LDC] to [Ofcom]- appendix 1*, 21 April 2017, page 4. (LDC126)

⁵⁶⁸ *Ibid.* (LDC126)

cumulative capex spending, notwithstanding being a smaller geographic roll-out. [Whistl] asserted that the regulatory uncertainty was a key reason that customers were slow to convert to its E2E service. This caused [Whistl] to sustain heavier losses in the start-up phase due to lower volumes. This meant it was a more risky plan for investors, with lower returns from an investment perspective.”⁵⁶⁹

4.236 In late April 2015, LDC notified PostNL that it would not continue negotiations on these revised business plans. In response to a statutory request for information, LDC explained to Ofcom that *“a combination of declining postal volumes and ongoing regulatory uncertainties made the long-term viability of achieving the original E2E roll-out projections look challenging and therefore LDC concluded it should not invest.”⁵⁷⁰*

4.237 On 30 April 2015, PostNL announced that LDC had terminated its *“discussion with PostNL on investment in Whistl UK E2E operations”*.⁵⁷¹

“LDC has notified PostNL that, due to ongoing changes in postal market dynamics and the complexity of the regulatory landscape, it will not proceed with the discussion on the proposed investment in Whistl UK to fund the further rollout of its current end-to-end (E2E) activities.”⁵⁷²

April to June 2015: Whistl’s closure of its bulk mail delivery service

4.238 On 30 April 2015, PostNL said it would *“assess alternative scenarios for Whistl’s E2E operations and remain committed to further developing Whistl’s successful activities in the UK.”⁵⁷³* It added that *“[i]n the meantime, the roll-out of E2E continues to be on hold.”⁵⁷⁴*

4.239 On 6 May 2015, PostNL announced a strategic review of its international activities prompted by the withdrawal of LDC:

“We regret that the joint venture in the United Kingdom did not succeed. Amongst other things, the continuous regulatory uncertainties in the three countries where we operate has led us to launch a strategic review of our activities abroad.”⁵⁷⁵

4.240 On 11 May 2015, Whistl announced that it was suspending its current bulk mail delivery operation:

“Following the announcement from LDC that it would not proceed with the proposed investment to fund further rollout of E2E we have now commenced an extensive review of the viability and potential for the rollout of an e2e postal delivery service in the UK.

⁵⁶⁹ Ibid. (LDC126)

⁵⁷⁰ Ibid. (LDC126)

⁵⁷¹ PostNL, *LDC concludes discussion with PostNL on investment in Whistl UK E2E operations*, 30 April 2015. (PD0032)

⁵⁷² Ibid. (PD0032)

⁵⁷³ Ibid. (PD0032)

⁵⁷⁴ Ibid. (PD0032)

⁵⁷⁵ PostNL, *Results PostNL Q1 2015*, 6 May 2015, page 1. (PD0033) Post NL did not announce the results of its strategic review in relation to UK operations and, by 30 July 2015, it had agreed the terms of a management buyout of Whistl.

To stem the losses from the operations we have taken the difficult decision to suspend the current E2E service during the review process and all mail will now be delivered through our long-standing downstream access service until we have concluded the review.”⁵⁷⁶

- 4.241 During this review Whistl sought to “review all reasonable and sustainable options for the continuation of the business area under threat or elements of it.”⁵⁷⁷ On 10 June 2015 [§< a Whistl Executive] reported to PostNL that:

“After much careful consideration and reflection of the ongoing risks associated with possible continued aggressive behaviour from Royal Mail together with the continued losses of between £7m-£9 million for the existing E2E areas we have in operation (in parts of London, Liverpool and Manchester) and the lack of likely external investment in the roll out of End-to-end since the notification from LDC of their withdrawal of interest in the Luke investment it is my and the UK management recommendation to close the E2E operation. We have reached this conclusion after much analysis of the risks and the financial implications.”⁵⁷⁸

- 4.242 On 10 June 2015, Whistl announced that it was ceasing its bulk mail delivery operation:

“The PostNL and Whistl management team have undertaken a thorough strategic review of the E2E (letter delivery to consumers homes) operation and have concluded, unfortunately, that there is no viable alternative solution that will ensure a sustainable future for the current service and therefore it will not continue.

The rollout of E2E began in 2012 and was put on hold due to numerous regulatory issues. These delays impacted on our ability to invest in the service, expand our coverage, and ultimately to meet the targets of the original business plan and deliver a long term sustainable service.”⁵⁷⁹

⁵⁷⁶ Financial Times, *UK mail group Whistl suspends 2,000 staff*, 11 May 2015. (PD0006)

⁵⁷⁷ Whistl, *Email from [§<] (Whistl) to [§<] (PostNL) re: suspension E2E*, 27 May 2015. (WH0813)

⁵⁷⁸ Whistl, *Email from [§<] (Whistl) to [§<] (PostNL) re: E2E consultation.pptx*, 20 June 2015. (WH0825)

⁵⁷⁹ Whistl, *Update on E2E review*, 10 June 2015. (PD0050)

5. Legal framework

The prohibition set out in Chapter II/ Article 102

- 5.1 Section 18 of the Competition Act 1998, known as the Chapter II prohibition, and Article 102 TFEU prohibit companies with market power from abusing that dominant position to the detriment of competition and ultimately consumers.
- 5.2 The Chapter II prohibition provides that:
- “... any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.”*
- 5.3 To find an infringement of the Chapter II prohibition, it is necessary to establish that:
- a) at the time of the infringement, Royal Mail⁵⁸⁰ held a dominant position on a relevant market(s) within the UK or any part of it;
 - b) Royal Mail abused its dominant position on that market or a related market; and
 - c) such abuse may have affected trade within the UK or any part of it.
- 5.4 Separately, if raised by the party under investigation, Ofcom may consider whether there is an objective justification for the exclusionary conduct and/or efficiencies which would outweigh the negative effects of the exclusionary conduct.⁵⁸¹
- 5.5 Article 102 TFEU is similarly worded, except that as a matter of European law it prohibits the abuse of a dominant position where it affects trade between EU Member States:
- “Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.”*
- 5.6 Regulation 1/2003⁵⁸² requires Ofcom to apply Article 102 TFEU alongside national competition law to any abuse prohibited by Article 102. Practically, this means that where Ofcom investigates a potential breach of the Chapter II prohibition and considers that there is a potential effect on trade between Member States it will also apply Article 102.

⁵⁸⁰ The Chapter II and Article 102 prohibitions apply only to ‘undertakings’. The concept of an undertaking has been held to encompass “every entity engaged in an economic activity”, Case C-41/90 *Hofner and Elser v Macrotron GmbH* EU:C:1991:161 [1991] ECR I-1979, paragraph 21, in relation to which “any activity consisting in offering goods or services on a given market is an economic activity”, Case C-180/98 *Pavlov v Stichting Pensioenfonds Medische Specialisten* EU:C:2000:428 [2000] ECR I-6451, paragraph 75. Ofcom considers that, given its commercial operations, Royal Mail is clearly an undertaking for the purposes of Chapter II and Article 102 TFEU.

⁵⁸¹ See judgment in Case C-209/10 *Post Danmark v Konkurrencerådet* EU:C:2012:172 [2012] 4 CMLR 23 (*‘Post Danmark I’*), paragraphs 40 and 41 and case law cited therein. See also case law cited in *Communication from the Commission: Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OJ [2009] C 45/7, paragraph 28.

⁵⁸² Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1 /1

- 5.7 Article 102 is only engaged if the undertaking holds a dominant position in the whole or a substantial part of the internal market. Member States will usually be ‘substantial’ parts of the internal market.⁵⁸³ It is not necessary to show that there has been an actual effect on trade as a result of the alleged conduct but that the conduct had the potential to affect trade between Member States. In many cases involving a single Member State, the nature of the alleged infringement and its propensity to foreclose the national market provides a good indication of the capacity of the agreement or practice to affect trade between Member States.⁵⁸⁴
- 5.8 Pursuant to Section 60 of the Competition Act 1998, Ofcom is required, so far as is possible, to deal with matters arising under UK competition law in a manner that is consistent with the EU competition law. In effect this means that decisions of the European Commission and the case law of the EU courts are of direct relevance and that the Chapter II prohibition and Article 102 TFEU are to be interpreted in the same way.⁵⁸⁵
- 5.9 For the purposes of this Decision references to the Chapter II prohibition and/or section 18 of the Act should be deemed to include an appropriate reference to Article 102 TFEU unless specifically excluded.

Dominance

- 5.10 The Court of Justice of the European Union (“CJEU”) has defined a dominant position as:
- “...a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers.”⁵⁸⁶*
- 5.11 For the purposes of the Chapter II prohibition and/or Article 102 TFEU, dominance is assessed within a relevant market.⁵⁸⁷ In order to determine whether an undertaking holds a dominant position it is therefore first necessary to define the relevant market.⁵⁸⁸ The concept of the relevant market implies the existence of effective competition between the products forming part of it, which “...presupposes that there is a sufficient degree of

⁵⁸³ See for example: *Lipton Cash Registers/Hugin* [1972] OJ L22/23; Case IV/29.877 *British Telecommunications* [1982] OJ L360/36, paragraph 26; Case 7/82 *GVL v Commission* EU:C:1983:52 [1983] 3 CMLR 645, paragraph 44; Case 322/81 *Michelin v Commission* EU:C:1983:52, [1983] ECR 3461, paragraph 28.

⁵⁸⁴ Commission Notice: *Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty*, [2004] OJ C101/81, paragraph 77.

⁵⁸⁵ See *Glaxosmithkline PLC & Others v. Competition and Markets Authority* [2018] CAT 4 at paragraphs 83-84

⁵⁸⁶ See Case 27/76 *United Brands v Commission* EU:C:1978:22 [1978] ECR 207 (*‘United Brands’*), paragraph 65.

⁵⁸⁷ *Commission Notice on the definition of the relevant market for the purposes of Community competition law*, [1997] OJ C 372/5, paragraphs 7-9; OFT, *OFT403, Market Definition – Understanding competition law*, 1 December 2004, paragraph 2.1. This guidance was originally published by the OFT and has been adopted by the CMA:

⁵⁸⁸ Case C-6/72 *Europemballage Corporation and Continental Can Company v Commission* EU:C:1973:22, [1973] ECR 215, paragraph 32. See also, for example, *United Brands*, paragraph 10; Case 85/76 *F Hoffmann- La Roche & Co AG v Commission* EU:C:1979:36 [1979] ECR 461, paragraph 21; and *Aberdeen Journals v Director General of Fair Trading* [2002] CAT 4, paragraph 88.

*interchangeability between all the products forming part of the same market in so far as a specific use of such products is concerned”.*⁵⁸⁹

- 5.12 Section 6 explains the relevant legal and economic framework for market definition and assessing dominance in more detail and also sets out our findings in relation to the relevant market in this case, before concluding that Royal Mail is dominant in this market.

Abuse

Examples of abusive conduct

- 5.13 A finding that a company holds a dominant position in a market or markets is not in itself a ground for making an infringement finding.⁵⁹⁰ The objective of the Chapter II prohibition and Article 102 TFEU is not to prevent an undertaking from acquiring or maintaining a dominant position (whether that dominant position has been obtained on its own merits or is a legacy of former state monopoly provisions) but to prevent abuses of that market power.
- 5.14 In this regard, the EU courts have defined the concept of an abuse in the following terms:
- “The concept of an abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of the market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.”*⁵⁹¹
- 5.15 The Chapter II prohibition and Article 102 TFEU both contain a list of conduct that may, in particular, amount to such an abuse. They are as follows:
- a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
 - b) limiting production, markets or technical development to the prejudice of consumers;
 - c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
 - d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

⁵⁸⁹ Case 85/76 *F Hoffmann- La Roche & Co AG v Commission* (*‘Hoffmann-La Roche’*) EU:C:1979:36, [1979] ECR 461, paragraph 28.

⁵⁹⁰ Case 322/81 *Michelin v Commission* EU:C:1983:313, [1983] ECR 3461, paragraph 57.

⁵⁹¹ *Hoffmann- La Roche*, paragraph 91. Variations on this articulation of the concept of an abuse of dominance have been repeated in numerous cases since this seminal judgment.

5.16 This list is not exhaustive. The courts have consistently held that the categories of abuse are not closed.⁵⁹² An abuse of dominant position does not even necessarily have to involve the use of the economic power conferred by its dominant position.⁵⁹³ Consequently, a dominant undertaking also cannot:

“... use regulatory procedures in such a way as to prevent or make more difficult the entry of competitors on the market, in the absence of grounds relating to the defence of the legitimate interests of an undertaking engaged in competition on the merits or in the absence of objective justification.”⁵⁹⁴

5.17 Thus, the question is whether in any given case the *conduct* in question is contrary to the Chapter II prohibition and/or Article 102 TFEU as a whole. It is not simply a question of whether the conduct in issue falls within one of the examples provided in those provisions.

5.18 In this case, example (c) is particularly relevant given the nature of Royal Mail’s conduct. However, the key question is whether, on the facts, the particular conduct of the dominant undertaking constitutes an abuse contrary to Article 102 TFEU and / or the Chapter II prohibition.

Competition on the merits and a dominant undertaking’s “special responsibility”

5.19 Competition law is directed at protecting the competitive process, rather than protecting particular competitors. This means that dominant companies are entitled to take reasonable steps to protect their own commercial interests. They are entitled to “compete on the merits” and the natural product of this normal competition may result in the exit from the market of competitors that are less efficient or which otherwise supply products and services that are less attractive to consumers in some way.⁵⁹⁵

5.20 In this regard, in *AstraZeneca*, the General Court held:

“It should be observed that the preparation by an undertaking, even in a dominant position, of a strategy whose object it is to minimise the erosion of its sales and to enable it to deal with competition from generic products is legitimate and is part of the normal competitive process, provided that the conduct envisaged does not

⁵⁹² Case 6/72 *Europemballage Corp and Continental Can Co Inc v Commission* EU:C:1973:22 [1973] ECR 215, paragraph 26; Case C-333/94P *Tetra Pak v Commission* [1996] ECR I-5951, paragraph 37. As the UK High Court also noted in (1) *Purple Parking Limited* (2) *Meteor Parking Limited v Heathrow Airport Limited* [2011] EWHC 987 (Ch), at paragraph 102: “a court is entitled to look at conduct, and ask the overall question of whether there is an abuse by reference to various ways of committing that abuse, and is not forced to find one single appropriate label to the abuse (particularly at the behest of the defendant) and apply some test applicable only to that form.” See also *Streetmap.Eu Limited v. (1) Google Inc. (2) Google Ireland Limited (3) Google UK Limited* [2016] EWHC 253 (Ch) , paragraph 58.

⁵⁹³ Case T-321/05 *AstraZeneca v Commission* EU:T:2010:266, [2010] E.C.R. II-2805 (*‘AstraZeneca GC’*), paragraph 354, applying *Continental Can*, paragraph 27; and Case 85/76 *Hoffmann-La Roche AG v Commission of the European Communities* EU:C:1979:36, [1979] E.C.R. 461, paragraph 91.

⁵⁹⁴ Case C-457/10 P *AstraZeneca AB and AstraZeneca plc v European Commission* EU:C:2012:770, [2013] 4 C.M.L.R. 7 (*‘AstraZeneca CJEU’*), paragraph 134. See also paragraphs 672 and 817 of *AstraZeneca GC*.

⁵⁹⁵ See, for example, the case-law cited by Royal Mail in paragraph 6.8 of its Response to the Statement of Objections, namely: Opinion of Advocate-General Kirschner in Case T-51/89 *Tetra Pak Rausing SA v Commission* [1990] ECR II-312, para. 68 (and subsequent); Case T-228/97 *Irish Sugar*, para. 112; Case C-468/06 *Sot. Lélou kai Sia EE and Others v GlaxoSmithKline AVEE Farmakeftikon Proïonton* [2008] ECR I-7139, para. 71.

depart from practices coming within the scope of competition on the merits, which is such to benefit consumers.”⁵⁹⁶

5.21 However, the case law also confirms that dominant undertakings have a “special responsibility” not to exercise their market power in a way that impairs genuine undistorted competition on the market.⁵⁹⁷ As the CJEU stated in *Post Danmark I*:

“According to [...] settled case-law, a dominant undertaking has a special responsibility not to allow its behaviour to impair genuine, undistorted competition on the internal market ([...]). When the existence of a dominant position has its origins in a former legal monopoly, that fact has to be taken into account.”⁵⁹⁸

5.22 Thus, the courts have also made clear that:

“Although it is true ... that the fact that an undertaking is in a dominant position cannot disentitle it from protecting its own commercial interests if they are attacked, and that such an undertaking must be conceded the right to take such reasonable steps as it deems appropriate to protect its said interests, such behaviour cannot be countenanced if its actual purpose is to strengthen this dominant position and abuse it.”⁵⁹⁹

5.23 In this regard, in *Irish Sugar*, the General Court explained that in order to lawfully protect its commercial position, a dominant undertaking’s conduct must at the very least be based on criteria of economic efficiency and consistent with the interests of consumers.⁶⁰⁰

5.24 In line with the principles set out above, in *Tomra*, the CJEU confirmed that the foreclosure by a dominant undertaking of a substantial part of the market cannot be justified by showing that the contestable part of the market is still sufficient to accommodate a limited number of competitors, for the following two reasons:

“...First, the customers on the foreclosed part of the market should have the opportunity to benefit from whatever degree of competition is possible on the market and competitors should be able to compete on the merits for the entire market and not just for a part of it. Second, it is not the role of the dominant undertaking to dictate how many viable competitors will be allowed to compete for the remaining contestable portion of demand.”⁶⁰¹

⁵⁹⁶ Emphasis added, Case T-321/05 *AstraZeneca AB and AstraZeneca plc v European Commission* EU:T:2010:266, [2010] ECR II-02805, paragraph 804. Confirmed in judgment on appeal, Case C-457/10 P *AstraZeneca AB and AstraZeneca plc v European Commission* EU:C:2012:770 [2013] 4 C.M.L.R. 7, paragraph. 129. The same quotation is relied upon by Royal Mail in paragraph 6.8 of its Response to the Statement of Objections.

⁵⁹⁷ Case 322/81 *Michelin v Commission* EU:C:1983:313, [1983] ECR 3461 at paragraph 57; Case C-202/07 *France Télécom SA v Commission* EU:C:2009:214 [2009] ECR I-2369 (*‘France Télécom’*) at paragraph 105.

⁵⁹⁸ Case C-209/10 *Post Danmark A/S v Konkurrencerådet* EU:C:2012:172 [2012] 4 CMLR 23, paragraph 23.

⁵⁹⁹ Emphasis added, Case 27/76 *United Brands v Commission*, EU:C:1978:22, [1978] ECR 207, paragraph 189. See also Case *France Télécom*, paragraph 46; Case T-203/01 *Michelin v. Commission* EU:T:2003:250 [2003] ECR II-04071; Case T-301/04 *Clearstream Banking AG and Clearstream International SA v Commission* EU:T:2009:317, [2009] ECR II-03155, paragraph 132.

⁶⁰⁰ Case T-228/97 *Irish Sugar plc v Commission* EU:T:1999:246, [1999] ECR II-2969, paragraph 189.

⁶⁰¹ Emphasis added; Case C-549/10 P *Tomra Systems ASA v Commission* EU:C:2012:211 [2012] 4 CMLR 27, at paragraph 42.

- 5.25 These longstanding aspects of the case law have most recently been set out succinctly by the CJEU in *Intel*:

“133. In that respect, it must be borne in mind that it is in no way the purpose of Article 102 TFEU to prevent an undertaking from acquiring, on its own merits, the dominant position on a market. Nor does that provision seek to ensure that competitors less efficient than the undertaking with the dominant position should remain on the market (see, inter alia, judgment of 27 March 2012, Post Danmark, C-209/10, EU:C:2012:172, paragraph 21 and the case-law cited).

134 Thus, not every exclusionary effect is necessarily detrimental to competition. Competition on the merits may, by definition, lead to the departure from the market or the marginalisation of competitors that are less efficient and so less attractive to consumers from the point of view of, among other things, price, choice, quality or innovation (see, inter alia, judgment of 27 March 2012, Post Danmark, C-209/10, EU:C:2012:172, paragraph 22 and the case-law cited).

135. However, a dominant undertaking has a special responsibility not to allow its behaviour to impair genuine, undistorted competition on the internal market (see, inter alia, judgments of 9 November 1983, Nederlandsche Banden-Industrie-Michelin v Commission, 322/81, EU:C:1983:313, paragraph 57, and of 27 March 2012, Post Danmark, C-209/10, EU:C:2012:172, paragraph 23 and the case-law cited).

136. That is why Article 102 TFEU prohibits a dominant undertaking from, among other things, adopting pricing practices that have an exclusionary effect on competitors considered to be as efficient as it is itself and strengthening its dominant position by using methods other than those that are part of competition on the merits. Accordingly, in that light, not all competition by means of price may be regarded as legitimate (see, to that effect, judgment of 27 March 2012, Post Danmark, C-209/10, EU:C:2012:172, paragraph 25).”⁶⁰²

- 5.26 Our investigation has therefore involved consideration of whether Royal Mail’s conduct in this case was: (a) an example of ‘competition on the merits’ (which is permitted), or (b) a breach of Royal Mail’s special responsibility as a dominant undertaking to avoid impairing genuine, undistorted competition.

Assessing whether conduct is abusive

- 5.27 Competition law enforcement is undertaken *ex post*, in the sense that it looks at behaviour that has occurred or is occurring. However, whether such conduct is abusive or anti-competitive should be assessed as at the time the acts said to give rise to the abuse of dominant position were committed.⁶⁰³ As we outline at paragraph 5.100 below, evidence as to what happened in practice may assist in determining whether conduct was at the

⁶⁰² Case C-413/14 P *Intel Corporation Inc. v. European Commission* EU:C:2017:632 [2017] 5 CMLR 18 (*‘Intel’*).

⁶⁰³ See, for example, Case T-472/13 *H Lundbeck A/S v European Commission* EU:T:2016:449, [2016] 5 CMLR 18 and *GlaxoSmithKline PLC v Competition and Markets Authority* [2018] CAT 4.

time it was committed reasonably likely to distort competition. But subsequent events cannot alter the correct classification of the conduct at the time it was committed.

- 5.28 For example, in *AstraZeneca*, the General Court made clear that the question is whether at the time the acts in issue were committed they constituted a breach of the dominant undertaking's special responsibility:

*"... the applicants cannot rely on the fact that in Belgium and the Netherlands AZ was no longer in a dominant position at the time when the SPCs conferred supplementary protection. The fact that AZ was no longer in a dominant position at the time when its abusive behaviour was able to produce its effects does not alter the legal classification to be attached to its acts, since those acts were committed at a time when AZ was under a special responsibility not to allow its behaviour to impair genuine undistorted competition on the common market."*⁶⁰⁴

- 5.29 The CJEU upheld the General Court's reasoning on this specific point, stating that: *"... the anti-competitive nature of its acts must be evaluated at the time when those acts were committed..."*⁶⁰⁵

- 5.30 As a result, dominant undertakings also cannot rely on the intervening / subsequent acts of regulators or other third parties as preventing a finding of infringement where the conduct in question is otherwise abusive. For example, in *AstraZeneca* the European Courts had to consider a Commission Decision finding that AstraZeneca abused its dominant position by submitting incorrect / misleading applications for patent extensions. In its judgment, the General Court endorsed the Commission's argument that:

*"... where it is established that behaviour is objectively of such a nature as to restrict competition, the question whether it is abusive in nature cannot depend on the contingencies of the reactions of third parties"*⁶⁰⁶

- 5.31 Thus, the starting point of the infringement was when the dominant undertaking took steps that were capable of achieving the desired anti-competitive outcome. On the facts at issue in *AstraZeneca*, this meant that the starting point was the submission of the applications for patents that were alleged to be misleading.⁶⁰⁷

- 5.32 The General Court also made clear that the anti-competitive conduct does not need to be 'fully successful' in order to constitute an abuse. The General Court held that:

a) *"... the mere fact that certain public authorities did not let themselves be misled and detected the inaccuracies in the information provided in support of the applications for exclusive rights, or that competitors obtained, subsequent to the unlawful grant of the exclusive rights, the revocation of those rights, is not a sufficient ground to consider*

⁶⁰⁴ Case T-321/05 *AstraZeneca v Commission* EU:T:2010:266, [2010] E.C.R. II-2805 ('*AstraZeneca GC*'), paragraph 379. See also paragraphs 380 and 606.

⁶⁰⁵ Case C-457/10 P *AstraZeneca AB and AstraZeneca plc v European Commission* EU:C:2012:770 [2013] 4 C.M.L.R. 7 ('*AstraZeneca CJEU*'), paragraph 110.

⁶⁰⁶ *AstraZeneca GC*, paragraph 360.

⁶⁰⁷ *AstraZeneca GC*, paragraphs 370-373. See also paragraph 361.

*that the misleading representations were not in any event capable of succeeding...*⁶⁰⁸

For example, the fact that AstraZeneca withdrew an application for a patent extension because it was worried it would obtain an unhelpful precedent did not mean that there was no abuse of its dominant position because the application did not produce any effects;⁶⁰⁹ and

- b) “[...] *the applicants’ argument that a finding of an abuse of a dominant position requires that an exclusive right obtained as a result of misleading representations has been enforced [had to be rejected]...*”⁶¹⁰

5.33 The CJEU upheld the challenged aspects of the General Court’s reasoning, explaining, in particular, that:

*“So far as concerns the fact that the misleading representations did not enable AZ to obtain SPCs in Denmark and that in Ireland and the United Kingdom the SPCs were ultimately issued on the basis of the correct date, it must be stated that the General Court did not err in law in holding, at paragraphs 602 to 604 of the judgment under appeal, that that fact does not mean that AZ’s conduct in those countries was not abusive, since it is established that those representations were very likely to result in the issue of unlawful SPCs. In addition, as the Commission has pointed out, insofar as the impugned conduct forms part of an overall strategy seeking to unlawfully exclude manufacturers of generic products from the market by means of obtaining SPCs in breach of the regulatory framework which established them, the existence of an abuse is not affected by the fact that that strategy did not succeed in some countries.”*⁶¹¹

Abusive discrimination

Basic principles

5.34 In this case we have examined whether Royal Mail has infringed the Chapter II prohibition and/or Article 102 by introducing a difference in the price of its various access services depending on the price plan of the particular access customer. We have looked at whether this difference in price amounted to abusive discrimination.

5.35 The basic tenets that apply in discrimination cases involving pricing practices are clear. The UK High Court has previously held that:

“the essence of discrimination in competition law is treating like products (or customers) in an unlike way”;⁶¹² and

⁶⁰⁸ Emphasis added; *AstraZeneca GC*, paragraph 360. See also paragraphs 601-609.

⁶⁰⁹ *AstraZeneca GC*, paragraph 604.

⁶¹⁰ *AstraZeneca GC*, paragraph 362.

⁶¹¹ *AstraZeneca CJEU*, paragraph 111.

⁶¹² *Streetmap.Eu Limited v. (1) Google Inc. (2) Google Ireland Limited (3) Google UK Limited* [2016] EWHC 253 (Ch), paragraph 54. The Court went on: “*Google’s display of a clickable thumbnail map on its SERP exclusively from Google Maps, at the prime position at the top of the page, involves a form of presentation of its online mapping product that is not given*

“the question is whether the arrangements between [the dominant company and customer X] and those between [the dominant company and customer Y] are equivalent transactions, or whether there is a relevant difference between [customer X and customer Y] which justifies this difference in treatment”.⁶¹³

5.36 However, price discrimination, even where undertaken by a dominant company, is not necessarily abusive or unlawful. As a matter of principle, competition law does not impose an obligation on dominant firms to maintain uniform pricing as between its customers.⁶¹⁴ Price discrimination can be regarded as an important part of competition in a well-functioning market where it is part of competition on the merits that brings consumer benefits. This is reflected in the wording of Article 102(c) and section 18(2)(c) of the 1998 Act which also require a finding of “competitive disadvantage”, rather than simply a disadvantage arising from the conduct in question.⁶¹⁵ As the CJEU stated in *MEO*:

“26. ... the mere presence of an immediate disadvantage affecting operators who were charged more, compared with the tariffs applied to their competitors for an equivalent service, does not, however, mean that competition is distorted or is capable of being distorted.

27. It is only if the behaviour of the undertaking in a dominant position tends, having regard to the whole of the circumstances of the case, to lead to a distortion of competition between those business partners that the discrimination between trade partners which are in a competitive relationship may be regarded as abusive...”

5.37 The nature and degree of analysis required to assess whether pricing discrimination is anti-competitive depends on the type of discrimination in issue.⁶¹⁶

Types of discriminatory practices

5.38 Broadly speaking, conduct amounting to price discrimination involves an undertaking:
(a) charging different customers or different classes of customers different prices for goods

to other online maps; and this preference is alleged to place those competing online maps at a competitive disadvantage unrelated to their intrinsic merits.”

⁶¹³ *Arriva The Shires Ltd v London Luton Airport Operations Ltd* [2014] EWHC 64 (Ch), paragraph 125. See also Case T-128/98 *Aéroports de Paris v Commission* EU:T:2000:290 [2000] ECR II-3929, paragraph 206.

⁶¹⁴ Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência* (‘*MEO*’), EU:C:2018:270 [2018] 4 CMLR 25, paragraphs 26-27.

⁶¹⁵ See the Opinion of Advocate General Wahl in *MEO* at 63: *“It should only be possible to penalise price discrimination, either under the law applicable to cartels or under the law applicable to abuses of a dominant position, if it creates an actual or potential anticompetitive effect. The identification of such an effect must not be confused with the disadvantage that may immediately be experienced, or suffered, by operators that have been charged the highest prices for goods or services. Accordingly, the fact that an undertaking has been charged a higher price when purchasing goods or services than that applied to one or more of its competitor undertakings may be characterised as a disadvantage, but it does not necessarily result in a ‘competitive disadvantage’.”* This passage of the Advocate General’s Opinion was endorsed in paragraph 26 of the CJEU’s Judgment of 19 April 2018, quoted above. See also *Attheraces v BSB* [2007] EWCA Civ 38, paragraph 267, in which the Court of Appeal found that charging different customers different prices does not by itself amount to an abuse of dominance. Lord Justice Mummery, giving the judgment of the court, said that the question is whether *“the circumstances (or arguably the purpose) of the intended price differential ... run counter to the purposes of [Article 102]”*.

⁶¹⁶ Opinion of Advocate General Wahl in *MEO*, paragraph 71.

or services whose costs are the same; or (b) charging a single price to customers for whom supply costs differ. The key point made in the case-law is that a dominant undertaking may not apply artificial price differences such as to place its customers at a competitive disadvantage and to distort competition.⁶¹⁷ However, price discrimination can take various forms and / or have different distortive effects on relevant and associated markets.

5.39 In its response to the draft penalty statement, Royal Mail referred to Advocate General Wahl's analysis of the price discrimination at issue in *MEO*, which he carried out by reference to his categorisation of different types of discriminatory price cases.⁶¹⁸ That analysis is helpful in providing a framework for considering the range of pricing behaviours that can amount to an infringement of Article 102 TFEU / the Chapter II prohibition. Advocate General Wahl identified two main categories of discrimination, 'first degree' and 'second degree' price discrimination. In its response to the Statement of Objections, Royal Mail pointed to a similar distinction drawn by Advocate General Mengozzi in *Post Danmark I*.⁶¹⁹ In *MEO*, Advocate General Wahl also referred to cases involving the impact of the conduct of vertical operators on the relevant market (the market where the undertaking is dominant) and associated markets, which we refer to as a 'hybrid' case.

5.40 As to first category, AG Wahl explained that:

"First degree price discrimination is that which is practised against competitors of the dominant undertaking. Most often, it refers to price discrimination practices which are designed to attract customers of competing operators, such as predatory pricing, differential rates of discount and margin squeezing. More generally, it covers every pricing practice which is designed to foreclose from the market or weaken the competitive position of operators present on the same market and at the same level (vertically speaking) as the dominant undertaking.

*These price discrimination practices are, because of the immediate exclusionary effects they are capable of creating, the ones which the competition supervisory authorities and the courts are generally asked to examine."*⁶²⁰

5.41 AG Wahl then outlined the second category of discrimination cases, as follows:

"Second degree price discrimination, which is mainly addressed by point (c) of the second paragraph of Article 102 TFEU, is that which affects 'trading partners' on the market downstream or upstream from the dominant undertaking. It includes, in particular, cases where a dominant undertaking decides to charge its customers, that is to say, entities with which it is not in direct competition, different prices. The aim of that provision is to prevent the commercial behaviour of undertakings in a

⁶¹⁷ Case T-301/04 *Clearstream* EU:T:2009:317, [2009] ECR II-03155, paragraph 170 and case law cited (Case T-83/91 *Tetra Pak v Commission* [1994] ECR II-755, paragraph 160, and Case T-229/94 *Deutsche Bahn v Commission* [1997] ECR II-1689, paragraph 78).

⁶¹⁸ Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 14, paragraph 2.37. (RM2655)

⁶¹⁹ See, for example, Royal Mail, *Response to Statement of Objections*, 27 November 2015, paragraphs 8.10, 8.30-8.35 and 8.37.

⁶²⁰ Emphasis added; Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência* EU:C:2017:1020, [2018] 4 CMLR 25, Opinion of Advocate General Wahl, paragraphs 72-73.

dominant position from distorting competition on an upstream or a downstream market, in other words between suppliers or customers of that undertaking. Co-contractors of such undertakings must not be favoured or disfavoured in the area of the competition which they practise amongst themselves. (reference omitted)

In so far as this latter type of price discrimination is concerned, the exclusionary effect and the effect of restricting the competitive process are not always immediately obvious. On the contrary, an undertaking operating upstream will, in principle, benefit fully from competition on the downstream market.”⁶²¹

5.42 Thus, consistent with the wording of Article 102(c) TFEU and section 18(2)(c) of the 1998 Act those cases have examined whether dissimilar conditions have been applied to equivalent transactions without any legitimate justification and whether this caused competitive disadvantage to trading partners of the dominant firm.⁶²²

5.43 AG Wahl also considered, however, a third category of ‘hybrid’ cases, which are “*similar*” to primary / first degree discrimination cases. He outlined that:

“76. To my mind, and as has been pointed out in a good number of analyses in legal literature, when examining price discrimination, such as that at issue in the present case, for the purposes of the application of point (c) of the second paragraph of Article 102 TFEU, a distinction must immediately be drawn between undertakings that are vertically integrated and will therefore have an interest in displacing competitors on the downstream market and those that have no such interest.

77. In the case of vertically integrated undertakings, the application by a dominant undertaking of discriminatory prices on the downstream or upstream market is in reality similar to first degree price discrimination which indirectly affects the undertaking’s competitors. Such discrimination may have the effect of weakening the competitors of the dominant undertaking on the downstream market.

78. The case which gave rise to the judgment in Deutsche Bahn v Commission [...] offers a good illustration of the restrictive effect on competition that may be caused by price discrimination, both first degree and second degree, practised by a vertically

⁶²¹ Emphasis added; Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência* EU:C:2017:1020, [2018] 4 CMLR 25; Opinion of Advocate General Wahl, paragraphs 74-75.

⁶²² In Case T-301/04 *Clearstream* EU:T:2009:317 [2009] ECR II-03155 the Court of First Instance found that “*the application to a trading partner of different prices for equivalent services continuously over a period of five years and by an undertaking having a de facto monopoly on the upstream market could not fail to cause that partner a competitive disadvantage*”. paragraph 194; Case T-128/98 *Aéroports de Paris v Commission* EU:T:2000:290 [2000] ECR II-3929, in which the Court of First Instance upheld a finding of abuse of dominance by the European Commission by way of applying discriminatory fees where that conduct placed a customer at a competitive disadvantage in a downstream market. The Court of First Instance held that “*...where the undertaking in receipt of the service is on a separate market from that on which the person supplying the service is present, the conditions for the applicability of Article 86 [now Article 102 TFEU] are satisfied provided that, owing to the dominant position occupied by the supplier, the recipient is in a situation of economic dependence vis-à-vis the supplier... It is sufficient if the service offered by the supplier is necessary to the exercise by the recipient of its own activity*” (at paragraph 165). See also Case T-228/97 *Irish Sugar v Commission*; Decision of the Office of Rail Regulation (17 November 2006) *English Welsh and Scottish Railway Limited*.

integrated undertaking. By applying different rates to container transporters operating on ‘western journeys’ in respect of equivalent services connected with the use of railway infrastructure, Deutsche Bahn AG had unquestionably placed those trading partners at a disadvantage in competition with itself and its subsidiary [...].”⁶²³

- 5.44 Thus, a vertically integrated undertaking’s pricing conduct on one market may have benefits on the market where it is dominant and / or on associated (upstream / downstream) markets. A related point is that discriminatory conduct can also involve the leveraging of the undertaking’s dominant position in one market to gain an advantage in a related or associated market.⁶²⁴ In *Streetmap*, Roth J explained that for there to be an abuse, what has to be established is that there is *anti-competitive* foreclosure as a result of the practice in issue.⁶²⁵
- 5.45 As the framework outlined in Advocate General Wahl’s Opinion in *MEO* demonstrates, a range of discriminatory pricing behaviours may be anti-competitive because they hinder or eliminate competition on the market on which a dominant position is held and / or on an associated market. We consider that the different categories or degrees of discrimination outlined above provide a helpful broad framework in which to consider the type of pricing conduct in issue and its effects. They are not exhaustive, however. It is important to note that the CJEU has not expressly endorsed or adopted this framework. Instead, the judgments of the CJEU focus on the application of an “in all the circumstances” test, discussed in the next section,⁶²⁶ to assess whether the *particular* impugned conduct amounts to an abuse. This fact-and-context specific focus reflects the purpose of Article 102 TFEU, which, as noted above, is to prohibit *any* abuse of a dominant position. The classes of abuse of dominance cases, including abusive pricing discrimination cases, are not closed.
- 5.46 Thus, the focus in any given case is on determining whether the particular pricing or other discriminatory practice in question amounts to ‘competition on the merits’ or anti-competitive foreclosure. As noted at paragraph 5.26, this is what our investigation has focused on.

⁶²³ Emphasis added; Case C-525/16 *MEO* — *Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência* EU:C:2017:1020 [2018] 4 CMLR 25; Opinion of Advocate General Wahl.

⁶²⁴ See *Streetmap.Eu Limited v. (1) Google Inc. (2) Google Ireland Limited (3) Google UK Limited* [2016] EWHC 253 (Ch) (*‘Streetmap’*), paragraphs 60-61.

⁶²⁵ *Streetmap*, paragraph 62.

⁶²⁶ See paragraphs 5.59 to 5.70.

Framework for assessing the equivalence of the transactions

5.47 The key relevant case-law and decisional practice for assessing equivalence are: (a) the judgment of Mann J in *Purple Parking*⁶²⁷; (b) the judgment of Rose J in *Arriva the Shires*⁶²⁸, and (c) the European Commission’s decision in *Clearstream*⁶²⁹.

5.48 These authorities demonstrate that it is not the case that *any* difference between customers renders the transactions not equivalent for the purposes of assessing whether there has been discrimination contrary to competition law. If that were the case, the prohibition against discrimination could never be applied, except in the case of *identical* (rather than *equivalent*) transactions. As Mann J explained in *Purple Parking*:

*“One has to take a realistic and common sense view of the transaction. (...) Each of the participants is, of course, using that access for their own particular purposes, and their underlying businesses have different models, but the overall relevant transaction is, for these purposes, the same... Were it to be otherwise then it would be hard to see how this statutory example of abuse could ever be established. The alleged abuser could always find things which differ in the purposes of each of the counterparties to the compared transactions which would make the transactions different, and that cannot be a realistic approach to the legislation.”*⁶³⁰

5.49 In *Arriva the Shires*, Rose J said the question was as follows:

*“There is no doubt that ATS and easyBus have been treated differently here. ... The question is whether the arrangements between Luton Operations and easyBus and those between Luton Operations and ATS are equivalent transactions, or whether there is a relevant difference between easyBus and ATS which justifies the difference in treatment.”*⁶³¹

5.50 In *Clearstream*, the European Commission analysed the content of the relevant transactions (in that case Central Securities Depositories and International Securities Depositories) in reaching its finding that they were equivalent. In that case the substantive content of the transactions was equivalent even through the users of the services had different supply-side characteristics.⁶³²

5.51 In the context of considering Royal Mail’s submissions on its explanation of the differences between its customers which it says justify the price differential, discussed at paragraphs 7.87 to 7.122 below, it is also important to note the following *dicta* of the Court of First Instance (now General Court) in *Irish Sugar*:

“..., the Court must reject the distinction which the applicant draws between the services offered to its customers by reference to the effect which they produce on its

⁶²⁷ (1) *Purple Parking Limited* (2) *Meteor Parking Limited v Heathrow Airport Limited* [2011] EWHC 987 (Ch) (*‘Purple Parking’*)

⁶²⁸ *Arriva the Shires Ltd v. London Luton Airport* [2014] EWHC 64 (Ch.) (*‘Arriva The Shires’*)

⁶²⁹ Decision of the European Commission in CASE COMP/38.096 – *Clearstream*, 2 June 2004

⁶³⁰ *Purple Parking Limited* at paragraph 135.

⁶³¹ *Arriva the Shires* at paragraph 125

⁶³² Decision of the European Commission in CASE COMP/38.096 – *Clearstream*, 2 June 2004, at paragraphs 307-309.

own market position. Such reasoning effectively implies that services which are identical at the commercial level, all conditions being taken into account, are not equivalent within the meaning of Article [102](c), depending on whether or not, for whatever reason, they share in the economic objectives which the undertaking which holds a dominant position has determined for itself. Such a definition is not compatible with that adopted by the case-law in dealing with equivalent transactions within the meaning of Article [102](c), in that two buyers of the same quantity of the same product pay a different price according to whether or not they are competitors of their supplier on another market (see to that effect *Hoffmann-La Roche*, paragraph 90). In any event, the applicant has not shown that the purchases of customers who were not sugar packers were more capable of reducing its structural overcapacity, unless one takes into account the consideration that purchases from competing sugar packers prevent it from itself discharging those quantities of sugar on the retail market, which would show that it exploited its dominant position on the industrial sugar market to place competitors on a derivative market at a disadvantage. It should be stressed that the applicant does not deny that the services offered to its sugar packer customers and its other customers are otherwise perfectly comparable at the commercial level, all conditions being taken into account.”⁶³³

Anti-competitive effects

The likelihood threshold

- 5.52 The EU case law expresses the relevant question for the competition authority as being whether particular conduct has or is capable of having an anti-competitive effect through the distortion of competition.⁶³⁴
- 5.53 In *Post Danmark II*, the CJEU confirmed that the anti-competitive effect of a particular practice must not be “purely hypothetical”.⁶³⁵ However, the Court also made clear that:

“... in order to establish whether such a practice is abusive, that practice must have an anti-competitive effect on the market, but the effect does not necessarily have to be concrete, and it is sufficient to demonstrate that there is an anti-competitive effect which may potentially exclude competitors who are at least as efficient as the dominant undertaking”.⁶³⁶

⁶³³ Emphasis added; T-228/97 *Irish Sugar v. European Commission* EU:T:1999:246 [1999] ECR II-2969, at 164

⁶³⁴ See, for example, paragraph 143 of Case C-413/14 P *Intel Corporation Inc. v European Commission* EU:C:2017:632 [2017] 5 C.M.L.R. 18; and paragraphs 26-37 of Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência*, EU:C:2018:270 [2018] 4 CMLR 25, in the context of deciding whether conduct was capable of giving rise to a competitive disadvantage within the meaning of Article 102(c) TFEU.

⁶³⁵ Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 (*Post Danmark II*), paragraph 65.

⁶³⁶ Emphasis added; *Post Danmark II*, paragraph 66, applying Case C-52/09 *Konkurrensverket v. TeliaSonera Sverige AB* EU:C:2011:83 [2011] ECR I-527 at paragraph 64. See also paragraph 112 of the CJEU’s judgment in Case C-457/10 P *AstraZeneca AB and AstraZeneca plc v European Commission* EU:C:2012:770, [2013] 4 C.M.L.R. 7. See also Case T-203/01

5.54 Thus, in *Post Danmark II*, the CJEU explained that the “in all the circumstances” test, discussed in the next sub-section of this Decision, is designed to determine:

*“whether conduct of the dominant undertaking produces an actual or likely exclusionary effect, to the detriment of competition and, thereby, of consumers’ interests”.*⁶³⁷

5.55 Similarly, in *Streetmap*, Roth J expressed the test in the following terms:

*“the impugned conduct must be reasonably likely to harm the competitive structure of the market”.*⁶³⁸

5.56 Further, in *Clearstream*, the Court of First Instance (now the General Court) held that: *“there is nothing to prevent discrimination between business partners who are in a relationship of competition from being regarded as abusive as soon as the behaviour of the undertaking in a dominant position tends, having regard to the whole of the circumstances of the case, to lead to a distortion of competition between those business partners. In such a situation, it cannot be required in addition that proof be adduced of an actual quantifiable deterioration in the competitive position of the business partners taken individually”.*⁶³⁹

5.57 The conduct should therefore be “likely” (i.e. probable) to have an anti-competitive effect on the market to fall within Article 102.

5.58 There are good policy reasons supporting the requirement that conduct does not need to have concrete effects in order to amount to an abuse, such that potential likely effects are sufficient. As the Court explained in *Microsoft*:

“... The expressions “risk of elimination of competition” and “likely to eliminate competition” are used without distinction by the Community judicature to reflect the same idea, namely that Art.[102 TFEU] does not apply only from the time when there is no more, or practically no more, competition on the market. If the Commission were required to wait until competitors were eliminated from the market, or until their elimination was sufficiently imminent, before being able to take action under Art.[102 TFEU], that would clearly run counter to the objective of that provision, which is to maintain undistorted competition in the Common Market and, in particular, to safeguard the competition that still exists on the relevant market.”

Michelin v. Commission EU:T:2003:250, [2003] ECR II-04071 at paragraph 239, in which the Court of First Instance held that the required anti-competitive effect “does not necessarily relate to the actual effect of the abusive conduct complained of” and that it is “sufficient to show that the abusive conduct...tends to restrict competition or, in other words, that the conduct is capable of having that effect”.

⁶³⁷ Emphasis added; Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25, paragraph 69. See also paragraphs 67 and 74 of that judgment.

⁶³⁸ *Streetmap.Eu Limited v. (1) Google Inc. (2) Google Ireland Limited (3) Google UK Limited* [2016] EWHC 253 (Ch), paragraph 88 (referring to the CFI’s judgment in Case T-201/04 *Microsoft v Commission* EU:T:2012:323, [2007] ECR-II-03601, at paragraph 1089).

⁶³⁹ Case T-301/04 *Clearstream Banking AG and Clearstream International SA v Commission of the European Communities* EU:T:2009:317 [2009] ECR II-03155, paragraph 193 (emphasis added; citing *British Airways v Commission*, paragraph 145)

In this case, the Commission had all the more reason to apply Art.[102 TFEU] before the elimination of competition on the work-group server operating systems market had become a reality because that market is characterised by significant network effects and because the elimination of competition would therefore be difficult to reverse..."⁶⁴⁰

Assessing the likely effects of the conduct “in all the circumstances”

5.59 To establish whether the specific conduct in question is abusive, a case-by-case assessment is required reflecting the prevailing factual, legal and economic context at the time of the conduct in question. The precise methodology by which abuses have been substantiated by competition authorities and the courts has therefore differed across the case law reflecting the different conduct being considered and the divergent ways in which conduct can distort competition.

5.60 In previous cases concerning different types of abusive pricing practices in varied factual contexts, the EU Courts have held that in order to determine whether a dominant undertaking has committed an abuse it is necessary to consider “*all the circumstances*” in order to determine whether the impugned conduct is likely to or gives rise to a distortion of competition. The ‘circumstances’ identified as relevant and necessary to consider depend on the nature of the conduct in issue, as well as the factual and legal context.

5.61 In the context of selective price reductions to downstream customers, the CJEU expressed this requirement in *Post Danmark I* as follows:

“...consider all the circumstances and to examine whether those practices tend to remove or restrict the buyer’s freedom as regards choice of sources of supply, to bar competitors from access to the market, to apply dissimilar conditions to equivalent transactions with other trading parties thereby placing them at a competitive disadvantage, or to strengthen the dominant position by distorting competition”.⁶⁴¹

5.62 *Post Danmark* was not super-dominant in the markets at issue in *Post Danmark I*.⁶⁴² However, in *Post Danmark II*, *Post Danmark* was both a statutory monopolist in respect of a proportion of the bulk mail delivery market⁶⁴³ and held a very large overall market share in that market.⁶⁴⁴ In outlining the test to be applied to assess the rebate scheme *Post Danmark* applied in this context, the CJEU first of all repeated the test set out in many previous cases, including *Post Danmark I*, quoted above.⁶⁴⁵ Second, the Court also outlined

⁶⁴⁰ Emphasis added; Case T-201/04 *Microsoft Corp v Commission* EU:T:2012:323, [2007] ECR-II-03601, paragraphs 561-562.

⁶⁴¹ Case C-209/10 *Post Danmark A/S v Konkurrencerådet* EU:C:2012:172 [2012] 4 CMLR 23 (*‘Post Danmark I’*), paragraph 26.

⁶⁴² *Post Danmark* had a statutory monopoly over addressed mail deliveries and was also subject to a universal service obligation in respect of addressed mail. However, *Post Danmark*’s market share was in the order of 50%, see paragraphs AG27 and AG94 of the Advocate General’s opinion in Case C-209/10 *Post Danmark A/S v Konkurrencerådet* EU:C:2012:172 [2012] 4 CMLR 23 (*‘Post Danmark I’*).

⁶⁴³ *Post Danmark* had previously been the statutory monopolist of the overall Danish postal market.

⁶⁴⁴ *Post Danmark*’s market share was in or around 95%. Case C-23/14 *Post Danmark A/S v Konkurrencerådet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 (*‘Post Danmark II’*), paragraph AG8 of the Advocate General’s Opinion.

⁶⁴⁵ *Post Danmark II*, paragraph 29.

other relevant circumstances which it determined were necessary to consider as a result of the facts (“*particularities*”) of the case:

- a) the particular criteria and rules governing the grant of the rebate in issue;⁶⁴⁶ and
- b) the extent of Post Danmark’s dominant position and the particular conditions prevailing on the relevant market.⁶⁴⁷

5.63 In considering the extent of Post Danmark’s dominant position and the particular conditions prevailing on the bulk mail market in that case, the CJEU noted the following facts at paragraph 39 of its judgment:

“... the order for reference states that Post Danmark held 95 per cent of that market, access to which was protected by high barriers and which market was characterised by the existence of significant economies of scale. Post Danmark also enjoyed structural advantages conferred, inter alia, by the statutory monopoly on the distribution of letters weighing up to 50 grams that concerned 70 per cent of all bulk mail. In addition, Post Danmark enjoyed unique geographical coverage encompassing all of Denmark.”⁶⁴⁸

5.64 In paragraph 40 of *Post Danmark II*, the CJEU then made clear that:

*“An undertaking which has a very large market share is by virtue of that share in a position of strength which makes it an unavoidable trading partner and which secures for it freedom of action (judgment in *F Hoffmann-La Roche & Co AG v Commission of the European Communities (85/76)* EU:C:1979:36; [1979] 3 C.M.L.R. 211 at [41]). In those circumstances, it is particularly difficult for competitors of that undertaking to outbid it in the face of discounts based on overall sales volume. By reason of its significantly higher market share, the undertaking in a dominant position generally constitutes an unavoidable business partner in the market (see judgment in *British Airways* at [75]).”⁶⁴⁹*

5.65 This point, coupled with the facts outlined in paragraph 39 of its judgment, led to the conclusion that competition on the relevant market was already very limited. It was against that background, that the rebate scheme at issue in *Post Danmark II* had to be assessed.⁶⁵⁰

5.66 Similar approaches to the ‘in all the circumstances’ test were outlined in the more recent judgments of the CJEU in *Intel* and *MEO*, which were amended insofar as necessary to reflect the particular facts in issue in each case.

⁶⁴⁶ Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* (*‘Post Danmark II’*) EU:C:2015:651 [2015] 5 C.M.L.R. 25, paragraph 29

⁶⁴⁷ *Post Danmark II*, paragraph 30.

⁶⁴⁸ Emphasis added; *Post Danmark II*.

⁶⁴⁹ Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 (*‘Post Danmark II’*). See also paragraphs AG43-47 of Advocate General Kokott’s Opinion in that case.

⁶⁵⁰ *Post Danmark II*, paragraphs 41 *et seq.*

5.67 In *Intel*, the impugned conduct involved loyalty rebates. The CJEU explained that in cases where the undertaking concerned submits, on the basis of supporting evidence, that its conduct was not capable of restricting competition:

*“... the Commission is not only required to analyse, first, the extent of the undertaking’s dominant position on the relevant market and, secondly, the share of the market covered by the challenged practice, as well as the conditions and arrangements for granting the rebates in question, their duration and their amount; it is also required to assess the possible existence of a strategy aiming to exclude competitors that are at least as efficient as the dominant undertaking from the market (see, by analogy, Post Danmark at [29]).”*⁶⁵¹

5.68 In *MEO*, which involved the application of Article 102(c) TFEU to the pricing practices of a non-vertically integrated undertaking, the CJEU explained that there is a need to show both that the impugned conduct is discriminatory and that it tends to distort competitive relationships.⁶⁵² It is therefore necessary *“to examine all the relevant circumstances in order to determine whether price discrimination produces or is capable of producing a competitive disadvantage, for the purposes of subparagraph (c) of the second paragraph of Article 102 TFEU”*.⁶⁵³ To that end, the CJEU held that:

“... in order for it to be capable of creating a competitive disadvantage, the price discrimination referred to in subparagraph (c) of the second paragraph of Article 102 TFEU must affect the interests of the operator which was charged higher tariffs compared with its competitors.

*When it carries out the specific examination [outlined in paragraph 28 of the Judgment], the competition authority or the competent national court is required to take into account all the circumstances of the case submitted to it. It is open to such an authority or court to assess, in that context, the undertaking’s dominant position, the negotiating power as regards the tariffs, the conditions and arrangements for charging those tariffs, their duration and their amount, and the possible existence of a strategy aiming to exclude from the downstream market one of its trade partners which is at least as efficient as its competitors (see, by analogy, judgment of 6 September 2017, *Intel v Commission*, C-413/14 P, EU:C:2017:632, paragraph 139 and the case-law cited).”*⁶⁵⁴

5.69 Thus, depending on the facts at issue in the particular case, the relevant circumstances may include:

a) the extent of the dominant undertaking’s dominant position on the relevant market;

⁶⁵¹ Case C-413/14 P *Intel Corporation Inc. v European Commission* EU:C:2017:632 [2017] 5 C.M.L.R. 18, paragraphs 138-139. See also paragraphs 70-78 of Advocate General Wathelet’s Opinion in Case C-123/16 P *Orange Polska S.A. European Commission* EU:C:2018:87.

⁶⁵² Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência*, EU:C:2018:270 [2018] 4 CMLR 25 (*‘MEO’*), paragraphs 25-27. See paragraph 5.36 above in which paragraphs 26-27 are partially quoted.

⁶⁵³ *MEO*, paragraph 28.

⁶⁵⁴ Emphasis added; *MEO*, paragraphs 30-31.

- b) the share of the market covered by the challenged practice;
- c) whether the undertaking was and / or is a statutory monopolist in relevant markets;
- d) the particular conditions of competition prevailing in the relevant market, such as whether:
 - i) access to the market is protected by high barriers to entry;
 - ii) the market is characterised by significant economies of scale;
 - iii) the undertaking concerned has unique structural advantages, such as large network coverage;
 - iv) the concerned undertaking is, as a consequence of the factors above, an unavoidable trading partner;
- e) the conditions and arrangements of the pricing in question, their duration and amount. For example, it may be necessary to consider (as in this case) whether the arrangements introduced by the undertaking apply dissimilar conditions to equivalent transactions with other trading parties thereby placing them at a competitive disadvantage and/or strengthening its dominant position by distorting competition; and/or
- f) the possible existence of a strategy aiming to exclude competitors that are at least as efficient as the dominant undertaking from the market.

5.70 We have assessed each of these factors, insofar as relevant, in the course of this decision.

Intent may be a relevant factor

5.71 Given that the concept of an abuse for the purposes of competition law is an objective concept, it is not necessary to prove that the dominant undertaking intended by its actions to foreclose competition.

5.72 However, as outlined above, the intent of the dominant undertaking may be a relevant factor to consider (among others) as part of the assessment of “all the circumstances” to determine whether conduct amounts to an abuse.⁶⁵⁵ Consistent with this case law, we have reflected Royal Mail’s objectives as evidenced by its contemporaneous internal documents, in our findings.

The scale of effect required

5.73 As to the scale or degree of potential adverse effects on competition that must be identified in order for conduct to be abusive, the case law, guidance and relevant decisional practice establishes that it is not necessary to show concrete effects or the potential elimination of all efficient competition.

⁶⁵⁵ Case C-549/10 P *Tomra v Commission* EU:C:2012:221 [2012] 4 CMLR 27, paragraph 19-20, cited in *Streetmap.Eu Limited v. (1) Google Inc. (2) Google Ireland Limited (3) Google UK Limited* [2016] EWHC 253 (Ch) at paragraph 66.

5.74 The CJEU has confirmed that as the structure of the relevant market has already been weakened by the presence of the dominant undertaking, “any further weakening of the structure of competition may constitute an abuse of a dominant position”.⁶⁵⁶ As a result, no *de minimis* or appreciability threshold applies.⁶⁵⁷ In its recent judgment in *MEO*, the CJEU made clear that such a threshold also does not apply in the context of cases involving the application of Article 102(c) TFEU.⁶⁵⁸ In the case-law, this has translated into the Courts and the Commission investigating whether the impugned conduct hinders, hampers or impairs, as well as whether it eliminates, in whole or in part, competition.

5.75 In *Streetmap*, Roth J noted that the economic experts in that case were agreed that anti-competitive foreclosure could be defined as follows:

*“the dominant firm uses its market power to limit effective competitors’ ability to compete by depriving or hindering their necessary access to inputs or customers. Therefore the impairment of competitors does not result from competition on the merits.”*⁶⁵⁹

5.76 This is consistent with the position of European Commission, which describes anti-competitive foreclosure in the following terms:

*“where effective access of actual or potential competitors to supplies or markets is hindered or eliminated as a result of the conduct of the dominant undertaking whereby the dominant undertaking is likely to profitably increase prices to the detriment of consumers.”*⁶⁶⁰

5.77 This approach is reflected in the reasoning of the Court of First Instance in *Microsoft* where it was stated at paragraph 563 that it is not necessary for the Commission:

*“... to demonstrate that all competition on the market would be eliminated. What matters, for the purpose of establishing an infringement of Art.[102 TFEU], is that the refusal at issue is liable to, or is likely to, eliminate all effective competition on the market. It must be made clear that the fact that the competitors of the dominant undertaking retain a marginal presence in certain niches on the market cannot suffice to substantiate the existence of such competition.”*⁶⁶¹

5.78 In *Post Danmark II*, where the Court was considering the exclusionary effect of a rebate scheme for direct mail advertising, the CJEU said:

“...it first has to be determined whether those rebates can produce an exclusionary effect, that is to say whether they are capable, first, of making market entry very

⁶⁵⁶ Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 (*Post Danmark II*), paragraphs 70-72.

⁶⁵⁷ *Post Danmark II*, paragraph 73.

⁶⁵⁸ Paragraph 29 of Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência*, EU:C:2018:270 [2018] 4 CMLR 25.

⁶⁵⁹ Emphasis added; *Streetmap.Eu Limited v. (1) Google Inc. (2) Google Ireland Limited (3) Google UK Limited* [2016] EWHC 253 (Ch), paragraph 63

⁶⁶⁰ Emphasis added; *Communication from the Commission: Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OJ [2009] C 45/7

⁶⁶¹ Case T-201/04 *Microsoft Corp v Commission* EU:T:2012:323 [2007] 5 C.M.L.R. 11, paragraph 563.

*difficult or impossible for competitors of the undertaking in a dominant position and, secondly of making it more difficult or impossible for the co-contractors of that undertaking to choose between various sources of supply or commercial partners. It then has to be examined whether there is an objective economic justification for the discounts granted”.*⁶⁶²

“Competitive disadvantage” within the meaning of Article 102(c) and Section 18(2)(c)

5.79 In relation to the term ‘competitive disadvantage’, which is used in Article 102(c) and section 18(2)(c) of the Act, the CJEU provided recent guidance on its correct interpretation and application in *MEO*.⁶⁶³

5.80 Applying a very similar approach to that outlined in paragraphs 5.52 to 5.58 above relating generally to abuse cases, in *MEO* the CJEU held at paragraph 37 that:

*“... a ‘competitive disadvantage’ does not require proof of actual quantifiable deterioration in the competitive situation, but must be based on an analysis of all the relevant circumstances of the case leading to the conclusion that that behaviour has an effect on the costs, profits or any other relevant interest of one or more of those partners, so that that conduct is such as to affect that situation.”*⁶⁶⁴

5.81 In the context of a case involving potential exclusionary effects of a margin squeeze, the CJEU in *TeliaSonera Sverige* held that reduced profitability could amount to a competitive disadvantage within the meaning of Article 102(c) TFEU, as follows:

*“Where access to the supply of a wholesale product is indispensable for the sale of the retail product, competitors who are at least as efficient as the undertaking which dominates the wholesale market and who are unable to operate on the retail market other than at a loss or, in any event, with reduced profitability suffer a competitive disadvantage on that market which is such as to prevent or restrict their access to it or the growth of their activities on it.”*⁶⁶⁵

5.82 To the extent necessary, in reaching our conclusions on the application of Article 102 and / or Article 102(c) we have set out our specific findings on whether Royal Mail’s conduct gave rise to a “competitive disadvantage” at in sub-section 7E. These findings draw upon the detailed analysis of all of the relevant circumstances of the case, in accordance with the legal framework set out above, at paragraphs 5.59 to 5.70.

⁶⁶² Emphasis added; Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25, at paragraph 31

⁶⁶³ Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência*, EU:C:2018:270 [2018] 4 CMLR 25

⁶⁶⁴ See also paragraphs 26-31 of the CJEU’s judgment, including paragraph 31 of the judgment which applies, by analogy, paragraph 139 of the CJEU’s judgment in *Intel*, which is quoted at paragraph 5.67 above.

⁶⁶⁵ Emphasis added; Case C-52/09 *Konkurrensverket v TeliaSonera Sverige AB* EU:C:2011:83 [2011] ECR I-527, paragraph 70

An AEC or price-cost test is not a necessary, relevant and appropriate tool in all cases

- 5.83 As explained in this sub-section, the relevant case-law shows that a price / cost test is one tool which can be used to assess whether conduct is abusive as part of the “all the circumstances” assessment. However, it is neither appropriate nor relevant in all cases.
- 5.84 We note that the price / cost test is also referred to as an “AEC test” in some of the relevant case-law. This is a particular form of price/cost test in which the costs being examined are those of a notional ‘as efficient’ competitor. This may also be referred to an “EEO” or “equally efficient operator” test.
- 5.85 The CJEU’s judgment in *Post Danmark II* provides key guidance in this regard.⁶⁶⁶ At paragraphs 5.62 above, we have outlined that this case involved an operator with a very large market share, in excess of 95% in the bulk mail market, with a unique network, and thereby amounted to an unavoidable trading partner. The CJEU considered whether in these circumstances it was necessary or relevant to conduct a price-cost test. As the Advocate General Kokott explained in paragraph 14 of her Opinion:

“In the course of its assessment, the Konkurrenceråd chose not to carry out a price/cost analysis in the form of an AEC test. It stated that this was not an appropriate assessment criterion given that, because of the special features that characterise it, there cannot be an as-efficient-competitor on the Danish postal market. In support of its assumption of abusive conduct, the competition authority relied instead on the special position occupied by Post Danmark on the relevant market, which, it contends, makes the undertaking an unavoidable trading partner. The Konkurrenceråd also referred, inter alia, to the existence of barriers to market entry, as well as to the specific modus operandi of the rebate scheme, in particular the fact that it applies retroactively to a one-year reference period, the extent of the discount of up to 16 per cent and an examination of the customers’ actual positions on the scale of rebates.”

- 5.86 As outlined above, the CJEU first explained the approach which should be taken to identifying and analysing all the relevant circumstances in the context of an operator that enjoys very high market shares and structural advantages in the market. It then explained the purpose of the AEC test, and outlined the types of cases in which it had been applied by the Court, as follows:

“53. The application of the as-efficient-competitor test consists in examining whether the pricing practices of a dominant undertaking could drive an equally efficient competitor from the market.

54. That test is based on a comparison of the prices charged by a dominant undertaking and certain costs incurred by that undertakings as well as its strategy (see judgment in Post Danmark (C-209/10) at [28]).

⁶⁶⁶ Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 (*Post Danmark II*).

55. *The as-efficient-competitor test has been specifically applied by the Court to low-pricing practices in the form of selective prices or predatory prices (see, in respect of selective prices, judgment in Post Danmark (C-209/10) at [28] to [35], and in respect of predatory prices, judgments in AKZO Chemie BV v Commission of the European Communities (C-62/86) EU:C:1991:286; [1993] 5 C.M.L.R. 215 at [70] to [73], and France Télécom SA v Commission of the European Communities (C-202/07 P) EU:C:2009:214; [2009] 4 C.M.L.R. 25 at [107] and [108]), and margin squeeze (judgment in TeliaSonera Sverige at [40] to [46]).*⁶⁶⁷

- 5.87 The Court then referred to a previous case, *Tomra Systems ASA v European Commission*,⁶⁶⁸ that had already found that the absence of a comparison of prices with costs did not constitute an error of law. It therefore held that:

*“... as the Advocate General stated in points 61 and 63 of her Opinion, it is not possible to infer from Article.[102 TFEU] or the case-law of the Court that there is a legal obligation requiring a finding to the effect that a rebate scheme operated by a dominant undertaking is abusive to be based always on the as-efficient-competitor test.”*⁶⁶⁹

- 5.88 This did not prevent recourse to such a test in the context of rebate schemes.⁶⁷⁰ However, the CJEU explained that:

“59. ... in a situation such as that in the main proceedings, characterised by the holding by the dominant undertaking of a very large market share and by structural advantages conferred, inter alia, by that undertaking’s statutory monopoly, which applied to 70 per cent of mail on the relevant market, applying the as-efficient-competitor test is of no relevance inasmuch as the structure of the market makes the emergence of an as-efficient competitor practically impossible.

*60. Furthermore, in a market such as that at issue in the main proceedings, access to which is protected by high barriers, the presence of a less efficient competitor might contribute to intensifying the competitive pressure on that market and, therefore, to exerting a constraint on the conduct of the dominant undertaking.”*⁶⁷¹

- 5.89 Similarly, in paragraphs 70-74 of her Opinion, Advocate General Kokott expanded on the same points as follows:

“70. If the abusive nature of the rebate scheme operated by a dominant undertaking is immediately shown by an overall assessment of the other circumstances of the individual case, as I have described above, [internal reference omitted] there is no need, from a legal point of view, to carry out a price/cost analysis such as an AEC test.

⁶⁶⁷ Emphasis added; Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 (*‘Post Danmark II’*). See also paragraphs AG61-62 of Advocate General Kokott’s Opinion in that case.

⁶⁶⁸ Case C-549/10 P *Tomra Systems v European Commission* EU:C:2012:221, [2012] 4 C.M.L.R. 27, paragraph 80.

⁶⁶⁹ *Post Danmark II*, paragraph 57.

⁶⁷⁰ *Post Danmark II*, paragraph 58.

⁶⁷¹ *Post Danmark II*, paragraphs 59-60. See also paragraph AG63 of Advocate General Kokott’s Opinion in that case. She also noted practical concerns about the application of the AEC test at paragraphs AG66-AG67.

71. It follows a fortiori that Article [102 TFEU] is not capable of giving rise to a legal obligation to carry out an AEC test where, because of the way in which the market is structured, it is impossible for another undertaking to be as efficient as the dominant undertaking. This may be because of the particular conditions of competition prevailing on the relevant market (such as the fact that the market —as here—is characterised by high barriers to entry, high economies of scale and/or network-based services) or because the level of the dominant undertaking's costs is specifically attributable to the competitive advantage which its dominant position confers on it. [reference - See, to that effect, judgment in *TeliaSonera* at [45], in fine].

72. In such cases, it would from the outset make no sense to carry out some form of price/cost analysis in order to examine whether the rebate scheme operated by the dominant undertaking has an exclusionary effect on a purely hypothetical as-efficient competitor. If no competitor can be as efficient as the dominant undertaking, then, by extension, an AEC test will not provide any reliable conclusions as to whether or not there are likely to be any exclusionary effects on the market.

73. On the contrary, on a market in which competition is so weakened by the presence of a dominant undertaking that as-efficient competitors cannot even establish themselves there, [internal reference omitted] the competitive pressure exerted even by less efficient undertakings must not be underestimated. Maintaining that pressure is one of the fundamental objectives pursued by Article [102 TFEU]. It is after all essential to ensure that the market structure and the choices available to customers do not deteriorate further because of the commercial conduct of the dominant undertaking. [reference to Judgments in *France Télécom* at [105]]; *Deutsche Telekom* at [83] and [176]]; *TeliaSonera* at [24]; and *Post Danmark (C-209/10)* at [20] and [23]], see, to similar effect, judgment in *British Airways* at [66]].

74. It follows that Article [102 TFEU] prohibits an AEC test from being carried out on a market where, on account of the structure of the market, it is impossible for another undertaking to be as efficient as the dominant undertaking.”⁶⁷²

- 5.90 In the light of its reasoning as outlined above, the CJEU held that the AEC test or price / cost test must be regarded as *one* tool amongst others for the purposes of assessing whether there is an abuse of dominant position.⁶⁷³ It is not a necessary condition for a finding to the effect that, in that case a rebate scheme, is abusive within the meaning of Article 102 TFEU.⁶⁷⁴ For example, in a situation involving an undertaking with a very large market share, with structural advantages (including a statutory monopoly), and where the structure of the market makes the emergence of an as efficient competitor practically

⁶⁷² Emphasis added; Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 ('*Post Danmark II*').

⁶⁷³ *Post Danmark II*, paragraph 61.

⁶⁷⁴ *Post Danmark II*, paragraph 62.

impossible, the test is of no relevance.⁶⁷⁵ Overall, the relevance or need for the application of the price / cost test is dependent on the particular facts of the case.⁶⁷⁶

- 5.91 We note that Royal Mail's more recent submissions in response to Ofcom's analysis of the price differential refer, in particular, to the CJEU's judgment in *Intel*.⁶⁷⁷
- 5.92 In *Intel*, the applicant challenged the General Court's alleged failure to examine all of the relevant circumstances in order to assess the likelihood of the impugned conduct restricting competition. Essentially, Intel alleged that the General Court adopted a presumptive approach.⁶⁷⁸ In that context, Intel also challenged, *inter alia*, the General Court's assessment of the relevance of the AEC test applied by the Commission in its Decision.⁶⁷⁹ Intel submitted, "*in particular, that, since the Commission applied that test, the General Court should have examined Intel's line of argument alleging that the application of that test was badly flawed and that, had it been correctly applied, it would have led to the conclusion contrary to that which the Commission reached, namely that the rebates at issue were not capable of restricting competition.*"⁶⁸⁰
- 5.93 In response to these grounds of challenges, the CJEU first reiterated the fundamental principles quoted at paragraph 5.25 above. It then referred to its previous case law on exclusivity and loyalty rebates, particularly, *F Hoffmann-La Roche & Co AG v Commission of the European Communities*,⁶⁸¹ at paragraph 137 of its judgment. However, it then explained at paragraph 138 that the case law must be: "*further clarified in the case where the undertaking concerned submits, during the administrative procedure, on the basis of supporting evidence, that its conduct was not capable of restricting competition and, in particular, of producing the alleged foreclosure effects.*" At paragraph 139, the Grand Chamber then set out the relevant 'in the circumstances' test, quoted at paragraph 5.66 above.
- 5.94 At paragraphs 141-144, the Grand Chamber then addressed Intel's arguments in relation to the failure by the General Court to consider its criticisms of the price/cost test carried out by the Commission in that case, as follows:

"141. If, in a decision finding a rebate scheme abusive, the Commission carries out such an analysis [of the intrinsic capacity of that practice to foreclose competitors which are at least as efficient as the dominant undertaking], the General Court must examine all of the applicant's arguments seeking to call into question the validity of

⁶⁷⁵ Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 ('*Post Danmark II*'), paragraphs 59 and 62.

⁶⁷⁶ *Post Danmark II*, paragraphs 61 and 62. See paragraphs AG68-71 of Advocate General Kokott's Opinion in *Post Danmark II*.

⁶⁷⁷ See: Royal Mail, *Response to letter of facts*, 24 November 2017, page 4, paragraphs 1.6 to 1.8 and page 13, paragraph 3.1 to 3.8 (RM2581); and Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 3, paragraphs 1.11(c) and page 13, paragraph 2.35. (RM2655)

⁶⁷⁸ See paragraphs 109-111 and 129-131 of Case C-413/14 P *Intel Corporation Inc. v European Commission* EU:C:2017:632 [2017] 5 C.M.L.R. 18 ('*Intel*').

⁶⁷⁹ *Intel*, paragraph 131.

⁶⁸⁰ *Intel*, paragraph 132.

⁶⁸¹ Case 85/76 *F Hoffmann-La Roche & Co AG v Commission of the European Communities* EU:C:1979:36; [1979] 3 C.M.L.R.

the Commission's findings concerning the foreclosure capability of the rebate concerned.

142. In this case, while the Commission emphasised, in the decision at issue, that the rebates at issue were by their very nature capable of restricting competition such that an analysis of all the circumstances of the case and, in particular, an AEC test were not necessary in order to find an abuse of a dominant position (see, inter alia, paras 925 and 1760 of that decision), it nevertheless carried out an in-depth examination of those circumstances, setting out, in paras 1002–1576 of that decision, a very detailed analysis of the AEC test, which led it to conclude, in paras 1574 and 1575 of that decision, that an as efficient competitor would have had to offer prices which would not have been viable and that, accordingly, the rebate scheme at issue was capable of having foreclosure effects on such a competitor.

143. It follows that, in the decision at issue, the AEC test played an important role in the Commission's assessment of whether the rebate scheme at issue was capable of having foreclosure effects on as efficient competitors.

144. In those circumstances, the General Court was required to examine all of Intel's arguments concerning that test."⁶⁸²

- 5.95 In *Intel*, the Grand Chamber was not asked to decide the circumstances in which a price/cost or AEC test should or should not be carried out and relied upon. Instead, it was asked to consider: (a) whether a presumptive approach could be adopted; and (b) the General Court could refuse to address arguments raised by an applicant in circumstances where the European Commission had carried out and relied upon a price-cost test in the contested decision. The Grand Chamber did not refer to or address the specific issues discussed in *Post Danmark II*.
- 5.96 We have therefore considered whether the present case is one in which it would be relevant or necessary to carry out a price / cost test to assess the effect of the price differential on an equally efficient operator. We address the lack of relevance of such a test to the facts at issue in this case at paragraphs 7.182 to 7.202.

Response to particular points made by Royal Mail on the legal framework

- 5.97 In this sub-section, we address some of the main legal arguments advanced by Royal Mail in response to Ofcom's Statement of Objections, Letter of Facts and / or the Draft Penalty Statement.
- 5.98 First, Royal Mail has submitted that in order for there to have been infringement within the meaning of Article 102(c) / 102 TFEU, prices must have been both charged and paid.⁶⁸³

⁶⁸² Emphasis added; Case C-413/14 P *Intel Corporation Inc. v European Commission* EU:C:2017:632 [2017] 5 C.M.L.R. 18.

⁶⁸³ See, for example, Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 77 to 78, paragraphs 5.32 to 5.40 (RM2386); Royal Mail, *Response to letter of facts*, 24 November 2017, page 11, paragraph 2.7 to 2.9. (RM2581); and Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 1 to 2, paragraphs 1.5 to 1.9, page 3, paragraph 1.11, pages 9 to 12, paragraph 2.1 to 2.24 and page 13, paragraph 2.31. (RM2655)

- 5.99 A particular feature of this case is that, when Ofcom opened an investigation under the Act, Royal Mail suspended the coming into force of the CCNs containing the price differential. Royal Mail ultimately withdrew the notices containing the differential some 14 months after they were issued. In the period prior to that withdrawal, Royal Mail maintained a public position that the price differential was lawful and that it intended to implement the price differential as soon as Ofcom had closed down the investigation.⁶⁸⁴ We address these arguments further below at paragraphs 7.203 to 7.228 in the context of our analysis of the particular conduct.
- 5.100 However, the preliminary point is that, as outlined above, as a matter of law we are required to consider the likely effects of Royal Mail’s conduct at the time the relevant acts were committed. While evidence of what actually happened subsequently may be informative, especially if the impugned conduct is alleged to have continued, uninterrupted, at the point of assessment,⁶⁸⁵ it is not necessarily determinative of the question whether the conduct was or was not abusive at the time the acts were committed. As the Court of First Instance made clear in *Microsoft* (see paragraph 5.58 above), a competition authority is not required to wait until the anti-competitive conduct has eliminated competition or otherwise had anti-competitive effects on the market before it acts. This would be counter-productive to the very object and purpose of Article 102 TFEU. Thus, we do not accept, as a matter of law, that the fact Ofcom opened an investigation, suspending the introduction of the price differential, means that the likely effects of the acts committed by Royal Mail should not be assessed in order to determine whether they were abusive.
- 5.101 We note also that Article 102(c) identifies as an example of abusive conduct: “*applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage*” (emphasis added). To fall within Article 102(c), the undertaking has to apply dissimilar conditions – not specifically prices as charged. We address Royal Mail’s factual argument that the CCNs, as announced, had no impact or effect in sections 7E and 7F below.
- 5.102 The Article 102 case-law relied upon by Royal Mail in this regard does not support the proposition that pricing needs to be “*implemented*” or “*applied*” in order for it to be potentially abusive as a matter of competition law. In *Compagnie Maritime Belge*,⁶⁸⁶ *British Airways*,⁶⁸⁷ *TeliaSonera*,⁶⁸⁸ and *Deutsche Telekom*,⁶⁸⁹ (the cases cited by Royal Mail in its written representations) the EU courts had to address arguments to the effect that the impugned conduct in question (which had been implemented) could not amount to an

⁶⁸⁴ See paragraphs 4.202 to 4.205.

⁶⁸⁵ See, for example, paragraphs 89-91 of *Streetmap.Eu Limited v Google Inc and Others* [2016] EWHC 253 (Ch).

⁶⁸⁶ Joined cases T-24,25,26,28/93 *Compagnie maritime belge transports SA and Compagnie maritime belge SA, Dafra-Lines A/S, Deutsche Afrika-Linien GmbH & Co. and Nedlloyd Lijnen BV v Commission of the European Communities*. EU:T:1996:139, para 149

⁶⁸⁷ Case T-219/99 *British Airways v Commission* EU:T:2003:343 [2003] ECR II-5917, para 297

⁶⁸⁸ Case C-52/09 *Konkurrensverket v TeliaSonera Sverige AB* EU:C:2011:83 [2011] ECR I-527, para 65

⁶⁸⁹ Case C-280/08 P *Deutsche Telekom v Commission* [2010] ECR I-09555, EU:C:2010:603, para 254

abuse as there had been no actual anti-competitive effects. In other words, in those cases the courts held that where a dominant undertaking actually implements an anti-competitive practice, the lack of actual effects on the market is not a barrier to the finding of abuse. Those cases are not authority for the proposition that pricing practices need to be actually implemented, in the sense that the abusive pricing must be charged and paid by a customer / relevant undertaking before they can amount to an abuse.

- 5.103 Royal Mail also cited *Irish Sugar*⁶⁹⁰ in support of the proposition that discriminatory prices must be charged in order to be abusive, “*as opposed to merely being contemplated or intended*”.⁶⁹¹ In that example, the Court of First Instance (now known as the General Court) upheld an appeal, in part, on the basis that there was no evidence that a policy of selective low pricing had actually been put in place or applied. On the facts, the evidence of the alleged unlawful pricing in question was a note from a sales director setting out a policy that he intended to pursue, but there was no evidence that this policy had ever been put in place. This is fundamentally different to the present case, in which Royal Mail actually issued Contract Change Notices introducing the price differential.
- 5.104 Finally on this point, we also note that:
- a) in *AstraZeneca* the European Courts found that the unlawful obtaining of supplementary certificates was contrary to competition law even where they were subsequently revoked before the basic patent expired because it altered the structure of the market by adversely affecting potential competition;⁶⁹² and
 - b) the case-law relating to Article 101 TFEU has made clear that anti-competitive prices do not need to be applied in order for there to be an infringement.⁶⁹³ Even one-off information exchanges / pricing signals, are capable of amounting to a concerted practice / infringement of Article 101, depending on all of the circumstances of the case.⁶⁹⁴
- 5.105 Second, Royal Mail has submitted that it is necessary for Ofcom to carry out a price / cost test in this case to assess the effect of the price differential on an equally efficient operator.⁶⁹⁵ In support of this submission, Royal Mail has presented reports prepared on its behalf by external advisors.⁶⁹⁶ Royal Mail states that the results of the price-cost test

⁶⁹⁰ Case T-228/97 *Irish Sugar plc v Commission of the European Communities* [1999] ECR-II-02969 EU:T:1999:246, at paragraphs 117-124

⁶⁹¹ Ofcom, *Transcript of an oral representations meeting with Royal Mail*, 23 March 2016, page 20, lines 15 to 25. (RM2462)

⁶⁹² Case T-321/05 *AstraZeneca AB and AstraZeneca plc v European Commission* EU:T:2010:2066 [2010] ECR II-02805, paragraphs 362, 375, 380 and 605. Confirmed in judgment on appeal, Case C-457/10 P *AstraZeneca AB and AstraZeneca plc v European Commission* EU:C:2012:770 [2013] 4 C.M.L.R. 7, paragraphs 108-109.

⁶⁹³ See Case 246/86 *Belasco* EU:C:1989:301 [1989] ECR 2117, paragraphs 12 and 15; *Balmoral Tanks Limited and Balmoral Group Holdings Limited v CMA* (*‘Balmoral Tanks’*) [2017] CAT 23, paragraph 81.

⁶⁹⁴ *Balmoral Tanks*, paragraphs 101-106, applying Case C-8/08 *T-Mobile Netherlands BV v Dutch Competition Authority* EU:C:2009:343 [2009] ECR I-4529.

⁶⁹⁵ Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 134 to 148, paragraphs 8.10 to 8.76 (RM2386); Royal Mail, *Response to letter of facts*, 24 November 2017, pages 13 to 15, paragraphs 3.1 to 3.18 (RM2581); and Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 13 to 15, paragraphs 2.31 to 2.43. (RM2655)

⁶⁹⁶ Compass Lexecon, *Economic assessment of Ofcom’s theories of harm*, 27 November 2015 (RM2313) and FTI Consulting, *Financial assessment of Ofcom’s theories of harm*, 27 November 2015 (RM2314) both submitted alongside Royal Mail’s Response to the Statement of Objections.

indicate that an EEO could operate profitably on the market and that, as such, the price differential did not place any efficient competitors at a competitive disadvantage. The crux of Royal Mail's submission is set out at paragraph 1.11(c)(ii) of its Response to Ofcom's Draft Penalty Statement as follows:

"Ofcom has not conducted any economic analysis of the price differential. Compass Lexecon's price/cost test demonstrates that the implementation of the price differential, even taken together with the zonal tilt, would not have foreclosed an as-efficient competitor. The ECJ's Intel judgment requires Ofcom to rebut this evidence, which currently stands unchallenged."

- 5.106 With respect to the applicable legal framework, we make three points in response to the arguments made by Royal Mail:
- a) First, there is no dispute that in reaching its decision on whether the price differential in the CCNs amounted to an abuse, we have to consider the likely effects of the conduct 'in all the circumstances'. What those relevant circumstances are and/or the appropriate tools for assessing those circumstances, depends on the particular facts of this case.
 - b) Second, *Intel* does not overrule or even address the finding in *Post Danmark II*, as well as in *Tomra*, that a price/cost test is neither legally required nor appropriate in all cases. *Intel* addresses a different issue, namely the consequences of the Commission having carried out and relied on such an analysis in its decision for the General Court's consideration of any appeal.
 - c) Third, *Intel* does not impose an obligation on a competition authority to: (i) carry out its own price/cost test; and/or (ii) rebut through a similar analysis any price/cost test put forward as evidence by the concerned undertaking. There is no dispute that Ofcom has to consider all evidence put before it and address it as part of its decision-making. But that does not translate into an obligation to accept that the type of evidence put forward by the undertaking is relevant or appropriate.
- 5.107 To the extent necessary, we address the price/cost analyses adduced by Royal Mail at paragraphs 7.182 to 7.202 below.

Our approach

- 5.108 In the light of the legal framework outlined above, we have undertaken an assessment of the reasonably likely effect of the price differential included in the CCNs, having regard to all of the relevant circumstances, including the particular features of the bulk mail delivery market in issue. This analysis is set out in Section 7 below.

Trade within the UK and between Member States

- 5.109 As noted above, the Chapter II prohibition requires that the dominant undertaking's conduct may affect trade within the United Kingdom in order to amount to an abuse, and

Article 102 of the TFEU requires that such conduct may affect trade between Member States.

- 5.110 With regard to the requirement in Article 102 of the TFEU that the conduct may affect trade between Member States, the EU Courts have confirmed that:

“to be capable of affecting trade between Member States, it is not necessary to demonstrate that the conduct complained of actually affected trade between Member States in a discernible way; it is sufficient to establish that the conduct is capable of having that effect. As regards abusive practices envisaged by Article [102], in order to assess whether trade between Member States is capable of being discernibly affected by the abuse of a dominant position, account must be taken of the consequences which result for the actual structure of competition in the common market (Compagnie Maritime Belge, paragraphs 201 and 203 and the case-law cited therein).”⁶⁹⁷

- 5.111 We set out our analysis as to whether Royal Mail’s conduct may affect trade within the UK and between Member States in Section 7H.

The burden and standard of proof

- 5.112 The burden of proof of proving an infringement of the Chapter II prohibition and Article 102 of the TFEU lies with the competition authority.⁶⁹⁸ However, this burden does not preclude Ofcom from relying, where appropriate, on inferences or evidential presumptions.⁶⁹⁹
- 5.113 The standard of proof that Ofcom is required to meet is the civil standard, namely whether ‘on the balance of probabilities’ the conduct amounts to an infringement,⁷⁰⁰ nothing more and nothing less.⁷⁰¹
- 5.114 We have also taken account of the principle of the presumption of innocence, enshrined in Article 6(2) of the European Convention on Human Rights and Fundamental Freedoms. This means that any doubt as to whether a point is established on the balance of probabilities must operate to the advantage of the undertaking alleged to have infringed the competition rules, namely Royal Mail.

Objective justification

- 5.115 It is open to a dominant undertaking to provide a justification for behaviour that is liable to be caught by the Chapter II prohibition or Article 102 of the TFEU. A dominant undertaking

⁶⁹⁷ Case T-228/97 *Irish Sugar v Commission* EU:T:1999:246 [1999] ECR II-03155, paragraph 170.

⁶⁹⁸ *Napp Pharmaceutical Holding Limited v Director General of Fair Trading* (*‘Napp’*) [2002] CAT 1, paragraphs 95 and 100. See also, more recently, *Tesco Stores Limited v Office of Fair Trading* [2012] CAT 31, paragraph 88.

⁶⁹⁹ *Napp*, paragraph 100.

⁷⁰⁰ *Willis v OFT* [2011] CAT 13, paragraphs 46–47. See also, more recently, *Tesco v OFT*, paragraph 88.

⁷⁰¹ *Re S-B* [2009] UKSC 17 at 34. See also *Re H (Minors)* [1996] AC 563 at paragraph 586; *Re D (Northern Ireland)* [2008] 1 WLR, paragraph 28; and *Re B* [2009] 1 AC 11, at paragraph 13.

may do so either by demonstrating that its conduct is objectively necessary or by demonstrating that its conduct produces substantial efficiencies which outweigh any anticompetitive effects on consumers.⁷⁰²

- 5.116 It is incumbent upon the dominant undertaking to provide all the evidence necessary to demonstrate that the conduct concerned is objectively justified. As the Competition Appeal Tribunal (“CAT”) recognised in *Albion Water II*:

*“It is for the party alleging an infringement to prove it and not for the dominant undertaking to demonstrate its absence. It is then for the dominant undertaking to raise any plea of objective justification and to support it with arguments and evidence.”*⁷⁰³

- 5.117 The same burden of proof is prescribed in EU case law.⁷⁰⁴
- 5.118 We set out our analysis of Royal Mail’s submissions in relation to objective justification for its conduct in Section 8.

Exclusions and Derogations

- 5.119 Section 19 of the Act provides that the Chapter II prohibition does not apply to any of the cases in which it is excluded by or as a result of Schedules 1 or 3 of the Act.
- 5.120 In certain circumstances a derogation from Article 102 of the TFEU may be applicable to conduct which would otherwise be abusive.
- 5.121 Royal Mail has submitted that it should benefit from the exclusion at paragraph 4 of Schedule 3 of the Act, which mirrors Article 106(2) of the TFEU.
- 5.122 None of the other exclusions set out in Schedules 1 and 3 of the Act are relevant to the circumstances of this case.
- 5.123 Article 106(2) of the TFEU provides:

“Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of

⁷⁰² See judgment in Case C-209/10 *Post Danmark v Konkurrencerådet* EU:C:2012:172 [2012] 4 CMLR 23, paragraphs 40 and 41 and the case law cited therein. See also case law cited in *Communication from the Commission: Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OJ [2009] C 45/7, paragraph 28.

⁷⁰³ *Albion Water and Another v Water Services Regulation Authority and Others* [2008] CAT 31 (*‘Albion Water II’*), paragraph 70.

⁷⁰⁴ Case T-201/04 *Microsoft v Commission* EU:T:2012:323, [2007] ECR II-03601, paragraph 688. In this case the General Court also noted that once the dominant undertaking has raised such a plea with supporting arguments and evidence, it then falls to the regulator, where it proposes to make a finding of abuse of a dominant position, to show that the arguments and evidence relied on by the undertaking cannot prevail and that the justification put forward cannot be accepted. See also paragraph 31 of the *Communication from the Commission: Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OJ [2009] C 45/7.

the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.”

- 5.124 We set out our reasoning in relation to the exclusion relating to services of general economic interest (Schedule 3 paragraph 4 of the Act and Article 106(2) of the TFEU) in Section 8.

6. Market definition and dominance

Introduction

- 6.1 This section contains our findings as to market definition and dominance.
- 6.2 In sub-section A, we explain our finding that the relevant market is a national market for bulk mail delivery, which consists of the activities of the inward sortation of bulk letters and large letters at inward mail centres and onward delivery to the final recipient, with delivery on the second day after collection (D+2) or later.
- 6.3 In sub-section B, we explain our finding in relation to dominance. Royal Mail is the incumbent provider of bulk mail delivery services in the UK. As the former statutory monopoly provider of postal services in the UK, and with a very high market share of over 98% in the market for bulk mail delivery services as of January 2014⁷⁰⁵, we find that it held a dominant position.
- 6.4 While the maintenance of very high market shares for a prolonged period of time provides evidence in and of itself that Royal Mail held a dominant position in the relevant market, Ofcom has also considered whether other factors may have undermined Royal Mail's market power. Our assessment shows that Royal Mail's conduct was not sufficiently constrained either by existing or potential competition in the bulk mail delivery market or by countervailing buyer power to prevent it from holding a dominant position in that market.

A. Market definition

Legal and economic background for defining the relevant market

- 6.5 For the purposes of the Chapter II prohibition and/or Article 102 TFEU, dominance is assessed within a relevant market.⁷⁰⁶ In order to determine whether an undertaking holds a dominant position it is therefore necessary to define the relevant market.⁷⁰⁷

⁷⁰⁵ As a former statutory monopoly provider of postal services in the UK until 2006, before Whistl entered the bulk mail delivery market in 2012, Royal Mail had a market share of nearly 100%. As explained in paragraph 6.84 below, Whistl's market share during its bulk mail delivery operations was less than 2%, and following Whistl's exit from bulk mail delivery in June 2015, Royal Mail's market share returned to nearly 100%.

⁷⁰⁶ *Commission Notice on the definition of the relevant market for the purposes of Community competition law*, [1997] OJ C 372/5 (the 'Commission Notice on Market Definition'), paragraphs 7-9 (PD0005); OFT, *Market Definition – Understanding competition law*, 1 December 2004 (PD0028), paragraph 2.1 - this guidance was originally published by the OFT and has been adopted by the CMA.

⁷⁰⁷ Judgment in Case 6/72 *Europemballage Corporation and Continental Can Company v Commission*, EU:C:1973:22, [1973] ECR 215, paragraph 32. See also, for example, the judgments in *United Brands*, paragraph 10; Case 85/76 *F Hoffmann- La Roche & Co AG v Commission* EU:C:1979:36 [1979] ECR 461 ('*Hoffmann-La Roche*'), paragraph 21; and *Aberdeen Journals v Director General of Fair Trading* [2002] CAT 4 ('*Aberdeen Journals I*'), paragraph 88.

6.6 Market definition is not an end in itself but a key step in identifying the competitive constraints acting on a supplier of a given product or service.⁷⁰⁸ Market definition provides a framework for the analysis of competition. As the European Commission's *Notice on the definition of relevant market for the purposes of Community competition law* explains:

*"The main purpose of market definition is to identify in a systematic way the competitive constraints that the undertakings involved face. The objective of defining a market in both its product and geographic dimension is to identify those actual competitors of the undertakings involved that are capable of constraining those undertakings' behaviour and of preventing them from behaving independently of effective competitive pressure."*⁷⁰⁹

6.7 There are two main dimensions to the definition of the relevant market.⁷¹⁰

- a) the product market: a relevant product market comprises all those goods and/or services which are regarded as interchangeable by any reason of the products' characteristics, prices and intended use,⁷¹¹ or, in other words, all those products which are "close enough" substitutes for them sensibly to be regarded as being in the same market;⁷¹² and
- b) the geographic market: a relevant geographic market is the geographic area in which the conditions of competition are sufficiently homogeneous, and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different.⁷¹³

6.8 We have assessed the relevant market prevailing as at January 2014 when Royal Mail issued the CCNs introducing the price differential.⁷¹⁴

Identifying the relevant product market

6.9 The relevant product market "is to be defined by reference to the facts in any given case, taking into account the whole economic context,"⁷¹⁵ including: (i) the objective characteristics of the products; (ii) the degree of substitutability or interchangeability between the products, having regard to their relative prices and intended use; (iii) the competitive conditions; (iv) the structure of supply and demand; and (v) the attitudes of consumers and users.⁷¹⁶

⁷⁰⁸ See, for example, *Albion Water and Another v Water Services Regulation Authority and Others* [2006] CAT 36 ('*Albion Water I*'), paragraph 90; and the Commission Notice on Market Definition, paragraph 2.

⁷⁰⁹ Commission Notice on Market Definition, paragraph 2. (PD0005)

⁷¹⁰ OFT, *Market Definition – Understanding competition law ('Market definition')*, 1 December 2004, paragraph 2.15. (PD0028)

⁷¹¹ Commission Notice on Market Definition, paragraph 7. (PD0005)

⁷¹² OFT, *Market Definition*, paragraph 2.5. (PD0028)

⁷¹³ Commission Notice on the definition of the relevant market for the purposes of Community competition law, [1997] OJ C 372/5, paragraph 8. (PD0005)

⁷¹⁴ There is no indication that the market boundaries changed in the months after the CCNs were issued.

⁷¹⁵ *Aberdeen Journals v Director General of Fair Trading* [2002] CAT 4 ('*Aberdeen Journals I*') at paragraph 96.

⁷¹⁶ *Aberdeen Journals I* at paragraph 96.

6.10 These factors are not, however, fixed or exhaustive. As the CAT has explained:

“Each case will depend on its own facts, and it is necessary to examine the particular circumstances in order to answer what, at the end of the day, are relatively straightforward questions: do the products concerned sufficiently compete with each other to be sensibly regarded as being in the same market? The key idea is that of a competitive constraint: do the other products alleged to form part of the same market act as a competitive constraint on the conduct of the allegedly dominant firm?”⁷¹⁷

6.11 The boundaries of the relevant market are determined by identifying constraints on a firm’s ability to set and/or influence prices. There are two main constraints to consider, namely demand-side substitution and supply-side substitution.

- a) Demand-side substitution is where consumers switch to other products or purchase the same products in other areas in response to an increase in the price charged for the focal product (see below). As described in the Commission Notice on Market Definition, information relevant to assessing demand-side substitution includes: product characteristics and intended use, evidence of substitution in the recent past, the views of customers and competitors, consumer preferences, barriers and costs associated with switching demand to potential substitutes, and different categories of customers and price discrimination.⁷¹⁸
- b) Supply-side substitution is where firms start competing in the supply of the product under investigation in response to a price increase in the short term and without incurring significant additional costs.⁷¹⁹

6.12 The process of defining a market typically begins with the products which are the subject of the investigation, i.e. the focal product (or focal group of products).⁷²⁰ In order to establish which products are close enough substitutes for the focal product to be in the relevant market, it is generally appropriate to use the framework provided by the Hypothetical Monopolist Test (“HMT”):⁷²¹

- a) The HMT seeks to establish whether a hypothetical monopolist could profitably impose a ‘small but significant and non transitory increase in price’ (“SSNIP”) above the competitive price level.⁷²²

⁷¹⁷ *Aberdeen Journals I* at paragraph 97.

⁷¹⁸ Commission Notice on Market Definition, paragraphs 36 to 43 (PD0005). For a longer description of the legal precedents on market definition see Ofcom, *Final decision of the Office of Communications CW/988/06/08: Complaint from THUS plc and Gamma Telecom Limited against BT about alleged margin squeeze in Wholesale Calls pricing*, 20 June 2013, from paragraph 4.9. (PD0016)

⁷¹⁹ Where the short term is defined as “such a period that does not entail a significant adjustment of existing tangible and intangible assets.” See also the Commission Notice on Market Definition, Footnote 4.

⁷²⁰ OFT, *Market Definition*, paragraph 3.2. (PD0028)

⁷²¹ Commission Notice on Market Definition, paragraphs 15 to 19 (PD0005); OFT, *Market Definition*, paragraphs 2.8 and 2.9 (PD0028); *Aberdeen Journals Limited v Director General of Fair Trading* [2002] CAT 4, paragraph 99.

⁷²² OFT, *Market Definition*, paragraph 3.3. (PD0028)

- b) Typically a 5-10% price increase is applied. The competitive price may not be the actual price, e.g. in circumstances where the actual price is inflated by market power.⁷²³
- c) If a SSNIP would be profitable to a hypothetical monopolist, the test is complete, and the focal product would constitute the relevant market for the investigation.
- d) If a SSNIP would not be profitable, because of demand- or supply-side substitution, then the market definition should be expanded to include the next closest substitute product(s). The test is applied to a progressively wider set of products until a SSNIP becomes profitable.

6.13 In practice it is rarely possible to define a market in strict accordance with the HMT.⁷²⁴ Nonetheless, the HMT remains the relevant conceptual framework for market definition.⁷²⁵ Also, it may not be necessary to define the market conclusively, when this does not alter the competitive assessment.⁷²⁶

Identifying the relevant geographic market

6.14 The geographic boundary of the relevant market can be defined using the same approach as is used for product market definition, that is, by applying the HMT to inform judgments as to demand- and supply-side substitutability.

6.15 For geographic markets, the HMT starts with the focal area which is “*an area under investigation in which the focal product is sold*”. This “*might be the area supplied by the parties to an agreement or the subject of a complaint about conduct or, if that area were relatively wide, past experience might suggest a narrower area that is more appropriate*”.⁷²⁷ The HMT asks whether a SSNIP in the focal area would encourage operators outside the area to begin to offer services to customers in the area and/or whether customers could switch to suppliers located outside the area.

6.16 However, the strict application of the HMT can sometimes lead to overly narrow geographic markets. To the extent that competitive conditions in different areas are sufficiently homogenous, different areas can be found to be in the same relevant geographic market.⁷²⁸

The relationship between bulk mail delivery and the bulk mail retail market

6.17 This Decision relates to the provision by Royal Mail of bulk mail delivery services. Before we set out our market definition assessment in relation to bulk mail delivery, it is helpful to describe the relationship between bulk mail delivery and the retail services for which it is

⁷²³ OFT, *Market Definition*, paragraphs 3.7 and 5.4 to 5.6. (PD0028)

⁷²⁴ *Ibid.*, paragraph 2.6. (PD0028)

⁷²⁵ *Ibid.* (PD0028)

⁷²⁶ *Ibid.*, paragraph 2.14. (PD0028)

⁷²⁷ OFT, *Market Definition*, paragraphs 2.9 and 4.2. (PD0028)

⁷²⁸ See in particular Commission Notice on the definition of the relevant market for the purposes of Community competition law, [1997] OJ C 372/5, paragraph 8. (PD0005)

used. While we do not formally define the retail market, as it is not necessary for our analysis of Royal Mail's conduct, the terms on which bulk mail delivery is provided (which, in turn, reflect competitive pressures on that product/service) affect the retail market for bulk mail services.

- 6.18 As explained in Section 2 *Background*, bulk mail producers and senders, such as banks, government departments and advertisers, are able to acquire letters services from a number of different retail suppliers, including Royal Mail, Whistl and UK Mail. Retail services offered by these suppliers consist of two components: 'collection and initial sortation' services (which includes the collection, outward sortation and trunking of mail) and 'delivery' services (which includes the inward sortation, distribution and delivery of mail).⁷²⁹ Bulk mail delivery is therefore an essential input to the supply of retail bulk mail services.
- 6.19 Generally, providers of retail bulk mail services offer their own collection and initial sortation services. For delivery, this depends on the type of provider:
- a) Royal Mail provides retail services based on Royal Mail's own delivery activities;
 - b) standard access operators (i.e. access-only operators) provide retail services based on Royal Mail's bulk mail delivery services; and
 - c) Whistl, which as of 2014 was expanding into the bulk mail delivery market, provided retail services based in some cases on Royal Mail's bulk mail delivery services and in other cases on its own delivery activities (in those locations where it had launched such activities, and provided that retail customers had contracted for Whistl to undertake the delivery).
- 6.20 In this Decision, we concentrate on the delivery part of the supply chain. Below we set out our conclusions on the product and geographic markets at level of bulk mail delivery.

Product market definition

Focal product

- 6.21 For the purposes of this Decision, we consider that the focal product is bulk mail delivery. This has the following characteristics:
- a) It includes both **letters and large letters**.⁷³⁰⁻⁷³¹ This Decision does not cover parcels, packages or unaddressed mail.

⁷²⁹ See paragraphs 2.16 to 2.28.

⁷³⁰ By a 'letter', we mean a mail item up to 240mm in length, 165mm in width, 5mm in thickness and weighing no more than 100g. By a 'large letter', we mean a mail item larger than a 'letter', up to 353mm in length, 250mm in width, 25mm in thickness and weighing no more than 750g. This is consistent with the definitions used in Ofcom's USP Access Condition.

⁷³¹ Even if we had considered letters and large letters separately and found separate markets, we consider this would not have affected our conclusion that Royal Mail was dominant. In both such markets, Royal Mail would still have had a very large market share, the barriers to entry would still be very high and customer buyer power would be limited.

- b) It relates to **bulk mail** services, which are high volume products for large scale mailings of often identical or similar letters and large letters. Bulk mail can be distinguished from single-piece mail, for example first class and second class stamped mail.
- c) It involves the **delivery** of bulk mail, including the inward sorting of mail at inbound IMCs, transportation between the IMC and the delivery office and delivery to the final recipient. It does not include the collection, outward sortation or trunking of bulk mail.
- d) Delivery is on the **second day after collection (D+2) or later**.^{732,733} This can be distinguished from other products, for example those that aim to deliver mail on the same day or next working day after collection (**D+1**).

6.22 Royal Mail offers a wide range of wholesale bulk mail delivery services, with different delivery charges applied depending on the size and the weight of the letter.⁷³⁴ For most access customers, these services are provided under the Access Letters Contract.⁷³⁵

Demand side substitution

6.23 We do not consider, and Royal Mail has not submitted, that there were any *direct* demand-side substitutes for bulk mail delivery. That is, there were no other services that could be used for inward sorting and delivery of bulk mail.

6.24 However, there were potentially *indirect* constraints from demand-side substitutes at the retail level. Bulk mail delivery is a wholesale service which is used, in conjunction with collection and outward sorting activities, to provide an end-to-end bulk mail service to retail users (such as banks and utility companies). If the price for bulk mail delivery increased, this would increase the price for retail bulk mail services, which could in turn reduce the demand for bulk mail services at the retail level. If this substitution at the retail level were substantial enough, it could make a price rise for bulk mail delivery unprofitable.

⁷³² Royal Mail's bulk mail delivery services (D+2 Access) include a 'service standard' under which Royal Mail has to deliver (or attempt to deliver) 95% of mail on the next working day following the working day on which the mail was handed over to Royal Mail by the relevant access operator; Royal Mail, *Access Letters Contract*, Schedule 2, Part A, paragraph 2.1. This would enable an access operator to offer a D+2 or D+3 service to their retail customers (depending on how quickly an access operator could arrange for handover to Royal Mail following collection and sortation of the mail), but would not enable the provision of a D+1 service.

⁷³³ In its response to the draft penalty statement (discussed in more detail in Section 10 below), Royal Mail argued that D+2 delivery differed from D+3 or later delivery, although it did not argue that they should be found to be in different product markets. As Whistl delivered less frequently than Royal Mail (namely 3 days per week on alternating days compared to 6 days per week for Royal Mail), its wholesale delivery service might instead have supported a slightly slower service, such as D+3. Our focal product (namely D+2 or later) would encompass both of these products. An alternative approach would be to take a wholesale D+2 service as the focal product and then consider whether a wholesale D+3 service is a direct substitute for it. This alternative approach would not change our conclusions since we consider that such services would clearly be substitutes. A significant proportion of bulk mail is not so time sensitive that allowing an additional day for delivery is likely to be problematic. Moreover, it is clear from the discussion in Section 4 that Royal Mail regarded Whistl's delivery service as a significant potential competitor even if it delivered on fewer days.

⁷³⁴ See paragraphs 3.31 to 3.33.

⁷³⁵ There are also a small number of legacy C9 contracts. These are no longer offered to new wholesale customers and only account for a small minority of Royal Mail's access volumes. See paragraph 3.3.

- 6.25 In this context, as of 2014 there had been a trend for greater use of electronic communications (e-communications) in place of bulk mail.⁷³⁶ E-communications include the use of e-mails, e-newsletters, online magazine and newspapers, pop-up advertisements or advertisements on websites or social media platforms, e-billing, etc. to deliver the same or similar content as that sent through standard retail bulk mail services. We refer to the move from bulk mail services to these potential substitutes as ‘e-substitution’. To the extent that increasing bulk mail delivery prices might have accelerated e-substitution, then it would contribute to the indirect constraints on bulk mail delivery at the time of the infringement.
- 6.26 We have considered two key elements when assessing the strength of these indirect constraints:
- a) first, the extent to which a SSNIP in bulk mail delivery was likely to lead to an increase in the retail price for bulk mail services; and
 - b) second, the sensitivity of demand for bulk mail services to an increase in retail price.
- 6.27 On the first point, an increase in the wholesale price of bulk mail delivery would increase the per item cost for all providers of retail bulk mail services. It would thus likely be mostly passed on as an increase in retail prices, rather than be absorbed by retail bulk mail operators. Indeed, it would be difficult for access operators to absorb a SSNIP given that bulk mail delivery is the main cost input into bulk retail services and margins were low – see paragraphs 2.29 to 2.34 and Figure 2.4.⁷³⁷
- 6.28 On the second point, to assess the reduction in demand in response to a retail price increase, we have mainly drawn on Royal Mail’s own assessment of the elasticity of demand for postal services, which is discussed immediately below. We also consider other evidence specifically related to e-substitution.

Royal Mail’s retail elasticity estimates

- 6.29 The elasticity of demand measures how changes in the price of a product affect the volumes sold. For bulk mail services, demand may reduce because of switching to e-communications or other mail types; or simply as a result of customers reducing the amounts of bulk mail which they send, without switching to any alternative.
- 6.30 During our investigation, Royal Mail provided us with several documents that included estimates of the price elasticity of demand for various mail services.⁷³⁸ A study from July

⁷³⁶ See, for example, Ofcom, *End-to-end competition in the postal sector – Ofcom’s assessment of the responses to the draft guidance on end-to-end competition*, 27 March 2013, paragraph 4.27. (PD0017)

⁷³⁷ Even if it is fully passed through, a 5-10% SSNIP in the wholesale price of bulk mail delivery would lead to a slightly smaller percentage increase in retail prices. In other words, the impact of a wholesale price rise on retail customers is likely to be slightly diluted.

⁷³⁸ Royal Mail’s response to the 3rd Section 26 Notice issued on 1 August 2014. (RM0683)

2014 consisted of an econometric assessment of past movements in demand. The model examined volumes for three Royal Mail product groups:⁷³⁹

- a) First Class unsorted;
- b) Second Class unsorted; and
- c) 'Other (mainly sorted and access) traffic'.

- 6.31 Given the volume of mail that was delivered by parties other than Royal Mail was very low, we consider that these estimates can effectively be regarded as market elasticity estimates.
- 6.32 We consider that the third category, 'Other (mainly sorted and access) traffic', is most relevant to bulk mail delivery.^{740, 741} [§].
- 6.33 Royal Mail's July 2014 study found that [§].^{742, 743, 744}
- 6.34 [§].⁷⁴⁵ For the purposes of market definition, we are generally interested in short-run elasticities to assess the constraints imposed by switching in the short term.⁷⁴⁶ We would expect the short-run price elasticity to be lower, as the impact of a price rise on volume reductions could increase over time as it may take time to change processes. Using long-run estimates is therefore a conservative approach.
- 6.35 Royal Mail's econometric modelling therefore suggests that demand for the delivery of 'Other (mainly sorted and access) traffic' was relatively unresponsive to price changes and a hypothetical monopolist would have been able profitably to increase prices, particularly in the short term. Moreover, a large proportion of the substitution that did occur would be to other products supplied by Royal Mail.
- 6.36 We have also looked at Royal Mail's elasticity estimates for a wider group of products. Royal Mail's 2014 study estimated that [§].⁷⁴⁷ Therefore, the results suggest that even if the market were wider than bulk mail delivery, a monopolist of all letters could profitably increase prices.

⁷³⁹ Royal Mail, *Inland Letter Traffic Model 2013 (ILTM(2013)): Modelling Letter Traffic Volumes by Content Type and Product Groups*, 31 July 2014, page (i). [§] (RM0679)

⁷⁴⁰ Our focal product encompasses all D+2 bulk mail, and therefore includes bulk mail that is both sorted and unsorted when it reaches Royal Mail. It therefore may be the case that some D+2 bulk mail is included in the Second Class category in Royal Mail's model. We also note the estimates of switching between 'Other (mainly sorted and access) traffic' and the Second Class category following a price rise suggest there is a degree of substitution between these categories. To the extent that some D+2 bulk mail is in the Second Class category, this would strengthen our findings. [§].

⁷⁴¹ The volume of sorted and access mail is considerably larger than the volume of unsorted mail.

⁷⁴² [§].

⁷⁴³ Royal Mail, *Inland Letter Traffic Model 2013 (ILTM(2013)): Modelling Letter Traffic Volumes by Content Type and Product Groups*, 31 July 2014, page (xiii) and footnote 14. (RM0679)

⁷⁴⁴ *Ibid.*, page (xii). (RM0679)

⁷⁴⁵ *ibid.*, page 42. (RM0679)

⁷⁴⁶ For example, the CMA refers to switching within a one year period "as a rough rule of thumb". OFT, *Market Definition*, paragraph 3.6. (PD0028)

⁷⁴⁷ Royal Mail, *Mail Volumes and Revenue Trends Report and Business Plan 2014 Projections*, July 2014, page 37. (RM0678)

- 6.37 Royal Mail engaged consultants to review some of the results of its July 2014 study. This included a review of the econometric modelling by IDEA at the University of Toulouse in June 2014. This review said that [redacted].⁷⁴⁸
- 6.38 Royal Mail also considered [redacted]. In addition, market research by BCG in 2012 estimated that the UK price elasticities were low and could potentially be lower than those estimated by Royal Mail.⁷⁴⁹
- 6.39 Furthermore, Royal Mail considered [redacted].⁷⁵⁰

Other evidence of limits to e-substitution as a constraint

- 6.40 The above findings on elasticity are consistent with other evidence that suggests the extent to which e-substitution could constrain a price rise for bulk mail delivery at the time was limited in the short-term (which is the relevant time horizon for market definition). We have assessed evidence relating to price sensitivity at the retail level as well as at the level of bulk mail delivery to reach this conclusion.
- 6.41 As we describe at paragraphs 6.24 to 6.26, for e-substitution to constrain bulk mail delivery prices, a price rise in bulk mail delivery would need to lead to a price rise in retail bulk mail services which then causes sufficient e-substitution to occur. We have therefore also looked at other evidence on the extent to which e-substitution was driven by the price of retail bulk mail services to assess this constraint.
- a) Evidence suggests that switching from physical mail to e-communications would often have been unrelated to price rises in bulk mail. For example:
 - i) once online IT platforms have been put in place, the price difference between sending correspondence via physical mail compared to electronic alternatives is significant (the marginal cost of electronic communication is likely to be close to zero);⁷⁵¹ and
 - ii) in internal documents from around this time, Royal Mail observed that while there was a trend from standard bulk mail services towards e-communications, this was driven primarily by non-price factors.⁷⁵²
 - b) In addition, evidence suggests that retail customers who could easily switch to e-communications had already switched, while remaining retail customers were likely to face some barriers to switching, due to mail recipient preferences. For example:

⁷⁴⁸ Ibid., Annex 4. (RM0678)

⁷⁴⁹ Ibid., pages 37 and 38. (RM0678)

⁷⁵⁰ Ibid. (RM0678)

⁷⁵¹ See Ofcom, *Review of the Regulation of Royal Mail - Statement*, 1 March 2017, page 37, paragraph 3.124. (PD0066)

⁷⁵² See *Royal Mail Access Pricing Review, Proposed amendments to the regulatory framework*, Ofcom, 2 December 2014 Annex 5, page 14, footnote 10. (PD0009) For our assessment of the relevant market, we are only interested in e-substitution to the extent it is driven by an increase in the price of bulk mail delivery.

- i) in 2014, 18% of UK households did not have access to the internet, and this proportion was considerably higher for older age groups;⁷⁵³
- ii) research undertaken by PwC in 2013 found that: (i) 42% of people who did not use internet banking stated that the main reason was concern over security; (ii) 34% of people who received financial statements by post did so to keep paper records; and (iii) around 30% of the non-statement mail sent by financial services companies was difficult to substitute due to regulation (e.g. the requirement for a ‘wet’ signature) or the delivery of a physical item (e.g. a credit card);⁷⁵⁴ and
- iii) Royal Mail’s 2013 Prospectus reported that 62% of consumers said they preferred paper-based statements and 60% said they paid more attention to paper statements than e-mail statements.⁷⁵⁵

6.42 Finally, we note that Royal Mail introduced significant price rises in 2011 and 2012 for a large proportion of bulk mail delivery, which it was able to sustain without large declines in volumes. For example, in April 2011, business mail access prices increased by more than 20% and advertising mail was increased by 8-12%.⁷⁵⁶ This was followed by further significant access price increases in April 2012 where business mail access prices increased by between 11% and 13%.⁷⁵⁷ Notwithstanding these increases volumes fell, on average, by around 4.8% per annum for 2011-12 and 2012-13.⁷⁵⁸

Royal Mail’s representations on the importance of e-substitution

6.43 In its written representations, Royal Mail argues that we have placed undue weight on the elasticity of demand for postal services, and have failed to take adequate account of the constraint exerted by e-substitution.

6.44 Royal Mail also argues that, in practice, it was unable at the relevant time to set prices in the way implied by the above elasticity estimates, due to the competitive dynamics not captured by the historical data used in Royal Mail’s econometric modelling discussed above.⁷⁵⁹ Royal Mail has identified the following as key factors that constrained its pricing:

- a) higher prices would drive innovation which facilitates e-substitution, such as electronic invoicing systems and online portals by banks;
- b) Pay-Per-Click, social networks, smartphones and tablets enabled growth in internet advertising;

⁷⁵³ Ofcom, *Communication Markets Report 2014*, 7 August 2014, page 262, figure 4.17. (PD0015) For adults that were 75 years old or more, internet take-up was only 32%. For adults who were between 65 and 75 years old, take-up was 67% (see page 349, figure 5.58).

⁷⁵⁴ PwC, *The outlook for UK mail volumes to 2023*, 15 July 2013, slides 22 and 36. (RM0673) This document was prepared by PwC for Royal Mail Group.

⁷⁵⁵ Royal Mail’s September 2013 Prospectus, top of page 51. (WH0039)

⁷⁵⁶ Ofcom, *Review of the Regulation of Royal Mail – Annexes 5 to 11*, 25 May 2016, page 76, paragraph A7.50. (PD0068)

⁷⁵⁷ Ibid. (PD0068)

⁷⁵⁸ Ibid., page 85, paragraph A7.78. (PD0068)

⁷⁵⁹ Royal Mail’s 2014 study described above used data between 1975 to 2013, although also looked at different sample periods. Royal Mail, *Inland Letter Traffic Model 2013 (ILTM(2013)): Modelling Letter Traffic Volumes by Content Type and Product Groups*, 31 July 2014. See, for example, pages 13 and 37. (RM0679)

- c) initiatives had been designed to overcome residual barriers and to migrate customers to digital alternatives, such as financial incentives and investments in the quality and functionality of digital alternatives;
- d) switching by a small number of large customers would have had a disproportionate impact on mail volumes;
- e) switching is often irreversible, which means that pricing incentives differ from those in a stable market; and
- f) there was uncertainty about the price point which would trigger mass digitisation, and research commissioned by Royal Mail concluded that estimated price elasticities would be significantly higher – [redacted] – in response to large price increases.⁷⁶⁰

6.45 Royal Mail also claims that its past behaviour demonstrates that it regarded e-substitution as an effective constraint on its ability to increase prices. For example:

- a) after the price increases in April 2011 and April 2012, the annual increase for the average access tariff was c.0.3 per cent p.a. in real terms above RPI;
- b) it did not price business mail in accordance with measured price elasticities [redacted]; and
- c) competition from non-mail alternatives was recognised in its documents on pricing, such as a paper from September 2014 which stated that: [redacted].⁷⁶¹

6.46 Royal Mail underlines the constraints which it claims to apply to advertising mail in particular. It contends that its pricing of advertising mail was [redacted].⁷⁶²

Response to Royal Mail’s representations on the importance of e-substitution

6.47 Considering the evidence in the round, we are not persuaded by Royal Mail’s arguments as to the indirect constraints imposed by e-substitution. Royal Mail’s elasticity estimates show that, at the relevant time, there was likely to have been limited e-substitution in response to a rise in the price of bulk mail delivery; and that a large proportion of the substitution that did occur would have been to other products supplied by Royal Mail.⁷⁶³ As discussed above, the elasticity estimates are supported by other evidence. In addition, the estimates were not purely academic in nature, but were used to inform Royal Mail’s business decision-making.⁷⁶⁴

6.48 Moreover, as Royal Mail recognised in its representations discussed at paragraph 6.44, many businesses would require technological innovation and investments in order to be able to move to electronic communications, particularly for transactional mail. Such steps would likely have taken some time to implement, and customers would therefore have

⁷⁶⁰ Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 61 to 63, paragraphs 4.6 to 4.1 (RM2386),

⁷⁶¹ Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 64 to 65, paragraphs 4.18 and 4.19. (RM2386)

⁷⁶² *Ibid.*, page 64, paragraph 4.19(b). (RM2386)

⁷⁶³ See paragraph 6.35.

⁷⁶⁴ For example, see footnote 739.

been unlikely to be able to respond quickly to a price increase. The potential for more e-substitution would also have been constrained by mail recipient preferences.

- 6.49 Although Royal Mail cites evidence from its pricing documents which suggests that it did consider the impact of price rises on e-substitution, these references discussed concerns around the potential impact of large price rises. For the purposes of market definition, we are interested in the impact of small but significant price rises (in the order of 5-10%) above the competitive level. The references cited by Royal Mail do not support Royal Mail's contention that e-substitution would render a SSNIP unprofitable. For example, [redacted].⁷⁶⁵
- 6.50 We recognise the threat of e-substitution may have exerted some constraint on Royal Mail's ability to introduce large price rises. However, we do not consider that e-substitution would have prevented a hypothetical monopolist from profitably increasing prices of bulk mail delivery by 5-10% above the competitive level. Although Royal Mail argues that this constraint is demonstrated by the fact it did not significantly increase prices after 2012,⁷⁶⁶ Royal Mail did raise prices significantly in 2011 and 2012 without large volume declines.⁷⁶⁷ Moreover, Ofcom's monitoring regime and the potential threat of regulation if it were to increase prices substantially may have exerted some constraint.
- 6.51 Regarding Royal Mail's arguments on the constraint e-substitution imposed on advertising mail, [redacted].⁷⁶⁸ In addition, for the purposes of market definition we have considered whether a SSNIP in the price of all types of bulk mail delivery would be profitable.⁷⁶⁹ Thus, even if there were some switching away from advertising mail, we remain of the view that this would likely have been insufficient to make a SSNIP on bulk mail delivery unprofitable.

Supply side substitution

- 6.52 We have also considered whether an increase in the price of bulk mail delivery could potentially have been constrained by supply-side substitution. This would have been the case if companies that did not provide bulk mail delivery could have started to supply bulk mail delivery in the short term without incurring significant risk or additional cost, such that a price rise by a hypothetical monopolist of bulk mail delivery would be rendered

⁷⁶⁵ Royal Mail, in paragraph 4.15 of its representations, argues that price elasticities would be around double in response to large price increases. It refers to its response to Ofcom's July 2015 Discussion paper: Review of the Regulation of Royal Mail, dated 18 September 2015, paragraph 2.12. (RM2357) This refers to its Mail Volume Trends Report, 2015, which refers to work it commissioned from Accent and RAND in 2011. The results discussed are taken from a report prepared by Accent in 2011 for Royal Mail. Accent, Letter mail e-substitution and prospective trends: customer stated intention analysis, December 2011.

⁷⁶⁶ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 64, paragraphs 4.16 to 4.18. (RM2386)

⁷⁶⁷ The fact that Royal Mail had already increased prices significantly suggests that a SSNIP by a hypothetical monopolist in bulk mail delivery would have been profitable. It is less relevant to our analysis that Royal Mail did not continue to increase prices. At high prices, cellophane-fallacy type situations might arise, where it is no longer profitable for a monopolist to further increase prices and applying the SSNIP test to those prices leads to overly wide market definitions.

⁷⁶⁸ [redacted]. Royal Mail, *Inland Letter Traffic Model 2013 (ILTM(2013)): Modelling Letter Traffic Volumes by Content Type and Product Groups*, 31 July 2014, pages 16 and 52. (RM0679)

⁷⁶⁹ This aligns our market definition with the conduct that we have assessed for the purposes of this Decision. Royal Mail's conduct was not limited just to advertising mail.

unprofitable. Given the high sunk and fixed costs involved in setting up a delivery network, such companies are likely to be limited to those who already operate a similar network for the purposes of providing another type of service, e.g. the delivery of parcels.

- 6.53 We do not consider that such supply-side substitution would have been likely to have occurred in response to a SSNIP in the bulk mail delivery market. Whistl was a large access operator and incurred significant additional cost and risk in rolling out a delivery network on a limited scale. Moreover, its entry into delivery was planned over a long period of time, in order to set up the network necessary to provide bulk mail delivery.⁷⁷⁰ No other access operator had tried to enter the bulk mail delivery market, nor are we aware of any other access operator having had plans to do so. We therefore consider that supply-side substitution would not have provided an effective constraint.
- 6.54 Even operators that had delivery networks for some products (such as couriers, parcel delivery operators, or newspapers and magazines distributors) would have been very unlikely to be able rapidly to diversify and achieve sufficient scale to be able to offer bulk mail delivery. The configuration and scale of those delivery networks is very different to that required for bulk mail delivery. For example, parcel and courier operators rapidly deliver a smaller number of items to specific addresses, as opposed to regularly delivering to most addresses. For couriers and parcels, this is reflected in their much higher cost per item than is the case for bulk mail delivery.
- 6.55 We therefore consider that supply-side substitution from other postal services is not a strong enough competitive constraint to warrant widening the product market. Royal Mail has not suggested that the relevant product market should be widened to reflect the scope for supply side substitution at the relevant time.

Conclusion on product market definition

- 6.56 On the basis of the available evidence, and having considered Royal Mail's representations, we conclude that demand- and supply-side substitution would not have been sufficient to prevent a hypothetical monopolist of bulk mail delivery from profitably imposing a SSNIP. We therefore define the relevant product market as that for bulk mail delivery, which consists of the activities of the sortation of bulk letters and large letters at inbound mail centres and onward delivery to the final recipient, with delivery on the second day after collection (D+2) or later.
- 6.57 We also consider that our conclusion below that Royal Mail is dominant would hold even if we were to consider a wider postal market. If we had concluded that it would not be profitable for a hypothetical monopolist of bulk mail delivery to increase prices, then we would have first considered widening the market so as to include the delivery of second class single-piece letters and large letters on the basis of constraints from demand and/or supply-side substitution. The evidence suggests that even if the product market were

⁷⁷⁰ See paragraph 2.37.

wider (contrary to our conclusions above), it would not extend beyond the delivery of all letters.

Geographic market definition

- 6.58 We assess below the scope of the relevant geographic market for bulk mail delivery services. We consider two possible approaches:
- a) the first would be to start from a focal area that was national in scope, and therefore to define a national market for bulk mail delivery; and
 - b) the second would be to start from a consideration of a smaller focal area, and to assess whether competitive conditions differed between localities.
- 6.59 We discuss these two possible approaches below. We conclude that the second approach, like the first, still supports the finding of a UK-wide market. Although at the relevant time competitive conditions differed between localities to some degree, they were sufficiently homogeneous to fall within a single geographic market. We also consider, however, that the exact scope of the relevant geographic market is immaterial as it would not affect either our conclusion that Royal Mail held a dominant position on the relevant market(s) or our assessment of Royal Mail's conduct in introducing the price differential. We consider Royal Mail's arguments as to the relevance of the geographic market definition to the calculation of the financial penalty in Section 10.

Reasons for adopting a national focal area, resulting in a national market for bulk mail delivery services

- 6.60 There are a number of reasons for considering a national focal area as the appropriate starting point when defining the relevant geographic market. As set out in paragraph 6.15, the focal area (from which the HMT begins) *"might be the area supplied by the parties to an agreement or the subject of a complaint about conduct ..."* The conduct that is the subject of this Decision is a price differential that applied on a nationwide basis. As outlined in Section 3 above, the price differential was applied between the two national price plans offered by Royal Mail, NPP1 and APP2.⁷⁷¹ This suggests that a national focal area is a reasonable starting point since the resulting HMT sheds light on whether a nationwide price rise would be constrained. Further:
- a) **Royal Mail supplies bulk mail delivery across the whole UK:** In January 2014, the majority of customers that bought bulk mail delivery from Royal Mail, i.e. access operators and CDA customers, required a national delivery service.⁷⁷² In principle, an operator could assemble a national bulk mail delivery service by using Royal Mail in some areas and operating its own bulk mail delivery service (or using a third party) in other areas. However, in practice, there are limits to this. Whistl could not rely solely on its own bulk mail delivery service as less than 1% of its volumes were from

⁷⁷¹ As prices on ZPP3 were calculated on the basis of the prices charged on APP2, the price differential was also incorporated into the prices to be charged on that plan.

⁷⁷² See paragraphs 2.12 to 2.15.

customers that only required local delivery.⁷⁷³ Even in areas where Whistl had its own delivery network, it still relied on Royal Mail for around 50%⁷⁷⁴ of deliveries.

- b) **Most bulk mail delivery is purchased at a nationwide price:** Customers bought the large majority of wholesale delivery services via the two national price plans, NPP1 and APP2, both of which had uniform prices that did not vary with delivery location. The fact that the ZPP3 contract had zonal prices which depended on the type of area mail was sent to does not alter this position. The proportion of volumes sent on the ZPP3 contract was small. For example, [3<] % of Royal Mail's access volumes were from access operators on zonal profiles in 2013/14.⁷⁷⁵

- 6.61 Taking the whole of the UK as the focal area (i.e. the area against which we would test whether it is the narrowest relevant market on the basis of demand- or supply-side substitution) would lead us to conclude that there was a single UK market at the relevant time (i.e. we would not conclude that the relevant geographic market was wider than the UK). Clearly, delivery outside of the UK is not a demand-side substitute for firms seeking to contact UK residents, and conditions of supply differ in other countries.

Reasons for adopting a smaller focal area, with the potential to define a number of local area markets

- 6.62 An alternative approach would be to consider much smaller focal areas as the appropriate starting point for geographic market definition. However, a strict application of the hypothetical monopolist test for geographic market definition could result in very narrow markets being defined, as from the demand-side, delivery to one address is unlikely to be a substitute for delivery to any other address. While supply-side substitution, where it is possible, is likely to be quick and easy for neighbouring addresses, the hypothetical monopolist test is still likely to lead to geographic markets at the depot or regional level. This would produce a large number of potential geographic markets (for example, there are 83 SSCs).
- 6.63 We have therefore considered whether competitive conditions are likely to have varied significantly across the UK. Such an approach would result, at the very least, in further aggregation across different areas. For example, competitive conditions are likely to have been sufficiently homogenous across areas where Royal Mail was the only delivery operator to treat them as part of the same geographic market.
- 6.64 We have also considered whether competition was sufficiently homogeneous as between areas where Whistl had and had not deployed its own delivery network. As explained at paragraphs 2.36 to 2.39 above, Whistl had rolled out its own bulk mail delivery network in

⁷⁷³ It expected this to grow slightly, to around 5% of its overall mail volumes by 2018. Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals – a confidential report prepared for TNT*, January 2014, pages 17 and 18. (WH0121)

⁷⁷⁴ In Q4 2013/2014, Whistl's conversion rate was between 42% and 55% in those SSCs where it had operated a delivery service since Q3 2013/2014 or before.

⁷⁷⁵ Royal Mail's response of 18 June 2014 to question 1.1 of a Notice (under section 55 of the Postal Services Act) issued in connection with the Access Pricing Review on 2 June 2014). (RM0605)

a few local areas. However, as a new entrant, it does not appear to have had sufficient scale to change competitive conditions in those areas to a significant extent.

- a) Royal Mail still had a high share of bulk mail delivery in the SSCs that Whistl had entered. For example, its average share in the SSCs that Whistl had entered was 84%; its lowest share was 75%. In broad terms, Royal Mail is thus likely to be in a similarly strong position in these SSCs that Whistl had entered to those SSCs where Whistl was not present (and where Royal Mail's share of supply was thus 100%).
- b) As discussed above, the vast majority (around 95%) of volumes were delivered through contracts with uniform prices that did not vary with delivery location. For customers using such contracts, Royal Mail did not reduce prices in the areas where Whistl had entered or was most likely to enter. Indeed, Royal Mail did not vary its prices at the SSC level at all. This suggests that competitive conditions were likely to have been similar throughout the UK.

6.65 We therefore consider that, while not identical, competitive conditions were sufficiently similar across all local areas to define a single national geographic market. If an operator had entered the bulk mail delivery market on a larger scale, and had time to develop its service, conditions of competition might have evolved and begun to vary in different areas. For example, customers may have stopped buying bulk mail delivery through national contracts and begun to use different operators in different areas to fulfil their requirements for national delivery, and local price competition may have emerged. In such circumstances, we might have defined the geographic market in a different manner. However, at the time of the conduct at issue, the evidence suggests that there were no substantial variations in competitive conditions across the UK.

6.66 Moreover, as we explain in paragraph 6.105 below, we would still have found Royal Mail to be dominant if we had defined subnational geographic markets.

Royal Mail's representations on geographic market definition

6.67 In its written representations, Royal Mail argued that competitive conditions were unlikely to have been sufficiently similar throughout the UK to define a single UK market. It argued that competitive conditions were not homogeneous because the scope for direct delivery competition varies significantly depending on the costs of entry in different parts of the UK. Royal Mail said that although an entrant might focus initially on meeting national delivery requirements, in time local competitive conditions might be expected to be reflected in differentiated pricing strategies.⁷⁷⁶

6.68 Similarly, the Compass Lexecon report submitted as part of Royal Mail's response to the Draft Penalty Statement argued that local markets cannot be considered homogeneous as:

⁷⁷⁶ Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 65 to 66, paragraphs 4.22 to 4.24. (RM2386)

- a) some postal markets are more contestable than others, and Whistl's roll out plan demonstrated this;⁷⁷⁷
- b) cost conditions in different delivery areas differ; and
- c) Royal Mail has differential pricing with respect to delivery zones.⁷⁷⁸

6.69 We agree that delivery costs vary between areas and that entry is relatively easier in some areas than others. However, in January 2014 these differences had not translated into sufficient divergence in competitive conditions to justify finding subnational markets for bulk mail delivery. This is for the reasons set out above. Further, as discussed above, volumes on ZPP3 were low meaning that most access operators did not face prices that varied with respect to delivery zone.

6.70 Moreover, as we explain below at paragraph 6.105, it would not alter our finding as to dominance or abuse if we were to define separate subnational geographic markets instead of a single national market.

Conclusion on geographic market definition

6.71 For the reasons set out above, we have concluded that there was a single UK market for bulk mail delivery at the relevant time. However, even if we defined local geographic markets, as Royal mail argues we should have, this would not have an impact on our finding, set out below, that Royal Mail was dominant.

6.72 In principle, defining too wide a relevant market could result in a competition authority failing to identify dominance that truly exists. This is not the case here as we find in the next section that Royal Mail did hold a dominant position even when assessing the market nationally. Alternatively, defining too wide a market could result in finding dominance over a wide area, despite competition operating more effectively in some narrower markets. This is also not the case, since as we describe in paragraph 6.105, our view that Royal Mail was dominant would not change if we considered there to be separate local geographic markets.

⁷⁷⁷ The report argued against the approach of combining 'contestable' and 'non-contestable' local areas into one UK market such that all areas would be considered part of the 'affected market' for the purpose of calculating the penalty, because the exclusion of an end-to-end competitor was only possible in the 'contestable' local areas. We discuss this argument in Section 10. See Compass Lexecon, *Assessment of relevant turnover for penalty calculation*, 8 March 2018, page 11, paragraph 4.14. (RM2654)

⁷⁷⁸ *Ibid.*, page 11, paragraph 4.11. (RM2654)

B. Dominance

Summary of Ofcom's findings on dominance

- 6.73 For the reasons set out below, Ofcom concludes that as at January 2014, Royal Mail held a dominant position in the relevant market. In particular, we set out our finding below that:
- a) as at January 2014, Royal Mail held a very high market share in the bulk mail delivery market, over 98%. Up to 2014, Royal Mail had consistently held a similarly high market share in the bulk mail delivery market (and Royal Mail continued to hold a very high market share in the period after the price differential was introduced, up to and including the date of this Decision);
 - b) both prior to, and after, January 2014, Royal Mail remained an unavoidable trading partner for any new entrants in the bulk mail delivery market, or existing competitors that wished to expand their delivery network;
 - c) significant barriers to entry and expansion in the bulk mail delivery market prevented potential entry from acting as an effective competitive constraint on Royal Mail; and
 - d) neither access operators nor large individual customers such as banks and other financial services providers held sufficient countervailing buyer power to effectively constrain Royal Mail's conduct.

Legal background

- 6.74 As set out in Section 5 *Legal Framework*, the CJEU has defined a dominant position as:

*"...a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers."*⁷⁷⁹

- 6.75 A firm therefore holds a dominant position when it has substantial market power on a given market.⁷⁸⁰

- 6.76 Market shares can be an important factor in determining whether an undertaking holds a dominant position. The CJEU has held that:

"although the importance of the market shares may vary from one market to another the view may legitimately be taken that very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position. An undertaking which has a very large market share and holds it for some time [...] is by virtue of that share in a position of strength which makes it an unavoidable trading partner and which, already because of this secures for it, at the

⁷⁷⁹ See Case 27/76 *United Brands v Commission* EU:C:1983:313 [1978] ECR 207, paragraph 65.

⁷⁸⁰ OFT402 Abuse of a dominant position (December 2004), adopted by the CMA, paragraph 4.11.

*very least during relatively long periods, that freedom of action which is the special feature of a dominant position”.*⁷⁸¹

- 6.77 In applying this principle, the CJEU has held that market shares in excess of 50% are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position.⁷⁸² A market share of between 70% and 80% is, in itself, a clear indication of the existence of a dominant position.⁷⁸³
- 6.78 In addition, the market shares of other undertakings operating in the same market, and how those have changed over time, are relevant.⁷⁸⁴ An undertaking is more likely to hold a dominant position if its competitors hold relatively weak positions and the undertaking in question has enjoyed a high and stable market share.⁷⁸⁵ The existence of a particularly high market share that is much higher than the market shares of competitors constitutes a ‘highly significant indicator’ of dominance.⁷⁸⁶
- 6.79 Further, as the CJEU indicated in the quotation set out at paragraph 6.76 above, an undertaking which has a very large market share and holds it for some time is “...by virtue of that share in a position of strength which makes it an unavoidable trading partner...”.⁷⁸⁷ Circumstances in which those seeking a particular product or service are placed in a position of economic dependence are indicative of the undertaking on which they are dependent holding a dominant position.⁷⁸⁸
- 6.80 As well as considering Royal Mail’s very high market share at the relevant time, we have also assessed the strength of any competitive constraints that could nonetheless prevent it from profitably sustaining prices above competitive levels. Competitive constraints include:⁷⁸⁹
- a) actual competition from existing competitors in the relevant market;
 - b) potential competition (from new entrants who are not currently active in the relevant market); and

⁷⁸¹ Case 85/76 *F Hoffmann-La Roche & Co AG v Commission* EU:C:1979:36 [1979] ECR 461 (*‘Hoffmann-La Roche’*), paragraph 41. See also, for example, *Aberdeen Journals v Director General of Fair Trading* [2003] CAT 11 (*‘Aberdeen Journals II’*), paragraph 310.

⁷⁸² Judgment in Case 62/86 *Akzo v Commission*, EU:C:1991:286 [1991] ECR I-3359 (*‘Akzo’*), paragraph 60. Undertakings with market shares of below 50% may still be dominant if other relevant factors mean that they still have substantial market power.

⁷⁸³ Judgments in Case T-336/07 *Telefónica v Commission* EU:T:2012:172 [2012] 5 CMLR 20 (*‘Telefónica’*), paragraph 150 and Case T-321/05 *AstraZeneca v Commission* EU:T:2010:266 [2010] E.C.R. II-2805 (*‘AstraZeneca GC’*), paragraph 243. See also OFT415 Assessment of market power (December 2005), adopted by the CMA (the ‘Assessment of market power guidelines’), paragraph 2.12. The OFT refers to Case 62/86 *Akzo v Commission*, EU:C:1991:286 [1991] ECR I-3359.

⁷⁸⁴ Assessment of market power guidelines, paragraph 3.3.

⁷⁸⁵ Assessment of market power guidelines, paragraph 4.2.

⁷⁸⁶ See judgments in Case T-219/99 *British Airways v Commission* EU:T:2003:343 [2003] ECR II-5917, paragraphs 210 and 211 and *Telefónica*, paragraph 163.

⁷⁸⁷ Case 85/76 *F Hoffmann-La Roche & Co AG v Commission* EU:C:1979:36 [1979] ECR 461 (*‘Hoffmann-La Roche’*), paragraph 41.

⁷⁸⁸ Judgments in Case C-226/84 *British Leyland v Commission* EU:C:1986:421 [1986] ECR 3263, paragraph 9 and Case T-229/94 *Deutsche Bahn v Commission* EU:T:1997:155 [1997] ECR II-1689, paragraph 57.

⁷⁸⁹ Assessment of market power guidelines, paragraphs 3.2 to 3.3.

c) buyer power.⁷⁹⁰

6.81 To be applicable, Article 102 TFEU requires that an undertaking holds a dominant position within the internal market or a substantial part of it. A dominant position covering the entire territory of a single Member State is sufficiently large in size to be considered a dominant position in a substantial part of the internal market within the meaning of Article 102 TFEU.⁷⁹¹

Assessment of dominance in the bulk mail delivery market

Market shares

6.82 For the purposes of assessing Royal Mail's position in the bulk mail delivery market, we have considered the market positions of Royal Mail and other market participants in January 2014, in particular, and in the period leading up to that date. However, we note that there have been no significant industry developments up to the date of this Decision (such as a new entrant in the bulk mail delivery market) that would alter our conclusions below.

6.83 Given that we have defined a nationwide geographic market, we have considered market shares of bulk mail delivery at a national level.

6.84 Before 2012, Royal Mail was the monopoly supplier of bulk mail delivery services in the UK. In April 2012, Whistl announced plans to start delivering its own letters to certain parts of the UK. In the financial year 2013/14 Whistl delivered around 0.5% of the total letters market volumes directly to households and businesses using its own delivery network.⁷⁹² In Q4 2013/14, Royal Mail's share of nationwide bulk mail delivery volumes was over 98% and Whistl's share was 1.2%.⁷⁹³ There was no nationwide end-to-end network other than that of Royal Mail; its national network was and still is unique.⁷⁹⁴

6.85 Looking at its share on a nationwide basis, consistent with our market definition, during 2014 Royal Mail's share was over 98%. This is sufficient to presume dominance.⁷⁹⁵

6.86 However, for completeness, we have also considered what Royal Mail's share of bulk mail delivery volumes was at other geographic levels. At the SSC level,⁷⁹⁶ the highest share that

⁷⁹⁰ Assessment of market power guidelines, paragraphs 6.1 to 6.4. See also *National Grid v GEMA* [2009] CAT 14 ('*National Grid*'), paragraph 60 and *Genzyme v OFT* [2004] CAT 4, paragraph 243.

⁷⁹¹ See paragraph 96 of the Commission's Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty, OJ C 101, 27.4.2004, p.81 to 96.

⁷⁹² Ofcom, *Annual monitoring update on the postal market, Financial Year 2013-14*, page 16, paragraph 3.28. (PD0012)

⁷⁹³ We calculated the total size of the market by summing Royal Mail's access volumes, Royal Mail's relevant retail volumes and Whistl's direct delivery volumes. Royal Mail's relevant retail volumes were calculated by reference to the products included in Product Profitability Statements 3 (Pre-sorted D+2 and later Letters and Large Letters), 6 (High volume unsorted D+2 and later Letters) and 7 (High volume unsorted D+2 and later Large Letters).

⁷⁹⁴ Around 0.1% of letters were delivered by other end-to-end operators. For example, in 2013-14, alternative operators to Royal Mail accounted for 0.6% of volumes of the addressed letter mail market, of which Whistl accounted for 0.5%. Ofcom, *Annual monitoring update on the postal market, Financial Year 2013-14*, page 16, paragraph 3.28 and page 61, paragraph 6.26. (PD0012).

⁷⁹⁵ See paragraph 6.77 above

⁷⁹⁶ Given that Whistl's roll-out plan was based on rolling out its delivery operations on an SSC by SSC basis, we do not consider it makes sense to consider shares of volumes for areas smaller than SSC level.

Whistl managed to achieve in any one SSC in Q4 2013/14 was 25%. Similarly, if we calculate Whistl's share of bulk mail delivery volumes in all SSCs that it entered, it achieved a share of 16% in Q4 2013/14. In those areas where Whistl was not present (meaning Whistl was reliant on Royal Mail for delivery), Royal Mail's share of delivery was 100%.

- 6.87 It is therefore clear that even on the basis of a narrower geographic market, Royal Mail had a very high market share, with a share of 75% even when calculated on the most conservative basis.
- 6.88 As discussed above in the context of product market definition, a large proportion of the substitution away from bulk mail delivery that does occur would be to other products supplied by Royal Mail. If we were to expand the market to include the delivery of other addressed letters (i.e. first and second class single piece letters and large letters, which only Royal Mail delivered), this would increase Royal Mail's share of volumes to around 99%.

Royal Mail was an unavoidable trading partner for access customers wishing to enter or expand in delivery, and had the ability to unilaterally alter terms of access

- 6.89 In addition to Royal Mail's very high market shares, we find that Royal Mail was an unavoidable trading partner for any access customer wishing to enter into the bulk mail delivery market, or expand its end-to-end service.⁷⁹⁷
- 6.90 For the reasons we set out in paragraph 7.24:
- a) retail bulk mail customers demanded national, or at least widescale, delivery of mail; rolling out bulk mail delivery could only be done gradually and full national roll out was unlikely; and
 - b) operators were likely to use Royal Mail's delivery service even in areas where they had their own network.
- 6.91 As a result, a new entrant into the bulk mail delivery market would need to contract with (or continue to contract with) Royal Mail for access to Royal Mail's delivery network for a substantial part of the retail mail volumes it handles. While Royal Mail is required by Ofcom to provide such access, it has some discretion over the terms of this access and the ability to unilaterally alter terms of access, which included the freedom to change its wholesale access prices.⁷⁹⁸ This means that a new entrant wishing to compete with Royal Mail in delivery would remain vulnerable to Royal Mail's ability to alter the terms of its access to Royal Mail's delivery network.

⁷⁹⁷ See paragraphs 7.24 to 7.26.

⁷⁹⁸ See paragraph 3.27 to 3.28.

Barriers to entry and expansion

- 6.92 As part of our consideration of dominance, we have also assessed whether potential entrants in the bulk mail delivery market acted as an effective competitive constraint on Royal Mail, or whether this was prevented by barriers to entry in that market.
- 6.93 We find that barriers to entry and expansion in the bulk mail delivery market were significant:
- a) **Sunk costs:** There are significant sunk costs in the infrastructure investment required to compete in delivery (notably sorting machines, IT systems and converting premises). There are also likely to be intangible sunk costs, such as those incurred in training a new workforce and gaining experience in running a bulk mail delivery network. Such sunk costs made entry harder because they could not be recovered if that entry was not successful, increasing the risks associated with attempting entry. It might have been possible for an entrant to mitigate some of the risks of unrecovered sunk costs by undertaking a gradual roll out programme. This could, for example, allow for more informed decision making as an entrant continued to expand, allowing an entrant to cease its expansion plan before it incurred certain scalable sunk costs if entry into bulk mail delivery proved less successful than expected. Such a gradual approach to roll out would also, however, have had the effect of lessening the constraint on Royal Mail resulting from such roll out.
 - b) **Royal Mail's high market share and advantages resulting from economies of scale:** Mail delivery is characterised by substantial economies of scale, given the relatively fixed costs involved in servicing a particular delivery route, which do not vary with the volume of items delivered. Royal Mail was the privatised former state monopoly; and retained a very high market share (over 98% in total, and 84% on average in the SSCs where Whistl had entered). As such, it benefited very significantly from these economies of scale and scope, which tended to reduce its average costs compared to rivals (although we recognise that a new entrant operator may have been able to offset some of Royal Mail's scale advantages by delivering on fewer days).
 - c) **Economies of scope:** Royal Mail also benefited from significant economies of scope, in that it delivered single-piece mail (such as first class and second class stamped mail) and parcels as well as bulk mail, providing it with a further significant source of cost advantage over rivals.
 - d) **Large retail customer base:** To realistically contemplate entry into the delivery market, a company was likely to want to already have (or be able to swiftly develop) a sufficiently large customer base in the retail market to ensure it has adequate volumes and economies of scale to justify the investment required.⁷⁹⁹ Apart from Royal Mail,

⁷⁹⁹ In principle, this could be achieved if an entrant agreed to deliver on behalf of a major access operator. However, since entry into delivery on a nationwide basis is very unlikely, that access operator is still likely to require Royal Mail to deliver significant amounts of its bulk mail. This makes it less attractive to use that new entrant (e.g. because it involves dealing

there were few companies that had significant retail market shares. Of the access operators, the two largest companies by some margin were Whistl and UK Mail. With respect to these two operators:

- i) UK Mail had indicated in 2012 that it did not currently see end-to-end entry as an attractive option to pursue.⁸⁰⁰
 - ii) Whistl, as at January 2014, had commenced roll out into the bulk mail delivery market and had plans to continue to enter new areas of the country. However, it had sought investment to proceed with its roll out, reflecting the significant costs associated with entering the bulk mail delivery market. Despite being a significant player in the retail market for bulk mail, as at January 2014, Whistl had achieved a less than 2% national market share, and at most a 25% market share in individual SSCs which it had already entered.
- e) **Royal Mail's brand, experience and reputation:** Royal Mail also had a strong brand image that was recognised nationwide, with a long track record of delivery services. This would make it more difficult for lesser-known entrants, without comparable delivery experience, to win business. Potential entrants would have needed to build up a credible reputation for reliable bulk mail delivery services before potential customers were prepared to use an entrant instead of Royal Mail. This gave Royal Mail a long-run advantage over a new entrant into the market which would be likely to increase barriers to entry for a potential competitor.⁸⁰¹
- f) **Royal Mail's VAT status:** Royal Mail's access services were VAT-exempt, whereas Royal Mail's retail operations (excluding universal services) and other end-to-end operators had to charge VAT for the total cost of the item. In 2014, Whistl was unsuccessful in a High Court legal challenge against the VAT exemption for regulated access.⁸⁰² In consequence, entrants such as Whistl would have found it more difficult to compete to deliver bulk mail for customers who could not reclaim VAT (such as financial institutions and charities) unless they could offer bulk mail delivery prices including VAT which matched (or were lower than) Royal Mail's VAT-exempt access prices. This will have made entry and expansion harder.

6.94 As explained in paragraphs 7.21 to 7.23 below, the high barriers to entry and expansion in the bulk mail delivery market were exacerbated by the declining volumes in that market. In particular, this made the timing of any entry and expansion in the market more important.

6.95 It is notable that it took six years (until 2012) for rivals to enter the delivery market for letters in competition with Royal Mail, despite such entry having been legal since 2006. We consider that this is consistent with the existence of high barriers to entry. Similarly, the

with an extra supplier and because diverting mail to the new entrant might make it harder for the access operator to meet the tolerances associated with national price plans like NPP1).

⁸⁰⁰ UK Mail, *Reports and Accounts 2012*, 31 March 2012, page 9. (PD0048)

⁸⁰¹ See Case IV/M.190 - *Nestlé/Perrier*, paragraph 96.

⁸⁰² *R. (on the application of Whistl UK Limited) v. Her Majesty's Revenue And Customs* [2014] EWHC 3480 (Admin).

fact that Whistl managed to achieve a national market share of only 1.2% after more than two years in the market is consistent with the existence of high barriers to expansion.

Buyer power

- 6.96 In assessing dominance, we have also examined whether access operators or large individual customers such as banks and other financial services providers held sufficient countervailing buyer power to provide an effective constraint on Royal Mail's conduct.
- 6.97 The main purchasers of Royal Mail's bulk mail delivery services were access operators, such as Whistl and UK Mail, and large individual customers such as banks and other financial services providers (including agency customers).⁸⁰³ Neither the access operators nor the customers who bought these services directly from Royal Mail had any real alternative supplier to which they could turn. As explained above, even when Whistl delivered some of its own mail, it covered only a very small proportion of the UK, and Royal Mail remained an unavoidable trading partner for the majority of its mail volumes.⁸⁰⁴
- 6.98 The lack of a credible outside option for delivering bulk mail severely weakened the bargaining position of Royal Mail's customers. Nor would the share of supply of any individual end customer be sufficient to constrain the behaviour of a dominant supplier. Accordingly, we do not consider that Royal Mail's customers held sufficient countervailing buyer power to negate the existence of a dominant position on Royal Mail's part.

Royal Mail's submissions

- 6.99 In its representations in this case, Royal Mail denies that it held a dominant position in any market relevant to the assessment of its conduct.⁸⁰⁵ It argues that Ofcom has placed too much weight on its high market share, which must be understood in the context of the constraints it faces, in particular, from e-substitution and from the scope for entry and expansion into the bulk mail delivery market, which were commercially viable options for access operators to pursue.
- 6.100 We do not agree with Royal Mail that we have placed too much weight on market shares. It is well-established in case law that market shares in excess of 50% are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position.⁸⁰⁶ Royal Mail's market share at the relevant time was approaching that of total monopoly. In any event, and notwithstanding Royal Mail's very high market share, we have also considered the characteristics of the bulk mail delivery market (including Royal Mail's position as an unavoidable trading partner, high barriers to entry, and a lack of

⁸⁰³ Royal Mail's September 2013 Prospectus reports that around 57% of Royal Mail's access mail volume came from access operators, with the remaining 43% from posting customers such as banks and other financial services providers (including agency customers). See page 55. (WH0039)

⁸⁰⁴ See paragraphs 6.89 to 6.91 and 7.24 to 7.26.

⁸⁰⁵ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 60, paragraph 4.2. (RM2386)

⁸⁰⁶ Judgment in *C-62/86 Akzo v Commission*, EU:C:1991:286 [1991] ECR I-3359, paragraph 60. Undertakings with market shares of below 50% may still be dominant if other relevant factors mean that they still have substantial market power.

countervailing buyer power) and have found that they also support the conclusion that Royal Mail held a dominant position at the time that the price differential was introduced.

- 6.101 For the reasons set out in the market definition section above,⁸⁰⁷ we do not consider that the threat from e-substitution was a sufficiently strong constraint on Royal Mail's behaviour and therefore does not undermine our finding that Royal Mail was dominant in bulk mail delivery.
- 6.102 Similarly, we do not agree that the threat of entry or expansion was sufficient to prevent Royal Mail from enjoying a dominant position as at January 2014.
- a) First, the fact that entry into bulk mail delivery could be commercially viable for a competitor does not mean that Royal Mail was not dominant. The high barriers to entry nonetheless suggest the threat of entry was unlikely to be able to constrain Royal Mail's behaviour to any significant extent, at the very least until entry occurred on a sufficiently large scale. This was not the position in January 2014 when the price differential was introduced, or at any other time.
 - b) In January 2014, Whistl's bulk mail delivery business represented a nascent competitor to Royal Mail. We acknowledge that actual entry of a scale competitor in bulk mail delivery would likely have exerted a greater constraint on Royal Mail. However, as we set out in more detail at 7.24 to 7.26 below, a competitor in bulk mail delivery would still remain dependent on Royal Mail's access products for a substantial proportion of its volumes. Consequently, even if an operator was able to roll out to a significant proportion of the market, Royal Mail would remain an unavoidable trading partner with control over an indispensable input for the provision of the nationwide service sought by most customers. As a result, Royal Mail would still likely have been able to raise barriers to entry and expansion and thus reduce the constraints on its bulk mail delivery business (see the discussion in Section 7).

Conclusion on dominance

- 6.103 Royal Mail's market share of over 98% indicates that it held a dominant position as at January 2014 at the time the price differential was introduced (as it had done previously and continued to do so until the date of this Decision).
- 6.104 Our finding of dominance is supported by the fact that Royal Mail remained (and remains) an unavoidable trading partner for any new entrant in the bulk mail delivery market, the high barriers to entry and expansion that exist within the bulk mail delivery market, and a lack of countervailing buyer power. This indicates that there was little by way of effective constraint on Royal Mail's behaviour, and consequently that it held market power in the relevant market. We therefore conclude that Royal Mail was dominant in the bulk mail delivery market.

⁸⁰⁷ Paragraphs 6.47 to 6.51.

- 6.105 Moreover, we note that our finding of dominance would still apply if, in the alternative to finding a national UK market for bulk mail delivery, we found that there were narrower geographic markets. Considering the position in each of the 83 SSCs in the UK as at January 2014, Royal Mail's volume share was 75% even in the SSC where Whistl had the highest share, which is consistent with a finding of dominance. In addition, many of the barriers to entry would have applied in a similar way, and therefore made it difficult for Whistl to expand. Moreover, regardless of the strength of competition in the areas where Whistl had (or might have) entered, Royal Mail was clearly dominant in the other areas of the UK in which it was the only bulk mail delivery operator. In the areas where Royal Mail was the only bulk mail delivery operator, which represented a large proportion of the UK, Royal Mail was an unavoidable trading partner for any rival that competed in bulk mail delivery elsewhere, such as Whistl.⁸⁰⁸ This afforded Royal Mail a position of economic strength equating to dominance.
- 6.106 Similarly, our finding of dominance would apply even if we had adopted a wider product market that included other letters products. This would lead to a finding that Royal Mail had an even higher market share, of around 99%. In addition, the barriers to entry discussed above would also apply in such a case.

⁸⁰⁸ We describe why Royal Mail was an unavoidable trading partner for a potential rival in bulk mail delivery in paragraph 7.24 to 7.26.

7. Abuse of a dominant position: legal and economic analysis

A. Overview

- 7.1 In Section 6, *Market definition and dominance*, we have found that Royal Mail held a dominant position in the market for bulk mail delivery in the UK. This section sets out our assessment of whether Royal Mail's conduct, in introducing the price differential, amounted to an abuse of that dominant position in the relevant legal and economic context.
- 7.2 We explained in Section 5, *Legal Framework*, that to establish an abuse of a dominant position in this case we need to show that Royal Mail's conduct meets the objective criteria of an abuse. We have to assess whether Royal Mail's actions influenced the structure of the market, in which the degree of competition was already weak, through recourse to methods that did not amount to competition on the merits, with the effect of hindering or eliminating existing competition or the growth of that competition.⁸⁰⁹ Such foreclosure effects may arise where a dominant undertaking's actions make entry into the market in question more difficult or impossible.
- 7.3 We have undertaken an in-the-round assessment of all the circumstances of the case to determine whether, at the time the price differential was introduced, i.e. when the CCNs were issued, Royal Mail's conduct was reasonably likely to give rise to a competitive disadvantage / restriction of competition. In particular, we have considered the factors identified by the CJEU in the case-law summarised at paragraph 5.69 above. We have identified the following relevant factors in this case:
- a) the extent of Royal Mail's dominant position and its status as a former statutory monopolist;
 - b) the share of the market covered by the price differential;
 - c) the particular conditions of competition prevailing in the bulk mail delivery market and the associated retail market on which access operators were competing (the retail market for bulk mail), which include:
 - i) the unique structural advantages in the markets enjoyed by Royal Mail due to its national network, which gives rise to significant economies of scale and scope;
 - ii) the high barriers to entry in the bulk mail delivery market, and the long-term decline of volumes in this market;

⁸⁰⁹ Case 85/76 *Hoffman-La Roche v Commission* EU:C:1979:36 [1979] ECR 461, paragraph 97; Case T-321/05 *AstraZeneca AB and AstraZeneca plc v European Commission* EU:T:2010:266 [2010] ECR II-02805, paragraph 804; confirmed in judgment on appeal, Case C-457/10 P *AstraZeneca AB and AstraZeneca plc v European Commission* EU:C:2012:770 [2013] 4 C.M.L.R. 7 at paragraph 129; Case-413/14 P *Intel Corporation Inc. v. European Commission* EU:C:2017:632 [2017] 5 CMLR 18 ('*Intel*'), paragraphs 135-136

- iii) Royal Mail's status as an unavoidable trading partner for access operators as the provider of wholesale bulk mail delivery;
 - iv) the competitive conditions in the associated retail market for bulk mail, which are characterised by tight profit margins;
 - v) Royal Mail's designation as a universal service provider;
- d) the conditions and arrangements associated with the price plans under the Access Letters Contract and how these would have been affected by the price differential;
- e) Royal Mail's strategy in respect of and objectives behind the price differential, as evidenced by its internal contemporaneous documents.
- 7.4 We have also considered the evidence available as to how the introduction of the price differential impacted the bulk mail delivery market in practice.
- 7.5 We have structured the analysis and findings made in this section as follows:
- 7.6 **Sub-section B** contains our assessment of competitive conditions at the relevant time on the bulk mail delivery market and the associated retail market for bulk mail. In particular, we explain that as of early 2014, competition in the bulk mail delivery market was already very limited; and was vulnerable to exclusionary conduct on the part of Royal Mail.
- 7.7 **Sub-section C** considers the nature of the conduct in question in the context of the affected markets. We find that, by introducing the price differential in the CCNs, Royal Mail used its position as an unavoidable trading partner for operators active on the retail market for bulk mail to penalise those of its access customers who also sought to compete with it by undertaking end-to-end delivery activities. Royal Mail did this in order to protect and enhance its position of dominance in the bulk mail delivery market. In this regard:
- a) In paragraphs 7.44 to 7.45 and 7.65 to 7.78, we find that, in introducing the price differential, Royal Mail applied dissimilar conditions to equivalent transactions with its access operator customers, charging higher prices for the same bulk mail delivery services when supplied under the APP2/ZPP3 price plans than it charged under the NPP1 plan.
 - b) In paragraphs 7.47 to 7.64, we explain that Royal Mail's access customers who chose to expand their operations to compete directly with Royal Mail in delivery would need to use APP2 or ZPP3. As a result, they would face systematically higher prices compared to those applicable to access operators who chose to rely instead on delivery by Royal Mail and who could use NPP1 without incurring adverse contractual consequences.
 - c) In paragraphs 7.87 to 7.122, we find that the difference in treatment applied by Royal Mail cannot be explained or justified on the basis of (i) differences between APP2/ZPP3 customers by comparison with NPP1 customers based on their geographic profile, total volumes or variability of volumes in a geographic area; or (ii) costs savings that are alleged to result from Royal Mail's requirement for NPP1 customers alone to provide more detailed volume forecasts than APP2/ZPP3 customers.

- 7.8 **Sub-section D** explains that Royal Mail’s conduct reflected a deliberate strategy to limit delivery competition from its first and only significant competitor, Whistl. In 2012, Whistl completed a trial of end-to-end delivery operations in west London. In 2013, it announced its plans to expand delivery operations to new geographic regions. These actions represented the first serious challenge to Royal Mail’s virtual monopoly of the bulk mail delivery market since the introduction of retail competition based on regulated access to Royal Mail’s delivery network. It is apparent from our review of Royal Mail’s internal documents, obtained using our statutory information gathering powers, that Royal Mail identified this nascent competition as a threat to its position and that it introduced the price differential, alongside other measures in the CCNs, as a direct response to the threat of competition from Whistl.
- 7.9 **Sub-section E** outlines our findings that the price differential was reasonably likely to give rise to a competitive disadvantage / lead to a restriction of competition. We also address the implications of the fact that the price differential’s implementation was subject to a contractual notice period, and that it was ultimately suspended (alongside other parts of the CCNs issued in January 2014).
- 7.10 **Sub-section F** examines the evidence of what in fact happened after the CCNs were issued. We find that such evidence is consistent with our findings as to the likely consequences of Royal Mail’s conduct in introducing the price differential through the CCNs.
- 7.11 **Sub-section G** set outs our overall conclusion on distortion of competition / competitive disadvantage.
- 7.12 **Sub-section H** addresses the effect on trade between EU Member States and within the UK.
- 7.13 **Sub-section I** sets out our conclusions as to the duration of the infringement.

B. Conditions of competition in the bulk mail delivery market and the associated retail market for bulk mail

7.14 In this sub-section, we outline and discuss the particular features of, and conditions of competition prevailing in, the bulk mail delivery market and associated retail market for bulk mail at the relevant time. We have assessed each of the factors listed at paragraph 7.3 above, and have found as follows:

- a) Royal Mail was the former statutory monopolist. As at January 2014 it was (and remains) overwhelmingly dominant in the bulk mail delivery market. Whistl had entered the bulk mail delivery market and had plans to roll out further. This planned roll out was the first real prospect of competitive entry at scale in the bulk mail delivery market;
- b) Royal Mail enjoyed significant structural advantages, including in particular a unique national network, giving rise to significant economies of scale and scope;
- c) the bulk mail delivery market was characterised by high barriers to entry and expansion. Furthermore, the bulk mail delivery market was (and is) declining, rendering entry or expansion increasingly difficult and risky. As a consequence of these factors, the potential for entry to occur could be affected by even small or relatively small changes in the profitability of entry or expansion, which could have a material impact in this context;
- d) Royal Mail was (and remains) an unavoidable trading partner for its access operator customers active in the retail market for bulk mail. This was also true for those of its access customers that wished to enter or expand their activities by undertaking their own end-to-end delivery activities in competition with Royal Mail. Access operators, such as Whistl, were economically dependent on Royal Mail in order to compete for demand in the retail market for bulk mail on a UK-wide basis;
- e) the downstream retail market for bulk mail was (and is) competitive. Profit margins were tight and Royal Mail's access charges made up the considerable majority (around 90%) of input costs. Thus, even a modest price differential would have a significant impact on access customers' profitability;
- f) Royal Mail was and is designated as the UK's universal service provider for certain types of mail. In its submissions, Royal Mail has emphasised the need for it to introduce the price differential in order to protect the USO due to the threat posed by end-to-end competition. Throughout the relevant period, however, the USO was subject to regulatory oversight by Ofcom, which included consideration of the impact of Whistl's end-to-end delivery business. As at the time of the conduct in issue in this case, Ofcom had determined that the nascent competition from Whistl did not pose a threat to the USO. Ofcom was also well placed to intervene, as end-to-end competition grew, and had made clear that it would do so if needed.

Royal Mail was and remains overwhelmingly dominant in the bulk mail delivery market

- 7.15 As set out above in Section 6, *Market definition and dominance*, despite there being complete liberalisation of the postal services sector in the UK since 2006, Royal Mail still accounted for over 98% of all bulk mail deliveries in the UK as of January 2014.
- 7.16 By January 2014, Whistl had started to roll out into the delivery market, but its operations remained on a very small scale:
- a) In 2012, Whistl began to operate a bulk mail delivery network in some parts of the UK thereby engaging in competition with Royal Mail in delivery.⁸¹⁰
 - b) Between 2012 and January 2014 Whistl's delivery network had expanded to cover a total of four SSCs located in London and Manchester.⁸¹¹ At this point Whistl was delivering to approximately 4.2% of UK addresses.⁸¹²
- 7.17 In February and March 2014, Whistl expanded into a further two SSCs, increasing its coverage to around 7% of UK addresses,⁸¹³ and it had announced plans to gradually expand to more than 30 SSCs, covering approximately 42% of UK addresses by 2017.⁸¹⁴ This nascent competition in the bulk mail delivery market was the first example of competition to Royal Mail's delivery network that could potentially grow to scale. Following Whistl's exit from bulk mail delivery, Royal Mail's market share has only increased.

The structural advantages enjoyed by Royal Mail

- 7.18 Royal Mail had (and has) a unique national network for the collection and, in particular, the delivery of bulk mail. This is a consequence of Royal Mail's historical position as the state-owned monopoly provider of postal services in the UK. Royal Mail's UK-wide core network is outlined in Section 2, paragraphs 2.21 to 2.22 above. This meant that Royal Mail enjoyed significant economies of scale and scope.⁸¹⁵

The bulk mail delivery market was and is characterised by already high barriers to entry and expansion; and is in long term decline

High barriers to entry and expansion

- 7.19 As discussed in more detail from paragraph 6.92 to 6.95 above, it was (and remains) difficult to enter and expand in the bulk mail delivery market having regard, in particular,

⁸¹⁰ See paragraph 2.36 above.

⁸¹¹ We note that in certain documents it is suggested that Whistl was active in five SSCs following its expansion into Manchester in November 2013 (see for example Royal Mail, *Options for protecting the USO – Draft discussion document, October 2013*, 13 November 2013, slide 4). (RM0960) This inconsistency arises because in late 2013 Royal Mail changed the boundaries of certain SSCs and most notably merged two of the SSCs in which Whistl was an active delivery operator.

⁸¹² Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals*, 28 January 2014, page 15. (WH0121)

⁸¹³ *Ibid.*, page 16, figure 3. (WH0121)

⁸¹⁴ Whistl, *Project Luke – Investment Memorandum*, May 2013, slide 53. (WH0709). See also Royal Mail, *Options for protecting the USO – Draft discussion document, October 2013*, 13 November 2013, slide 4. (RM0960)

⁸¹⁵ See also paragraphs 6.93(b) and (c).

to the high fixed costs and substantial economies of scale and scope which characterise the market.

- 7.20 The barriers to entry and expansion are illustrated by the fact that, although the market was liberalised in 2006, it was six years before a rival (Whistl) commenced bulk mail delivery operations on any scale in 2012. Whistl has been the only significant entrant to date.

Bulk mail was (and still is) declining

- 7.21 Since 2006, the volume of letters and large letters delivered in the UK has declined significantly, with volumes falling by 6.3% per annum from 2008 to 2013.⁸¹⁶ Total addressed mail volumes fell from 16.1 billion items in 2009-10 to 12.8 billion items in 2013-14,⁸¹⁷ which is a total decline of 21%.⁸¹⁸ In the years prior to January 2014, the rate of decline had slowed down; between 2012-13 and 2013-14 total letters volumes decreased by 3.2% to 12.8 billion items compared to a decline of 8.0% in the previous year.⁸¹⁹
- 7.22 In 2013-14, Royal Mail's access volumes declined by 1.0% to 7.2 billion items. This was the first time access volumes had declined since access competition was introduced in 2004. In the same period, combined access and retail bulk volumes declined by 3.3% with revenues declining by 0.3%.⁸²⁰ Figure 7.1 shows the decline in volumes in the period leading up to January 2014.

⁸¹⁶ PwC, *The outlook for UK mail volumes to 2023*, 15 July 2013, page 7. (RM0673)

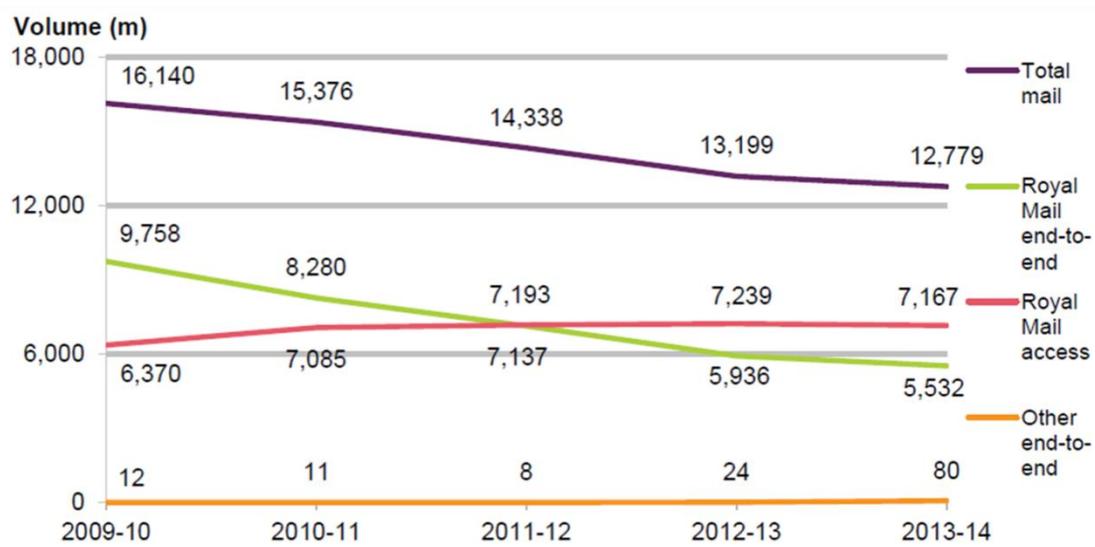
⁸¹⁷ Ofcom, *Annual monitoring update on the postal market financial year 2013-14*, 2 December 2014, page 55, figure 6.1. (PD0012)

⁸¹⁸ *Ibid.*, page 54, paragraph 6.8.

⁸¹⁹ *Ibid.*

⁸²⁰ *Ibid.*, page 2, paragraph 1.7 and page 14, paragraph 3.25.

Figure 7.1: Mail volumes 2009-10 to 2013-14



Source: Ofcom, *Annual monitoring update on the postal market financial year 2013-14*, 2 December 2014, page 55, figure 6.1. (PD0012)

7.23 This declining volume trend tends to make the bulk mail delivery market less attractive to enter as time goes on, reducing the overall size of the addressable market; and decreasing the volumes of mail / time periods over which the fixed and sunk costs of entry can be recouped.

Royal Mail was an unavoidable trading partner for any access operator

7.24 Consistent with its high market share and unique network coverage, Royal Mail was an unavoidable trading partner for access operators active on the retail market for bulk mail. This was also the case for those of its access customers, like Whistl, that were undertaking, or considering undertaking, end-to-end delivery activities in competition with Royal Mail in the bulk mail delivery market. This is a product of the fact that:

- a) **Retail bulk mail customers demand national, or at least widescale, delivery of mail.** Customers on the retail bulk mail market are unlikely to have localised demand for delivery. They are typically organisations that operate across the UK, such as financial institutions, government bodies, communications and energy companies, high street retailers, charities and direct marketing companies. Whistl identified that only 0.5% of its upstream volumes came from customers requiring delivery confined to a particular local area.⁸²¹
- b) **Rolling out bulk mail delivery can only be done gradually in practice.** Given the significant investment in premises, sorting machines, staff and operational design required to operate a delivery network, and therefore the risks involved, it is unrealistic

⁸²¹ Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals – a confidential report prepared for TNT*, January 2014, page 18, figure 4. (WH0121)

for an entrant to launch bulk mail delivery services across a large geographic area simultaneously.⁸²² A more plausible entry strategy is to begin by providing a service in a limited geographic area and then gradually expand the areas covered. This is consistent with Whistl's approach, which started by providing bulk mail delivery in just one SSC and then planned gradually to expand the number of SSCs over time so as to reach 42% of households within a period of around five years.⁸²³

- c) **Operators would be likely to use Royal Mail's delivery service even in areas where they have their own network, particularly during the early phases of roll-out.** Even in locations where an access operator was undertaking its own end-to-end deliveries, it is unlikely to be able to deliver all of the mail it collects that is addressed to that area. Remaining volumes would need to be handed over to Royal Mail for delivery. The proportion of an entrant's retail volumes that it delivers itself is known as the conversion rate. Evidence from Whistl's operations in 2013 and 2014 shows that the conversion rate was relatively low (around 50%⁸²⁴) initially. Although this was expected to rise over time as Whistl agreed terms with its retail customers,⁸²⁵ Whistl anticipated that its conversion ratio "*is unlikely to reach 100%.*"⁸²⁶
- d) **An end-to-end entrant would be unlikely ever to find it profitable to compete nationally in bulk mail delivery.** It is unlikely that it would ever be profitable for an entrant in the bulk mail delivery market to provide delivery services throughout the whole of the UK. This is because of the significant economies of scale and scope involved in postal delivery services. As outlined above, given its legacy as the former statutory monopolist and its position as the provider of the universal postal service, Royal Mail had a unique national bulk mail delivery network enabling it to benefit from scale and scope economies. By contrast, a new entrant would find it harder to enter

⁸²² Among other matters, a postal delivery network is a labour-intensive activity and it is therefore necessary to recruit a substantial number of employees. Whistl expected to recruit an additional 20,000 staff members to support its roll out to 42% of UK Postcodes. (See Whistl, *E2E Competition – [redacted] TNT Post UK Ltd*, 30 September 2013) (WH0082)

⁸²³ Whistl, *E2E Competition – [redacted] TNT Post UK Ltd*, 30 September 2013, slide 35. See also Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals – a confidential report prepared for TNT*, January 2014, page 16 (WH0121): In relation to Whistl, the "*speed of the roll-out (roughly one SSC per quarter) is driven primarily by the central resource and start-up requirements (e.g. the management time needed to ensure operational success and high quality customer service; to locate premises; to recruit and train delivery operatives; to reorganise upstream depots which prepare mail for delivery; and to develop local management expertise around Great Britain) needed to launch services in a particular SSC.*"

⁸²⁴ Whistl, *Project Luke – Investment Memorandum*, May 2013, slide 53. (WH0709)

⁸²⁵ As noted above (paragraph 2.37), Whistl could automatically convert a relatively limited proportion of its volumes (around 25%), but was required to seek consent from its 'national' customers to switch their volumes.

⁸²⁶ Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals*, 28 January 2014, page 17 (WH0121). Whistl's CEO Nick Wells identified a number of factors for its partial conversion rate including the novelty of the TNT Post service and the perceived risk in moving away from the long-established delivery service of Royal Mail, the limited financial discount available in cash terms given the limited geographical coverage and the visual appearance of advertising mail items which need to be over-labelled with Whistl's postage mark in order to obscure the Royal Mail postage mark. (Whistl, *Witness Statement of Nick Wells*, 28 January 2014, page 6, paragraph 15.) (WH0132)

profitably in less densely populated areas because of the challenges of achieving sufficient scope and scale. This is consistent with:

- i) Royal Mail's estimates of delivery costs which varied materially between different geographic areas, being lower in urban and suburban areas than in rural areas.⁸²⁷
- ii) Whistl's own assessment that the "*overall scale of the roll-out is limited by the extent to which it is economically viable to launch a competing delivery network in each SSC. Many SSCs have an insufficient population density to support two competing networks.*"⁸²⁸
- iii) Royal Mail's submissions on Ofcom's Draft Penalty Statement to the effect that some of the bulk mail delivery market was not contestable.⁸²⁹

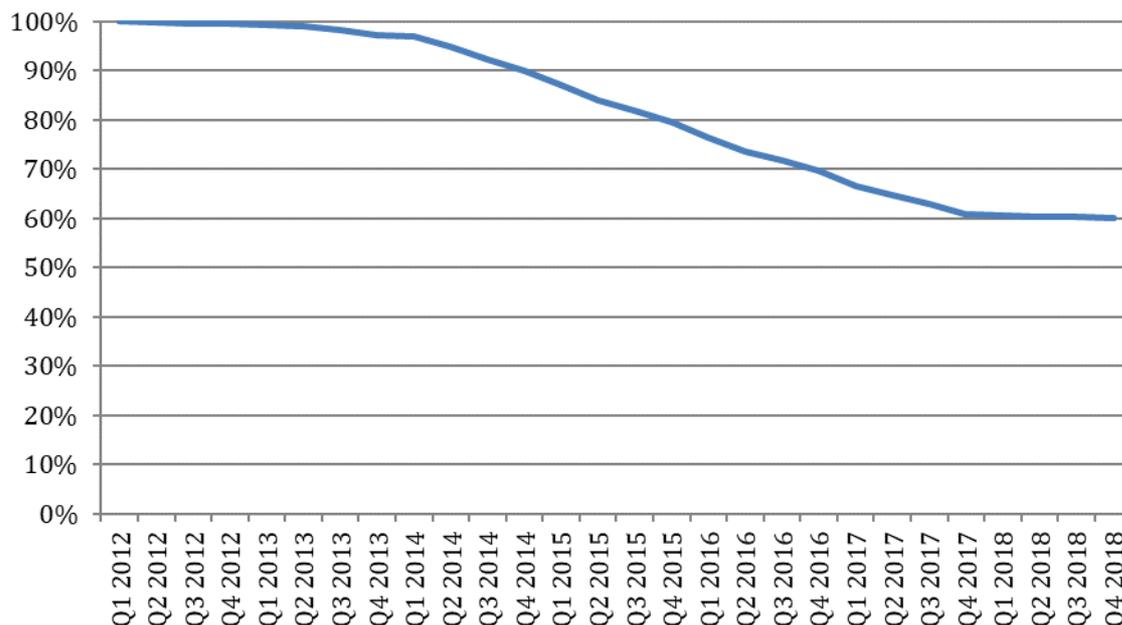
7.25 A large proportion of a competing operator's mail would therefore still need to be delivered by Royal Mail even if it commenced a roll out of its own end-to-end network. As the competitor would have more limited geographic coverage, a large share of an entrant's mail volumes would still need to be delivered by Royal Mail pursuant to an access agreement between the parties. This proportion would be greatest in the early years following the launch of a competing bulk mail delivery service. However, at least partial reliance on Royal Mail's network would be enduring in the long-term. This finding is supported by the evidence of the roll out planned by Whistl. As shown in figure 7.2, even at the end of Whistl's planned seven-year roll out, it still expected to depend on Royal Mail to deliver the majority of the mail it collected from its retail customers.

⁸²⁷ Royal Mail, *Zonal Cost Calculations – Calculating Zonal DLRAICs and DSACs*, 25 March 2014, slide 5. (RM0109)

⁸²⁸ Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals – a confidential report prepared for TNT*, January 2014, page 16. (WH0121)

⁸²⁹ See for example Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 6, paragraphs 1.27(d), page 7, paragraph 1.28(a) and page 38, paragraph 6.33. (RM2655) and the accompanying submission on relevant turnover: Compass Lexecon, *Assessment of relevant turnover for penalty calculation*, 8 March 2018. (RM2654). In Section 10, we have addressed Royal Mail's arguments on this relating to the calculation of "relevant turnover" for the purposes of assessing the level of the penalty.

Figure 7.2: Share of Whistl’s retail mail delivered by Royal Mail in Whistl’s business plan



Source: Ofcom calculations, Whistl’s business plan.

7.26 In sum, access operators that competed with Royal Mail in bulk mail delivery, such as Whistl, were and would remain economically dependent on Royal Mail in order to compete for demand in the retail market for bulk mail on a UK-wide basis. There was no way in which they could avoid purchasing delivery services from Royal Mail and paying its access charges.

The retail market for bulk mail was (and remains) competitive with tight profit margins

7.27 As outlined at paragraph 2.32 above, Royal Mail’s access charges make up the considerable majority of input costs for operators using access to compete in the retail market for bulk mail. Typically, the margin between access operators’ retail prices and the access charge paid to Royal Mail (which needs to cover collection and initial sortation costs as well as any overheads) is around 10%.⁸³⁰ As Royal Mail’s charges cannot be avoided or reduced (other than by carrying out end-to-end delivery activities), competition between access operators therefore takes place within this small margin.

7.28 As a result of the competition between access operators (and particularly between UK Mail, Whistl and Royal Mail), overall profit margins are tight. For example, in 2014, UK Mail reported an operating profit of approximately £12.7 million on revenue of approximately

⁸³⁰ See above, figure 2.4.

£245 million in its mail business.⁸³¹ Similarly, in 2014, Whistl reported an underlying operating profit of approximately £9.6 million on revenue of approximately £575 million.⁸³²

Ofcom was engaged in regulatory supervision of the financial sustainability of the USO and the impact of Whistl's end-to-end expansion

- 7.29 As set out in Section 2, *Background*, Ofcom has designated Royal Mail as the UK's universal service provider for certain categories of mail. As a consequence, in January 2014, Royal Mail was (and remains) subject to a number of regulatory obligations to collect and deliver letters six days per week at uniform prices across the UK. The universal service does not extend to bulk mail, which is the subject of this Decision.
- 7.30 In its representations, Royal Mail has emphasised its designation as the universal service provider in the UK as an important aspect of the factual context. It has stated that the price differential was developed as a commercial response to the threat posed to the USO by the emergence of end-to-end competition.⁸³³ We have therefore considered whether Whistl's limited entry by January 2014, and its planned roll out, posed an immediate threat to Royal Mail's position.

There is a comprehensive regulatory regime in place to secure the provision of a Universal Postal Service

- 7.31 As well as being the concurrent regulator for competition law purposes, Ofcom is the regulatory authority with responsibility for the postal services sector. In carrying out its regulatory functions, Ofcom has the primary duty to act in a way that it considers will secure the provision of a universal postal service.⁸³⁴ In performing that primary duty, Ofcom must have regard to the need for the provision of a universal postal service to be: (a) financially sustainable; and (b) efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times.⁸³⁵
- 7.32 As explained in Section 2, the UK regulatory regime for the postal services sector stems from a long-term process of liberalisation set at the EU level. In the UK, the postal services sector was fully liberalised in 2006 and so open to competition from this time.

Ofcom carried out multiple detailed reviews and consistently found that Whistl's entry did not pose a threat to the universal service

- 7.33 In carrying out its functions in relation to the postal services sector, Ofcom assessed on a number of occasions the impact of Whistl's planned end-to-end letter delivery operations

⁸³¹ UK Mail, *Report and accounts 2014*, page 16. (PD0049)

⁸³² Whistl, *Whistl UK Limited – Annual report and consolidated financial statements for the year ended 31 December 2014*, page 2. (PD0051) It should be noted that this figure was calculated by eliminating certain start-up and one-off costs, most notably costs associated with the start up of Whistl's end-to-end business. On a statutory basis, Whistl recorded an operating loss of £3.7 million.

⁸³³ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 9, paragraph 1.27 (RM2386); Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 4, paragraph 1.13. (RM2655)

⁸³⁴ Postal Services Act 2011, section 29(1).

⁸³⁵ Postal Services Act 2011, section 29(3).

on the relevant markets, and in doing so examined the extent to which it posed a threat to the universal postal service. For the purposes of these assessments, Ofcom had access to the confidential business plans of both Royal Mail and Whistl.

- 7.34 In March 2012, Ofcom set out its view of end-to-end competition as part of its conclusions setting out the 2012 regulatory framework for post. Ofcom's position acknowledges the need for a balance to be struck between: (a) the benefits of end-to-end competition, which potentially provides incentives on Royal Mail to reduce costs, innovate and focus on customer service; and (b) the potential risks that such competition could pose to the sustainability of the universal service by removing revenue from Royal Mail. Ofcom explained that:

*“End-to-end competition could potentially provide both costs and benefits to the universal service. On the one hand it would remove business from Royal Mail, challenging its already weak financial position, and, in this sense, might affect the sustainability of the universal service. On the other hand, it potentially increases the incentives on Royal Mail to reduce cost, innovate and focus on customer service. The effect of end-to-end competition on the provision of the universal service will depend on the entrant's plans and the circumstances which the market and Royal Mail finds itself in at the time. We therefore plan to assess end-to-end competition on a case by case basis.”*⁸³⁶

- 7.35 Thus, Ofcom made clear that it would assess the provision of the universal service on an ongoing and forward-looking basis. Ofcom said it would continue to monitor the market and, if it considered there were any significant developments, it would initiate a review to assess whether it was necessary to take any regulatory steps to preserve the universal postal service.

- 7.36 In July 2012, Ofcom issued an update regarding end-to-end competition following Whistl's commencement of its end-to-end delivery trial in west London.⁸³⁷

- a) The update followed a detailed examination of Whistl's confidential business plans in order to assess their likely impact on the provision of the universal service, including its financial sustainability and efficiency.⁸³⁸ Specifically, Ofcom modelled the likely impact of Whistl's roll-out on Royal Mail's financial position.⁸³⁹ The modelling included a sensitivity analysis, which considered how the impact would be affected: (i) if Whistl were more or less successful than anticipated in its plans; (ii) if additional competitors

⁸³⁶ Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012, paragraph 1.53 (PD0025)

⁸³⁷ Ofcom, *Update on Ofcom's position on end-to-end competition in the postal sector*, 25 July 2012. (PD0026)

⁸³⁸ *Ibid.*, page 3, paragraph 1.11. (PD0026)

⁸³⁹ This assessment took into account representations from other stakeholders including Royal Mail, who had submitted what it described as “*preliminary modelling output which forecasts the potential impact of end-to-end competition on its ability to provide the universal service.*” See *ibid.*, page 3, paragraph 1.12. (PD0026)

were to enter the market; or (iii) if other key modelling assumptions were to change (e.g. market volumes or Royal Mail's achieved efficiency levels).⁸⁴⁰

- b) Based on that analysis, Ofcom decided that no regulatory intervention was needed in order to secure the ongoing provision of a universal postal service.⁸⁴¹ This decision took account of: (a) Whistl's low projected market share in the early years of its plans; (b) the limited impact that Whistl's plans were expected to have on Royal Mail's cash flow position in the short term; and (c) the degree of uncertainty around Whistl's end-to-end plan given that it was the first of its kind in the UK.
- c) Ofcom also considered that there was significant uncertainty around Royal Mail's commercial reaction to end-to-end entry and that there were options for Royal Mail to respond competitively. For example, Ofcom suggested that such a response could involve Royal Mail achieving greater efficiency savings because of competitive pressure or adjusting its commercial strategy (for example using its commercial freedom to address geographic cost differentials through zonal pricing).⁸⁴²
- d) Ofcom reiterated that it would continue to assess developments in the market and react to them, if necessary, in a timely manner to address any risk to the universal service. Ofcom also emphasised its ongoing duty to secure the provision of the universal service. To that end, Ofcom explained that it had considered, as part of the scenario analysis, instances where it would be possible that intervention might be required to protect the universal postal service.⁸⁴³ Consequently, Ofcom committed to continue to monitor the postal market carefully.⁸⁴⁴ Ofcom also said it intended to publish guidance setting out a more detailed framework for assessing the case for intervention in relation to end-to-end competition.⁸⁴⁵

7.37 In March 2013, following consultation, Ofcom published further guidance on its approach to assessing the impact of end-to-end competition on the universal postal service. Consistent with its earlier analysis, Ofcom confirmed that it would take account of the following considerations:⁸⁴⁶

- a) Royal Mail's financial position absent end-to-end competition;
- b) the likely scale of end-to-end competition and the incremental impact on Royal Mail's financial position; and
- c) the potential for commercial responses by Royal Mail to mitigate the direct impact of increased competition. As well as improving the efficiency of its own operations, Ofcom explained that Royal Mail also had the ability to change how access prices are set for different geographic areas (i.e. zonal pricing) so as to ensure that end-to-end

⁸⁴⁰ Ibid., page 4, paragraph 1.15. (PD0026)

⁸⁴¹ Ibid., page 1, paragraph 1.1. (PD0026)

⁸⁴² Ibid., page 4, paragraph 1.17. (PD0026)

⁸⁴³ Ibid., page 5, paragraph 1.19. (PD0026)

⁸⁴⁴ Ibid., page 5, paragraph 1.20. (PD0026)

⁸⁴⁵ Ibid., page 5, paragraph 1.22. (PD0026)

⁸⁴⁶ Ofcom, *End-to-end competition in the postal sector – Final guidance on Ofcom's approach to assessing the impact on the universal postal service*, 27 March 2013, pages 15 to 17, paragraphs 4.5 to 4.15. (PD0018)

competitors pay a cost reflective price for Royal Mail delivering mail in the areas where its competitors have chosen not to enter. Ofcom emphasised, however, that Royal Mail's flexibility to negotiate changes to its contracts was subject to competition law and the *ex ante* regulatory conditions on access.

- 7.38 Alongside this guidance Ofcom also published a further statement in which it confirmed that Ofcom did not consider end-to-end competition was a threat to the universal service at that time.⁸⁴⁷
- 7.39 In addition to the decisions set out above, Ofcom also confirmed publicly in November 2012,⁸⁴⁸ July 2013,⁸⁴⁹ November 2013⁸⁵⁰ and April 2014⁸⁵¹ that, based on the evidence it had seen (including the confidential business plans of both Royal Mail and Whistl), it did not consider that end-to-end competition was currently a threat to the universal postal service, so as to merit any regulatory action.
- 7.40 In June 2014 (5 months after it had issued the CCNs), Royal Mail submitted a further request for Ofcom to review Whistl's activities, which it saw as posing an immediate threat to the universal service. Ofcom carried out a further comprehensive review and, on 2 December 2014, found that *"there does not appear to be any immediate threat to the sustainability of the universal service."*⁸⁵²

Conclusion on the degree of competition in the bulk mail delivery market at the time the price differential was introduced

- 7.41 Our key conclusions on the prevailing features and conditions of the bulk mail delivery market, and its associated retail market, are summarised at paragraph 7.14 above.
- 7.42 In light of our assessment of those features and conditions, we conclude that:
- a) Competition in the bulk mail delivery market was already very limited as at January 2014.
 - b) The passage of time reduced the potential for such competition to emerge when the high barriers to entry and expansion are taken into account in the context of a declining market.

⁸⁴⁷ Ofcom, *End-to-end competition in the postal sector – Ofcom's assessment of the responses to the draft guidance on end-to-end competition*, 27 March 2013. (PD0017)

⁸⁴⁸ Ofcom, *Annual monitoring update on the postal market financial year 2011-12*, 20 November 2012. (PD0010)

⁸⁴⁹ Ofcom, *Briefing for Analysts: The Regulatory Framework for Postal Services*, 18 July 2013. (PD0013)

⁸⁵⁰ Ofcom, *Annual monitoring update on the postal market financial year 2012-13*, 22 November 2013. (PD0011)

⁸⁵¹ Ofcom, *Briefing for Analysts: The Regulatory Framework for Postal Services*, 24 April 2014. (PD0014)

⁸⁵² Ofcom, *Review of end-to-end competition in the postal sector*, 2 December 2014, page 19, paragraph 3.48. (PD0022) In its written representations, Royal Mail argues that reference to this December 2014 decision is *"misconceived... [because] it is necessary to consider at the time the pricing was put forward whether it was objectively justified"*: see Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 161, paragraph 9.35. (RM2386) However, the 2014 assessment relied principally on Whistl's December 2013 business plan – that is, the prevailing plan at the time Royal Mail issued the CCNs introducing the price differential. The 2014 assessment is, therefore, an objective assessment of the implications for the universal service of Whistl's end-to-end delivery business at the time Royal Mail introduced the price differential alongside other measures.

- c) At the same time, the associated retail market for bulk mail was competitive. Access operators operated within tight profit margins as the access costs, i.e. Royal Mail's access charges, accounted for a significant proportion of the overall price charged to retail bulk mail customers. Royal Mail was an unavoidable trading partner in respect of those charges.
- d) Royal Mail's overwhelming scope and scale in the bulk mail delivery market, coupled with its position as an unavoidable trading partner in the associated retail market for bulk mail, meant that competition in the bulk mail delivery market was rendered vulnerable to exclusionary conduct on the part of Royal Mail.

7.43 To the extent they are relevant, we address the submissions made by Royal Mail on the features identified above and the conclusions we reached in this section at paragraphs 6.99 to 6.102 above (in responding to Royal Mail's arguments against our conclusion on dominance); and in the remainder of section 7 (as part of our response to Royal Mail's submissions on our effects analysis).

C. The price differential amounted to discrimination against Royal Mail's competitors

Introduction

- 7.44 Section 3 (*Royal Mail's Access arrangements and the Contract Change Notices of January 2014*) contains a detailed description of the Access Letters Contract and the terms of the Contract Change Notices introduced by Royal Mail on 10 January 2014. In this sub-section we:
- a) consider their likely impact as introduced on end-to-end delivery operators seeking to compete with Royal Mail; and
 - b) explain the reasons for our finding that the price differential was discriminatory because it applied dissimilar conditions to equivalent transactions with Royal Mail's access operator customers who, as we have explained in sub-section B above, were economically dependent on Royal Mail in order to operate their businesses (i.e. retail bulk mail delivery services provided using access in accordance with NPP1 and APP2/ZPP3).
- 7.45 As set out in Section 3, under the price differential, different prices were to be charged for *the same services* by reference to the particular price plan used by an access operator. The relevant changes made by the CCNs were as follows:
- a) APP2 prices (for all products and services) were increased by approximately 1.2% relative to NPP1 prices; and
 - b) as illustrated by Table 3.5, ZPP3 prices were derived from APP2 prices based on a 'zonal tilt' (which adjusts the APP2 price for each zone). The new ZPP3 prices therefore also incorporated the price differential. The precise impact of the price differential on a ZPP3 customer would depend on the particular zonal profile of that operator. However, because the weighted average of ZPP3 prices was equivalent to APP2 prices, an APP2 operator (who met the APP2 profile) would face the same higher prices on ZPP3.⁸⁵³
- 7.46 As we explain in the following sub-sections:
- a) Due to the particular restrictions that apply to NPP1, that pricing plan was in practice only available to access customers with a national profile of mail who did not seek to compete with Royal Mail in bulk mail delivery on a material scale. Access customers who chose to expand their operations to compete directly with Royal Mail in delivery beyond a limited number of SSCs would therefore have faced systematically higher prices (around 1.2%) on the price plans that were available to them (APP2 and ZPP3) for the provision of the same services by Royal Mail.

⁸⁵³ This is explained in paragraphs 3.59 to 3.66.

- b) Royal Mail's transactions with its access customers on NPP1 and APP2/ZPP3 were equivalent for the purposes of our assessment.
- c) The price differential cannot be explained or justified on the basis of (i) differences between APP2/ZPP3 customers by comparison with NPP1 customers based on their geographic profile, total volumes or variability of volumes in a geographic area; or (ii) costs savings that are alleged to result from Royal Mail's requirement for NPP1 customers alone to provide more detailed volume forecasts than APP2/ZPP3 customers.

The lower prices on NPP1 would not have been available in practice to access customers that competed with Royal Mail in delivery on a material scale

- 7.47 In this sub-section, we outline the basis for our finding that the lower prices on NPP1 were in practice available only to access operators who did not enter the bulk mail delivery market in competition with Royal Mail on any material scale. This finding is supported by:
- a) Royal Mail's contemporaneous analysis of the implications of the price differential for end-to-end operators; and
 - b) Whistl's conclusion that it could not operate on NPP1 and continue its expansion as an end-to-end operator.

End-to-end operators of material scale were unable to benefit from the lower access prices on NPP1

The requirements of NPP1

- 7.48 As set out above in Section 3, prior to the price differential being introduced, the defining difference between NPP1 and the other price plans under the Access Letters Contract was that NPP1 depended on operators having a standard national delivery profile that fitted with certain geographic profile requirements. In particular:
- a) The National Spread Benchmark specified the minimum proportion of an access operator's mail that must be submitted to Royal Mail for delivery to each of 83 contiguous areas of the UK, known as Standard Selection Codes or SSCs. The relevant proportion was specified by reference to Royal Mail's own national profile.
 - b) Where an operator did not submit sufficient letters in a given SSC it would 'fail' that SSC for the purposes of the National Spread Benchmark. The minimum requirement to 'pass' an SSC for the purposes of NPP1 was that an access operator had to achieve 70% of the target.
 - c) The Access Letters Contract provided for 'tolerances', which allowed operators on NPP1 to deviate, to a limited extent, from the National Spread Benchmark. Of present relevance, operators on NPP1 were allowed to fail to meet the National Spread Benchmark in a specified number of SSCs. Under the terms and conditions of the Access Letters Contract, as varied by the CCNs, operators would have been allowed to miss the benchmark in five SSCs in England and Wales and one SSC in Scotland (but

none in Northern Ireland), without incurring adverse contractual consequences.⁸⁵⁴ In other words, to comply with the National Spread Benchmark, an access operator would have been required to 'pass' at least 77 of the 83 SSCs. Prior to January 2014, NPP1 operators were allowed to fail to meet the National Spread Benchmark in up to six SSCs in England and Wales and three SSCs in Scotland and Northern Ireland.

- 7.49 If an operator failed to meet the National Spread Benchmark, they would be at risk of one or more of the following sanctions under the Access Letters Contract:
- a) **Surcharges.** The NPP1 surcharge regime was highly complex but it was, in effect, intended to protect Royal Mail from a loss of revenue in failing SSCs by requiring the access operator to pay the difference between its total postage in that SSC and what the postage would have been had the operator met the 70% target. The greater the deviation from the profile requirement, the greater the surcharge.⁸⁵⁵
 - b) **Automatic transfer.** If surcharges exceeded a level equivalent to 15% of the total postage paid by an operator under NPP1, Royal Mail would remove that operator from NPP1.⁸⁵⁶
 - c) **Eligibility.** Use of NPP1 required the operator to show to Royal Mail's reasonable satisfaction that it has a reasonable likelihood of meeting the National Spread Benchmark. It is difficult to form a definitive view as to how this eligibility rule would have been enforced by Royal Mail.⁸⁵⁷ However, the eligibility requirement gave rise to a risk of Royal Mail finding an operator ineligible to use NPP1 by reason of its past failure(s) to meet the benchmark.⁸⁵⁸
- 7.50 Taking these characteristics of NPP1 together, the ability of an access operator to benefit from the lower NPP1 access prices without incurring adverse contractual consequences depended on whether: (a) they had a standard national profile; and (b) they did not deviate from that profile by more than the permitted amount. There were a number of reasons why access operators might diverge from the national profile so as to cause a 'failure' in particular SSCs. For example, a regionally focused operator might be unable to achieve a national spread. However, this aspect of NPP1 presented a particular problem for national access operators who sought to expand their operations into end-to-end delivery.

⁸⁵⁴ See paragraph 3.87.

⁸⁵⁵ See paragraphs 3.84 to 3.92. National Spread Benchmark surcharges were calculated as the total price the operator would have paid for the additional mailing items that would be required to achieve the benchmarks in those SSCs. Operators were permitted to fail a certain number of SSCs and this tolerance was applied to the largest failures (i.e. those SSCs where the gap between the operator's actual volume and the volume that would be required to meet the benchmark is greatest).

⁸⁵⁶ See paragraph 3.101.

⁸⁵⁷ This is because Royal Mail retains considerable discretion over some aspects of the rules. Also, while operators could become liable to surcharges in some circumstances, Royal Mail has discretion over whether an operator has to pay the surcharge.

⁸⁵⁸ See paragraph 3.83.

National end-to-end operators of material scale would not be able to benefit from NPP1 and so would face higher prices

- 7.51 As noted above, the minimum requirement to ‘pass’ an SSC for the purposes of the NPP1 National Spread Benchmark was that an access operator achieved 70% of its target for that SSC. There was therefore a high risk that an end-to-end operator that commenced its own delivery services in a given SSC would ‘fail’ that SSC, by itself delivering (or ‘converting’) more than a limited proportion of its retail customers’ mail (amounting to 30% of its NPP1 target for that SSC).⁸⁵⁹
- 7.52 If an operator were to confine its end-to-end operations to a very limited number of areas (undertaking its own delivery in less than 6 SSCs), it could still potentially meet the National Spread Benchmark, and therefore use NPP1 without adverse consequences, given the ‘tolerances’ referred to at paragraph 7.48 above.
- 7.53 However, any further expansion of its operations (extending to 6 or more SSCs, at conversion rates exceeding 30% of the targets applicable to those SSCs) would result in the operator failing the National Spread Benchmark. This would expose the operator to the various potential adverse consequences under the Access Letters Contract which are set out at paragraph 7.49 above, as follows:
- a) First, if such an operator were to attempt to use NPP1, it would become liable for surcharges as soon as it exceeded the applicable tolerances. Royal Mail’s analysis of Whistl’s business plans in its written representations to Ofcom shows that it would have been more commercially attractive for Whistl to operate on NPP1 only while it was rolling out its delivery network to a maximum of 13 SSCs, at which point the total effective NPP1 price (including surcharges) would exceed the total effective APP2/ZPP3 price (including the price differential).⁸⁶⁰
 - b) Second, if an expanding end-to-end operator sought to remain on NPP1 notwithstanding the surcharges to which it was subject, it would be automatically removed from that price plan once the level of its surcharges reached 15% of total postage paid.
 - c) Third, and in any event, an expanding end-to-end operator would be at risk of a finding by Royal Mail that it was ineligible to use NPP1, on the basis that it was unable to demonstrate to Royal Mail’s reasonable satisfaction that it had a reasonable likelihood of meeting the National Spread Benchmark.⁸⁶¹

⁸⁵⁹ The precise point at which end-to-end conversion would cause an SSC failure would depend on the starting point in that SSC. If the access operator’s starting profile was lower than the benchmark, a smaller degree of conversion would cause a failure.

⁸⁶⁰ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 127, paragraphs 7.98 to 7.100. (RM2386)

⁸⁶¹ This would be particularly relevant for an operator that was not using NPP1 but wished to switch to it. By not having a national profile, an APP2/ZPP3 operator active in delivery may be unable to prove to Royal Mail’s reasonable satisfaction that it had a reasonable likelihood of meeting the relevant benchmarks.

- 7.54 As regards the third of those consequences, Royal Mail clearly enjoyed an element of discretion in deciding upon the eligibility of an operator to use NPP1. In its written representations, Royal Mail has stated that it would “*only refuse access to NPP1 to a new customer or an existing customer seeking to switch plans if they fail the [National Spread Benchmark] by a significant margin (i.e. where a customer would fail to comply with the benchmark by an additional 7 to 13 SSCs beyond the stated tolerances)*.”⁸⁶² This position is, however, not supported by any contemporaneous evidence as to the policy Royal Mail intended to apply under the contract. Royal Mail’s contemporaneous internal modelling of Whistl’s likely response to the price differential proceeded on the basis that, if the notified price changes failed to incentivise Whistl to move to NPP1 and cease rolling out, Whistl would have remained on APP2 as it rolled out further.⁸⁶³
- 7.55 We have therefore reached the conclusion that an access operator rolling out its own delivery network on any material scale⁸⁶⁴ would have been highly unlikely to meet the National Spread Benchmark without incurring surcharges. The likely effect would have been to compel the operator either:
- a) to cease or limit the expansion of its bulk mail delivery operations and remain on/move to NPP1, so as to avoid the 1.2% price differential on Royal Mail’s access costs; or
 - b) to remain on/move to APP2 or ZPP3 (once its roll out reached a sufficient scale that NPP1 was no longer viable or available) and pay the higher prices under these plans if it decided to continue with its expansion plans for bulk mail delivery operations.
- 7.56 In sum, if an end-to-end entrant decided to continue its roll out, it would reach a ‘tipping point’ at which one or more of the adverse consequence of using NPP1 would require it to remain on/transfer to APP2 / ZPP3 and pay the higher prices under the price differential. The lower prices available under NPP1 would in practice be unavailable to it, given the surcharges and other contractual consequences that would be triggered by the changes in the volumes of mail which it provided to Royal Mail for delivery as its own delivery operations expanded. In the remainder of this Decision we refer to this ‘tipping point’ as the point at which NPP1 would become “unavailable in practice” to an end-to-end entrant.

⁸⁶² Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 126, paragraph 7.96. (RM2386)

⁸⁶³ For example, in assessing which price changes to make, Royal Mail distinguishes between those outcomes in which end-to-end operators would “*switch to [NPP1] and stay there*” and those in which operators would “*end on [APP2] and grow to 20+ SSCs.*” (Royal Mail, *Options for protecting the USO – Draft discussion document*, October 2013, 13 November 2013, slide 10. (RM0960))

⁸⁶⁴ We do not consider that our assessment is materially affected by whether the precise point at which an access operator would find it commercially unattractive to use NPP1 would occur once the operator failed the National Spread Benchmark in six out of 83 SSCs (as permitted by the contractual tolerances) or in 13 out of 83 SSCs (as Royal Mail concluded in its contemporaneous modelling of Whistl’s incentives based on the price differential). In either case, an end-to-end operator would need to choose between confining its end-to-end roll out to a small proportion of SSCs or paying the higher prices applicable under APP2/ZPP3.

Royal Mail’s own internal contemporaneous analysis of the implications of introducing the price differential envisaged that it would result in higher prices for access customers competing in delivery

- 7.57 Royal Mail’s own analysis in its contemporaneous internal documents supports the conclusion, set out above, that NPP1 would become unavailable in practice to an end-to-end operator that decided to continue with end-to-end expansion on a material scale and, as a consequence, such an operator would have to pay the higher prices under APP2/ZPP3.
- 7.58 Specifically, Royal Mail’s analysis shows that it understood that:
- a) the characteristics of NPP1 would limit the level of end-to-end activity that could be carried out while operating on NPP1; and
 - b) by adjusting its wholesale prices, Royal Mail would create the need for an entrant to consider whether to proceed with roll out and incur higher prices on APP2/ZPP3 or limit expansion so as to access the lower prices of NPP1.
- 7.59 For example, Royal Mail noted that:
- a) a “[a] small scale DD operation (5 or less SSCs) could be supported on [NPP1]”;⁸⁶⁵
 - b) if Whistl switched to NPP1 “that would then dent their direct delivery ambitions”.⁸⁶⁶
- 7.60 Similarly, in a presentation to its Chief Executive’s Committee, Royal Mail was clear that “[a] larger scale Direct Delivery operator would need to move to a zonal Price Plan to minimise surcharges”.⁸⁶⁷ This presentation also notes that “9 USPA customers [with zonal contracts] would receive up to a 1.5% higher price if they cannot switch to PP1” and “[Whistl] might choose to switch to PP1 to avoid a £6million impact of the new price differential on PP2”.⁸⁶⁸ Royal Mail therefore anticipated that an end-to-end competitor, such as Whistl, would either have to switch to NPP1 (thus limiting their direct delivery ambitions) or switch to APP2/ZPP3 and thereby have to incur the price differential.
- 7.61 We discuss Royal Mail’s strategy and objectives in introducing the price differential further in sub-section D below.

Whistl determined that it could not use NPP1 during its roll out and would therefore pay higher prices under APP2/ZPP3

- 7.62 Our finding that end-to-end operators of material scale would not have been able to use NPP1 in practice is also supported by contemporaneous evidence from Whistl, which shows that it considered the national spread profile requirement of NPP1 to be inconsistent with its roll out plan. In an internal paper of January 2014, Whistl assessed

⁸⁶⁵ Royal Mail, Presentation entitled *Proposed actions on Access contracts to protect the USO*, 30 September 2013, slide 4. (RM1126)

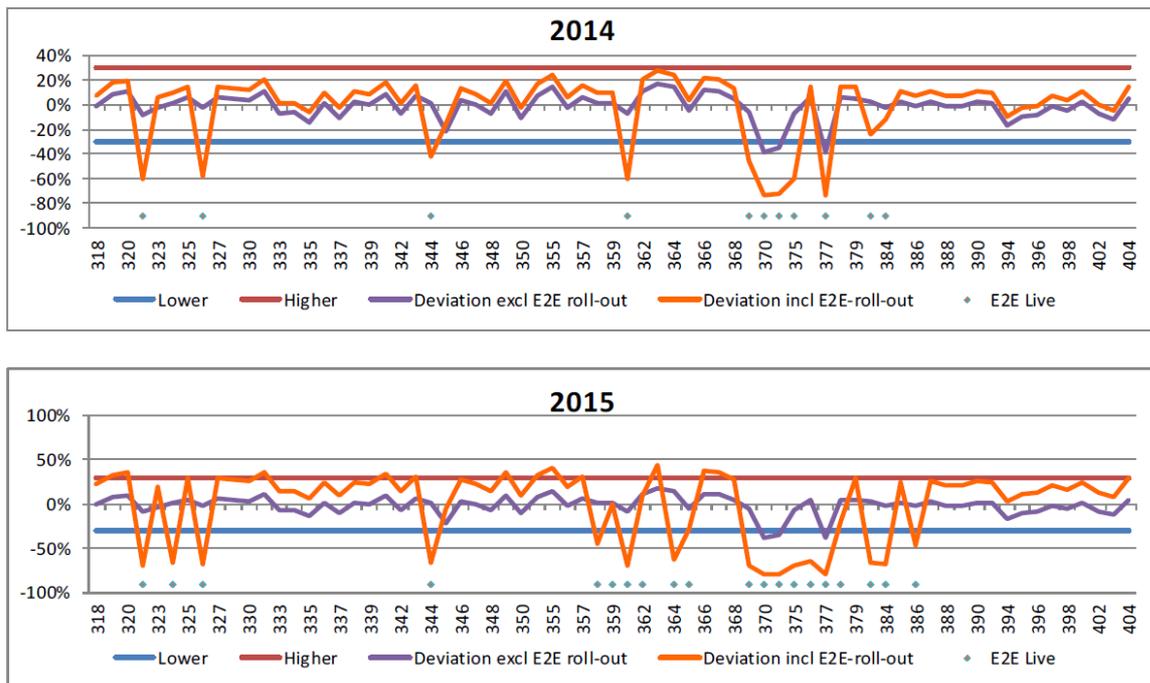
⁸⁶⁶ *Ibid.*, slide 25. (RM1126)

⁸⁶⁷ Royal Mail, *Options for protecting the USO – Draft discussion document*, October 2013, 13 November 2013, slide 9. (RM0960)

⁸⁶⁸ *Ibid.*, slide 12. (RM0960)

how its roll out plan would affect its national spread profile against the National Spread Benchmark. Figures 7.3 and 7.4, which are taken from Whistl’s analysis, show that over time Whistl’s national spread profile would have increasingly deviated from the National Spread Benchmark due to the roll out of its delivery services into additional SSCs. The orange line indicates Whistl’s projected actual national spread profile and wherever this falls below the blue lower limit line, it will fail the SSC referred to in the x axis.⁸⁶⁹ SSCs in which Whistl projected having an active delivery operation at some point during the year are indicated by blue dots above the x axis.

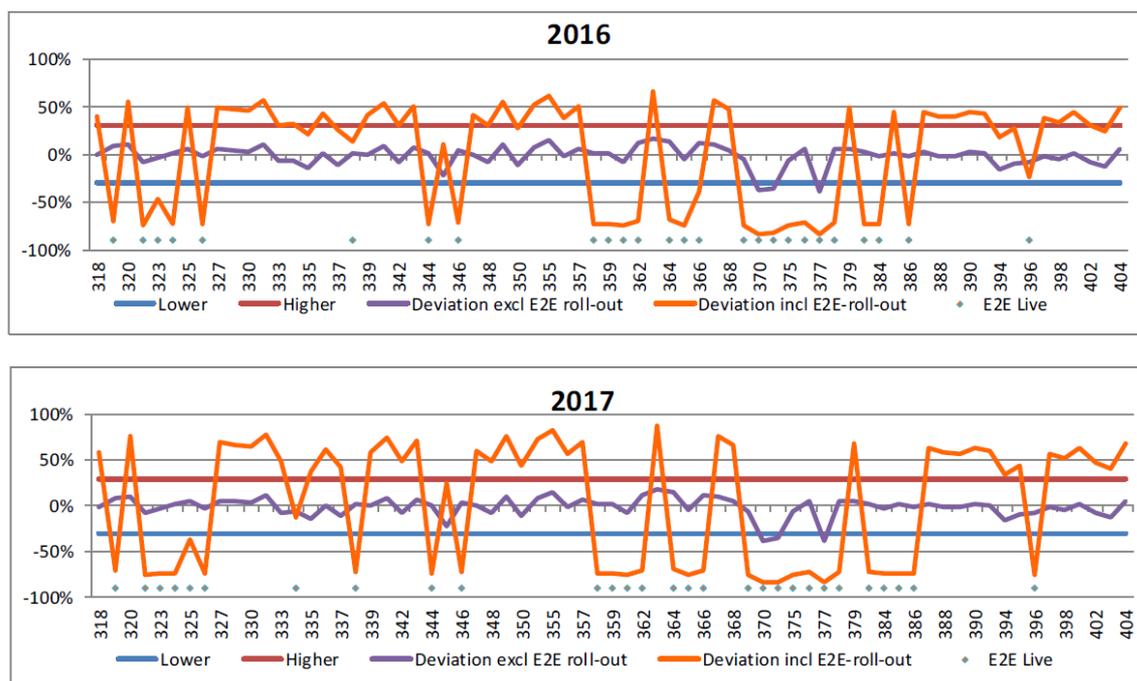
Figure 7.3: Whistl’s assessment of its national spread profile during roll out (2014 and 2015)



Whistl: *Whistl, Impact of Price plan proposal Royal Mail, 14 January 2014, slide 8. (WH0739)*

⁸⁶⁹ These graphs describe national spread performance in England and Wales with each SSC described by the three-digit code in the x-axis (i.e. 69 SSCs between 318 to 404). The red coloured upper line has no significance – an SSC fails if the proportion of mail going to it is too low (the blue line), not too high.

Figure 7.4: Whistl’s assessment of its national spread profile during roll out (2016 and 2017)



Whistl: Whistl, *Impact of Price plan proposal Royal Mail*, 14 January 2014, slide 9. (WH0739)

- 7.63 The charts indicate that, as Whistl’s end-to-end coverage increases, it would have been increasingly unable to meet the requirements of NPP1. In almost every active delivery area, Whistl expected to fail to meet the National Spread Benchmark to a very significant degree.⁸⁷⁰ If it were to use NPP1, Whistl calculated that in 2014-15 it would incur total annual surcharges of approximately £9.4 million and by 2017-18 this would rise to approximately £65 million.⁸⁷¹
- 7.64 In contrast, Whistl’s national profile without any end-to-end activity (represented by the purple line) would be compatible with the National Spread Benchmark requirement of NPP1. Although Whistl projected that, without any end-to-end operations, its profile would fall marginally below the benchmark in some London locations (in particular several SSCs between 370 to 377), this would not produce any surcharges because up to five failures are permitted (in SSCs in England and Wales).

Equivalent transactions

- 7.65 As outlined in Section 5, *Legal Framework*, as a matter of competition law, Royal Mail is entitled to offer different terms and conditions, or to vary its service offering, to reflect differences in the nature of transactions between its customers. Uniformity in pricing is not legally required, so dominant undertakings are entitled to offer different prices, terms and

⁸⁷⁰ National Spread Benchmark compliance is assessed on an annual basis. It is therefore possible that an SSC will not fail if delivery operations in that area are launched late in the year. These areas will however fail in subsequent years. This is reflected in Whistl’s charts and, by 2017, every live delivery area was projected to cause an SSC failure (with one exception – area 334 – where deliveries only began that year).

⁸⁷¹ Whistl, *Impact of Price plan proposal Royal Mail*, 14 January 2014, slide 6. (WH0739)

conditions, consistent with their ability to compete fairly on the merits, to reflect the economic conditions of supply and demand in the market.

- 7.66 As part of our assessment to determine whether the price differential was a legitimate response to market conditions (as Royal Mail argues) or whether it was a form of unlawful discrimination, we have therefore assessed whether there was a relevant difference between the transactions which justified the difference in treatment or whether the transactions were equivalent for these purposes.
- 7.67 Specifically, we have considered whether Royal Mail's transactions with customers on (a) NPP1 and (b) APP2/ZPP3 are equivalent to one another, having regard to the substantive content of the services supplied by Royal Mail, or whether there were any relevant differences between them that could justify the price differential.⁸⁷²

The objectives served by the price plans

- 7.68 In its representations, Royal Mail submitted that "*the access price plans... are designed to cater for different posting characteristics and reflect the implications for Royal Mail of those differing characteristics.*"⁸⁷³
- 7.69 As set out at paragraph 3.9 to 3.23 above, however, the continued existence of NPP1 alongside APP2 was an "*unintended consequence*" of the fact that Royal Mail was unable to secure consent from all of its access customers to replace their NPP1-type terms with the APP2 arrangements, which had been proposed by Royal Mail as a new "*single national price plan*".⁸⁷⁴ In consequence, some customers were left on NPP1 and some were moved to APP2.
- 7.70 The national pricing arrangements in 2014 simply reflected these historical events, and were not the result of any deliberate design on Royal Mail's part to cater for different customer needs. On the contrary, NPP1 and APP2 were both designed to perform the same underlying function, namely to achieve the administrative convenience of a single averaged price, while seeking to ensure that Royal Mail faced the same average cost through the specification of profile requirements, based on the overall profile of bulk mail delivered by Royal Mail.
- 7.71 Although they were framed differently, the NPP1 and APP2 profile requirements therefore referred to different characteristics of the *same underlying benchmark profile*:
- a) in the case of NPP1, it is the Royal Mail benchmark profile broken down by SSC; and
 - b) in the case of APP2, it is the Royal Mail benchmark profile broken down by zone (or, more precisely, broken down by postcode sector and then aggregated by zone).

⁸⁷² This is also the approach adopted by the European Commission in *Clearstream*, Decision of 2 June 2004 (COMP/38.096)

⁸⁷³ See Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 114, paragraph 7.38. (RM2386)

⁸⁷⁴ See *Ibid.*, page 29, paragraph 2.50. (RM2386)

- 7.72 As shown by the development of these plans, in both cases the aim of these benchmarks was to ensure operators provided a specified mix of cheaper to deliver items and more costly to deliver items, thereby imposing the same average cost on Royal Mail.⁸⁷⁵
- 7.73 In the case of ZPP3, it was not necessary to apply any such profile requirements because this plan was based on separate prices for individual mail items, based on the costs of delivery to particular locations. This plan, which was largely unchanged since its introduction in 2004, had been priced by Royal Mail on an equivalent basis to its other plans for ten years prior to the introduction of the price differential. This means, for example, that if an operator who perfectly matched the national spread profile switched to the zonal plan, it would be expected to pay the same price as it would have done on a national plan.⁸⁷⁶

The transactions provided by Royal Mail on NPP1 and APP2/ZPP3 are equivalent for the purposes of assessing whether Royal Mail applied dissimilar conditions

- 7.74 Considering each plan in detail, it is clear from the evidence in this case that the substance of the transactions carried out by Royal Mail in respect of D+2 access was (and is) equivalent between customers on each of the price plans – NPP1, APP2 and ZPP3. Fundamentally, the service provided by Royal Mail is the delivery of letters on behalf of the access operator. The processes and costs of providing that service, and the assets and network used for delivery, do not depend on the price plan under which a customer’s mail is submitted for posting. They are the same. While costs of processing and delivery may vary *by item* and *by area*, they do not vary *by price plan*. For example, a letter addressed to a postcode sector allocated to the rural zone will be processed by Royal Mail in the same way and incur the same costs regardless of the price plan under which the letter was submitted.⁸⁷⁷
- 7.75 In every case, access mail is handled by Royal Mail in the same way as part of its delivery process, in that Royal Mail:
- a) receives access letters at its IMC;
 - b) carries out its inward sortation process;
 - c) transports mail to the relevant delivery offices;
 - d) sequences letters and large letters into walks; and then,
 - e) completes the final delivery.

⁸⁷⁵ There may be differences in the effective profile because Royal Mail appears to update the zonal profile more frequently than it updates the National Spread or Urban Density Benchmarks. This is not, however, a difference in the nature of the services.

⁸⁷⁶ See above paragraph 3.48.

⁸⁷⁷ We recognise that the cost of delivery may vary between different *locations*, and that this is reflected in the four different zonal prices that Royal Mail uses in ZPP3 and, at least to some extent, the surcharge arrangements in NPP1 and APP2. The abusive conduct we have identified does not relate to the principle of having different prices to reflect different delivery costs. However, the price differential means that an operator with the benchmark national profile would obtain access more cheaply on NPP1 than would be the case for an operator with an *identical profile* on APP2 or ZPP3.

- 7.76 There are a considerable number of differences that may exist between different mailings. For example, the way the address is presented may change how Royal Mail processes the items. Such differences are, however, wholly independent of the price plan under which the items happen to be processed.
- 7.77 This was reflected in the terms, conditions and operational framework for access, which applied to all access customers on any plan in 2014. This involved a common contractual framework with an identical set of basic terms and conditions, approximately 20 identical annexes and a common set of operational requirements and product specifications which are set out in a single user guide. Indeed, *the only differences* in the terms and conditions for NPP1, APP2 and ZPP3 were contained within a single annex to the main contract (annex 4) which set out the different eligibility, profile and surcharges arrangements.⁸⁷⁸ As set out at paragraph 7.70 above, in the case of NPP1 and APP2, this difference served a common objective of enabling Royal Mail to offer administratively convenient averaged pricing supported by profile requirements that were intended to ensure Royal Mail delivered to an acceptable mix of costly and cheaper areas.
- 7.78 Thus, while the contractual position appears complex and there are many product varieties offered by Royal Mail, the actual content of the transaction being undertaken between Royal Mail and its customers was equivalent in all material respects.

Response to Royal Mail's arguments on equivalence

Royal Mail's argument that some other access-only operators would also pay the higher charges on APP2/ZPP3

- 7.79 In its representations in this case, Royal Mail states that "[t]he application of higher access prices (i.e. for those on APP2/ZPP3) was not, as suggested by Ofcom, conditional on an operator competing with Royal Mail in bulk mail delivery. If this were true, customers on APP2/ZPP3 that did not compete with Royal Mail in bulk mail delivery would have avoided the higher price."⁸⁷⁹ Royal Mail goes on to say that this would not have been the case as a number of access only operators would also have been expected to remain on APP2/ZPP3 either out of choice or because they were unable to meet the NPP1 requirements.⁸⁸⁰
- 7.80 The fact remains, however, that the lower prices of NPP1 were, in effect and by design, available only to national access operators if they did not undertake end-to-end activities on any material scale. The fact that other smaller, localised operators may also have been incidentally affected⁸⁸¹ does not detract from the discriminatory character of the price

⁸⁷⁸ ZPP3 has additional requirements that reflect the 'pay as you go' nature of the price plan. This includes the printing of the delivery zone on the exterior of letters and additional information provided to Royal Mail at the point of hand over to break down volumes by zone.

⁸⁷⁹ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 124, paragraph 7.86. (RM2386)

⁸⁸⁰ *Ibid.*, pages 124 to 125, paragraphs 7.86 to 7.88 (RM2386)

⁸⁸¹ For example, Royal Mail identifies [redacted] (a CDA operator) as being unable or unlikely to use NPP1. This reflects [redacted] the operator's non-national customer base]. Royal Mail, Presentation entitled *Proposed actions on Access contracts to protect the USO*, 30 September 2013, slide 28. (RM1126)

differential. In any event, Royal Mail's internal documents show that it was aware of such incidental effects at the time that it introduced the price differential, but considered that they may in practice be able to avoid suffering a commercial disadvantage by reason of the price differential:

- a) In September 2013, in a review of the then proposed price changes, Royal Mail said that "[a] regional operator could always switch to a national consolidator to access the lowest prices."⁸⁸²
- b) In December 2013, in a presentation to Ofcom setting out the then proposed price changes, Royal Mail suggested that certain APP2 users (Whistl and [X]) "[c]an switch to Price Plan 1 [NPP1]" whereas others ([X] and [X]) "[c]an only switch to Price Plan 1 [NPP1] if they take an agency agreement through [X] a larger access operator."⁸⁸³

7.81 However, the options for Whistl from Royal Mail's perspective were to "stay on [APP2] [where] they will have a price disadvantage vs UKM [UK Mail]" or "if they move on to [NPP1] this will limit their direct delivery ambitions."⁸⁸⁴

Royal Mail's argument that an end-to-end competitor could have avoided the price differential through price plan arbitrage

- 7.82 Royal Mail argues that Whistl and, by extension, any end-to-end competitor, could have remained on NPP1 at the full extent of its planned roll out (at 31 SSCs) and, by employing an arbitrage strategy, secured a lower overall price than would have been possible on APP2.⁸⁸⁵ The arbitrage strategy envisaged by Royal Mail would have involved an operator selectively streaming its items between the NPP1 and ZPP3 plans, sending cheaper zonal items via ZPP3 and more expensive zonal items via NPP1 at the national price.⁸⁸⁶ Under this arbitrage scheme, so long as the operator carefully balanced the items to control surcharges, it could mitigate NPP1 surcharges and achieve a lower overall price than would be the case if it were to use APP2.⁸⁸⁷
- 7.83 The potential for arbitrage between the different plans already existed prior to the introduction of the price differential and Whistl's commencement of an end-to-end service.⁸⁸⁸ Royal Mail had, however, consistently characterised such arbitrage as an unfair and inappropriate use of the price plans. It had communicated that view both publicly to

⁸⁸² Royal Mail, Presentation entitled *Proposed actions on Access contracts to protect the USO*, 30 September 2013, slide 4. (RM1126). We understand this to mean that such an operator could work with another access operator in order to make use of its ability to access NPP1.

⁸⁸³ Royal Mail, *April 2014 Access Pricing*, 03 December 2013, slide 9. (RM2349)

⁸⁸⁴ Royal Mail, Presentation entitled *Proposed actions on Access contracts to protect the USO*, 30 September 2013, slide 11. (RM1126)

⁸⁸⁵ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 128, paragraph 7.105. (RM2386)

⁸⁸⁶ *Ibid.*, page 127, paragraph 7.101. (RM2386)

⁸⁸⁷ *Ibid.*, page 127, paragraph 7.102. (RM2386)

⁸⁸⁸ An access operator could have engaged in arbitrage even if it did not have its own delivery operation (indeed, as explained in Annex 2, Whistl complained to Royal Mail that NPP1 was being used for arbitrage). Further, had an access operator wished to engage in arbitrage, it could have done so even if the price differential was not in place.

the market at large, as well as directly to Whistl in the period leading up to the issuing of the CCNs.⁸⁸⁹ For example:

- a) In November 2013, Royal Mail used its contractual powers explicitly to attempt to close down such arbitrage opportunities.⁸⁹⁰ At that time, following complaints from two wholesale customers that their competitors were using a form of arbitrage, Royal Mail took action to reduce the potential for arbitrage on APP2.⁸⁹¹ In a letter to its access customers, Royal Mail publicly explained that the price plans allowed for “*an unintended opportunity for customers to use the permitted tolerances to exploit arbitrage which, if practised, can have a detrimental revenue impact on Royal Mail and ultimately reduce the targeted financial contribution of Access to Royal Mail’s Universal Service.*”⁸⁹²
- b) On 26 November 2013, Whistl wrote to Royal Mail setting out its concerns that NPP1 was also being used for arbitrage and proposed that amendments to the tolerances and profile requirements of NPP1 should be considered to prevent arbitrage.⁸⁹³ Royal Mail welcomed this input and invited further evidence, noting that “*we are exploring other measures to reduce arbitrage and those measures would impact both price plans... Our aim is to reduce the opportunity for arbitrage across all price plans and as a result, to ensure we receive a cost reflective price for the services we provide to our access customers.*”⁸⁹⁴

7.84 Thus, while the arbitrage strategy described by Royal Mail might theoretically have been possible, no rational end-to-end entrant would seriously have considered relying upon such arbitrage as a viable long-term plan to avoid the adverse consequences of the price differential. On the contrary, it was clear from Royal Mail’s public pronouncements that it regarded arbitrage as illegitimate, and that it would take steps to prevent it.⁸⁹⁵ It was also clear that Royal Mail had the means of doing so, given its contractual power to change any term or condition of access without the consent of its access customers.

7.85 It is notable that Royal Mail’s internal modelling of Whistl’s likely response to the price differential did not envisage Whistl engaging in arbitrage between price plans. Nor did Whistl attempt to pursue this strategy in response to the price differential.

⁸⁸⁹ See Annex 2.

⁸⁹⁰ See above paragraphs 3.70 to 3.71, which sets out the changes introduced by CCN 001 to address arbitrage problems.

⁸⁹¹ Royal Mail, *Letter to access operators*, 15 November 2013, page 1. (WH0100)

⁸⁹² *Ibid.*, page 1. (WH0100)

⁸⁹³ Whistl, *Letter to Royal Mail re: CCN 001*, 26 November 2013, pages 3 to 4. (WH0101)

⁸⁹⁴ Royal Mail, *Letter to Whistl re: CCN 001*, 9 December 2013, page 3. (WH0104)

⁸⁹⁵ It should also be noted that this public stance was reflected in Royal Mail internal papers. For example, in November 2013, a presentation to Royal Mail’s Chief Executive’s Committee discussed a proposal to remove arbitrage opportunities from all plans (by permitting operators to operate on only one plan) and noted that in doing so, it would be “*removing a “loophole” in its current contracts which customers are exploiting to the detriment of the USO.*” Royal Mail, *Options for protecting the USO*, October 2013, slide 13. (RM0960)

7.86 We also note that since making this argument in its written representations, Royal Mail continues to consult on and implement measures that remove opportunities for arbitrage.⁸⁹⁶

Royal Mail's argument that there are relevant differences in the characteristics of NPP1 and APP2/ZPP3 customers which justify the price differential

7.87 In its representations, Royal Mail identifies a number of differences between customers using NPP1 and those using APP2/ZPP3, which are said to show that the underlying transactions are not equivalent as between access operators on NPP1 and those on APP2/ZPP3. Specifically, Royal Mail relies on differences in:

- a) total mail volume;
- b) geographic profile; and
- a) variability of volumes in particular geographic areas.

7.88 For the reasons set out below, the differences identified by Royal Mail do not affect the equivalence of the transactions that were being undertaken between Royal Mail and its customers on NPP1 and APP2/ZPP3 for the purposes of assessing discrimination.

Total volumes

7.89 Royal Mail argues that *"national customers (typically on NPP1) tend to have larger overall volumes than customers on APP2 and ZPP3."*⁸⁹⁷

7.90 The price differential cannot, however, be justified by reference to differences in volumes between customers:

- a) If Royal Mail had intended to adjust its prices to reflect differences in customer volumes, it could do this by offering a volume discount. However Royal Mail has in the past explicitly rejected this possibility. In 2012, [§ a Royal Mail Executive] advised Whistl *"that it was difficult for him to see how he could cost justify a volume related discount at the IMC since there were very little cost savings which could be made upstream on the basis of volumes."*⁸⁹⁸
- b) Whether an access customer is on NPP1 or APP2 does not provide a good proxy for that customer's likely overall level of volumes. Whistl, an APP2 user, was at the material time (and remains) the largest access operator by volume. The purpose and likely effect of the price differential was to render the lower price of NPP1 unavailable to it unless it curtailed its end-to-end delivery plans.

⁸⁹⁶ See Annex 2 below, paragraphs A2.14 to A2.18.

⁸⁹⁷ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 111. (RM2386) Specifically, Royal Mail said (at paragraph 7.27) that: [§].

⁸⁹⁸ See Royal Mail, *Attendance Note – Royal Mail meeting with TNT*, 6 December 2012, page 2. (RM2337)

Geographic profile

- 7.91 Royal Mail argues that APP2/ZPP3 customers' mail profile may depart from Royal Mail's baseline profile to a greater extent than NPP1 customers.⁸⁹⁹
- 7.92 Differences in a geographic profile of delivery can affect Royal Mail's exposure to different costs. However, we do not accept that a systematically higher price to all APP2/ZPP3 customers can be justified by the potential for divergence from Royal Mail's benchmark profile:
- a) ZPP3 prices varied by zone, thereby reflecting the different costs of delivery to different geographic areas. For example, if an access operator tended to send mail to rural areas (which are more costly for Royal Mail to deliver to), then it would pay a higher price as a result.
 - b) Similarly, under APP2, operators had to observe a specified delivery profile, based on the proportion of mail delivered by zone. In this way, Royal Mail sought to ensure that the average price charged under that plan was cost reflective. If an operator failed to observe the required profile, surcharges were applicable – see paragraphs 3.102 to 3.109.
 - c) In the case of Whistl, over time its end-to-end delivery activities may have meant that the average cost of its customers' mail delivered via Royal Mail would have increased, as it did not plan to cover highly rural areas (which are costly to deliver in) during its end-to-end roll out from 2014 to 2018. To the extent this occurred, Royal Mail's APP2 surcharging regime would have accounted for this potential increase in rural volumes (and hence a higher average cost of delivery).
- 7.93 Even if there were differences in the costs of serving some access operator customers arising from their geographic profile, they do not justify a flat price differential applicable between all NPP1 customers and all APP2/ZPP3 customers. The fact that the price differential was the same for all APP2/ZPP3 customers means that the higher price under this plan was not targeted at the particular areas where any individual access operators sent their mail but instead applied regardless of the geographic profile of the access customers concerned. Indeed, an APP2/ZPP3 customer would have been subject to the price differential between the plans even if it had exactly the same profile as Royal Mail.

⁸⁹⁹ Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 109 to 110, paragraphs 7.21 to 7.26. (RM2386) In particular Royal Mail argued that the geographic distribution of mail for customers on NPP1 should be and generally is aligned with that of Royal Mail but the geographic distribution of mail for customers on APP2 diverges from Royal Mail's profile in a greater number of areas, particularly those reflecting the regional focus of APP2 customers (for example, [3<]), as well as Whistl's roll-out and arbitrage by a number of customers between APP2 and ZPP3. Royal Mail also presented an analysis which it said showed that APP2 volumes are approximately twice as divergent as NPP1 compared to Royal Mail's fall-to-earth profile (Figure 7.1).

Variability of volumes in particular geographic areas

- 7.94 Royal Mail argues that the “*distribution of volumes across local areas is significantly more variable for APP2 and ZPP3 customers than for NPP1 customers*”⁹⁰⁰ and that “*large, national customers (typically on NPP1) are more predictable in the local areas where they require delivery over time.*”⁹⁰¹
- 7.95 We do not consider that variability of a particular access operator’s or a group of access operators’ volumes in a given geographic area can justify the price differential in circumstances where Royal Mail processed and delivered virtually all bulk mail volumes throughout the UK, with the only significant exception being those volumes which were delivered directly by Whistl (in the period before it exited the delivery market). As set out above, Royal Mail handled all access letters in the same way as part of its delivery process. This means that it was the total delivery volumes (across all operators) in a given area which would drive material changes in Royal Mail’s costs, not the level of (or fluctuations in) each access operator’s individual mail volumes.
- 7.96 Access operators, other than those which compete in delivery, have little influence over the total volume of mail Royal Mail received for delivery in each area. Other than mail delivered directly by a competitor, Royal Mail received for delivery all bulk mail sent by retail bulk mail customers, regardless of which access operators have a relationship with those retail customers. This means, for example, that where an access operator lost a major customer to a competitor, the ‘losing’ access operator’s mailing profile would be altered (as the mailings transfer to another operator), but those volumes would not disappear from Royal Mail’s network. This is because, assuming the retail customer continued to have demand for bulk mail, that retail customer simply switched its volumes to a different access operator (or Royal Mail’s bulk retail business). The ‘gaining’ access operator would then hand over those same volumes to Royal Mail.
- 7.97 There are circumstances where volume changes would not simply move between operators, such as e-substitution. However, there is no evidence to suggest this is more or less likely depending on whether the retail customer is served by an operator using NPP1, APP2 or ZPP3. We also consider below the specific circumstances of end-to-end competition which may result in some variability of volumes as they are removed from Royal Mail’s network, which forms the basis of Royal Mail’s ‘cost justification’.
- 7.98 Royal Mail also argues that: “[c]ustomers also differ in the predictability of the distribution of mail between different local areas over time as measured by the degree of stability in the IMCs accessed by customers over a given time.”⁹⁰² All customers (including APP2 and ZPP3 customers) had to provide forecasts each day setting out their estimated daily volumes to be handed over to Royal Mail at each IMC they anticipated using in the next seven days.

⁹⁰⁰ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 112, paragraphs 7.28 to 7.29. (RM2386)

⁹⁰¹ *Ibid.*, pages 112 to 113, paragraphs 7.30 to 7.33. (RM2386) We address Royal Mail’s arguments relating to variability driven by the total volume of mail handled by the access operator at paragraphs 7.89 to 7.90 above.

⁹⁰² Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 114, paragraph 7.34(c). (RM2386)

This was the operational framework that Royal Mail had put in place to manage its expectations around IMC access.⁹⁰³ If it wished to improve these forecasts, Royal Mail had the contractual right to make changes without consent.

Royal Mail’s ‘cost justification’ based on NPP1 forecasts does not justify the price differential

- 7.99 Building on its submissions regarding the differences between NPP1 and APP2/ZPP3 customers, which are addressed above, Royal Mail argues that the customers on these price plans differ fundamentally in their ability to help Royal Mail predict and deal with volume drops on a local basis and thereby to realise cost savings.
- 7.100 In summary, Royal Mail argues that:
- a) it could use advance forecasts of volume reductions in particular SSCs to make operational changes and realise costs savings sooner in those SSCs;
 - b) customers using the NPP1 price plan, who must show adherence to the National Spread Benchmark requirements, are well placed to provide the local level volume forecasts by SSC which would permit such costs savings to be made; and
 - c) APP2/ZPP3 customers, whose geographic profile tends to diverge more significantly from Royal Mail’s and who do not have to adhere to SSC-level profile requirements, would, by contrast, be materially less able than NPP1 customers to help Royal Mail predict volume drops in particular SSCs.⁹⁰⁴
- 7.101 Royal Mail contends that the price differential between NPP1 and APP2/ZPP3 reflected the superior ability allegedly possessed by NPP1 customers to provide the local forecasts needed to unlock cost savings. Royal Mail states that:
- a) *“[the price differential] offered a lower price to customers that were able to assist Royal Mail in responding promptly to volume reductions and thereby realise cost savings earlier”*; and
 - b) *“it reflected the higher opportunity cost of serving APP2/ZPP3 customers in circumstances where a reduction in volume without warning delayed the achievement of cost savings by Royal Mail”*.⁹⁰⁵
- 7.102 Royal Mail’s ‘cost justification’ relies on the benefits it claims are derived from a contractual change it made through the CCNs, when introducing the price differential, which required NPP1 users alone to provide additional forecasting information.⁹⁰⁶ Specifically, NPP1 users were required to identify (once per year) each SSC in which its

⁹⁰³ Royal Mail, *Access Letters Contract (Schedule 2)*, pages 37 to 38, clause 12. (RM0026)

⁹⁰⁴ Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 10 to 11, paragraphs 1.35 to 1.36; pages 119 to 121, paragraphs 7.57 to 7.70. (RM2386)

⁹⁰⁵ *Ibid.*, page 11, paragraph 1.37 and page 122, paragraph 7.74. (RM2386)

⁹⁰⁶ Royal Mail, *Access Letters Contract Change Notices 003 - 005*, 10 January 2014. (RM0031)

relative volumes would drop over the following two years. There are two aspects to these forecasts:

- a) They related to *relative volumes drops* in instances where the proportion of mail sent to a given SSC falls. This means that a general decline in volumes that applied evenly across SSCs would not trigger this forecast requirement.
- b) They related to *substantial relative volumes drops* where the access operator's "SSC Ratio"⁹⁰⁷ declines by a factor of more than 0.4 compared to the previous year's ratio. To put this in context, this would mean that if an operator perfectly matched the National Spread Benchmark (thereby holding an SSC Ratio of 1), a 40% drop in volume in a given SSC would result in a decline of 0.4 (so long as all remaining volumes remained constant).

7.103 As part of the contractual changes linked to this new forecasting requirement, Royal Mail also introduced new surcharges, which would apply in the following two separate circumstances:

- a) first, where a drop in volumes in fact occurred in a given SSC which was sufficiently large that it should have been subject to prior identification in a forecast, but was not; and
- b) second, where such a drop in volumes was forecast to occur in a given SSC but did not in fact eventuate.

7.104 As explained at paragraphs 3.76 to 3.79 above, this additional forecasting requirement was introduced alongside the price differential in the CCNs of January 2014, but was not due to take effect until 4 August 2014, several months after the price differential was planned to come into operation.⁹⁰⁸

7.105 As part of its justification for the price differential, Royal Mail argues that only NPP1 customers could provide "*forecasting by exception*", meaning that such customers could provide notification of significant local changes in volume which would result in non-compliance with profile requirements, i.e. they could forecast and notify Royal Mail of the SSCs in which they expected to deviate from the National Spread Benchmark.⁹⁰⁹ In relation to APP2/ZPP3 customers, Royal Mail contends that it could not rely on such customers adhering to the National Spread Benchmark (given they were not required to follow the national profile), and was therefore unable to secure reliable forecast data from APP2/ZPP3 customers.⁹¹⁰

⁹⁰⁷ In summary, the SSC Ratio is the actual proportion of mail sent by an access operator in a given SSC divided by proportion of mail expected by the National Spread Benchmark.

⁹⁰⁸ This change was suspended alongside the suspension of the price differential and was withdrawn in March 2015.

⁹⁰⁹ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 116, paragraph 7.48, page 119, paragraph 7.57, page 120, paragraphs 7.59 to 7.64. (RM2386)

⁹¹⁰ *Ibid.*, page 116, paragraph 7.48, page 118, paragraph 7.55, page 119, paragraph 7.57 and page 121, paragraphs 7.65 to 7.70. (RM2386)

Assessment of Royal Mail's cost justification

- 7.106 We do not consider that the price differential introduced by Royal Mail can be justified by reference to any potential cost savings associated with the local volume forecasts (as described above) that Royal Mail required its NPP1 customers but not its APP2/ZPP3 customers to provide. Our reasons are set out below, and can be summarised as follows:
- a) First, the cost savings on which Royal Mail's 'cost justification' relies would only in practice have resulted from declines in volumes associated with end-to-end competition.
 - b) Second, however, and as explained at paragraphs 7.47 to 7.64 above, NPP1 customers would be very unlikely to undertake their own end-to-end delivery activities to any material extent in competition with Royal Mail, given the adverse contractual consequences that this would entail. It follows that the volume change forecasts that Royal Mail required only NPP1 customers to provide would not in fact have enabled Royal Mail to realise cost savings of the kind described above.
 - c) Third, and in any event, there is no reason to suppose that APP2/ZPP3 customers could not also have provided valuable forecasts in relation to anticipated volume reductions in particular SSCs resulting from their intended roll out of end-to-end delivery services. Royal Mail did not, however, attempt to obtain such forecast information from them, or offer any financial incentive for such information, equivalent to the lower prices conferred on NPP1 customers by the price differential.
 - d) Fourth, Royal Mail's failure to seek forecast information from APP2 customers is particularly stark given that its calculations of the costs savings that it considered could be achieved by obtaining such information were in fact based on the roll out plans of an APP2 customer – Whistl – in the Manchester area.
 - e) In short, Royal Mail's cost justification involves penalising operators for not providing information, even though Royal Mail did not seek or contractually require them to provide that information.

Development by Royal Mail of the cost justification

- 7.107 As a preliminary point, we note that the evidence in Royal Mail's contemporaneous documents does not support the contention that the price plans were originally developed with the intention of separating customers depending on their capacity to forecast volumes. These documents show that Royal Mail originally considered a cost justification to be "*difficult*" on the basis that the price differential would be introduced to incentivise operators to provide a national distribution of mail.⁹¹¹ It only developed its cost justification based on the claimed distinction between operators' ability to provide forecasts following its discussions with its economic advisers, Oxera.⁹¹²

⁹¹¹ Paragraph 4.26 above; see also paragraphs 4.30 and 4.76 above.

⁹¹² We note that although Royal Mail had previously consulted on a possible price differential, this was predicated on imposing a volume commitment on certain users (not on their ability to forecast volumes).

- 7.108 As set out in Section 4, during Royal Mail’s internal decision-making process leading to the introduction of the price differential, Oxera advised Royal Mail to develop a cost-based justification for the proposed differential in order to ensure that imposing a higher price on its APP2/ZPP3 customers did not amount to unlawful price discrimination (see paragraphs 4.60 to 4.66 and 4.75 to 4.77). When Royal Mail first began to develop the purported justification for the price differential, it considered two possible ways to justify it: (a) a ‘value based justification’, and (b) a ‘cost based justification’.
- 7.109 With respect to the ‘value based justification’, Royal Mail’s argument was that Whistl would get broadly similar “value” from using the APP2 plan (with the higher price) as it would from using the NPP1 plan (with a lower price, but subject to the surcharges applicable to deviations from Royal Mail’s geographic profile). Royal Mail estimated the cost, in surcharges, for Whistl attempting to use NPP1 during its end-to-end to roll out. Royal Mail attempted to connect the price differential to the benefit of Whistl being able to use APP2 to avoid these surcharges. Royal Mail’s economic advisors, Oxera, expressed doubts as to the robustness of the ‘value based justification’, noting that it depended on the particular parameters Royal Mail elected to impose on the price plans, and that these would vary as Royal Mail changed those parameters (see paragraphs 4.78 to 4.81). Oxera advised that Royal Mail should therefore seek to develop a cost justification for the price differential (see paragraph 4.76).
- 7.110 In the light of Oxera’s advice, Royal Mail focussed on developing an alternative theory that NPP1 customers provided “*richer information*”⁹¹³ about the profile of their mail and that this predictability, compared to APP2 customers, enabled Royal Mail to better plan its network. However, Oxera also identified difficulties with Royal Mail’s new theory. It pointed out that “[t]he ‘value’ for Royal Mail resides in getting advance knowledge of volume profiles... these profiles do not necessarily have to be in accordance with NPP1”.⁹¹⁴ In other words, the value Royal Mail had identified, in terms of potential cost savings derived from volume predictability, derived not from a customer observing the NPP1 profile in particular, but from the provision of information in connection with any profile that enabled Royal Mail to predict and plan for any substantial decline in volumes within a given area (see paragraph 4.89 to 4.91 above).
- 7.111 Oxera also noted that a “*less helpful*”⁹¹⁵ aspect of this justification was that a customer on any of Royal Mail’s price plans should be eligible to receive a discount if they could commit to maintaining a pre-specified geographical profile of volumes (irrespective of whether this matched the NPP1 profile) and to providing advance notice of any anticipated reduction of volumes within a given area. Oxera added that: “*For a very large customer, such as*

⁹¹³ Royal Mail, *Disclosure Committee 6 January 2014 – Changes to Access Pricing Plans: explanation and justification of Royal Mail’s approach*, 6 January 2014, page 12, paragraph 15. (RM0124)

⁹¹⁴ E-mail from [redacted] (Oxera) to [redacted] (Royal Mail), 10 October 2013, page 1. (RM1154)

⁹¹⁵ *Ibid.*, page 2. (RM1154)

[Whistl], the value of this information could be the same, if not greater, than the value coming from the implicit commitment made by most customers on NPP1.”⁹¹⁶

- 7.112 In order to demonstrate the putative cost savings identified by its second theory, Royal Mail estimated the cost savings it expected to achieve in Manchester following Whistl’s entry.⁹¹⁷ Based on the estimate, Royal Mail used the impact of Whistl’s entry in Manchester as the basis for a model it developed to extrapolated potential cost savings across the full extent of Whistl’s expected end-to-end scale as a direct delivery competitor. Thus, the quantified ‘cost savings’ of forecast information were specifically based upon the end-to-end entry plans of a customer on the APP2 price plan.
- 7.113 Despite this, Royal Mail decided to introduce the new forecasting requirement for customers on NPP1 only. On that basis, Royal Mail attributed the theoretical cost saving associated with advance forecasting to NPP1 and its new forecast requirement, and used this as a justification for applying the price differential.
- 7.114 There is no evidence that Royal Mail contemplated seeking forecast volumes from APP2/ZPP3 customers, or explored the options for, or viability of, doing so, notwithstanding Oxera’s comments on the cost justification.⁹¹⁸

Ofcom’s assessment of Royal Mail’s cost justification

- 7.115 The costs savings on which Royal Mail relies in this context are based on its ability to reconfigure its delivery operation at an SSC level in response to a significant change in volumes. Royal Mail submits that it could realise these cost savings more quickly where it has advance notice of such a change, provided by way of forecasts.
- 7.116 There are a number of characteristics associated with the type of volume changes posited by Royal Mail in its new forecasting requirement which mean that in practice such volume changes are only likely to have resulted from volume declines attributable to the introduction of end-to-end competition in a given area:
- a) First, in order to lead to potential cost savings by way of operational reconfiguration within an SSC, the volume changes must involve an absolute decline in the volume of mail delivered by Royal Mail. A shift in volumes as between access operators using Royal Mail’s delivery services would not result in such a decline, and therefore would not necessitate any local level operational changes.
 - b) Second, the volume change must be local in nature to enable Royal Mail to reconfigure delivery operations. This aspect is reflected in the design of the NPP1 forecasting requirement whereby the trigger for notifying Royal Mail was a material change of

⁹¹⁶ Ibid. (RM1154)

⁹¹⁷ E-mail from [redacted] (Oxera) to [redacted] (Royal Mail), 25 November 2013, page 1. (RM1185)

⁹¹⁸ At the oral hearing, Ofcom asked Royal Mail to confirm upon what evidence its submissions relating to the development of the CCNs were based and, in particular, whether these were based on documents already on our case file or whether these submissions were based on other evidence. Royal Mail confirmed that it was not relying on evidence that had not been shared with Ofcom. Ofcom, *Transcript of an oral representations meeting with Royal Mail*, 23 March 2016, pages 129 to 130. (RM2462)

volume in a given SSC or SSCs.⁹¹⁹ A general decline in bulk mail volumes, e.g. as the result of ongoing substitution from bulk mail to electronic communications, could not result in the type of immediate and localised cost savings which Royal Mail claims that the provision of customer forecasts would allow.

- c) Third, the volume change must be of a sufficient scale to enable operational reconfiguration. This is reflected in Royal Mail's operational research which indicated that volume changes of at least 10% or more (of total SSC volume) may lead Royal Mail to consider reconfiguration.⁹²⁰
- d) Finally, the volume change must be sudden in nature. Royal Mail's modelling of cost savings is predicated on the savings that would be allowed by advance planning for a rapid reduction in operations, for example by preparing voluntary redundancy programmes so that staffing levels could be scaled back more quickly at the moment of volume loss. As Royal Mail explained in contemporaneous documents prepared as part of the process of developing a justification for the price differential: "*[w]e have used detailed understanding of workload and our experience in making changes to our processes to quantify the speed and magnitude of savings that might be realised given a sharp decline in volume.*"⁹²¹ (Emphasis added)

7.117 This practical association between end-to-end competition and the costs savings identified by Royal Mail gives rise to the following difficulty for the cost justification: as is shown by Royal Mail's contemporaneous internal assessment of Whistl's incentives, NPP1 would not be available in practice to an end-to-end entrant if it wanted to roll out end-to-end delivery services on any material scale given the applicable surcharges and other potential adverse contractual consequences (see paragraph 7.47 to 7.64 above). By introducing volume forecast requirements only for NPP1 customers, in order to support the price differential in their favour, Royal Mail therefore sought advance information from a customer group that would not in practice enable it to make the relevant costs savings.

7.118 Royal Mail argued that there were other circumstances than end-to-end competition that could give rise to valuable information consistent with its cost justification. It has proposed three additional hypothetical scenarios in which it says that changes in posting behaviour might also enable operational reconfiguration. These are:

- a) changes in posting behaviour of individual wholesale customers. Royal Mail identifies that "*[t]he larger customers, in particular, [X] could drive significant local volume reductions through changes in their posting behaviour*";⁹²²

⁹¹⁹ If volume in every SSC declined at the same rate, the requirement to forecast volumes under NPP1 would not be triggered.

⁹²⁰ Royal Mail, *Notes from meetings and conference calls with Operations on planning and forecasting and insight into changes in customer behaviour*, 4 October 2013, page 1. (RM1145)

⁹²¹ Royal Mail, *Cost justification*, 10 March 2014, page 1, paragraph 5. (RM0082)

⁹²² Royal Mail, *Response of Royal Mail Plc to the questions in Ofcom's letter of 18 May*, 1 June 2016, page 2, paragraph 1.11 (a). (RM2471)

- b) changes in posting behaviour of groups of wholesale customers in parallel. Royal Mail provided the example of significant volumes declines in banking volumes associated with e-substitution, claiming that these tended to be concentrated in urban areas and that the impact could be significant if the e-substitution programme of different banks coincided (although, as Royal Mail noted, this had not occurred as at May 2016);⁹²³ or
- c) changes in posting behaviours of bulk mail producers which in aggregate would reduce volume in local areas. By way of example, Royal Mail argued that if *“a local authority, government or other public organisation (such as an NHS Trust) switches online for certain communications, there can be a significant impact in a local area (or areas) which might affect the posting patterns of more than one access customer that serves this customer or group of customers.”*⁹²⁴

7.119 However, Royal Mail has not put forward evidence to show that such circumstances have ever in fact ever occurred (with the exception of end-to-end competition); or to show that, if they did occur, they would be capable of driving such changes in volumes as to trigger the kind of network reconfiguration described in its modelling. Royal Mail’s contemporaneous modelling did not address any such circumstances, but focussed instead on the cost savings that could be made with the benefit of advance notice as to Whistl’s end-to-end entry plans, having regard to the operational reconfiguration Royal Mail considered could be possible following Whistl’s Manchester roll-out.

7.120 Moreover, while retail customers for bulk mail served by NPP1 operators may have gradual volume declines across wider areas, due to these customers, or groups of customers, changing their business practices (for example, turning to e-substitution), the likelihood of these causing sudden localised large volume declines of the type described above, and aligned to Royal Mail’s system of SSCs, is small.

7.121 Royal Mail defends its decision to seek forecast information only from NPP1 customers on the basis that APP2/ZPP3 customers would be less able to provide granular local information. It states that its *“expectation of [APP2/ZPP3] customers’ forecasting capability was based on discussions with customers”*.⁹²⁵ To substantiate this argument, Royal Mail relies on meeting notes of discussions involving various individuals in its operations team in late 2013.⁹²⁶ However:

- a) these meeting notes do not suggest that Royal Mail had any discussions with APP2/ZPP3 customers about their forecasting capability. The notes observe that, unlike NPP1 customers, *“APP2 and ZPP3 customers had no incentive to engage in conversations on how business changes may affect compliance with profile requirements”*,⁹²⁷

⁹²³ Ibid., pages 2 to 3, paragraph 1.11 (b). (RM2471)

⁹²⁴ Ibid., page 3, paragraph 1.11 (c). (RM2471)

⁹²⁵ Ofcom, *Transcript of an oral representations meeting with Royal Mail*, 23 March 2016, page 135, lines 2 to 4. (RM2462)

⁹²⁶ Royal Mail, *Response of Royal Mail PLC to the questions in Ofcom’s letter of 18 May 2016*, 1 June 2016, paragraph 5.1. (RM2471)

⁹²⁷ Royal Mail, *Notes from meetings and conference calls with Operations on planning and forecasting and insight into changes in customer behaviour*, 4 October 2013, page 3. (RM1145)

- b) there is no evidence that NPP1 customers were able to forecast mail volumes in a materially different way to APP2/ZPP3 customers. The fact that APP2 and ZPP3 are not based on the same type of geographic profile as NPP1 need not prevent operators on these plans providing SSC-level forecasts to Royal Mail, based on their knowledge of their own roll-out plans. As indicated in Royal Mail's notes, "[Whistl] need to understand their own performance accurately in the context of their bid for capital";⁹²⁸ and
- c) in its oral representations in this case, Royal Mail has also observed that Whistl could switch from APP2 to NPP1 "*within a very short timescale, within a matter of weeks, if not days*"⁹²⁹, notwithstanding the forecasting requirements that would then apply to it.

7.122 For the reasons set out above, Ofcom therefore does not accept Royal Mail's argument that the price differential was explained or justified by the requirement for only NPP1 customers to provide forecasts. Among other matters: (a) the class of customer (NPP1 customers) that was obliged to provide forecasts would not in fact have provided valuable information of the type needed to make the cost savings identified; and (b) the classes of customers that may in fact have such valuable information to provide (APP2 and ZPP3 customers) were neither required to nor incentivised to provide it.

⁹²⁸ Ibid. (RM1145).

⁹²⁹ Ofcom, *Transcript of an oral representations meeting with Royal Mail*, 23 March 2016, page 49, lines 19 to 23. (RM2462)

D. Royal Mail's conduct reflected a deliberate strategy to limit competition from its first and only significant competitor

- 7.123 The evidence on the case file shows that Royal Mail developed the price differential, which was introduced together with the other pricing changes in the CCNs, in order to limit Whistl's ambitions to expand its nascent bulk mail delivery operations. We note that Whistl was the first and only significant entrant to the bulk mail delivery market in the UK despite the complete liberalisation of the market in 2006. The second largest access operator, UK Mail, had publicly stated that it had no plans to enter the market.⁹³⁰
- 7.124 Section 4, *Chronology of events*, considers the development of the price differential by Royal Mail as part of its "Letters Strategy" and "Letters Pricing Strategy", by reference to Royal Mail's, contemporaneous internal documents. As explained there:
- a) In the early stages of its project to develop a letters strategy, in June 2013, Royal Mail considered that "[a]cross the board price price changes [sic]", which could "[r]educe the incentive for customers to consider an alternative service," should be regarded as a "[l]ast resort".⁹³¹ Accordingly, Royal Mail sought to "[d]evelop a "best case" commercial response which does not reduce revenues e.g. zonal tilting and price plan differentials."⁹³² It finally concluded that "any response that involves significant revenue dilution (e.g. an across the board price cut) is not realistic."⁹³³
 - b) As an alternative to competing on the merits through price reductions on the bulk mail delivery market, Royal Mail instead investigated how it could adjust its wholesale prices so as to address "the direct delivery threat"⁹³⁴ by discouraging Whistl from expanding its competing end-to-end operations.
 - c) As part of that investigation, Royal Mail undertook a scenario analysis which considered a number of different levels of price differential in combination with different levels of zonal tilt to see how they could be expected to affect Whistl's roll-out plans.⁹³⁵
 - d) Whistl's expected reactions were assessed using Royal Mail's 'entrant cost model' which it had developed to "[e]stimate likely costs faced by entrants choosing to compete in the market for letters delivery."⁹³⁶ Royal Mail has confirmed that this model was based on detailed observations about Whistl's delivery operation, particularly the

⁹³⁰ UK Mail, *Reports and Accounts 2012*, 31 March 2012, page 7. (PD0048)

⁹³¹ Royal Mail, Presentation entitled *Letters Strategy – Royal Mail Group Board*, 26 June 2013, slide 34. (RM1033)

⁹³² *Ibid.* (RM1033)

⁹³³ *Ibid.* (RM1033)

⁹³⁴ Royal Mail, *Options for protecting the USO – Draft discussion document*, October 2013, 13 November 2013, slide 4. (RM0960).

⁹³⁵ See paragraphs 4.46 to 4.55.

⁹³⁶ Royal Mail, Presentation entitled *Entrant Cost Model - Estimating the likely costs faced by an entrant into the downstream letters delivery market*, 25 March 2014, slide 2. (RM0106)

design of its Manchester operation.⁹³⁷ The results of this scenario analysis are reproduced below.

Figure 7.5: Slide 10 from Royal Mail presentation ‘Options for protecting the USO’

The best combination of actions is to apply a moderate price incentive on PP1 and make a significant change to the zonal tilt which improves our competitiveness in London

Description	Scenario					
	0	1	2	3	4	5
Do nothing and wait for market to develop without defending USO	Apply moderate "value" justified incentive on PP1 and moderate zonal tilt	Apply moderate "value" justified incentive on PP1 and significant zonal tilt	No changes to zonal tilt which allows stretched "value" justified PP1 incentive	Apply moderate "value" justified incentive on PP1 and stretched zonal tilt	Do not offer PP1 incentive and just change the zonal tilt	
Price incentive for the National Price plan	None	0.3p	0.2p	0.5p	0.1p	None
Zonal price difference (tilt) vs national average price (0%)	Urban: -12% Suburb: 0% Rural: 14% London: 10%	Urban: -25% Suburb: -1% Rural: 44% London: 0%	Urban: -25% Suburb: 10% Rural: 44% London: -25%	Urban: -12% Suburb: 0% Rural: 14% London: 10%	Urban: -25% Suburb: 23% Rural: 44% London: -50%	Urban: -25% Suburb: 10% Rural: 44% London: -25%
Likely outcome for Direct Delivery operator (#)	Stay on PP2 and grow to 20+ SSCs	End on PP2 and grow to 20+ SSCs	Switch to PP1 and stay there *	End on PP2 and grow to 20+ SSCs	End on PP2 and grow to 20+ SSCs	End on PP2 and grow to 20+ SSCs
Market share loss	9.4% By 2017	5.9% By 2017	1.4% By 2014	7.3% By 2017	9.4% By 2017	6.5% By 2017
RM revenue loss	£240m	£160m	£40m	£190m	£240m	£170m

(#) A DD operator would switch to PP1 to start with for all scenarios 1-4

(*) It is not profitable for DD operator to switch back to PP2 at any point

All of these assume no major investment is available to the entrant and that the entrant needs 10% profits in any expansion



Source: Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 10. (RM0960)

7.125 Royal Mail found that the optimum scenario (numbered “2” in Figure 7.5, and shown in green) was to apply a “price incentive” for NPP1 (i.e. a price differential) of 0.2p; and a “significant zonal tilt”. This outcome was judged as “the best combination of actions” for Royal Mail to adopt based on the impact which was expected to result on Whistl’s end-to-end roll out plans. Under scenario 2, Royal Mail anticipated that Whistl would “[s]witch to [NPP1] and stay there”,⁹³⁸ and would limit itself to a ‘small scale operation’ on the bulk mail delivery market⁹³⁹, with a market share of only 1.4%, resulting in a £40m revenue loss to Royal Mail. Royal Mail expected that Whistl would respond to the higher charges on APP2 and choose not to continue its roll out because, having switched to NPP1 to avoid the

⁹³⁷ Ibid., slide 4. (RM0106)

⁹³⁸ Ibid., slide 10. (RM0960)

⁹³⁹ See Royal Mail, Presentation entitled *Proposed actions on Access contracts to protect the USO*, 30 September 2013, page 4. (RM1126)

differential, “[i]t is not profitable for [the] DD operator to switch back to [APP2] at any point.”⁹⁴⁰

- a) The other rejected scenarios all involved Whistl winning substantially larger shares of the bulk mail delivery market, with greater consequential loss of revenue to Royal Mail. For example, Royal Mail’s assessment of applying the “significant” zonal tilt (in the form ultimately introduced in the CCNs) without applying a price differential (Scenario 5 in Figure 7.5) found that a direct delivery operator would “end on [APP2], and grow to 20+SSCs”, achieving a market share of 6.5% and losing Royal Mail £170m in revenues.⁹⁴¹ The price differential was therefore identified as a necessary element of the package of measures required to deter Whistl from its end-to-end expansion plans. Royal Mail’s advisers, Oxaera, identified a key distinction between Scenario 2 and the other scenarios as being the likely impact of the package of measures on a direct delivery operator’s incentives.⁹⁴²
- b) Consistent with Royal Mail’s scenario analysis, the changes actually effected by the CCNs closely resembled the “best combination of actions” identified by scenario 2: the zonal tilt applied by Royal Mail matched the “significant zonal tilt” as modelled; and the price differential was set at a slightly more aggressive level of 0.25p.

7.126 Royal Mail understood that Whistl’s delivery operation at the relevant time was still on a sufficiently small scale (fewer than five SSCs in England and Wales) that it could move to NPP1 without incurring surcharges, and thereby avoid the price differential.⁹⁴³ Royal Mail then assessed how Whistl’s market share would evolve in future, and how this would vary as a result of Royal Mail changing its price plans to include a differential. Royal Mail concluded that Whistl would be affected in a context where it had to “switch to [NPP1] to avoid differential.”⁹⁴⁴ Under Royal Mail’s Scenario 2, the effect of this likely outcome for Whistl was modelled by Royal Mail, as shown in Figure 7.6 below. Two possible commercial responses were identified. The first (which was the one adopted in the scenario analysis slide set out as Figure 7.5 above) would be to cap its total scale of end-to-end deliveries at current levels in order to continue to qualify for the lower prices on NPP1 (confining itself to a 1.4% market share). The second possibility identified by Royal Mail was that Whistl pursued expansion, but at the cost of “forgo[ing] [a] reasonable rate of return for 2-3 years” (as it paid higher prices on APP2).

⁹⁴⁰ Royal Mail, *Options for protecting the USO – Draft discussion document, October 2013*, 13 November 2013, slide 10. (RM0960)

⁹⁴¹ *Ibid.*, slide 10. (RM0960)

⁹⁴² See paragraphs 4.92 to 4.95 above. See also paragraph 4.29.

⁹⁴³ *Ibid.*, slide 4. (RM0960) This shows that Royal Mail had understood that the scope of Whistl’s current bulk mail delivery operation was that it had rolled out to five SSCs in England. We understand however that Whistl had in fact, at this stage, rolled out to four SSCs in England according to the then prevailing scheme of SSCs.

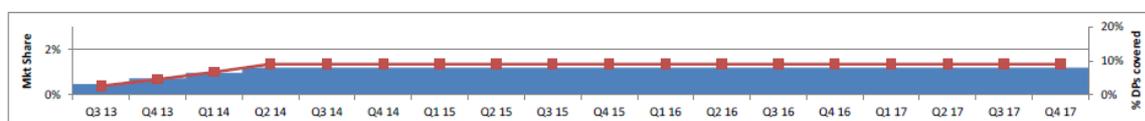
⁹⁴⁴ Royal Mail, spreadsheet *Working notes*, 17 October 2013. (RM0840)

Figure 7.6: Slide 11 from Royal Mail presentation 'Options for protecting the USO'

The proposed actions of scenario 2 impact TNT's published expansion plans from Q3 2014



Changes to price plans, TNT funds expansion through profits and require a reasonable rate of return in each year



Source: Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 11.

7.127 Royal Mail's expectations as to the impact of the price differential on Whistl's end-to-end delivery plans are also apparent from an exchange between Royal Mail employees and its economic advisers, Oxera, describing how the proposed structure of the price plans would place Whistl at a "competitive disadvantage".⁹⁴⁵ Oxera assessed the proposed action of introducing a price differential, which was at the time proposed to be 0.3p. Oxera noted that it had:

"...not been provided with evidence showing the impact that a price differential of this magnitude would have on [Whistl's] incentives or its direct delivery business plan. However, we understand that whilst small relative to the overall access price (1.5%), 0.3p is a substantial proportion of the upstream margin that access operators compete on (between 15% and 60%, depending on whether it measured on the basis

⁹⁴⁵ See paragraph 4.82 above. Oxera, Economic assessment of the proposed actions on Access contracts – Note prepared for Royal Mail, 3 October 2013, page 9. (RM1134)

of Royal Mail's upstream costs or the margins available for some individual customer contracts".⁹⁴⁶

7.128 Oxera then explained that:

*"[w]e have been told by Royal Mail that [Whistl] would migrate to [NPP1] to avoid being placed at a competitive disadvantage. This would allow them to continue their current level of roll-out and re-assess whether they would be prepared to make the step-change in their roll-out required to compensate for the additional 0.3p per item that it would have to pay for the mail it would continue to send via Royal Mail..."*⁹⁴⁷

Royal Mail's representations on its documentary evidence

7.129 Royal Mail alleges that its *"intentions vis-à-vis Whistl have been misconstrued by Ofcom."*⁹⁴⁸ In particular Royal Mail alleges Ofcom's *"selective reliance on extracts from certain documents"*⁹⁴⁹ fails to take account of a number of factors.

7.130 First, Royal Mail claims that the price differential was intended to better align different price plans to the characteristics of customers using those plans and *"reflected a long held view by Royal Mail that access customers with the flexibility to significantly change local postings without providing advance notice to Royal Mail should pay for the costs that Royal Mail was forced to incur which might otherwise have been rationalised more quickly and that, conversely, the benefits of having advance notice of local volume changes should be reflected in lower prices."*⁹⁵⁰ Royal Mail identifies a number of documents which it says highlight this objective.

7.131 Royal Mail's representations that the price differential can be cost justified on the basis of forecast information are addressed at paragraphs 7.106 to 7.122 above. As explained there, the forecasting obligation introduced for NPP1 customers alone does not provide a credible justification for the price differential, given that (a) such customers could not be expected to provide valuable forecast information of the kind sought by Royal Mail; and (b) APP2 and ZPP3 customers could provide such information, but were not asked to do so. It is in any event clear from the contemporaneous documents that an important objective for Royal Mail in introducing the price differential was to address *"the direct delivery threat"*⁹⁵¹ without *"revenue dilution"*⁹⁵², by limiting Whistl's competitive entry and expansion in the bulk mail delivery market.

7.132 Second, Royal Mail claims that Ofcom has failed to take account of the fact that it assessed the impact of the price changes on other wholesale customers and not just Whistl.⁹⁵³ This

⁹⁴⁶ Ibid. (RM1134)

⁹⁴⁷ Ibid. (RM1134)

⁹⁴⁸ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 148, paragraph 8.77. (RM2386)

⁹⁴⁹ Ibid., page 148, paragraph 8.78. (RM2386)

⁹⁵⁰ Ibid., page 149, paragraph 8.80. (RM2386)

⁹⁵¹ Royal Mail, *Options for protecting the USO – Draft discussion document, October 2013*, 13 November 2013, slide 4. (RM0960)

⁹⁵² Ibid., slide 7. (RM0960)

⁹⁵³ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 150, paragraph 8.82. (RM2386)

point is addressed at paragraphs 7.79 to 7.81 above. It does not detract from Royal Mail's objective of limiting Whistl's competitive roll-out, as described in the preceding paragraphs.

- 7.133 *Third*, Royal Mail claims that its “*focus on Whistl reflected the risk of a complaint being made by Whistl and the necessary analysis of competition law and regulatory compliance.*”⁹⁵⁴ In respect of the price differential, Royal Mail claims that its documents show that the differential was determined on an objective and cautious basis by reference to its cost justification.⁹⁵⁵ Having reviewed Royal Mail's internal contemporaneous documents in detail (see Section 4 *Chronology of events*), we do not agree that the focus on Whistl reflected competition law or regulatory compliance activities. Our conclusion is that the focus on Whistl, Royal Mail's only significant competitor for delivery, predominantly reflected the strategy behind the CCNs, which was to limit competition from Royal Mail's first and only significant delivery competitor, Whistl. Moreover, Royal Mail's position is incompatible with its own contemporaneous assessment of the likely effect of the price differential, when introduced together with the other changes in the CCNs, which was that Whistl would need to switch to NPP1 and stay there, confining its end-to-end activities to a small scale because it would “*not be profitable*” to “*switch back to [APP2] at any point*”.⁹⁵⁶
- 7.134 Royal Mail also claims that its focus on Whistl should be understood as part of “*a high-level assessment of the impact of all of the proposed changes by reference to the costs of an efficient entrant to ensure that profitable entry and expansion opportunities remained.*”⁹⁵⁷ To support this assertion Royal Mail refers to its entrant cost model, based on which it said that it expected that an efficient entrant would be able to absorb the differential. Contrary to this assertion, however, and as explained above at paragraph 4.48, the entrant cost model was developed as a proxy for Whistl's costs, in order to calibrate the prices changes based on their likely impact on Whistl's end-to-end delivery plans.⁹⁵⁸
- 7.135 There is, however, no evidence in any of Royal Mail's contemporaneous documents that it considered whether an “*as efficient entrant*” would continue to be able to compete following the CCNs, separate from its analysis of the implications of its preferred package of measures on Whistl's ability and incentives to continue to roll out. Those documents (as discussed in detail in Section 4) show an expectation that Whistl would not be able to extend its roll out, at least without foregoing a reasonable rate of return over a number of years. Royal Mail's key decision-making papers rely only on the cost justification as an answer to concerns about regulatory or competition law compliance.⁹⁵⁹

⁹⁵⁴ Ibid., page 150, paragraph 8.83. (RM2386)

⁹⁵⁵ Ibid., page 151, paragraph 8.84(b). (RM2386)

⁹⁵⁶ Royal Mail, Options for protecting the USO – Draft discussion document, October 2013, 13 November 2013, slide 10. (RM0960)

⁹⁵⁷ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 151, paragraph 8.84(c). (RM2386)

⁹⁵⁸ See above figures 4.3 and 4.4.

⁹⁵⁹ See for example Royal Mail, *Chief Executive's update to RMG Board on protecting the USO and direct delivery*, 11 December 2013, page 2, paragraph 12 (RM0137), Royal Mail, *Chief Executive's Committee – Minutes of meeting held on*

7.136 We also note that in describing its work for Royal Mail, Oxera explained that its advice was limited to (i) assisting Royal Mail to design the price changes and assessing their economic merit; and (ii) helping to articulate an economic justification for the changes, advising on modelling work to develop that justification and assessing the outputs of that work.⁹⁶⁰

Royal Mail later made clear that it was after issuing the CCNs, and in response to Whistl's complaint, that it commissioned Oxera to consider whether the price changes "*can lead to the exclusion of either an equally efficient operator or a hypothetical reasonably efficient operators.*"⁹⁶¹

7.137 Fourth, Royal Mail says that Ofcom is wrong to conclude that the price differential was designed to target Whistl. Instead, it claims that the rationale of the price differential was to develop a commercial response to the recognised threat posed to the USO by end-to-end competition. As set out in Section 4, the threat which Royal Mail wanted to address was the threat posed by direct delivery competition to its revenues and market position. That threat was equated to a threat to the USO. Bulk mail was and is not covered by the USO. Royal Mail's concern was that if it were to lose sufficient revenues from bulk mail, and did not respond to changes in the market, the USO could become unsustainable. However:

- a) We have set out in paragraphs 7.29 to 7.40 and Section 8 that Royal Mail's conduct in introducing the price differential was not justified by any perceived threat to the USO. Ofcom had already assessed the situation and determined that there was no immediate threat to the USO, and it would continue to monitor the situation.
- b) The existence of a USO does not relieve a dominant undertaking of its obligations to comply with competition law. It is clear, as set out above, that the price differential was targeted at Whistl, with the aim of limiting entry and expansion in the bulk mail delivery market on a material scale, irrespective of the wider benefits that such competition could bring (including, for example, its impact on Royal Mail in driving efficiencies, innovation and other benefits to consumers).

18th December 2013, 18 December 2013, page 10. (RM0963) and Royal Mail, *Disclosure Committee 6 January 2014 – Changes to Access Pricing Plans: explanation and justification of Royal Mail's approach*, 6 January 2014, page 5, paragraph 1.4. (RM0124)

⁹⁶⁰ Oxera, *Oxera's preliminary economic analysis of Royal Mail's Access Contracts pricing proposals*, 28 February 2014, pages 1 to 2. (RM0044)

⁹⁶¹ Royal Mail, *Letter to [§<] (Ofcom)*, 20 June 2014. (RM0606) See also Oxera, *Do Royal Mail's access pricing proposals have exclusionary effects?*, 20 June 2014, page 5. (RM0609)

E. The likely distortive effects of the price differential

Introduction

- 7.138 In this part we explain, based on an assessment of all the circumstances of this case (carried out in line with the legal framework set out in Section 5), our conclusion that the introduction of the price differential in the CCNs issued by Royal Mail in January 2014 was reasonably likely to distort competition. That is, it was reasonably likely to give rise to a competitive disadvantage within the meaning of Article 102(c) and Section 18(2)(c) Competition Act 1998 and/or was reasonably likely to lead to a restriction of competition.
- 7.139 In particular, we set out findings to the following effect:
- a) The price differential amounted in effect to a penalty on access customers seeking to compete in bulk mail / end-to-end delivery, making entry significantly more difficult and therefore less likely to occur (see paragraphs 7.141 to 7.166 below).
 - b) By reducing the incentive of competitors to enter or expand in the bulk mail delivery market beyond a limited degree, the price differential was likely to cause harm to consumers (see paragraphs 7.167 to 7.171 below).
 - c) Given the nature of the discrimination in issue, the type of foreclosure effect we are concerned with, and the prevailing conditions of competition in the market at the time this conduct took place, it is neither necessary nor appropriate for us to carry out an AEC test (or any other type of price-cost test) in assessing the likely effect of the price differential (contrary to the submissions of Royal Mail) (see paragraphs 7.172 to 7.202 below).
- 7.140 As set out in Section 4 (*Chronology of events*) of this Decision, the CCNs, which introduced the price differential, were suspended on 21 February 2014 as a result of Ofcom's decision to open an investigation. Royal Mail relies on the suspension of the price differential as a basis upon which to conclude that it was incapable of amounting to an abuse of its dominant position because the price differential was not in fact charged to an operator. This argument is addressed at paragraphs 7.203 to 7.228 below.

The price differential amounted in effect to a penalty on access customers seeking to compete in bulk mail / end-to-end delivery, making entry significantly more difficult and therefore less likely to occur

- 7.141 In this sub-section, we explain that it is reasonably likely that the price differential would achieve its intended effect by materially impacting the profitability of entry into the bulk mail delivery market, making such entry significantly more difficult and therefore less likely to occur. In particular, we outline that:
- a) the price differential would result in a significant increase in an end-to-end entrant's access costs from the point at which NPP1 became unavailable in practice to the entrant;

- b) the resulting financial impact of the price differential on an end-to-end competitor's profitability would have been material. This effect can be illustrated concretely by reference to a number of metrics, including its impact on Whistl's 2014 business plan;⁹⁶² and
- c) the introduction of the price differential increased the already high barriers to entry and expansion in the bulk mail delivery market, reducing an operator's incentive to engage in such entry. The price differential amounted effectively to a penalty on entry that was reasonably likely to make entry significantly more difficult and therefore less likely to occur.

The price differential would result in a significant increase in access costs for end-to-end competitors who would need to operate on APP2/ZPP3 and so face higher access prices

7.142 As set out in sub-section C above, under the terms of the Access Letters Contract:

- a) An end-to-end operator could, in the very early phases of an end-to-end delivery roll-out, operate on NPP1, avoiding the higher APP2/ZPP3 prices due to the price differential.⁹⁶³ The total access payments the operator would need to pay to Royal Mail would gradually decline as it switched an increasing proportion of its delivery requirements to its own network.
- b) If an end-to-end operator sought to expand its entry in the bulk mail delivery market beyond a very limited number of SSCs, NPP1 would become unavailable in practice to it, because of the various adverse contractual consequences that would follow, in particular increasing surcharges and an inability to meet the eligibility criteria attaching to that plan. The surcharges would rapidly increase as roll out continued. In its representations, Royal Mail recognised that after 13 SSCs the total effective NPP1 price for an end-to-end operator would come to exceed the APP2/ZPP3 price (see paragraph 7.53(a)). After this point, the operator would find it commercially unattractive to remain on NPP1, and would instead have to pay the higher prices under APP2/ZPP3 resulting from the price differential.

7.143 It is important to note that the operator would then face an immediate steep increase in access costs as a result of its end-to-end roll out, given that the majority of its mail would still be delivered by Royal Mail. This is for two reasons:

- a) **Limited roll out:** NPP1 would become unavailable in practice to an entrant at a very early stage in its roll out, which would of necessity be gradual.⁹⁶⁴

⁹⁶² Whistl submitted its business plan at the time of its complaint to Ofcom on 19 March 2014 and again in response to a statutory information request (under of the Postal Services Act 2011) dated 10 July 2014. We refer to this as Whistl's business plan in the rest of this document. (WH0218)

⁹⁶³ See paragraphs 7.52 to 7.53.

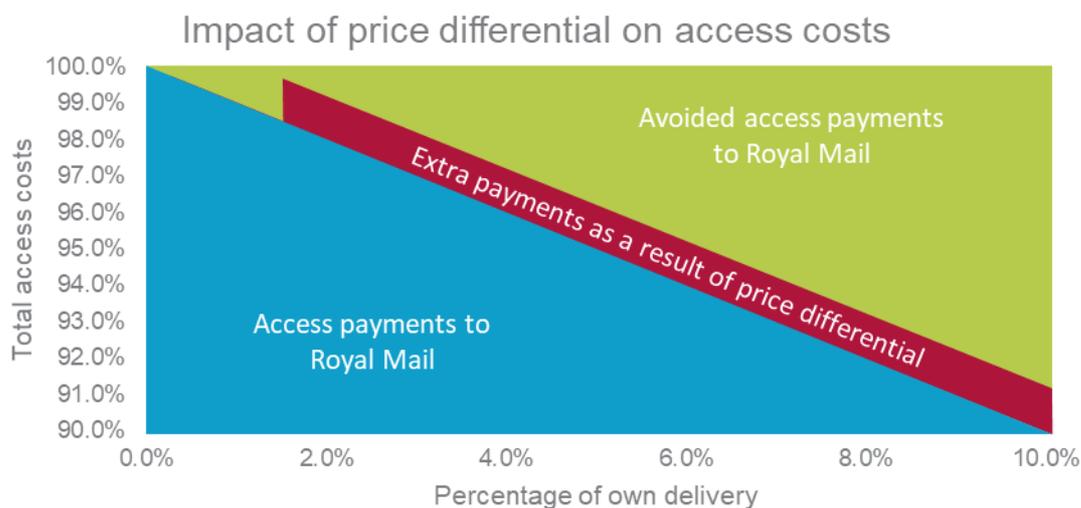
⁹⁶⁴ At paragraphs 7.24 to 7.26 we explain why an access operator's roll out in the bulk mail delivery market is likely to be gradual and, accordingly, Royal Mail would remain an unavoidable trading partner for any competing end-to-end operator.

b) **Limited conversion rate:** An entrant in the bulk mail delivery market would be likely to have a low conversion rate initially and would be unlikely ever to deliver 100% of its customers' mail. For example, Whistl expected its conversion rate to grow from c.40% in 2013 to 85% at its projected coverage in 2018.⁹⁶⁵ Thus, even in SSCs where the operator had entered, it could still expect to pay access charges to Royal Mail.

7.144 A relatively small expansion of an operator's end-to-end activities, for example, one or two additional SSCs, would expose the operator to the imposition of NPP1 surcharges and then require the operator to pay the higher prices on APP2/ZPP3 for all items still delivered over Royal Mail's network.

7.145 At least in the early stages of an operator's roll out, the additional cost would be offset only to a very limited extent by benefits from small quantities of additional self-supply. The price differential would therefore reduce the financial incentive for an entrant to expand to a point beyond which it could remain, or would be expected to remain, on NPP1. This analysis is illustrated by Figure 7.7 below.

Figure 7.7: Illustration of the impact of the price differential on access costs



Source: Ofcom illustrative diagram. The vertical axis shows total access costs as a percentage of the amount that would be paid if the operator relied on Royal Mail for all its deliveries. This diagram assumes that an entrant initially uses NPP1 but no longer does so once it delivers 1.5% of its own mail (this precise threshold is illustrative).

7.146 In this figure:

- The blue shaded area illustrates that, absent the price differential, as an operator rolls out its own delivery operations, its total access payments to Royal Mail will fall.
- The green shaded area illustrates that the savings an entrant would make from carrying out its own delivery will increase. For end-to-end delivery to be profitable, ultimately

⁹⁶⁵ See paragraph 2.37.

the savings shown by the green shaded area need to cover the costs of delivery and an allowance for suitable profits reflecting the risk involved.

- c) The red shaded area illustrates the extra payments to Royal Mail as a result of the price differential. This shows the jump or step change in access costs once the price differential applies, depicting the ‘ratchet’ effect the price differential would have on access payments. The size of these extra payments gradually declines as the operator delivers a greater proportion of its own mail, if the price differential does not in fact result in an operator ceasing further roll out.

This impact of the price differential would have been material, as illustrated concretely by reference to its likely effects on Whistl

7.147 As described above, the price differential would significantly increase the access costs incurred by an operator that sought to deploy its own delivery network, particularly in the early phases of its roll out. In light of the conditions prevailing in the bulk mail delivery market and the associated retail market as at January 2014, the impact of the price differential on an entrant expanding in the former market would have been material.

7.148 This is demonstrated by an analysis of the likely impact of the price differential on Whistl’s costs and the resulting consequences for its profitability.

7.149 Table 7.1 sets out the additional costs associated with the price differential given Whistl’s projected access volumes in its 2014 business plan. The first column shows these costs for calendar years. The second column shows them for financial years (e.g. the 2014 figure relates to the financial year starting in April 2014 and ending in March 2015).

Table 7.1: Whistl’s additional access costs as a result of the price differential from 2014 to 2018.

	Calendar year	Financial year starting in April
2014	£6.6 million *	£8.7 million
2015	£8.0 million	£7.7 million
2016	£7.0 million	£6.8 million
2017	£6.2 million	£6.1 million
2018	£5.9 million	£4.5 million **

Source: Ofcom calculations, Whistl’s business plan. The sum of the columns differs due to rounding.

* We have assumed that the price differential applies from April 2014 onwards. The effect of the differential on all volumes in 2014 (including the first quarter) would have been £8.9m.

** This figure only relates to the period April 2018-December 2018 (rather than the full financial year) since the final period in Whistl’s business plan is December 2018.

- 7.150 All of these figures are calculated using the volume of Whistl's expected access mail in its business plan at the time the CCNs were issued, multiplied by 0.25p per letter (which is an approximation of the price differential.)
- 7.151 The figures in Table 7.1 show that if Whistl had expanded its bulk mail delivery operations in line with its business plan, the additional cost associated with the price differential would have fallen slightly over time (as it would have been using Royal Mail's delivery services for a lower proportion of its access volumes). However, the additional cost per year associated with the price differential would remain substantial.
- 7.152 As Whistl's business plan only extended to 2018, we have not calculated the impact of the price differential beyond 2018. Based on the figures in the table above, we have calculated that the present value (i.e. discounted cash flow) of the additional access costs that Whistl would have faced as a result of the price differential in the period 2014-2018 was £28.9 million.⁹⁶⁶ Given the price differential would have continued to apply to access volumes delivered by Royal Mail after this initial period, this calculation of present value of the additional access costs is an underestimate of its total likely impact in absolute terms.
- 7.153 We consider that following metrics demonstrate that the impact of the price differential was likely to be material:
- a) a comparison between Whistl's profits as an access operator and the costs associated with the price differential;
 - b) a comparison between Whistl's forecast profits as operator with a growing delivery business and the cost of the price differential; and
 - c) a comparison of the level of LDC's pending investment in Whistl with that cost.
- 7.154 First, we compare the financial impact of the price differential with Whistl's profits. As Nick Wells (Whistl's CEO) explained: "*This is a massive impact on our business which, in 2012, made an annual profit of £9.8 million.*"⁹⁶⁷
- 7.155 Whistl's operating profits for its access business, excluding its delivery business, in the calendar years 2013 and 2014 were £8.5 million and £9.6 million respectively. We note that when Whistl's delivery business is included together with its access business, Whistl made an operating loss of £0.7m in 2014 and an operating profit of £6.4m in 2013, excluding exceptional items.⁹⁶⁸ Comparing the operating profits for 2013 and 2014 with the

⁹⁶⁶ This is calculated using a pre-tax, real discount rate of 9%, which Frontier Economics say was Whistl's weighted average cost of capital in its business plan. See Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals – a confidential report prepared for TNT*, January 2014, page 58, footnote 100. (WH0121)

⁹⁶⁷ Whistl, *Witness Statement of Nicholas Mark Wells*, 28 January 2014, page 16, paragraph 47. (WH0132).

⁹⁶⁸ Whistl, *Whistl UK Limited – Annual report and consolidated financial statements for the year ended 31 December 2014*, page 2 and page 17. (PD0051) Ofcom has calculated the figures for Whistl's delivery business and its access business together on the basis of Whistl's reported statutory operating profit/(loss) (of -£3.7m in 2014 and -£8.1m in 2013) less exceptional items (of £3.0m in 2014 and £14.5m in 2013). In 2014, exceptional items were the costs of rebranding from 'TNT Post' to 'Whistl'. In 2013 they consisted of a recalculation of a cost of sales accrual, relating mainly to periods prior to 2013.

figures in Table 7.1 demonstrates that, the cost associated with the price differential amounted to a significant proportion of Whistl's profits as an access operator.

- 7.156 Second, as we outlined above, the present value of the additional costs for Whistl associated with the price differential between 2014 and 2018 was £28.9 million. For the same period, the present value of its projected EBIT from its delivery operations was £52.7 million.⁹⁶⁹ Thus, the cost of paying the price differential would have amounted to 55% of Whistl's forecasted profit from its delivery operations over the 2014-2018 period.
- 7.157 The above calculations proceed on the basis that Whistl would have had to move to APP2/ZPP3 once its delivery operations expanded beyond 6 SSCs (the point at which the tolerances of the National Spread Benchmark would have been exceeded). We note that Royal Mail has suggested that Whistl / an end-to-end operator could have remained on NPP1 until its roll out expanded beyond 13 SSCs (see paragraph 7.53 above).⁹⁷⁰ This makes no real difference to our analysis and conclusions on materiality.
- 7.158 Whistl expected to begin operating its delivery service in its 13th SSC in the first quarter of 2015.⁹⁷¹ Accordingly, even if Royal Mail had allowed Whistl to remain on NPP1 while rolling out to 13 SSCs, this would only have delayed the application of the price differential by less than one year. In this scenario, the additional costs of the price differential alone at the point at which the operator moves to APP2/ZPP3 (£22.3 million, discounted over 2014-2018) would still have amounted to at least 40% of Whistl's forecast profit for 2014-2018. Further, this analysis does not include the surcharges to which Whistl would have been subject on NPP1 as a result of no longer following a national profile, while it rolled out from five to 13 SSCs.⁹⁷² This calculation therefore understates the impact of the price differential, because in addition to the higher costs of the price differential once on APP2 (included in the calculation), Whistl would also have incurred surcharges on NPP1 during its planned roll out.
- 7.159 The calculations outlined above are all based on Whistl's 2014 business plan, which did not take into account other changes introduced by the CCNs, including, in particular, the changes to zonal tilts. We acknowledge that other changes introduced by the CCNs, which are not the subject of this Decision, would also have had an adverse impact on Whistl's profitability. However, this would have meant that the cost of the price differential would

⁹⁶⁹ See Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals – a confidential report prepared for TNT*, January 2014, page 58. As described above for the costs, this is calculated using a pre-tax, real discount rate of 9%. (WH0121)

⁹⁷⁰ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 127, paragraphs 7.98 to 7.100. (RM2386) Royal Mail also argued that Whistl could have rolled out still further using NPP1 by adopting arbitrage practices between NPP1 and the ZPP3 plans. We address this argument at paragraphs 7.82 to 7.86.

⁹⁷¹ Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals*, 28 January 2014, page 13, table 2. (WH0121) This shows Whistl expected to roll out to Glasgow Central (Whistl's 12th SSC) and Croydon, Bromley (Whistl's 13th SSC) in Q1 of 2015.

⁹⁷² 13 SSCs represents the maximum point at which the total cost of NPP1 surcharges exceeds the costs of operating on APP2 (including paying the price differential). In the counterfactual, Whistl could have avoided these surcharges by remaining on APP2 throughout. In the counterfactual, Whistl would not have been penalised for doing this since the price differential between the plans is absent.

have amounted to larger proportion of the profits Whistl expected to derive from its end-to-end business once those other changes were accounted for. Thus, our assessment of the materiality of the impact of the price differential on Whistl's expected profits is conservative. On Royal Mail's own contemporaneous analysis, it was the addition of the price differential which would hinder roll out in the delivery market beyond a small number of SSCs (see paragraph 7.125(a) above).⁹⁷³

7.160 Third, as outlined above, over the years 2014 to 2018 the price differential increased Whistl's costs by £28.9 million on a present value basis.⁹⁷⁴ That £28.9m is a material amount in this industry can be illustrated through a comparison with LDC's proposed investment, which was £28.4 million.⁹⁷⁵ LDC's proposed investment was important for enabling Whistl's plans for delivery and clearly represented a significant amount of money for Whistl's business.

A financial impact of this magnitude would make entry significantly more difficult for access operators wishing to expand their activities to compete with Royal Mail in bulk mail delivery, reducing their incentive to roll out and as a result making entry less likely to occur

7.161 In assessing whether the price differential was reasonably likely to give rise to foreclosure effects by making market entry and expansion more difficult or impossible, it is necessary to consider its application in the context of the prevailing market conditions as at January 2014.⁹⁷⁶

7.162 As set out in paragraphs 7.15 to 7.17 above, competition in the bulk mail delivery market was already very limited as at January 2014. The emerging competition in the bulk mail delivery market from Whistl was the first example of competition to Royal Mail's delivery network that could potentially grow to scale. Any attempt to enter the bulk mail delivery market at scale, or at all, faced high barriers before the price differential was introduced. That growth would also have to be achieved in the context of a declining market. This meant that entry and expansion in the market would become increasingly difficult and risky over time. In such circumstances, the potential for entry to occur could be affected by even small or relatively small changes in the profitability of entry or expansion, which could be material in this context and thus could reduce an entrant's incentives to roll out and make entry less likely to occur.

⁹⁷³ As described in paragraph 7.246, Royal Mail submitted a report in which concluded that the price differential accounted for 19.6% of the total estimated impact of the CCNs on Whistl's forecast operating profits. See FTI Consulting, *Updated assessment of Whistl's Business Plans*, 24 November 2017, page 20, paragraph 4.27. (RM2579) We have not taken a view on the precise scale of the impact of the other changes on Whistl's expected profits (which would involve considering how Whistl would have revised its business plan in response to the zonal tilt alone), but we consider that these other changes were likely to have significantly reduced Whistl's expected future profitability. This impact of the price differential relative to Whistl's expected future profits is therefore likely to be larger than we have presented. We have, however, sought to isolate the impact of the price differential for the purposes of assessing its potential impact on an operator's incentive to expand its delivery operations.

⁹⁷⁴ See paragraph 7.152.

⁹⁷⁵ Whistl, *Share Sale and Purchase Agreement relating to the acquisition of TNT NN1 Limited*, 13 December 2013, page 23, clause 3. (WH0061)

⁹⁷⁶ See paragraphs 5.59 to 5.70.

- 7.163 We have found that the impact of the price differential on the profitability of an end-to-end operator would be material. In the context of the prevailing conditions in the bulk mail delivery market, and the associated retail market for bulk mail, such a material impact on profitability was likely to make entry or expansion in bulk mail delivery significantly more difficult. The introduction of the price differential increased the already high barriers to entry and expansion in the bulk mail delivery market, thereby reducing the incentives on an access operator to risk entry.
- 7.164 By introducing the price differential in the CCNs, Royal Mail used its position as an unavoidable trading partner for access operators effectively to penalise those of its access customers who also sought to compete with it by undertaking end-to-end delivery activities. As a result, we conclude that the introduction of the price differential was reasonably likely to have a foreclosing effect because it made entry less likely to occur. This, in turn, would preserve and potentially enhance Royal Mail's dominant position on the bulk mail delivery market. We note that this conclusion, that the impact of the price differential would be material in any decision by Whistl, or any other potential direct delivery entrant, to proceed with roll out to a material scale, is consistent with Royal Mail's own contemporaneous analysis of its potential impact (see sub-section D, above).
- 7.165 For the avoidance of any doubt, we have not concluded (nor was it necessary for us to conclude for the purposes of finding an abuse) that entry was rendered impossible or totally unprofitable by the introduction of the price differential, i.e. that its application would result in the complete foreclosure of the bulk mail delivery market. The abusive conduct we have identified in this case instead involved Royal Mail penalising any growth in bulk mail delivery competition beyond a limited scale, and thereby making it less likely that it would occur, to the detriment of consumers.
- 7.166 In sub-section F, below, we explain our finding that the introduction of the price differential was a material contributing factor to: (a) the disruption of LDC's agreed investment in Whistl in January 2014; and (b) the reduction or suspension of parts of Whistl's planned further roll out of its end-to-end delivery operations.

Incentivising competitors to give up delivery competition causes harm to consumers

- 7.167 As a general principle, competition typically puts downward pressure on prices, encourages quality improvements, efficiency and incentivises investment in the development of new products and processes.
- 7.168 In the relevant context of this case, increased competition in the bulk mail delivery market would, for example, tend to increase the pressure on Royal Mail and potential rivals to reduce their costs and to pass the benefits of these cost reductions onto customers through: cost reductions for consumers of retail bulk mail services, such as banks or

government bodies; and / or cost reductions for access operators in the form of lower access costs.⁹⁷⁷ For example:

- a) The report presented by Royal Mail from its external advisors, FTI Consulting, refers to the discounts Whistl offered when it competed in delivery.⁹⁷⁸ Whistl planned to offer, on average, a 5% discount to its usual retail price when customers chose to partly use Whistl's own delivery.⁹⁷⁹ FTI Consulting said that in practice Whistl offered larger average discounts of 7% to non-VAT exempt customers and 19% to VAT exempt customers compared to Royal Mail access charges.⁹⁸⁰
- b) Competition in the delivery market could act as a constraint on the prices offered by Royal Mail at the wholesale level. Although the provision of collection and initial sortation services is competitive, this element constitutes a relatively small proportion of the value chain (approximately 10%). The major part resides in delivery services, where Royal Mail faced very limited competition (see Figure 2.4, above). As a competitor such as Whistl expanded in the market, Royal Mail could have been incentivised to respond with lower access prices for access operators, achieved through costs savings or other efficiencies. However, as noted at paragraph 7.124 above, on the facts at issue in this case, Royal Mail dismissed this option.

7.169 Similarly, any benefits from greater innovation could also be expected to flow through to consumers of retail bulk mail services. For example, in this case we note there were potential benefits and innovations in Whistl's service, including:

- a) Full tracking of letters, including scanning on delivery, enabling much greater information to be shared to mail producers.⁹⁸¹ This would be an improvement on Royal Mail's access services which did not, and do not today, offer any tracking.
- b) A delivery cycle in which Whistl would deliver to each address three days per week (compared to Royal Mail's six-day delivery schedule) to reduce costs and hence prices. This may have been beneficial to bulk mail producers who, in using D+2 or later services, do not require urgent delivery.
- c) Delivery products that would expand Whistl's offering beyond the confines of Royal Mail's D+2 Access services and offer greater choice to mail products. For example, Whistl developed a 'local sort' product that would offer a lower rate to letters that were to be delivered close to the point of collection (a service not offered by Royal Mail).

7.170 Thus, by raising the already high barriers to entry in the bulk mail delivery market, and by making it less likely that the nascent competition in the bulk mail delivery market would continue to grow, Royal Mail's introduction of the price differential was reasonably likely to give rise to consumer harm. Using a dominant position to raise barriers to entry or

⁹⁷⁷ This applies whether or not a delivery competitor is as efficient as Royal Mail.

⁹⁷⁸ FTI Consulting, *Updated Assessment of Whistl's Business Plans*, 24 November 2017, paragraph 5.45. (RM2579)

⁹⁷⁹ Whistl, *Project Luke – Investment Memorandum*, May 2013, slide 9. (WH0709)

⁹⁸⁰ FTI Consulting, *Updated Assessment of Whistl's Business Plans*, 24 November 2017, paragraph 5.45. (RM2579)

⁹⁸¹ Whistl, *E2E Competition – [3<] TNT Post UK Ltd*, 30 September 2013, slides 9 and 10. (WH0082)

expansion, and so limit nascent competition, is likely to harm the interests of consumers at both the wholesale and retail level.

7.171 As we explain in sub-section F below, it is not now possible to establish for sure what would have happened if the price differential had not been introduced, i.e. whether Whistl would have successfully expanded its delivery operations or would have ultimately exited the market at some point in the future in any event. However, we have concluded that, by introducing the price differential, Royal Mail pre-empted the outcome of the competitive process, leveraging its overwhelming dominance in the bulk mail delivery market, and its consequent status as an unavoidable trading partner for access operators, to penalise entry with the effect that it was less likely to occur.

The price differential cannot be categorised as pure first-degree/primary or second-degree/secondary price discrimination

7.172 We have set out above our analysis of the likely effects of the price differential by reference to the prevailing conditions and features of the bulk mail delivery market and retail market for bulk mail at the relevant time. In analysing the nature of the price discrimination in issue, the following points are of note:

- a) Both Royal Mail and Whistl were present in the bulk mail delivery market and the associated retail market for bulk mail, though Royal Mail was overwhelmingly dominant in the former market. Whistl was (and any other potential entrant would be) both a customer and an existing / potential competitor on the bulk mail delivery market upon which Royal Mail was dominant. The interrelationship between the bulk mail delivery market and its associated retail market underpins how the price differential was designed, and was reasonably likely, to operate in practice.
- b) Royal Mail's pricing conduct did not involve it engaging in low pricing practices in an effort to induce its own customers to remain purchasers of its services or to persuade its competitors' customers to switch to its services.
- c) The price differential was designed to apply where an access operator expanded its activities to encompass delivery beyond a limited number of SSCs in the bulk mail delivery market, effectively imposing a price penalty for entry into the market on which Royal Mail was and is dominant. Royal Mail thereby applied dissimilar conditions to equivalent transactions completed with its trading partners, i.e. as between access operators. The desired outcome of introducing the price differential, on top of other measures, was to preserve and protect Royal Mail's dominant position on the bulk mail delivery market.

7.173 At paragraphs 5.38 to 5.46 of Section 5, *Legal Framework*, we have set out the broad framework outlined by Advocate General Wahl in *MEO*⁹⁸² for classifying different types of

⁹⁸² Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência* ('MEO'), EU:C:2018:270 [2018] 4 CMLR 25

pricing discrimination. As we observed there, while Advocate General Wahl in *MEO*, and Advocate General Mengozzi in *Post Danmark I*,⁹⁸³ have found such a framework to be helpful, the CJEU has not expressly adopted or endorsed such an approach. Instead, the Court's case law focuses on whether the conduct is abusive in light of an analysis of all of the relevant circumstances of the case.

- 7.174 That being said, we consider that it is useful to draw upon the broad framework outlined by Advocate General Wahl in examining the price differential, and, in particular, in considering Royal Mail's contention that the price differential amounts to pure primary / first-degree price discrimination, thereby equating the price differential with pricing practices such as margin squeeze and predatory pricing.⁹⁸⁴
- 7.175 With respect to primary / first-degree discrimination, such conduct is practised against the competitors of the dominant undertaking that operate on the same level as the dominant undertaking. Such practices, as Advocate General Wahl explained, involve most often low pricing practices which are designed to attract customers of competing operators, such as predatory pricing, differential rates of discount and margin squeeze.⁹⁸⁵
- 7.176 By contrast, secondary / second-degree discrimination, as defined by Advocate General Wahl, involves the application of pricing practices which affect trading partners on a downstream/upstream market, on which the dominant undertaking is not present.
- 7.177 On the facts of this case, the introduction of the price differential involved elements of both types of pricing discrimination:
- a) The price differential applied dissimilar conditions to equivalent transactions to Royal Mail's trading partners, who consumed access services as an indispensable input to their activities on the retail market for bulk mail, as set out in sub-section C above. However, the pricing practice in issue was practiced 'against' its existing or potential competitors in the bulk mail delivery market, i.e. the market on which it is dominant. Royal Mail was also present on the retail market. The price differential does not therefore fall neatly within the category of secondary discrimination of the type considered by AG Wahl.
 - b) At the same time, however, the pricing discrimination in issue here does not involve the application of low prices, in an attempt to compete for customers, which is the usual purview of primary-line / first-degree price discrimination.
 - c) The conduct at issue instead deploys a pricing practice akin to secondary price discrimination, but which is designed to draw a distinction between Royal Mail's access

⁹⁸³ Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25, paragraph AG46.

⁹⁸⁴ See, for example, Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 134, paragraph 8.10 and pages 97 to 99, paragraph 6.35 to 6.36, page 101, paragraph 6.53 and page 139, paragraph 8.30. 142, paragraphs 8.30. (RM2386)

⁹⁸⁵ Case C-525/16 *MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência ('MEO')*, EU:C:2018:270 [2018] 4 CMLR 25, Opinion of Advocate General Wahl, paragraph 72. See also paragraph 55 of Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25 (*Post Danmark II*) which refers to these examples of pricing discrimination as low-pricing practices.

customers by reference to their business model, i.e. whether they compete with Royal Mail in the bulk mail delivery market.

- 7.178 Thus, in our view, the price differential does not fall neatly within either of the main pricing practice categorisations outlined by Advocate General Wahl in *MEO* (or Advocate General Mengozzi in *Post Danmark I*). That does not mean, however, that the price differential cannot amount to unlawful price discrimination. The pricing categorisations outlined in Advocate General Wahl's Opinion cannot be applied rigidly or as an exhaustive means of identifying the types of price discrimination which could amount to an abuse of dominance.
- 7.179 The point is illustrated by Advocate General Wahl's analysis of what we refer to as a 'hybrid' case. The particular example considered by Advocate General Wahl was a situation in which a vertically integrated operator applied different conditions to its customers / suppliers on the downstream or upstream markets, to the benefit of its own upstream/downstream arm. However, other hybrid cases may arise where the conduct and effects of that conduct may be applied and / or felt across different markets upon which the dominant undertaking or its competitors operate.⁹⁸⁶
- 7.180 To the extent that it is useful to rely on the price discrimination categorisations outlined by Advocate General Wahl, we have concluded that the price differential at issue in this case constituted a further type of 'hybrid' case, involving elements of both primary line and secondary line discrimination.
- 7.181 In any event, even if the price differential should be treated as falling within the category of first-degree or primary line discrimination, this does not dictate the types of evidence or analysis that may be relevant to assessing whether it is unlawful. The abusive conduct that we have identified in this case concerned Royal Mail seeking, through the price differential, to penalise entry in the bulk mail delivery market, leveraging its position as the unavoidable trading partner for access customers to increase significantly the costs of such entry. We have therefore focused on identifying the evidence and tools which are relevant for assessing this specific type of conduct, which could give rise to foreclosure effects through increasing barriers to entry, even if the potential for entry was not entirely eliminated such that it remained theoretically possible.

The application of an AEC or price-cost test based on Royal Mail's costs is not necessary or appropriate in this case

- 7.182 In this sub-section, we address Royal Mail's arguments that in assessing the likely effects of the price differential we were obliged to undertake an AEC test, which Royal Mail refers to as the assessment of whether its conduct would exclude an 'equally efficient operator'

⁹⁸⁶ See, for example, the case of *Deutsche Bahn v Commission* (T-229/94, EU:T:1997:155), to which Advocate General Wahl refers in paragraph 78 of his Opinion in *C-525/16 MEO — Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência*, EU:C:2018:270 [2018] 4 CMLR 25.

("EEO"). Royal Mail contends that if an EEO could compete profitably despite the application of the price differential, it is not open to Ofcom to find an abuse.

7.183 We also consider the relevance (or lack thereof) of the sensitivity analyses completed by Royal Mail, which adjust the assumptions used in the EEO analysis by reference to, *inter alia*, Royal Mail's projection of the roll out profile of a new entrant.

7.184 In summary, we explain that, on the particular facts of this case, Ofcom was not required as a matter of law to undertake an AEC/EEO test, nor was it relevant to the conduct at issue:

- a) EEO tests (and other related price-cost tests) have been found relevant by the CJEU in situations where a dominant undertaking has engaged in 'low-pricing practices' (such as selective prices, predatory prices or some types of margin squeeze⁹⁸⁷), designed to retain or win new customers. That is not the type of conduct at issue here. Royal Mail raised the price of the price plan that was available to end-to-end competitors.
- b) A price/cost test of any design would not assist in assessing the likely effects of the particular type of price discrimination in issue here. The price discrimination did not involve lowering any prices that provided benefits to consumers. The concern to be assessed is whether, by penalising entry in the manner described earlier in this subsection E, Royal Mail made entry into the bulk mail delivery market significantly more difficult, thereby reducing the incentives to enter, making entry less likely to occur. It is not alleged that the price differential rendered such entry in the market automatically unprofitable and our assessment of the effect of the price differential does not involve a comparison with prices and costs. The prohibition of an abuse of dominance also protects the emergence of competition by 'less efficient' operators, which may still exert competitive pressure on the dominant undertaking to the benefit of consumers. Price/cost tests of any design therefore cannot identify the foreclosure effects with which we are concerned in this case.
- c) A comparison of the impact of the price differential on an EEO's costs (calculated on the basis of the overwhelmingly dominant operator's costs) fails to reflect economic reality in the circumstances of this case.

Summary of Royal Mail's case that it is necessary to assess foreclosure by reference to a price/cost test

7.185 One of the main themes of Royal Mail's submissions in response to the Statement of Objections, and the AEC and price/cost tests prepared on its behalf by Compass Lexecon and FTI Consulting, is that:

- a) the price differential amounts to primary-line price discrimination; and

⁹⁸⁷ See, for example, paragraph 55 of *Post Danmark II*.

b) consequently, Ofcom is obliged to conduct an AEC/ EEO test.⁹⁸⁸

7.186 For example, in its report on this issue, Compass Lexecon states that: “... *primary line price discrimination should be properly understood as a question of exclusion on an EEO basis...*”⁹⁸⁹ On that basis, the author contends that: “... *If an EEO can profitably compete for retail customers seeking end-to-end delivery, then there is no foreclosure and, as such, no competitive disadvantage.*”⁹⁹⁰ In its submissions in response to the Statement of Objections, Royal Mail states:

*“Each of Ofcom's allegations of harm can be described as allegations of primary line price discrimination in that they produce effects vis-à-vis Royal Mail's own rivals (i.e. competing DDOs). The principal concern arising from primary line discrimination is that the practice may give rise to foreclosure. This is amenable to investigation using a price/cost test, which should be undertaken by reference to the costs of the dominant undertaking. If an EEO would be able to compete profitably, there can be no competitive disadvantage within the meaning of Article 102(c)/section 18(2)(c) CA98.”*⁹⁹¹

*“... Provided that the DDO's actual delivery costs (calculated – consistent with the EEO standard – using Royal Mail's own costs) do not exceed this maximum level, then an equally efficient DDO has the ability profitably to compete with Royal Mail and/or access-only operators for retail customers. If an equally efficient DDO can compete, there can be no competitive disadvantage because the DDO would have the ability to operate profitably.”*⁹⁹²

7.187 Royal Mail’s economic advisers, Compass Lexecon, explain the test in the following terms: “*The appropriate tests are therefore price-cost tests to establish whether an EEO could compete profitably in aggregate. If an EEO can attract customers in competition with Royal Mail and the AOs [access operators] and earn normal economic profits, it will choose to operate in the market and may be expected to pursue profit maximising growth opportunities.*”⁹⁹³

7.188 Thus, Royal Mail’s case is essentially that on the facts of this case the AEC/EEO test is a substitute for the ‘all the relevant circumstances’ test applied by the CJEU. Unless Ofcom could prove that the price differential foreclosed any as efficient competition in the bulk mail delivery market, it cannot find Royal Mail’s conduct to be abusive.

⁹⁸⁸ See, for example, Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 134, paragraph 8.10 and pages 139 to 142, paragraphs 8.30 to 8.45. (RM2386)

⁹⁸⁹ Compass Lexecon, *Economic assessment of Ofcom's theories of harm*, 27 November 2015, page 15, paragraph 3.9. (RM2313)

⁹⁹⁰ *Ibid.*, page 16, paragraph 3.15. (RM2313)

⁹⁹¹ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 13, paragraphs 1.48. (RM2386) Internal reference omitted.

⁹⁹² *Ibid.*, page 141, paragraph 8.43. (RM2386) See also pages 134 to 142, paragraphs 8.10 to 8.45 and page 148, paragraph 8.75.

⁹⁹³ Compass Lexecon, *Economic assessment of Ofcom's theories of harm*, 27 November 2015, page 9, paragraph. 2.6. (RM2313)

- 7.189 Further, Royal Mail argues, citing the CJEU’s judgement in *Intel*, that whether or not Ofcom was required itself to undertake a price/cost test for its own assessment, it is necessary for Ofcom to consider and assess the evidence presented by Royal Mail on the potential effects of the price differential on an as-efficient competitor.⁹⁹⁴
- 7.190 Royal Mail’s advisers, Compass Lexecon and FTI Consulting, also carried out sensitivity analyses, involving adjustments to some of the inputs to the modelling. Royal Mail does not rely on these analyses as the basis for contending that Ofcom is precluded from finding an abuse of dominant position.⁹⁹⁵ This is because its case is that an abuse can only arise if it would have been unprofitable for an EEO to compete (referred to as the “base case” scenario). However, for completeness, we also briefly address these sensitivity analyses below.

A price/cost test is not necessary or appropriate on the facts of this case

- 7.191 Having considered Royal Mail’s representations, we remain of the view that it is not necessary or appropriate to undertake a price/cost test in the circumstances of this case.
- 7.192 First, as set out in Section 5 *Legal Framework*, the case-law of the CJEU does not require a price/cost test to be applied in all cases involving an alleged abuse of dominance. On the contrary, the case-law outlined in that section demonstrates that:⁹⁹⁶
- a) A price cost/test is not necessary or appropriate in all cases. It is one tool amongst others which may be relevant in some circumstances in assessing whether there has been an abuse.
 - b) The application of a price/cost test (AEC / EEO) has primarily been found relevant in cases involving low-pricing practices by dominant undertakings, which are the usual types of cases giving rise to primary-line pricing discrimination. This is not such a case.
 - c) There are some cases, where an AEC / EEO test is unlikely to be of any relevance. For example, in circumstances where (i) access to the market at issue is protected by high barriers to entry due to the presence of an undertaking in the relevant market which has a position of overwhelming dominance and (ii) the overwhelmingly dominant undertaking is also an unavoidable trading partner for potential entrants, conduct which hinders the emergence of a less efficient competitor that could still exert competitive pressure on the dominant undertaking is reasonably likely to distort competition on that market.⁹⁹⁷ In such circumstances, an AEC/EEO test is of no practical relevance in determining whether there has been an abuse.

⁹⁹⁴ Royal Mail, *Response to letter of facts*, 24 November 2017, page 14, paragraph 3.15. (RM2581)

⁹⁹⁵ See Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 145, paragraphs 8.61 to 8.62. (RM2386)

⁹⁹⁶ See paragraphs 5.83 to 5.96.

⁹⁹⁷ As the CJEU stated at paragraph 60 of its judgment in Case C-23/14 *Post Danmark A/S v Konkurrenceradet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25: “in a market such as that at issue in the main proceedings, access to which is protected by high barriers, the presence of a less efficient competitor might contribute to intensifying the competitive pressure on that market and, therefore, to exerting a constraint on the conduct of the dominant undertaking.” See also the Opinion of Advocate General Kokott in that case, at paragraph 73 “...the competitive pressure exerted even by

- 7.193 Royal Mail relies on *Post Danmark I*, in particular, as justifying its position that an EEO test is required in this case. However, at paragraph 28 of its judgment in that case, the Grand Chamber stated: “*in order to assess the lawfulness of a low-price policy practised by a dominant undertaking, the Court has made use of criteria based on comparisons of the prices concerned and certain costs incurred by the dominant undertaking, as well as on the latter’s strategy*”.⁹⁹⁸ In paragraph 26, as outlined above, the Grand Chamber also emphasised the requirement that it is necessary to consider all of the circumstances of the case before concluding whether a dominant undertaking has abused its dominant position by its pricing practices. It is clear that such a test is not a substitute for an assessment of the relevant conduct in light of all of the circumstances of the case. Royal Mail’s arguments are premised incorrectly on the assumption that an EEO test is determinative. For the reasons given at paragraphs 5.105 to 5.107 above, Royal Mail’s reliance on the CJEU’s judgment in *Intel* in this regard is misplaced.
- 7.194 A price/cost test (whether on the basis of an EEO or a reasonably efficient operator test) is not capable of identifying all of the circumstances in which a dominant undertaking’s conduct hinders, hampers, impairs competition or makes entry more difficult. The prohibition of abuse of dominant position does not seek, as a general rule, to protect only as-efficient or equally-efficient operators from the actions of dominant undertakings. As found in *Post Danmark II*, the prohibition is also concerned with maintaining the competitive constraint exercisable by even less efficient competitors where the dominant undertaking enjoys an overwhelmingly dominant position in the relevant market.⁹⁹⁹
- 7.195 Thus, as a matter of law, an AEC/EEO, or any other form, of price/cost test, is not a prerequisite in all cases for a determination that a pricing practice amounts to an abuse of dominant position.
- 7.196 Second, as we have outlined above, the price differential is not a case of ‘pure’ primary-line or first-degree discrimination (see paragraphs 7.172 to 7.181 above). Further, and in any event, the issue in this case is not whether the NPP1 or APP2/ZPP3 prices are *too low*; indeed, Royal Mail expressly rejected any package of pricing that involved “*significant revenue dilution*”.¹⁰⁰⁰ Neither is this case a potential example of margin squeeze involving the relationship between Royal Mail’s upstream and downstream prices and costs. We are not seeking to establish whether the prices charged to all customers by a dominant undertaking make it impossible for a competitor at the same level of the dominant undertaking to compete on price.
- 7.197 Competing on price, including through low pricing practices which may involve a degree of price discrimination, can be regarded as an important part of a well-functioning market because it can bring consumer benefits through lower prices. Thus, a low-pricing strategy,

less efficient undertakings must not be underestimated. Maintaining that pressure is one of the fundamental objectives pursued by [Article 102]. It is after all essential to ensure that the market structure and the choices available to customers do not deteriorate further because of the commercial conduct of the dominant undertaking.”.

⁹⁹⁸ Case C-209/10 *Post Danmark v Konkurrencerådet* EU:C:2012:172 [2012] 4 CMLR 23

⁹⁹⁹ Case C-23/14 *Post Danmark A/S v Konkurrencerådet Bring Citymail Danmark A/S* EU:C:2015:651 [2015] 5 C.M.L.R. 25, paragraph 60, and paragraph 73 of Advocate General Kokott’s Opinion.

¹⁰⁰⁰ See paragraph 4.115.

even where those prices are not uniformly applied to all customers, is not assumed to be unlawful (see paragraph 5.36 of Section 5). In that context, the AEC/EEO test allows a dominant undertaking to predict the limits on its ability to compete for customers on price and ensures that competition law does not inadvertently ‘chill’ competition on prices when that may be in customers’ interests.

7.198 In this case, however, the concern raised by Royal Mail’s conduct which we have identified as abusive is different. The price discrimination did not involve lowering any prices that provided benefits to consumers.¹⁰⁰¹ Rather, we have found that the introduction of the price differential was discriminatory conduct targeted at potential scale entrants. It operated as a penalty for further entry (beyond the limited degree achievable on NPP1) into the bulk mail delivery market dominated by Royal Mail, raising the already significant barriers to such entry. Thus, we had to assess whether the price discrimination at issue involved Royal Mail leveraging market power over an indispensable input for operators on the associated retail market in order to make such entry less likely, even if not impossible. To establish whether such an effect was reasonably likely to arise, we had to analyse the impact of the relative level of the NPP1 price compared with the APP2/ZPP3 price including the price differential, and the likely impact of such price differences on competition. As set out in subsection 7E above, we have found that the price differential would have had a material impact on an entrant’s profitability, which would be reasonably likely to make entry significantly more difficult by raising the already high barriers to entry, thereby reducing an entrant’s incentive to roll-out. No price/cost test (of any form) was necessary or appropriate to establish whether Royal Mail’s conduct was abusive in this manner.

7.199 Third, as we have explained in detail in sub-section 7B above, the relevant market in this case was characterised by high barriers to entry, in particular given Royal Mail was (and remains) overwhelmingly dominant, benefited (and still benefits) from significant economies of scale and scope and was an unavoidable trading partner with control over an indispensable input for potential scale entrants into the bulk mail delivery market. Thus:

- a) Potential entry into the bulk mail delivery market was vulnerable to exclusionary conduct (see paragraph 7.162).
- b) Conduct which hindered the emergence of a less efficient scale entrant into the bulk mail delivery market (by making it significantly more difficult/reducing incentives to enter) was reasonably likely to limit a potential source of competitive pressure on Royal Mail to the detriment of consumers (see paragraphs 7.167 to 7.171).¹⁰⁰²
- c) An EEO/AEC test (comparing the absolute level of prices under the plans and Royal Mail’s or a notional efficient entrant’s costs) is not relevant in these circumstances.

¹⁰⁰¹ The evidence set out in Section 3 clearly shows that the price differential operated as an increase to APP2 and ZPP3 in addition to the annual, inflation related price increases that Royal Mail applied to all access products. This is reflected in the fact that suspension of the price differential resulted in a decrease to APP2/ZPP3 prices and not an increase to NPP1 prices.

¹⁰⁰² Indeed, even in the case where a hypothetical EEO entrant could still in principle match Royal Mail’s prices and make a profit, Royal Mail’s discriminatory conduct would still have diminished that entrant’s ability to compete as effectively as it could have done absent the price differential.

7.200 Fourth, without prejudice to the reasons outlined above as to why, on the facts of this case, we do not consider it necessary or relevant to carry out a price/cost test (whether on an EEO or on some other basis), we make the following brief observations on why the analyses put forward by Royal Mail would not appropriately reflect economic reality given the prevailing features and conditions of the bulk mail delivery market at the time the price differential was introduced:

- a) **The EEO Test:** The EEO test advanced by Royal Mail is based on Royal Mail's costs, which its own advisers appear to acknowledge are not likely to be similar to those of an entrant, and it assumes a conversion rate of 100%. In their report, Compass Lexecon note that the sensitivity analysis that was carried out, which made certain adjustments to the inputs to the modelling for the base case EEO model (as discussed in (b) below), "*may be considered closer to the position of a new entrant*".¹⁰⁰³ It is therefore clear that their EEO test approach is not a realistic basis for assessing the impact of a pricing practice in the context of an overwhelmingly dominant undertaking responding to nascent competition in the market.
- b) **The sensitivity analysis:** The sensitivity analysis conducted by Royal Mail's advisers: (i) assumes a roll out profile based on Royal Mail's estimates of the likely operating costs of a new entrant; and (ii) assumes an initial conversion rate of 60%, rising to 80%.¹⁰⁰⁴ However, each of the scenarios examined by Royal Mail's advisers is still based on Royal Mail's downstream costs (using an adjusted version of Royal Mail's LRAIC model, see paragraph 5.46 of the FTI report). Royal Mail does not seek to model the actual costs of a new entrant to assess the impact of the price differential on a competitor in that position, despite the fact that Royal Mail had developed a "*Direct Delivery Operating Cost Model*" as a "*proxy [for] the likely costs of an efficient entrant*".¹⁰⁰⁵
- c) **Other relevant factors are not considered:** Royal Mail's assessment of a notional as-efficient entrant also fails to capture a number of other factors which are relevant to an access operator's decision as to whether to enter:
 - i) A potential entrant (and its investors) would take into account risk as well as expected profitability. The price differential reduced the upside potential for higher profits from entering into bulk mail delivery and increased the downside in the event that entry proved unsuccessful.
 - ii) As discussed in Section 6, Royal Mail had a number of advantages unrelated to costs, such as reputation and experience, and VAT status.¹⁰⁰⁶ These would make it more difficult to attract customers even if an entrant could match retail prices.

¹⁰⁰³ Compass Lexecon, *Economic assessment of Ofcom's theories of harm*, 27 November 2015, page 12, paragraph 2.20 and page 40, paragraph 5.18. (RM2313)

¹⁰⁰⁴ *Ibid.*, pages 39 to 40, paragraphs 5.13 to 5.15. (RM2313)

¹⁰⁰⁵ *Ibid.*, page 31, paragraph 4.66. (RM2313)

¹⁰⁰⁶ Royal Mail's advisers acknowledge that Royal Mail had a tax advantage, but argue that an EEO would have been able to offer a VAT free retail price. *Economic assessment of Ofcom's theories of harm*, [3<] (Compass Lexecon), November 2015,

- 7.201 Finally, we note that Royal Mail’s internal contemporaneous documents do not indicate that it undertook an EEO test of the impact of the price differential (in isolation or in combination with the other price changes) as part of its internal process leading to its introduction.¹⁰⁰⁷ The price/cost test work conducted by Royal Mail’s current advisers was completed only after the conduct had begun and a competition investigation had been launched. We consider that such *ex post* analysis by advisers is not persuasive in circumstances where its conclusions are inconsistent with the contemporaneous evidence as to what Royal Mail considered to be the likely impact of the price differential, applied on top of the zonal tilt (see sub-section D above).
- 7.202 Moreover, Royal Mail’s contemporaneous internal analysis of that impact is consistent with our findings:
- a) based on our assessment of all the circumstances of this case, that the price differential was reasonably likely to give rise to a competitive disadvantage and/or was reasonably likely to lead to a restriction of competition, as explained in the first part of this sub-section E above; and
 - b) as to the consequences of the introduction of the price differential on Whistl and LDC, in at least the initial period after its introduction (and suspension), as explained in sub-section F below.

The suspension of the price differential does not prevent a finding of abuse on the particular facts of this case

- 7.203 As set out in Sections 3 and 4, as a result of Ofcom opening its investigation, the implementation of the price differential was suspended on 21 February 2014, some six weeks after it was introduced through the CCNs (its introduction had also been signalled to the market in December 2013, see paragraphs 4.104 to 4.105 above).
- 7.204 In this section, we address Royal Mail’s submissions that the suspension of the CCNs, including the price differential, means that the price differential could not give rise to an abuse.

Royal Mail’s representations on the suspension of the CCNs, including the price differential

- 7.205 First, Royal Mail argues that there can be no breach of Article 102(c) in this case because the conduct this provision condemns is “*applying dissimilar conditions to equivalent transactions*”¹⁰⁰⁸ and, because the price differential was not ultimately charged and paid,

paragraph 2.12. As discussed above, the emergence of an as-efficient competitor could have been practically impossible in this case.

¹⁰⁰⁷ See Section 4. As explained above, while certain cost modelling was carried out by Royal Mail, there is no evidence to suggest that Royal Mail sought to use it for the purpose of assessing whether an as-efficient competitor would be foreclosed if the price differential was introduced. Instead, that cost model was developed as a proxy for Whistl’s costs, in order to calibrate the prices changes based on their likely impact on Whistl’s end-to-end delivery plans; and we understand it was also used to support a purported cost justification for introducing the price differential.

¹⁰⁰⁸ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 77, paragraph 5.35 (RM2386)

*“dissimilar conditions... were never applied to any transaction.”*¹⁰⁰⁹ Royal Mail submits that *“[i]n those circumstances, simply issuing the Contract Change Notices did not and could not amount to abusive price discrimination contrary to Article 102(c)/section 18(2)(c) CA98.”*¹⁰¹⁰ It asserts that these provisions *“do not condemn the announcement of an intention to apply dissimilar conditions to equivalent transactions.”*¹⁰¹¹

7.206 Second, Royal Mail argues that our approach to assessing the effect of its conduct in this case amounts to assessing the impact of ‘hypothetical conduct’ because the differential was not charged. Royal Mail argues that *“under Article 102/Chapter II Ofcom may assess the (likely) competitive effect of the issuing of the Contract Change Notices, but not a hypothetical scenario as to what might have happened if the announced prices had actually been charged.”*¹⁰¹²

7.207 Third, as the suspension of the price differential / the CCNs was expected by operators, and the CCNs were in practice suspended, rational operators would not have responded at all to the changes and / or altered their behaviour in the anticipation of being affected by them.

7.208 In support of its submissions that until the price differential was actually charged and paid in practice, it could not amount to an abuse of dominance, Royal Mail advances the following factual arguments

- a) The issuing of the CCNs which included the price differential amounted to *“mere announcements”* of pricing *“proposals”* that could not affect competition without the prices announced actually being charged and paid in practice.¹⁰¹³
- b) As such, Royal Mail argues that rational postal operators would have interpreted the circumstances surrounding the CCNs (including the suspension of the CCNs and the investigation by Ofcom, which could have been expected to prevent unlawful changes from being implemented) such that they would not have expected to be adversely affected by the CCNs.¹⁰¹⁴ Royal Mail states that:

*“[T]he notices could not be implemented unless: (i) having considered the complaint, Ofcom choose not to launch an investigation (which would imply Ofcom had no concerns in relation to the Contract Changes Notices); or (ii) having chosen to launch an investigation, Ofcom subsequently concluded that the Contract Change Notices did not raise competition concerns.”*¹⁰¹⁵

“...[I]n circumstances in which the implementation of the prices announced in the Contract Change Notices would be suspended in the event of a complaint leading to

¹⁰⁰⁹ Ibid., page 78, paragraph 5.39 (RM2386)

¹⁰¹⁰ Ibid., page 78, paragraph 5.39 (RM2386)

¹⁰¹¹ Ibid., page 77, 5.35 (RM2386)

¹⁰¹² Ibid., page 74, para 5.20 (a) (RM2386)

¹⁰¹³ Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 74 to 77, paragraphs 5.20 to 5.40. (RM2386)

¹⁰¹⁴ See in particular, *ibid.*, section 5, pages 70 to 90. (RM2386)

¹⁰¹⁵ Ibid., page 74, para 5.21. (RM2386)

an investigation by Ofcom, no rational postal operators would have assumed that prices that were capable of infringing Article 102/Chapter II would ever be implemented – and so would not have altered their behaviour on the market in response to the announcement of such prices.”¹⁰¹⁶

- c) This is because, Royal Mail submits, a rational operator would take the view, following the introduction of the price differential / issuance of the CCNs, that a complaint would be made and Ofcom would open an investigation. Thus, according to Royal Mail, a rational operator would proceed on the assumption that they would only be required to pay competitive prices.¹⁰¹⁷ On this basis, it is said that the price differential was incapable of giving rise to anti-competitive effects. Specifically, Royal Mail argues that:
- i) at the point at which the prices were introduced, rational economic operators would not have made commercial decisions on the basis that they would be required to pay prices capable of distorting competition. They would not have responded or altered their behaviour at all if they considered the price differential to be unlawful – on the assumption a complaint would be made, an investigation would therefore be opened and the price differential would be suspended;¹⁰¹⁸
 - ii) rational operators would not have altered their behaviour in response to the price differential once it was suspended;¹⁰¹⁹ and / or
 - iii) any steps taken in response to the price differential, despite its suspension, can be ignored as amounting only to a ‘fear of legality’.¹⁰²⁰ This is because any prices ultimately paid or implemented would have been sanctioned by Ofcom as lawful. Royal Mail cites in support of this argument the fact that Whistl did not assume it would pay the prices included in the CCNs in any of its subsequent business plans.

Our assessment

7.209 In paragraphs 5.98 to 5.104 of Section 5, *Legal Framework*, we have explained why we reject Royal Mail’s submissions on this issue insofar as they raise points of legal principle. In particular:

- a) The requirement in a case under Article 102(c) TFEU/section 18(2)(c) of the Act that the conduct must involve the application of dissimilar conditions to other trading partners, does not mean that pricing practices are captured only when the relevant prices are actually *charged* and *paid* by those trading partners. Equally, under Article 102 TFEU/the Chapter II prohibition generally, Ofcom is required to assess the reasonably likely impact of the price differential on a forward-looking basis, i.e. it is required to assess whether the conduct was abusive at the time the relevant acts were committed.

¹⁰¹⁶ Ibid., page 85, paragraph 5.72. (RM2386)

¹⁰¹⁷ Ibid. (RM2386)

¹⁰¹⁸ Ibid., page 71, paragraphs 5.8 and pages 85 to 86, paragraphs 5.71 and 5.72, (the latter paragraph is quoted above). (RM2386)

¹⁰¹⁹ Royal Mail, *Response to Statement of Objections*, 27 November 2015, paragraphs 1.17, 5.7 to 5.8. (RM2386)

¹⁰²⁰ Royal Mail, *Response to Statement of Objections*, 27 November 2015, paragraphs 1.13 (RM2386) and Royal Mail, *Response to letter of facts*, 24 November 2017, paragraphs 5.45 to 5.51. (RM2581)

We take into account the evidence as to what in fact occurred in order to inform an assessment of what the reasonably likely effects of the conduct were at the time it was engaged in.

- b) The case law of the European Courts makes clear that a competition authority does not have to wait until the anti-competitive conduct has an actual concrete impact on competition before taking action. Such a requirement would run counter to the object and purpose of Article 102 TFEU and the Chapter II prohibition.
- c) The intervention of third parties, such as Ofcom, cannot be relied upon to avoid responsibility for conduct which, assessed at the time, was likely to have had anti-competitive effects. A dominant undertaking has a special responsibility not to exercise its market power in a way that impairs genuine undistorted competition on the market.

7.210 As a result, we have assessed (as set out at paragraphs 7.141 to 7.171 above) what the reasonably likely effects of the price differential would have been from the point at which it was introduced in January 2014. On that basis, we have concluded that the price differential was reasonably likely to distort competition. This conclusion is supported by our findings as to what actually happened in the bulk mail delivery market as set out in sub-section F below.

7.211 In the rest of this section, we address the factual points raised by Royal Mail, as summarised above.

7.212 Having carefully considered Royal Mail's arguments, we do not agree that the price differential as introduced was incapable of having any anti-competitive effects on the market because it was expected to be, and was in fact, suspended as a result of the initiation of Ofcom's investigation. Applying the relevant aspects of the legal framework summarised above, our conclusion on the facts of this case rely, in particular, on the following points:

7.213 First, Royal Mail's submissions are inconsistent with the position it adopted at the time, which is demonstrated by its internal contemporaneous documents. The documents suggest that Royal Mail was well aware at the time it decided to introduce the price differential in January 2014 that Ofcom might open an investigation in response to a complaint, in particular from Whistl, and that the price differential might be suspended as a result. Specifically, in response to Whistl's letter of 8 January 2014 setting out its concerns about the proposed changes via the CCNs, [X a Royal Mail executive] wrote to the Board stating, *inter alia*, that:

"... We fully expect the access pricing changes to be suspended pending the outcome of the Ofcom investigation... We think [Whistl's] claims about the harm they will suffer are exaggerated, but it is possible that they may find it difficult to attract new customers given the market uncertainty that may be created by their complaint. It is

*also possible that [Whistl's] financing may be conditional on there being no regulatory or competition law dispute ongoing...*¹⁰²¹

- 7.214 Royal Mail therefore anticipated that, even if a complaint was made and Ofcom decided to open an investigation, resulting in the suspension of the CCNs, including the price differential, this would not prevent the price changes having an impact on Whistl or the market more generally.
- 7.215 Further, this advice was offered to the Royal Mail Board against a background in which:
- a) the internal Royal Mail discussions indicated a desire to send a “*very assertive signal*” to the market through the introduction of the price differential and other price changes, despite the legal risks (see paragraph 4.103 above);¹⁰²²
 - b) Whistl’s public announcements and business plans made clear that a funding partner was required in order to fund capex and startup losses for its delivery operations (see paragraphs 4.2 to 4.8 above);
 - c) Royal Mail’s internal documents show that it was aware that a direct delivery investor had been sought and identified by Whistl, and that investor confidence in direct delivery was an important factor in assessing whether roll out would occur (see paragraphs 4.18 and Figure 4.1, and 4.114); and
 - d) any new entrant would need to convert and/or build its customer base in order to support and sustain its roll out.
- 7.216 All of these points suggest, as indicated by the email quoted above, that the introduction of the price changes was reasonably likely to be factored into Whistl’s business plans at the time the price differential was introduced. Our review of Whistl’s internal documentation and findings in relation to its response to the price differential (see sub-section D above and sub-section F below) shows that Royal Mail’s understanding of the position, as quoted above at paragraph 4.135, corresponds with the reaction of Whistl and its investor, LDC.
- 7.217 Second, on the facts of this case, it is plain that Royal Mail’s submission that the CCNs, including the introduction of the price differential, amounted to “*mere announcements*” which were incapable of having any effect on competition pending actual implementation (i.e. being charged and paid) is unsustainable because:
- a) The price differential was not announced as a *potential* change to Royal Mail’s access conditions, which was subject to consultation or negotiation (a point which Royal Mail in fact accepts¹⁰²³). On the contrary, its introduction involved the exercise of Royal Mail’s unilateral power to change the access contractual terms. The CCNs were different in nature, for example, to Royal Mail’s announcement in December 2013 of its ‘decision in principle’ to introduce a price differential between NPP1 and APP2/ZPP3. Thus, Royal Mail had introduced a legally binding change to its access

¹⁰²¹ Royal Mail, *email from [redacted] to the Royal Mail Board re legally privileged and confidential*, 9 January 2014. (RM0138)

¹⁰²² E-mail from [redacted] (Royal Mail) to [redacted] (Royal Mail), 2 December 2013. (RM0372)

¹⁰²³ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 74, para 5.20 (a) (RM2386)

conditions. That change could only be altered, removed or avoided through: (i) the actions of a third party regulator or court in determining that the price differential as introduced was unlawful; and / or (ii) a further decision by Royal Mail to withdraw the change, over which the access operator had no power.

- b) The purpose of the CCNs was, like all such notices issued by Royal Mail, to enable Royal Mail's customers to prepare for changes in terms and conditions and make the necessary adjustments to their business planning processes or systems in time for when the changes came into force. In relation to access prices, this was particularly critical as access operators needed to determine their own retail pricing (informed by Royal Mail's wholesale prices) and communicate this appropriately to customers in advance of the change in wholesale pricing. In the context of potential or existing competing delivery operators, affected operators would also need to take account of the changes in the context of planning and executing entry.
- c) The fact that the period was also intended to allow an operator to raise a dispute / make a complaint, if they considered necessary or appropriate, did not, as discussed further below: (i) relieve Royal Mail of its special responsibility as a dominant undertaking; or (ii) mean that a rational operator would simply ignore the implications of the changes in their business planning.

7.218 Thus, in the absence of Ofcom's intervention in response to Whistl's complaint, the higher prices associated with the price differential would have been charged to access operators on APP2 and ZPP3 from the date of its implementation.

7.219 The facts of this case are therefore similar to those considered by the European Courts in *AstraZeneca* (see paragraphs 5.27 to 5.33 above). In that case, the Advocate General explained that:

*"... this is not a situation where conduct 'would only restrict competition if a series of further contingencies were to occur'. Rather, this is clearly more akin to a situation where conduct would restrict competition unless further contingencies (such as the intervention of third parties) occurred to prevent that happening."*¹⁰²⁴

7.220 In light of the above, we do not accept that rational economic operators would or could have ignored the implications of the price differential, as introduced in January 2014, for their businesses, pending full implementation in March 2014. We note that our findings about what happened in the bulk mail delivery market in the months after the price differential was introduced, as set out in sub-section F, support this conclusion.

7.221 Third, for similar reasons, we reject Royal Mail's arguments (summarised at paragraphs 7.208(b) and (c) above) to the effect that, at the point at which the price differential was introduced, rational economic operators would not have responded or altered their behaviour at all if they considered the price differential to be unlawful – on the assumption

¹⁰²⁴ See paragraph A68 of Advocate General Mazák's Opinion in Case C-457/10 P *Astrazeneca AB v European Commission* EU:C:2012:770 [2013] 4 C.M.L.R.7

that a complaint would be made, an investigation would therefore be opened and the differential would be suspended.

- 7.222 As a matter of law, the existence of contractual provisions allowing for unilateral price changes to be suspended during a dispute or investigation does not relieve Royal Mail from its special responsibility as a dominant undertaking to avoid distorting competition. On the contrary, that obligation is particularly important where a dominant undertaking has such a power.
- 7.223 Further, and in any event, we do not accept that rational operators would behave in the manner contended by Royal Mail. On the contrary, Royal Mail's submissions in this regard are unrealistic.
- 7.224 In this regard: (a) operators knew that the price differential (or other parts of the CCNs) could be suspended; and (b) the price differential was in fact suspended. This does not mean, however, that the introduction of unlawful prices would be incapable of having *any* anti-competitive effects on the market:
- a) We note the findings made in paragraphs 7.217-7.220 above. It is clear that once the price differential was introduced through the CCNs that operators could not simply ignore their implications based on their own views as to the legality of the price differential and their anticipation of an investigation. The provision of access by Royal Mail is an indispensable input for the services provided by access operators on the bulk mail delivery market, the price of which amounts to a significant proportion of the cost of that service. In circumstances where its unavoidable trading partner has announced the price terms upon which it intends to operate, a rational operator would not proceed on the assumption that the price differential could have *no* implications for them. This would be particularly the case in circumstances where an operator was considering making significant investments in the market, which involves decisions as to what risks to incur in the light of projected future profits. Operators would have to consider the risks, if any, to their business plans on a number of scenarios: (i) a complaint was not in fact made; (ii) the complaint might not give rise to an investigation; (iii) even if Ofcom decided to investigate, the complaint would inevitably take at least some time to be resolved, giving rise to uncertainty in the market; and (iv) the outcome of the investigation could not be predicted with any confidence.
 - b) For these same reasons, even after the price differential's implementation was suspended, it is reasonably likely that the acts committed by Royal Mail would have continuing effects on the market. Forward-looking business planning has to take account of the potential costs and risks to the business, and therefore any potential consequences for the business that would flow from the implementation (in whole or in part) of suspended price changes. Pending the withdrawal of the price differential, or the determination that it was unlawful, it is unrealistic to suggest that a rational operator / investor would ignore the implications of the price differential for its business.

- c) The above points are supported by:
- i) The fact that even after the price differential was suspended, Royal Mail made it clear to the market that it intended to begin charging the price differential as soon as it was possible for it do so (see paragraphs 4.204 to 2.207 above). Royal Mail only withdrew the CCNs in March 2015, some 14 months after they were issued. Therefore, a rational operator would have been uncertain as to whether Royal Mail would proceed to implement the CCNs at least until the point that changes were withdrawn; and
 - ii) the conclusions we reach in sub-section F below about the immediate impact of the introduction of the price differential and the months that followed.

7.225 Fourth, Royal Mail’s submissions on the issue of suspension amount ultimately to an attempt to outsource its special responsibility as a dominant undertaking to third parties, i.e. access operators / Ofcom.

7.226 Royal Mail has submitted that there is no circularity or enforcement gap inherent in its argument that competition law does not apply in this case because, in its view, *ex ante* regulatory tools are the appropriate means of preventing unlawful pricing before it is implemented – which is reflected by the inclusion of the suspensory clause in the Access Letters Contract.¹⁰²⁵ There are two main problems with this argument:

- a) It conflicts with Royal Mail’s special responsibility as a dominant undertaking to avoid distorting competition. As we have explained above, a dominant undertaking that abuses its position cannot contend as a defence for its actions that a regulator could or should have prevented the dominant undertaking from taking such an action on an *ex ante* basis, or that its contractual terms suspend its actions in the light of an investigation. Royal Mail cannot contract out of its obligations under Article 102 TFEU and the Chapter II prohibition by including a suspension clause in its contracts. This was made clear to Royal Mail at the time, as Royal Mail’s own note of its meeting with Ofcom of 10 December 2013 records (see further paragraphs 4.106 to 4.111, above):

“Ofcom emphasised that Royal Mail must undertake its own due diligence on the price proposals and that this was not just a regulatory issue but also likely to be a competition issue.”¹⁰²⁶

- b) In any event, Ofcom did commence an ‘*ex ante*’ regulatory review using its Postal Services Act 2011 powers on the same day as it opened the Competition Act 1998 investigation (9 April 2014). On 2 December 2014, Ofcom consulted on a set of proposed conditions that would have prevented Royal Mail, as a matter of its regulatory obligations, from imposing any price differential between NPP1 and APP2/ZPP3. Ultimately Ofcom did not proceed with these proposals because of Whistl’s decision to terminate its end-to-end delivery business.¹⁰²⁷ However, this

¹⁰²⁵ Ofcom, *Transcript of an oral representation hearing with Royal Mail*, 21 May 2018, pages 108 to 110. (RM2690)

¹⁰²⁶ Royal Mail, *Note of meeting with Ofcom*, 10 December 2013, page 2. (RM2324)

¹⁰²⁷ Ofcom, *Review of the Regulation of Royal Mail – Statement*, 1 March 2017, page 63, paragraph 5.12. (PD0067)

regulatory review was forward looking in nature in the sense that it would have introduced pricing rules with prospective effect. It would not have operated to sanction Royal Mail for actions already taken that amount to an abuse of its dominant position. Ex ante regulatory tools were therefore a complement to ex post enforcement in this case, rather than a replacement.

7.227 We also note that different strands of Royal Mail's arguments in this regard contradict one another / are circular:

- a) Royal Mail argues that, in light of the suspension of the price differential, Ofcom would have been and remains precluded from deciding it was unlawful because it was never charged in practice. If this was right, Ofcom would not have been able to prevent the lifting of the suspension of the price differential as a result of its investigation. It would have to wait until concrete harm occurred, i.e. on Royal Mail's case, an operator has in fact paid an access price that includes the price differential, before the conduct could be found to be unlawful (in a manner, which as explained above, is inconsistent with the very purpose of the competition law regime).
- b) However, at the same time, Royal Mail contends that an access operator or competitor could have ignored the implications of unlawful price changes, from the outset, because they could expect that Ofcom's intervention would prevent them being charged in practice.

7.228 The correct position is in fact that price changes as introduced can: (a) amount to unlawful abuse of dominance from the outset; and (b) have continuing effects even if they are suspended, as opposed to prohibited or withdrawn. Ofcom can and has reached such a conclusion in respect of the price differential for the reasons set out in this Decision.

F. Developments in the market support our finding that the introduction of the price differential was reasonably likely to distort competition

Summary

- 7.229 In Section 4, *Chronology of events*, we set out a detailed account of the development of Whistl's bulk mail delivery operation in the period from 2013 to June 2015, as evidenced by contemporaneous documents and statements from the relevant parties in response to statutory requests for information.
- 7.230 In this part, we explain that the contemporaneous evidence discussed below supports our assessment that Royal Mail's conduct was reasonably likely to distort competition in the market for bulk mail delivery. Our findings relate to the immediate consequences of the introduction of the price differential on Whistl's end-to-end delivery operation, and the continuing impact of the price differential in the period after Royal Mail issued the CCNs. In particular, we find that the introduction of the price differential was a material contributing factor (among other factors) to:
- a) the disruption of LDC's decision to complete its agreed investment in Whistl in January 2014; and
 - b) Whistl's decisions to reduce and then suspend parts of its planned further roll out of its end-to-end delivery operations.
- 7.231 In relation to Whistl's ultimate exit from the delivery market in June 2015, we have not found it necessary to make any findings in this Decision as to (i) the causes of Whistl's exit; or (ii) the extent to which that exit could be attributed to the introduction of the price differential.

Consequences for LDC's investment and Whistl's roll out

Disruption to LDC's investment in Whistl in January 2014

- 7.232 As set out in Section 4, *Chronology of events*, LDC decided not to complete its investment in Whistl as planned in January 2014 because LDC had determined that the introduction of the CCNs, including in particular the price differential, had a material adverse effect on Whistl's business plan. It is difficult to isolate the impact of each of the different pricing changes in the CCNs. However, the evidence contained in contemporaneous internal documents shows that:
- a) when the introduction of the price differential was signalled in December 2013, its anticipated impact led to the inclusion of the MAE condition (see paragraphs 4.143 to 4.157 above); and
 - b) the actual introduction of the price differential in January 2014, on top of the other pricing changes in the CCNs, was a material factor in LDC's decision to invoke the MAE condition (see paragraphs 4.188 to 4.193 above).

7.233 This was because LDC determined that the differential pricing introduced by the CCNs would have a material adverse effect on Whistl's delivery business. In summary, as set out in the detailed chronology:

- a) The MAE condition was added to the LDC Agreement at a late stage (approximately four days before execution) as a direct response to Royal Mail's announcement on 6 December 2013 that it would be introducing a differential in pricing between ZPP1 and APP2 (with no indication being given at that time of any of the other prospective changes to be included in the CCNs).¹⁰²⁸
- b) Once Royal Mail had issued the CCNs on 10 January 2014, LDC, relying upon the new MAE Condition, identified a material adverse impact resulting from the changes, and postponed the investment. LDC took the view that "[i]f accepted this [i.e. the CCNs] would result in [Whistl] (or any other new entrant) being on a price plan where the differential means they could not be profitable competing with [Royal Mail]".¹⁰²⁹
- c) Having made its investment conditional on the acceptability of Royal Mail's prices causing no material adverse effect on Whistl, LDC invoked the MAE condition and decided not to complete.¹⁰³⁰
- d) The agreement of December 2013 provided a long stop date for completion of 13 June 2014, but LDC had determined that it would not invest until its concerns with Royal Mail's pricing had been resolved.¹⁰³¹ The parties agreed to vary and extend the long stop date for the LDC Agreement until December 2014.¹⁰³²

7.234 In practice, because Ofcom intervened by opening an investigation, the price differential was suspended with effect from 21 February 2014. However, that did not mean that the price differential as introduced (and which Royal Mail did not withdraw until the following year) was incapable of having continuing effects on the market. As outlined above, even after parts of the CCNs were suspended, including the price differential, this did not prompt LDC to finalise the agreement. On the contrary, it continued to wait to see if the price differential, and other changes, would be implemented in whole or in part.

Consequences for Whistl's roll out: reduction to and suspension of roll out

7.235 As set out in full in Section 4, *Chronology of events*, because of the anticipated impact of the price changes on Whistl's business plan and the associated delay to the investment from LDC, Whistl immediately took steps to reduce its planned roll out. Later, Whistl decided to suspend its roll out entirely (during the course of April to October 2014), and in practice this meant that Whistl did not roll out further after March 2014, which was the

¹⁰²⁸ LDC, *Letter from [redacted] (LDC) to [redacted] (Ofcom) – appendix 1*, 21 April 2017, page 2. (LDC126) See also email from [redacted] PostNL's external legal advisors] to various of 11 December 2013 (LDC025).

¹⁰²⁹ LDC, *TNT Update Paper*, 22 March 2014, page 1. (LDC076)

¹⁰³⁰ LDC, *Email from [redacted] (LDC) to [redacted] (LDC) re: Complaint – legally privileged*, 2 February 2014. (LDC047)

¹⁰³¹ LDC, *TNT Update Paper*, 22 March 2014, pages 2. (LDC076)

¹⁰³² LDC, *Letter from [redacted] (LDC) to [redacted] (Ofcom) – appendix 1*, 21 April 2017, page 4. (LDC126)

point at which it completed its final incremental expansion to Liverpool.¹⁰³³ Whistl determined that it would not resume its roll out unless Ofcom made a decision which required Royal Mail to remove the price changes – and this decision was not reversed in light of the suspension of the price differential and other changes introduced in the CCNs on 21 February 2014 (see paragraphs 4.181 to 4.187).

7.236 We recognise that the decision to reduce and then suspend roll out was a response to the package of price changes introduced by the CCNs. However, we consider that the evidence contained in the contemporaneous internal documents shows that the financial implications of the price differential, which would come on top of the other pricing changes in the CCNs, was a material factor in the decision to reduce and then suspend further roll-out:

- a) After Royal Mail’s announcement on 6 December 2013 of its decision in principle to introduce a price differential, Whistl recognised the risk posed by a price differential: “[e]ven a small differential (which would need to be matched commercially) could turn the business (10 million profit 2012) into a loss-making one within a year and, effectively, halt our end-to-end roll-out.”¹⁰³⁴ As set out at paragraph 4.146 above, even before the price differential was introduced, Whistl developed plans to postpone further property investments in its end-to-end operations and delayed three of the seven proposed expansion areas for 2014.
- b) After the CCNs were issued on 10 January 2014, Whistl concluded that a price differential “could seriously harm [the] E2E case,”¹⁰³⁵ suspended further investment in the roll out plan and attempted to limit further financial exposure.¹⁰³⁶ As set out above, the suspension was associated with the disruption to LDC’s investment (to which the price differential was also a material contributing factor).
- c) Even though the price differential was suspended in February 2014, Whistl did not further expand its end-to-end business after March 2014. It decided to delay entry indefinitely into four of the seven SSCs it had previously planned to roll out in during the course of 2014, and in fact it only completed two of the seven planned roll outs.¹⁰³⁷ Whistl’s analysis of the potential roll out scenarios completed in January 2014 (see paragraph 4.183 above) factored in the outcome of the complaint to Ofcom, i.e. whether or not the price differential and other elements of the CCNs would be

¹⁰³³ In its response to a statutory information request, Whistl explained this limited roll out was necessary “[g]iven the lead times for ordering the letter-sequencing machines, which meant that some orders had already been placed; the need for PostNL to demonstrate its confidence in E2E to the would-be external investors; and Whistl’s commercial need to demonstrate to the customers that it intended to continue its rollout of end-to-end” – see Whistl, *Response to 2nd section 26 Notice – request 3*, 20 March 2017, page 2. (WH0834)

¹⁰³⁴ Whistl, *Email from [redacted] (Whistl) to [redacted] Whistl’s external legal advisors] re: Luke – management issue list*, 8 December 2013. (WH0714)

¹⁰³⁵ PostNL, *Email from [redacted] (PostNL) to [redacted] (Whistl) and [redacted] (Whistl) re: FW: Updated Commitment overview*, 9 December 2013. (WH0720)

¹⁰³⁶ Revised roll-out scenarios were developed by Whistl in January 2014 and discussed with LDC in January and February 2014. Whistl, PostNL and LDC agreed that Whistl should postpone launches in East London, Birmingham, North London and Central South East London. See paragraph 4.185.

¹⁰³⁷ See paragraphs 4.214 to 4.216.

implemented in practice. Whistl continued to rely on this scenario planning in revising its potential roll out plans in June – November 2014 (see paragraphs 4.214 to 4.216 above).

- 7.237 We note that Royal Mail predicted such a halt in roll out from Whistl in a presentation to the Chief Executive’s Committee in November 2013, see paragraphs 4.46 to 4.57 above.
- 7.238 We acknowledge that other factors, such as the changes to the zonal tilt and existing market conditions, may have also been relevant factors in the context of the decisions made by Whistl and / or LDC. However, the evidence available to us demonstrates that the introduction of the price differential was a material contributing factor to the above developments. That is a sufficient basis for us to conclude that the available *ex post* evidence supports and is consistent with our conclusions as to the reasonably likely consequences of the price differential at the time of its introduction, i.e. in January 2014; and the reasonably likely continuing effects of the price differential, even after its suspension.
- 7.239 As discussed further below in sub-section I, we have not found it necessary to determine whether the introduction of the price differential materially contributed to the further events which ultimately led to Whistl’s exit from the bulk mail delivery market.

The potential for Whistl to compete in end-to-end delivery absent the price differential

- 7.240 As discussed further below in response to Royal Mail’s submissions, in reaching our decision that the introduction of the price differential was abusive it was not necessary for us to determine whether, absent the price differential, Whistl would have exited the market in any event and / or otherwise proven to be less successful than it anticipated in its business plans.
- 7.241 However, in light of Royal Mail’s reliance in its submissions on claims that it was inevitable that Whistl would fail, it is relevant to note that, at least in the period up to and as at the time the price differential was introduced, end-to-end competition was considered to be viable by a range of actors, including Royal Mail. In summary:
- a) The potential for successful end-to-end competition was reflected in Ofcom’s regulatory framework established in 2012. Ofcom recognised that while “[e]nd-to-end competition has no significant presence in the UK. There is, however, the clear prospect of it developing in the future.”¹⁰³⁸ Ofcom considered that the potential for end-to-end competition was a key regulatory safeguard applying to Royal Mail in a context in which it was not subject to price controls.¹⁰³⁹ The significance of the role of end-to-end competition in the framework is also evident in Ofcom’s decision to review the framework following Whistl’s exit from end-to-end competition:

¹⁰³⁸ Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012, page 8, paragraph 1.52. (PD0025)

¹⁰³⁹ *Ibid.*, page 76, paragraph 6.157 to 6.158. (PD0025)

*“Given that Whistl was by far the largest end-to-end competitor to Royal Mail, its withdrawal from the provision of end-to-end letter delivery services has resulted in Royal Mail no longer facing the prospect of significant end-to-end competition in bulk letters mail. We are therefore concerned that Royal Mail may have weakened incentives to deliver efficiency improvements and an increased ability to charge excessive prices.”*¹⁰⁴⁰

- b) In the period leading up to the introduction of the price differential in particular, Royal Mail itself took the view that end-to-end competition was viable. Moreover, Royal Mail’s own internal analysis and evidence gathering in respect of Whistl’s end-to-end business suggested that Whistl was a threat to its market share and profitability:
- i) In its submissions to Ofcom during 2013 and 2014 in relation to the threat posed by direct delivery operations to the USO, Royal Mail identified a range of factors which it considered increased the viability of end-to-end competition in the UK. In particular, Royal Mail’s assessment considered the extent of access competition in the UK which: *“gives established access mail providers the considerable advantage of being able to roll out a direct delivery network far more quickly thanks to existing customer relationships.”*¹⁰⁴¹ In its view, this meant that a large proportion of the UK market was contestable. Royal Mail said its *“analysis shows that around 70% of the addressed letters market by volume is contestable under [Whistl’s] current business model.”*¹⁰⁴² This was based on assessing a large access operator’s (such as Whistl’s) ability to convert its own volumes including those from large banks, to attract new volumes from other access operators and to win further volumes from Royal Mail’s second class retail services.¹⁰⁴³ Royal Mail also explained that a new entrant in delivery could benefit from a virtuous circle in which its expansion enables it to continually increase volume, benefit from economies of scale and acquire new customers.¹⁰⁴⁴
- ii) In a submission to Ofcom in December 2013, Royal Mail emphasised, in particular, the potential for Whistl to compete in the delivery market:¹⁰⁴⁵

*“[Whistl’s] Direct Delivery Operation is expanding quickly through switching of DSA traffic to their own delivery network”;*¹⁰⁴⁶

¹⁰⁴⁰ Ofcom, *Review of the regulation of Royal Mail – Discussion paper*, 17 July 2015, page 8, paragraph 3.17. (PD0065)

¹⁰⁴¹ Royal Mail, *Response to Ofcom’s consultation: End-to-end competition in the postal sector, Draft guidance on Ofcom’s approach*, January 2013, page 2. (PD0075)

¹⁰⁴² Royal Mail, *Direct Delivery: A Threat to the Universal Postal Service Regulatory Submission to Ofcom*, 20 June 2014, page 37. (PD0043)

¹⁰⁴³ *Ibid.*, page 38. (PD0043)

¹⁰⁴⁴ *Ibid.*, page 37. (PD0043)

¹⁰⁴⁵ Royal Mail, *Direct Delivery Modelling Update: Why Regulatory Action is Necessary Now to Protect the USO*, 10 December 2013. (RM2363)

¹⁰⁴⁶ *Ibid.*, slide 6. (RM2363)

*“[Whistl] can afford to charge much lower prices to entice large customers”, because its “likely incremental costs are significantly lower than their average total cost per item”;*¹⁰⁴⁷

*“[Whistl] can grow their local market share significantly beyond the 20% implied by their public statements”;*¹⁰⁴⁸ and

Given this *“market share potential, the scope for roll out of [Whistl’s] direct delivery network could be higher than we previously anticipated.”* Royal Mail noted that *“if [Whistl] are successful in obtaining this investment, it will accelerate the completion of their stated rollout plan within c.2 years.”*¹⁰⁴⁹

- iii) Royal Mail maintained this position that Whistl could not only achieve its roll out ambition but, in fact, exceed it. In its June 2014 submission to Ofcom, Royal Mail concluded that *“it is likely that direct delivery will reach a level which goes beyond that foreshadowed in [Whistl’s] stated plans.”*¹⁰⁵⁰ Royal Mail also advised the BIS select committee:

*“Direct delivery can grow quickly in the UK. The impact this has on the finances of the Universal Service are significant. The damage done to the financial sustainability of the Universal Service is most clearly seen and measured at a postcode level. In new direct delivery areas, Whistl’s local market share quickly reached around 14% as it switched mail into the new service. In our view it can comfortably exceed this share.”*¹⁰⁵¹

7.242 Royal Mail’s contemporary position is consistent with its submissions, addressed in Section 8, *Objective justification and Article 106(2)*, that its actions against Whistl were necessary (i.e. objectively justified) by reference to the need to secure the financial sustainability of the universal service. In this context, Royal Mail stated that *“[t]he UK is uniquely at risk from direct delivery.”*¹⁰⁵²

7.243 Thus, the contemporaneous evidence suggests that end-to-end entry, including by Whistl, was capable of imposing a competitive restraint on Royal Mail in the short term.¹⁰⁵³ However, it cannot now be determined how the competitive process would have played out over the long term if the price differential had not been introduced and it is not necessary for us to do so in the light of our findings on the reasonably likely effects of the price differential.

¹⁰⁴⁷ Ibid., slide 7. (RM2363)

¹⁰⁴⁸ Ibid., slide 8. (RM2363)

¹⁰⁴⁹ Ibid., slide 9. (RM2363)

¹⁰⁵⁰ Royal Mail, *Direct Delivery: A Threat to the Universal Postal Service Regulatory Submission to Ofcom*, 20 June 2014, page 79. (PD0043)

¹⁰⁵¹ Royal Mail, *Written evidence submitted by Royal Mail plc*, published on 11 November 2014, page 7, paragraph 2.4. (PD0077)

¹⁰⁵² Ibid., page 5. (PD0077)

¹⁰⁵³ Moreover, even if Whistl had ultimately exited, in the interim Royal Mail’s bulk mail delivery business would have faced direct competition and consumers would have benefited from that competition.

Royal Mail's representations on the evidence of developments in the market

- 7.244 Royal Mail has advanced two main arguments about what the evidence of the developments in the market shows:
- a) First, Royal Mail has argued that the evidence available does not demonstrate that LDC's decision not to invest and the suspension of Whistl's roll out were linked to the price differential. Royal Mail has argued that the events we have identified relate to the issuing of the CCNs generally (incorporating all of the pricing changes) and not to the price differential specifically; and
 - b) Royal Mail has argued that Whistl would have exited the delivery market in any event, and therefore that Royal Mail's conduct was not capable of having an effect on that competitor.

Royal Mail's argument that LDC's and Whistl's actions following the introduction of the CCNs cannot be attributed to the price differential

- 7.245 In relation to LDC's investment, Royal Mail argues that:
- a) It would have been standard commercial practice to include a MAE clause in respect of Royal Mail's access pricing decisions, and therefore no "*adverse inference*" can be drawn from the fact that LDC extended the range of circumstances that would trigger the MAE clause to include a change to the access prices introduced by Royal Mail.¹⁰⁵⁴ Royal Mail noted in this regard that the Investment Memorandum issued in May 2013 and PWC due diligence report of October 2013 mentioned the risk of possible changes to access pricing, and argued that any reasonable investor properly advised would have already included such a clause in light of this risk.¹⁰⁵⁵
 - b) LDC's decision to introduce the MAE clause was not based on any financial or economic analysis of the potential effect of the price differential and simply reflected the risk that Royal Mail might change its access prices.¹⁰⁵⁶
 - c) The parties considered the MAE clause to be engaged by the CCNs as a whole, and there is no evidence to suggest that the price differential alone would have been considered sufficient to engage the MAE clause.¹⁰⁵⁷
- 7.246 In relation to the suspension of Whistl's roll out, Royal Mail argues that:
- a) Whistl knew that the CCNs would be suspended once it made a complaint to Ofcom and Ofcom opened an investigation, and therefore it knew that it would not need to

¹⁰⁵⁴ Royal Mail, *Response to letter of facts*, 24 November 2017, page 27, paragraphs 5.15 to 5.18. (RM2581)

¹⁰⁵⁵ *Ibid.*, page 5, paragraphs 1.11(a) and page 26, paragraphs 5.7 to 5.10; Ofcom, *Transcript of an oral representation hearing with Royal Mail*, 21 May 2018, pages 44 to 45. (RM2690)

¹⁰⁵⁶ Royal Mail, *Response to letter of facts*, 24 November 2017, pages 28 to 29, paragraphs 5.19 to 5.30. (RM2581)

¹⁰⁵⁷ *Ibid.*, pages 29 to 30, paragraphs 5.31 to 5.34. (RM2581)

pay the announced prices unless Ofcom concluded that the prices were not anti-competitive or in breach of the regulatory conditions.¹⁰⁵⁸

- b) Whistl did not take the announced prices into account in its business planning and modelling or in the various scenarios it considered for roll-out. In particular, Royal Mail said that in Whistl's February 2014 business plan prepared immediately following the announcement of the CCNs, Whistl assumed that it would never pay the prices announced in the CCNs and took no steps to implement them.¹⁰⁵⁹
- c) Whistl's overriding concern, and the key driver behind its decision to delay its roll-out, was that Ofcom would find the CCNs to be lawful, rather than the specific price changes announced by Royal Mail. In particular, Royal Mail argues that the outcome of the roll-out scenarios modelled by Whistl were driven by considerations of whether Ofcom would find in Royal Mail's favour.¹⁰⁶⁰
- d) The impact of the price differential cannot have been said to be Whistl's key concern, as the evidence on which Ofcom relies relates to all of the announced price changes contained in the CCNs, not just the price differential, and the potential impact of the price differential was modest compared to the potential impact of the other announced price changes.¹⁰⁶¹ Royal Mail said that analysis carried out by its economic advisers indicated that the price differential would have accounted for less than 20% of the total estimated impact of the CCNs, whereas 80% of the impact would have come from other changes introduced by the CCNs.¹⁰⁶² In this regard, Royal Mail presented a report from external advisors, FTI Consulting, which concluded that the price differential accounted for 19.6% of the total estimated impact of the CCNs on Whistl's forecast operating profits between 2014 and 2018. The report submits that "*accounting for the impact of the price differential alone (i.e. assuming it alone was implemented), the E2E business was still expected to achieve positive operating profits from 2016 onwards.*"¹⁰⁶³

Our assessment

7.247 We do not accept Royal Mail's submissions for the following reasons.

7.248 First, we have set out our interpretation of and findings on the evidence at Section 4, subsection C.

7.249 With respect to the disruption of LDC's investment, we note the following points in response to Royal Mail's submissions on this particular issue:

¹⁰⁵⁸ Ibid., pages 30 to 31, paragraphs 5.37 to 5.38. (RM2581)

¹⁰⁵⁹ Ibid., pages 31 to 33, paragraphs 5.39 to 5.44. (RM2581)

¹⁰⁶⁰ Ibid., pages 33 to 34, paragraphs 5.45 to 5.51. (RM2581)

¹⁰⁶¹ Ibid., pages 18 to 21, paragraphs 4.11 to 4.28. (RM2581)

¹⁰⁶² Ibid., page 21, paragraph 4.26 (RM2581); Ofcom, *Transcript of an oral representation hearing with Royal Mail*, 21 May 2018, pages 41 and 58. (RM2690)

¹⁰⁶³ FTI Consulting, *Updated assessment of Whistl's Business Plans*, 24 November 2017, page 21, paragraph 4.29. (RM2579)

- a) Contrary to Royal Mail’s submission, we are not drawing any inappropriate “*adverse inference from the inclusion of the MAE Clause*”¹⁰⁶⁴ in the agreement following Royal Mail’s announcement of 6 December 2013 that it had made a “decision in principle” to introduce a price differential between NPP1 and APP2/ZPP3. We do not treat this factual development as determinative of whether the price differential had or was reasonably likely to have anti-competitive effects. Our factual findings on this issue are just one element of our overall assessment of whether the contemporaneous evidence supports our conclusions on the likely impact of the price differential. What this evidence shows is that, following Royal Mail’s signalling of its pricing intentions, Whistl and LDC reacted by recognising a specific risk to the viability of Whistl’s planned roll out.¹⁰⁶⁵
- b) As to Royal Mail’s contention that the inclusion of MAE conditions is standard practice, even if that is the position generally, it is notable that on the facts of this case the particular MAE clause was only included in response to the “in principle” decision to introduce the price differential (see paragraphs 4.148 to 4.152 above).
- c) The evidence also shows that the price differential materially contributed to the invocation of the MAE clause. Once Royal Mail issued the CCNs on 10 January 2014, LDC took the view that “[i]f accepted this [*i.e. the CCNs*] would result in [*Whistl*] (or any other new entrant) being on a price plan where the differential means they could not be profitable competing with RMG.”¹⁰⁶⁶ The price differential was therefore identified as at least one of the reasons behind the invocation of the MAE Condition. Other elements of the CCNs may have been relevant to that decision, but that does not alter the fact that the price differential was a material driver behind this decision.
- d) Royal Mail also relies on the fact that Whistl and LDC were aware of the risk that Royal Mail would change its access prices at some point.¹⁰⁶⁷ However, an awareness on the part of Whistl and LDC that Royal Mail could change its prices does not preclude a finding that any such change, or one component of a package of changes, amounts to an abuse of a dominant position.¹⁰⁶⁸

7.250 As to Royal Mail’s submissions on our findings in respect of the reduction and suspension of Whistl’s roll out plans:

- a) We have explained in detail in Section 4, sub-section C above, based on the evidence on the case file, the steps that Whistl took (i) following Royal Mail’s announcement on 6 December 2013 of its decision in principle to introduce a price differential and (ii) after Royal Mail issued the CCNs. This evidence is sufficient to support our

¹⁰⁶⁴ Royal Mail, *Response to letter of facts*, 24 November 2017, pages 25 to 30, paragraphs 5.4 to 5.34. (RM2581)

¹⁰⁶⁵ See paragraphs 4.143 to 4.157.

¹⁰⁶⁶ LDC, *TNT Update Paper*, 22 March 2014, page 1. (LDC076)

¹⁰⁶⁷ Royal Mail, *Response to letter of facts*, 24 November 2017, pages 26 to 27, paragraphs 5.7 to 5.14. (RM2581)

¹⁰⁶⁸ See the discussion above in paragraphs 5.30 to 5.33.

conclusion that the price differential was a material contributing, if not the only, factor in Whistl's decision-making in this regard. Whistl also explained to Ofcom that:

- i) the limited additional expansions which did take place (in February 2014 and March 2014) went ahead "*merely because the sorting equipment had been ordered and staff already recruited - therefore at the point of the CCNs this part of the roll-out plan was actually concluded*";¹⁰⁶⁹ and
 - ii) "[t]he reason Whistl did not expand its network after March 2014 was because there was no investment capital available to do so."¹⁰⁷⁰ This highlights the impact on Whistl of being unable to secure the investment from LDC (and to secure the associated working capital facility from RBS).
- b) We have outlined at paragraphs 7.203 to 7.228 above why we do not accept Royal Mail's submissions on the effect of the suspension of the price differential (and the CCNs more generally).
- c) We note Royal Mail's allegation that the fact that Whistl did not assume it would pay the price differential in any of its business plans indicated that Whistl's "*overriding concern*" was a "*fear*" that Ofcom would clear some or all of the pricing contained in the CCNs. We consider that the contemporaneous evidence, discussed above, indicates that Whistl and LDC were concerned that the price differential, on top of the other changes introduced by the CCNs, would have a materially adverse impact on Whistl's end-to-end business. That is reflected in Whistl's complaint to Ofcom.¹⁰⁷¹ We do not consider that the fact that Whistl did not produce a business plan based on paying the price differential is evidence to suggest that Whistl was not, in fact, concerned about the impact of the price differential. On the contrary, as Royal Mail notes,¹⁰⁷² when Whistl was modelling possible changes to its roll out scenarios (as discussed at paragraph 4.183 above), Whistl acknowledged the possibility that one of the outcomes of Ofcom's investigation was that Ofcom may not uphold Whistl's complaint. However, the relevant scenarios only contemplated suspension of further roll out at that point. This indicates that they considered such roll out would not be viable in the event that the price differential was ultimately implemented (in the event that Ofcom were to conclude it was lawful). The parties also noted that "*any decision from Ofcom that did not fully uphold the complaint would need to be financially assessed.*"¹⁰⁷³
- d) It is correct that Whistl also complained about other elements of the CCNs at the same time as it raised concerns about the price differential. That does not preclude us from determining that one element of that package is unlawful. As we have outlined above:

¹⁰⁶⁹ Whistl, *Comments from Whistl on the Statement of Objections addressed to Royal Mail*, 4 November 2015, page 35 (WH0642)

¹⁰⁷⁰ Whistl, *Response to 2nd section 26 Notice – request 3*, 20 March 2017, page 1. (WH0834)

¹⁰⁷¹ Whistl, *Complaint submitted to Ofcom on behalf of TNT Post...*, 28 January 2014. (WH0128)

¹⁰⁷² Royal Mail, *Response to letter of facts*, 24 November 2017, page 33, paragraph 5.45. (RM2581)

¹⁰⁷³ Whistl, *Minutes of Meeting (Whistl, PostNL and LDC) held in Marlow on 11 March 2014*, 11 March 2014, page 1. (WH0295)

- i) Royal Mail’s own analysis considered the price differential to be required, on top of other measures, to achieve its desired outcome of reducing the incentive for further direct delivery roll out. This is evident in Royal Mail’s scenario analysis of November 2013 (see paragraphs 4.46 to 4.54 and Figures 4.3 and 4.4), which shows that it is only the combination of a “*significant zonal tilt*” and a “*moderate ‘value’ justified incentive*” (i.e. a price differential) that would limit Royal Mail’s market share loss in delivery to 1.4% and lead to the likely outcome for the end-to-end competitor being that it would “[s]witch to [NPP1] and stay there”, i.e. that it would abandon long term delivery ambitions.
- ii) The scale of the price differential was material in the context of the specific markets in issue, the bulk mail delivery market and the associated retail market. We have set out our assessment above in sub-section E that the financial impact of the price differential would have been material for an end-to-end entrant, both in absolute terms and also relative to expected profits. We found that this penalty on competition was reasonably likely to raise the already high barriers to entry in the bulk mail delivery market, making entry significantly more difficult. As a result, the price differential was reasonably likely to reduce incentives to enter the bulk mail delivery market, making such entry less likely to occur (as Royal Mail anticipated), thereby preserving or strengthening Royal Mail’s dominant position.
- iii) We consider that the internal contemporaneous documents – and Whistl’s complaint – are consistent with Whistl being concerned about the implications of multiple aspects of the pricing in the CCNs, and that the price differential was a material concern.

7.251 For these reasons, although the evidence suggests other changes were also a factor in Whistl’s decision to suspend further roll out after April 2014, we consider that the evidence does demonstrate that the price differential was a material factor in this decision

Royal Mail’s argument that Whistl would have exited the market in any event such that its conduct was not capable of distorting competition

7.252 As noted above, Royal Mail argues that Whistl’s commercial position in the period up to its exit from the bulk mail delivery market in June 2015 is relevant to determining whether the price differential would have been capable of distorting competition in the bulk mail delivery market. In particular, it argues that it is a “*problem*” for Ofcom’s assessment that “*Whistl failed without ever paying the price differential (or any other element of the Contract Changes Notices).*”¹⁰⁷⁴

7.253 Royal Mail goes on to argue that “[t]he reality is that Whistl failed for reasons entirely unrelated to the Contract Change Notices.”¹⁰⁷⁵ To support this analysis, Royal Mail presented reports prepared by external advisors reviewing Whistl’s business in the period

¹⁰⁷⁴ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 153, paragraph 8.92. (RM2386)

¹⁰⁷⁵ *Ibid.* (RM2386)

from 2012 to 2015 and setting out its position on the likely reasons for its exit from the end-to-end market.¹⁰⁷⁶

- 7.254 In summary, these reports argued that there were a number of factors that reduced Whistl's expected profitability which were unrelated to the CCNs. These factors were:
- a) delays to roll out plans that arose prior to the announcement of CCNs;¹⁰⁷⁷
 - b) underperformance of Whistl's business compared to its projections (including in relation to roll out progress and customer conversion rate);¹⁰⁷⁸
 - c) operational issues, such as examples of late delivery or mis-delivery of certain council tax letters and polling cards;¹⁰⁷⁹
 - d) Whistl's loss in its appeals against the application, by HMRC, of a VAT exemption applied to Royal Mail's access delivery services (against which Whistl competed while not benefiting from such an exemption);¹⁰⁸⁰
 - e) higher than forecast discounts (compared to Royal Mail's pricing) required to retain delivery customers;¹⁰⁸¹
 - f) higher than expected costs and lower than expected productivity;¹⁰⁸² and
 - g) reductions in projected profitability in Whistl's business plans from March 2013 to January 2015.¹⁰⁸³

Our assessment

7.255 We have considered Royal Mail's extensive representations regarding Whistl's business plans which were provided to its external advisors as part of access to file arrangements in our investigation, including those plans generated after the CCNs were issued.

7.256 As we have outlined in Section 4, sub-section D above, Whistl's eventual exit from the bulk mail delivery market occurred 17 months after Royal Mail issued the CCNs. During this time Whistl had suspended its roll out plans and continued as a non-scale end-to-end operator with delivery activities in only 6 SSCs. The delay to, and suspension of, Whistl's roll out, to which the introduction of the price differential materially contributed, was likely to be one of the relevant factors in the overall decision-making process leading to Whistl's subsequent decision to exit the market. However, we recognise that it is likely that the ultimate decision made by Whistl to exit the market took account of a number of factors going beyond the implications of the CCNs or the price differential in isolation.

¹⁰⁷⁶ FTI Consulting, *Assessment of Whistl's Business Plans*, 27 November 2015, page 3, paragraph 1.11. (RM2317) Whistl's business plans were disclose, page 3, d to Royal Mail's advisors as part of access to file in this investigation.

¹⁰⁷⁷ FTI Consulting, *Updated Assessment of Whistl's Business Plans*, 24 November 2017, pages 26 to 29, paragraphs 5.13 to 5.23. (RM2579)

¹⁰⁷⁸ *Ibid.*, pages 29 to 32, paragraphs 5.24 to 5.34. (RM2579)

¹⁰⁷⁹ *Ibid.*, pages 33 to 34, paragraphs 5.35 to 5.38. (RM2579)

¹⁰⁸⁰ *Ibid.*, pages 34 to 35, paragraphs 5.39 to 5.43. (RM2579)

¹⁰⁸¹ *Ibid.*, page 36, paragraphs 5.44 to 5.48. (RM2579)

¹⁰⁸² *Ibid.*, pages 37 to 39, paragraphs 5.49 to 5.55. (RM2579)

¹⁰⁸³ *Ibid.*, pages 39 to 41, paragraphs 5.56 to 5.66. (RM2579)

7.257 For the purposes of this Decision, we have not found it necessary to make any finding in relation to the causes of Whistl's exit and/or to attribute that exit to the price differential (or more broadly to Royal Mail's actions in introducing the CCNs). This does not affect our finding that, in introducing the price differential, Royal Mail abused its dominant position.

7.258 In particular, we note that:

- a) As the case law cited in Section 5, *Legal Framework*, confirms, competition law is designed to protect the process and structure of competition from being distorted by the actions of a dominant undertaking. Whistl had the right to succeed or fail on its own merits, without competition being distorted by anti-competitive conduct on the part of Royal Mail. Even if Whistl was, as claimed by Royal Mail during this investigation, inefficient/incapable of succeeding in the longer run, that does not alter the special responsibility of Royal Mail not to impair genuine undistorted competition on the market. It was not for Royal Mail to determine, by exercise of its dominant position, the degree of competition (or the forms of competition) that it would permit to exist in the market.
- b) Even if Royal Mail was right to contend that Whistl would have ceased its end-to-end activities at some point in the future, we do not agree that this implies that competition was unaffected by Royal Mail's conduct. The available evidence suggests that Whistl could have exerted a competitive constraint on Royal Mail for so long as it competed on the bulk mail delivery market.
- c) As set out above, in its role as regulator, Ofcom considered, regularly, on an *ex ante* basis what impact end-to-end competition would have on the universal service. At no stage was it suggested that such reviews were unnecessary because end-to-end entry was unviable. Instead, given the uncertainties surrounding roll out, Ofcom made clear that it would keep the market under review. As explained above, entry was considered viable at least to some degree. However, as set out above, Royal Mail resorted to abusive conduct in response to the nascent competition threat from Whistl. We set out our conclusions on the duration of the infringement in sub-section I below.

G. Overall conclusion on distortion of competition / competitive disadvantage

7.259 As we found in sub-section B above, competition in the bulk mail delivery market was already very limited when Royal Mail introduced the price differential. Royal Mail was overwhelmingly dominant, with a very large market share of over 98%. It enjoyed a unique national network, benefiting from economies of scale and scope, and was an unavoidable trading partner for all operators active in the retail market for bulk mail. All of these advantages derived from its position as a former statutory monopolist and its market power was sustained by the high barriers to entering the market. This meant that competition in the bulk mail delivery market was vulnerable to exclusionary conduct on the part of Royal Mail. It is in that specific context that we have assessed the question of whether the introduction of the price differential amounted to an abuse of a dominant position. Our key findings are as follows:

- a) The introduction of the price differential reflected a deliberate strategy on the part of Royal Mail to limit nascent competition from its only significant competitor in the delivery market, Whistl.
- b) By introducing the price differential in the CCNs, Royal Mail was seeking to use its position as an unavoidable trading partner for operators active on the retail market for bulk mail to penalise those of its access customers who also sought to compete with it by undertaking end-to-end delivery activities. The price differential involved charging higher prices for the same bulk mail delivery services when supplied under the APP2/ZPP3 price plans than were applied under the NPP1 price plan, which was not available in practice to access operators that chose to compete with Royal Mail in delivery beyond a particular scale.
- c) Royal Mail did not have a legitimate justification for discriminating in this way against its access customers that chose to compete with it. The purpose and effect of this conduct was to protect and enhance Royal Mail's position of dominance in the bulk mail delivery market.
- d) Having undertaken an assessment of all the relevant circumstances in this case, including contemporaneous evidence as to Royal Mail's strategy and the effect of the introduction of the price differential, we have concluded that the price differential was reasonably likely to give rise to a competitive disadvantage and/or was reasonably likely to lead to a restriction of competition in the relevant market from the point at which Royal Mail issued the CCNs. This was because, at the point at which the lower NPP1 prices were no longer available in practice to an end-to-end entrant, it would result in a significant increase in the end-to-end operator's access costs for the proportion of its mail that would continue to be delivered by Royal Mail. The resulting financial impact of the price differential on an end-to-end competitor's profitability would have been material.

- e) In the context of the bulk mail delivery market where competition was only just emerging and with high barriers to entry, our assessment is that an impact on profitability of this magnitude would make entry and expansion significantly more difficult, further raising barriers to entry and expansion, and reducing an operator's incentives to engage in such entry.
- f) Royal Mail's conduct was therefore reasonably likely to make entry less likely to occur and, in consequence, to give rise to consumer harm as a result of the reduced competitive pressure upon Royal Mail to reduce its prices, improve its efficiency and innovate.
- g) Our findings as to the likely consequences of Royal Mail's conduct in introducing the price differential, as summarised above, are consistent with the evidence of what in fact happened in practice to Whistl after the CCNs were issued and/or subsequent developments, as set out in sub-section F. In particular, we have found that the introduction of the price differential was a material contributing factor (among other factors) to:
 - i) the disruption of LDC's decision to complete its agreed investment in Whistl in January 2014;¹⁰⁸⁴ and
 - ii) Whistl's decisions to reduce and then suspend parts of its planned further roll out of its end-to-end delivery operations.¹⁰⁸⁵

¹⁰⁸⁴ See in particular paragraphs 4.188 to 4.193.

¹⁰⁸⁵ See in particular paragraphs 4.181 to 4.187.

H. Effect on trade between EU Member States and within the UK

Effect on trade within the UK

- 7.260 The Chapter II prohibition applies to conduct by a dominant undertaking which may affect trade in the UK. This threshold is satisfied where the conduct is capable of affecting trade within the UK, including any part of the UK.¹⁰⁸⁶
- 7.261 The Chapter II prohibition is not read as importing a requirement that the effect on trade within the UK should be appreciable.¹⁰⁸⁷
- 7.262 The infringement was reasonable likely to distort competition within the UK-wide bulk mail delivery market. Accordingly, we find that the infringement may have affected trade within the whole or part of the UK.

Substantial part of the EU

- 7.263 As set out in Section 6, *Market definition and dominance*, Royal Mail is dominant in the market for bulk mail delivery in the UK, which amounts to a substantial part of the internal market. Its conduct was therefore capable of amounting to a breach of Article 102 TFEU provided that conduct has an effect on trade between Member States.

Effect on trade between EU Member States

- 7.264 In determining whether or not there is an effect on trade between Member States, it is not necessary to show that there has been an actual effect on trade as a result of the conduct in question but that the conduct had the potential to affect trade between Member States. In this regard, the CJEU has held that conduct:

*“extending over the whole of the territory of a Member State by its very nature has the effect of reinforcing the compartmentalization of markets on a national basis, thereby holding up the economic interpenetration which the Treaty is designed to bring about and protecting domestic production.”*¹⁰⁸⁸

- 7.265 That case law has been followed subsequently both by the CJEU¹⁰⁸⁹ and the General Court.¹⁰⁹⁰ In view of the fact that Royal Mail is dominant in a market which is national in scope and the fact that the conduct in question applied in respect of the entire geographic market, we consider that Royal Mail’s conduct had the potential to affect trade between Member States.

¹⁰⁸⁶ See, for example, the judgment in *Irish Sugar plc v Commission* T-228/97, EU:T:1999:246, paragraph 170

¹⁰⁸⁷ *Aberdeen Journals v Director General of Fair Trading* [2003] CAT 11 (*'Aberdeen Journals II'*), paragraphs 459 to 460

¹⁰⁸⁸ Case 8/72 *Vereeniging van Cementhandelaren / Commission* [1972] ECR 977.

¹⁰⁸⁹ See Case 126/80 *Salonia v Poidomani* [1981] ECR 1563.

¹⁰⁹⁰ See for example Case T-66/89 *Publishers' Association v Commission (No 2)* [1992] ECR II-1995.

I. Duration

Royal Mail's submissions

- 7.266 In addition to its representations on the substance of the abuse finding, Royal Mail has submitted a number of arguments relating to the duration of the conduct subject to our infringement finding.
- 7.267 First, Royal Mail argues that anti-competitive conduct never took place because the discriminatory prices were never paid by its customers; that is, because the CCNs were suspended before the effective date on which they were to commence (which was 31 March 2014) and that they were later withdrawn.¹⁰⁹¹
- 7.268 In the alternative, Royal Mail argues that either the conduct was a one-off act, which took place on 10 January 2014, or that any conduct ended on 21 February 2014, when the CCNs were automatically suspended under the terms of the Access Letters Contract because Ofcom opened an investigation.¹⁰⁹²

Our assessment

- 7.269 We have carefully considered Royal Mail's submissions by reference to the chronology set out in Section 4 above.
- 7.270 For the reasons set out in this Decision, we do not accept Royal Mail's argument that the suspension of the CCNs precluded the potential for anti-competitive effects in this case. We have explained at paragraphs 7.203 to 7.228 our findings in this regard.
- 7.271 As to when the conduct ended in this case, by way of summary, the following findings are relevant:
- a) The CCNs had clear and unavoidable commercial consequences for access operators. Once the CCNs were introduced, Royal Mail's access operator customers needed to assess the impact that the new prices would have on their businesses and prepare a commercial response. Operators could assess this impact because of the nature and characteristics of the CCNs, which distinguish them from, as Royal Mail has submitted, "*mere announcements*" or "*proposals*" – see paragraphs 7.217 to 7.220 above.
 - b) As a binding change to the terms and conditions of access, Royal Mail had done everything in its control to make the price differential enter into force. Only the intervention of third parties in the form of Ofcom opening an investigation, or withdrawal of the CCNs by Royal Mail, would prevent the prices from entering into force. Our conclusion on this issue is that rational economic operators needed to take

¹⁰⁹¹ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 167, paragraphs 10.2 to 10.3 (RM2386); Royal Mail, *Response to letter of facts*, 24 November 2017, page 11, paragraphs 2.7 to 2.9 (RM2581); and Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 44 to 45, paragraphs 6.60 to 6.68. (RM2655)

¹⁰⁹² Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 167 to 168, paragraphs 10.4 to 10.8. (RM2386); and Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 45, paragraphs 6.67 to 6.68. (RM2655)

the impending effects of the price differential into account and have regard to its consequences in their business planning at the moment the CCNs were issued – see paragraphs 7.221 to 7.224 above.

- c) The introduction of the price differential was at least a material contributing factor in the disruption to LDC's investment in January 2014 and Whistl's decision to reduce and then suspend its planned further roll out in the months after the CCNs were issued. The consequences of these steps were reasonably likely to have continuing effects extending beyond the suspension of the CCNs by Royal Mail. See paragraph 7.224 and sub-section F above.
- d) In the period following the suspension of the CCNs and prior to that withdrawal, Royal Mail maintained a public position that the price differential was lawful and that it intended to implement the price differential as soon as Ofcom's investigation was concluded – see paragraphs 4.204 to 4.207 above.
- e) The CCNs were finally withdrawn on 11 March 2015 (see paragraph 4.228 to 4.230); until at least this point market participants would have had no certainty that the price differential (contained within those CCNs) would not enter into force.

7.272 Taking into account all the points made above, we have determined the duration of the infringement found in this Decision as follows:

- a) Royal Mail's infringing conduct started on 10 January 2014 when the CCNs were issued;
- b) the infringement continued until *at least* 21 February 2014, i.e. the point of suspension of the CCNs, including the price differential; and
- c) the infringement was reasonably likely to give rise to continuing effects beyond the point of suspension.

7.273 We have not found it necessary to reach a concluded view on whether the infringement continued after 21 February 2014.

8. Objective justification and Article 106(2) TFEU

Introduction

- 8.1 Under section 18 of the 1998 Act and Article 102 TFEU, it is open to dominant undertakings to demonstrate that otherwise abusive conduct is objectively justified and therefore not an infringement, even if it is abusive on its face.¹⁰⁹³ The relevant case law and decisional practice establishes that conduct may be objectively justified if:
- a) the conduct in question was objectively necessary to pursue a legitimate objective;¹⁰⁹⁴ or
 - b) the conduct in question produced substantial efficiencies which outweighed any effects on consumers.¹⁰⁹⁵
- 8.2 It is for the dominant undertaking to raise any plea of objective justification and to support that plea with arguments and evidence. It then falls to the person alleging the abuse to show that the arguments and evidence relied on by the dominant undertaking cannot prevail and accordingly that the justification put forward cannot be accepted.¹⁰⁹⁶
- 8.3 In this case Royal Mail has argued that its conduct was objectively justified. In addition, Royal Mail has argued that as the designated universal service provider it should benefit from the application of Article 106(2) TFEU, so that its conduct is exempt from competition law.

Royal Mail's representations

- 8.4 Royal Mail presented two defences, which, it says, mean that it has not infringed competition law. Although these are distinct legal points, both relate to Royal Mail's claim of a threat to the financial sustainability of the universal postal service caused by Whistl's

¹⁰⁹³ Case 53/03 *Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) and Others v GlaxoSmithKline plc and GlaxoSmithKline AEVE* Opinion of Advocate General Jacobs; Case C-209/10 - *Post Danmark A/S v Konkurrencerådet* (Post Danmark I), at paragraph 40.

¹⁰⁹⁴ The claimed objective justification must amount to more than simply a commercial advantage to the undertaking itself: see Case C-27/76 *United Brands v Commission* EU:C:1983:313, [1978] ECR 207, at paragraph 189: "Although it is true ... that the fact that an undertaking is in a dominant position cannot disentitle it from protecting its own commercial interests if they are attacked, and that such an undertaking must be conceded the right to take such reasonable steps as it deems appropriate to protect its interests, such behaviour cannot be countenanced if its actual purposes is to strengthen this dominant position and abuse it".

¹⁰⁹⁵ Case C-209/10 *Post Danmark A/S v Konkurrencerådet* (Post Danmark I) at paragraph 41.

¹⁰⁹⁶ See *Arriva the Shires v. London Luton Airport* [2014] EWHC 64 (Ch.) at paragraph 131 citing Case T-201/04 *Microsoft Corporation v. Commission* [2007] ECR II-3601; see also Case T-301/04 *Clearstream Banking AG and Clearstream International SA v Commission* EU:T:2009:317, [2009] ECR II-03155, at paragraph 185.

entry into the bulk mail delivery market. Royal Mail has argued that the price differential (and other changes effected by the CCNs):

- a) was objectively justified as a matter of Section 18 of the Act and Article 102 TFEU; and / or
- b) was objectively justified and necessary to secure economically acceptable conditions for the provision of the universal postal service (a service of general economic interest) and therefore exempted from the application of competition law by virtue of Article 106(2) TFEU and paragraph 4 of Schedule 3 of the Act.

Objective justification

8.5 In its written and oral representations, Royal Mail emphasised the importance of the universal postal service and referred to several government, Ofcom and other third party documents to support that view. Royal Mail states that: “[t]his overarching objective – the need to protect the USO for the benefit of consumers – is evident throughout the documents prepared by Royal Mail during the development of the price changes”.¹⁰⁹⁷ Royal Mail also submits that the development of the January 2014 pricing changes was intended to secure the provision of the universal service for the benefit of consumers and reflects Royal Mail’s view that end-to-end entry posed a threat to the universal service.

8.6 Royal Mail’s argument that the Contract Change Notices were objectively justified is set out in its written representations in the following terms:

“As is clear from the internal documents ... the desire to protect the USO, in particular, by protecting the volumes delivered through the Universal Service, was a key motivation behind the Contract Change Notices. Through the Contract Change Notices, Royal Mail sought to avoid, or at least mitigate, the rise in average unit cost, and so avoid the inefficiencies in the Universal Service network that would result.

The price differential, which reflected the cost benefit to Royal Mail of receiving advance customer forecasts at the local level and thereby its ability to plan in advance and remove costs at the local level, was intended to contribute to Royal Mail’s objective of sustaining the USO. The improved ability to adjust (otherwise fixed) costs in advance would reduce the overall cost base of the USO and so mitigate the rise in average unit costs as volumes dropped.

If the rise in average unit costs continued, Royal Mail would have been obliged to consider increasing the price of service delivered through the Universal Service, in particular, if the loss in volume resulted in Royal Mail’s EBIT margin falling below the 5-10 per cent target set by Ofcom. This may necessarily have included price rises for services such as First and Second Class mail, Special Delivery and Signed For services, which would have been expected to adversely affect consumers of those services.

¹⁰⁹⁷ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 160, paragraph 9.31. (RM2386)

For example, assuming that Whistl achieved approximately 43 per cent coverage and 10 per cent national market share by 2019/20 (which is comparable to Whistl's announced roll-out plans to achieve coverage of approximately 42 per cent by 2017), Royal Mail's modelling indicates that prices of USO products would have needed to rise by approximately 12 per cent in order fully to offset the projected net revenue loss of approximately £260 million.

The proposals contained in the Contract Change Notices, including the price differential, if implemented, would therefore have avoided or at least mitigated the need for any such price rises and so would have brought clear benefits for consumers. Had Royal Mail not proposed to change its prices in response to challenges facing the USO (as indeed Ofcom explicitly expected it to do), it is clear that the future sustainability of the USO would have been threatened. In this regard, even if Royal Mail's conduct did prevent, restrict or distort competition and so infringed Article 102 / Chapter II (which is denied ...) such conduct was objectively justified.”¹⁰⁹⁸

8.7 In its oral representations, Royal Mail characterised this point in the following terms:

“In short, by mitigating the rise in average unit costs as volumes dropped, Royal Mail was seeking to minimise price rises through the realisation of efficiencies. This would clearly benefit consumers and fall within the criteria of objective justification.”¹⁰⁹⁹

Securing economically acceptable conditions for the provision of the universal service

8.8 Royal Mail has additionally argued that the price differential was objectively justified and necessary to create economically acceptable conditions for the performance of its universal postal service obligations. In other words, Royal Mail has argued that it should be exempt from the application of Article 102 pursuant to Article 106(2) because of its role in performing services of general economic interest. In support of this position, Royal Mail has submitted that:

- a) universal postal services, such as that provided by Royal Mail in the UK, have been recognised as services of general economic interest (SGEI) for the purpose of Article 106(2);
- b) a dominant undertaking's conduct can be exempt even if it could have achieved economically acceptable conditions by less restrictive measures, and even if it leads to the elimination of competition (where necessary); and
- c) measures aimed at preventing or deterring 'cherry-picking' of services by other operators have been justified under Article 106(2) in a number of EU cases. Royal Mail

¹⁰⁹⁸ Royal Mail, *Response to Statement of Objections*, 27 November 2015, pages 162 to 163, paragraphs 9.42 to 9.46. (RM2386) Footnotes omitted.

¹⁰⁹⁹ Ofcom, *Transcript of an oral representations meeting with Royal Mail*, 23 March 2016, page 123, lines 17 to 22. (RM2462)

states that the Contract Change Notices were “*in part, a counter-balance to the “cherry-picking” of more profitable geographies and types of mail by Whistl*”.¹¹⁰⁰

- 8.9 With regard to the necessity of its conduct to secure economically acceptable conditions, Royal Mail argues that Ofcom has acknowledged that it “*must be able to generate a 5-10 per cent EBIT margin in order to secure the financeability and sustainability of its business.*”¹¹⁰¹ Based on this claim, Royal Mail submits that it “*must be able to generate an EBIT margin within the 5-10% range to provide the universal service under economically acceptable conditions.*”¹¹⁰²
- 8.10 Royal Mail then presents an analysis of the impact of Whistl’s entry on its EBIT margin (the results of which we set out below at table 8.1). This analysis compares the position with the CCNs that “*assume[s] [Whistl’s] roll-out is limited to 6 SSCs*” to a series of positions without the CCNs, in which Whistl is assumed to achieve a more extensive roll out. In the former case, Royal Mail states that its EBIT would be [~~3~~ above 5%] whereas in the latter cases it would fall to [~~3~~ below 5%].¹¹⁰³

¹¹⁰⁰ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 165, paragraph 9.51. (RM2386)

¹¹⁰¹ *Ibid.*, page 163, paragraph 9.47. (RM2386) In fact, Ofcom said “[a]n indicative EBIT margin range of 5% to 10% is appropriate and consistent with the need for Royal Mail to earn a reasonable commercial rate of return commensurate with the level of risk within the business.” See paragraph 5.47 of Ofcom’s statement of 27 March 2012 *Securing the Universal Postal Service: Decision on the new regulatory framework*. (PD0025)

¹¹⁰² Ofcom, *Transcript of an oral representations meeting with Royal Mail*, 23 March 2016, page 126, lines 5 to 8. (RM2462)

¹¹⁰³ See Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 164, table 9.1. (RM2386)

Table 8.1: Excerpt from Royal Mail’s representations showing its analysis of the impact of Whistl's roll-out on the EBIT margin of the Reported Business

DDO Roll-out assumption	Estimated revenue impact relative to base case (£m)	EBIT margin of the Reported Business (%)	Approximate price increase on USO products required to offset revenue impact (%)
Assume the Contract Change Notices were introduced			
Assume roll-out is limited to 6 SSCs ("Base case")	0	[X]	[X]
Assume the Contract Change Notices were not introduced			
Whistl reaches a delivery-point coverage of 21 per cent and approximately 4 per cent national market share by 2019/20	110	[X]	[X]
Whistl's roll-out in line with Royal Mail's expectations in December 2013/January 2014	240	[X]	[X]
Whistl reaches approximately 43 per cent coverage and 10 per cent national market share by 2019/20	260	[X]	[X]

Source: Table 9.1 from Royal Mail’s written representation. (RM2386)¹¹⁰⁴

8.11 Based on this, Royal Mail concludes that “the proposals set out in the Contract Change Notices were necessary to preserve the economically acceptable conditions under which the Universal Service could be operated.”¹¹⁰⁵ Royal Mail states that it is not necessary to show that other measures could have secured economically acceptable conditions for the provision of the universal postal service.¹¹⁰⁶

Assessment

Objective necessity

8.12 As noted above, conduct may be objectively justified, and therefore not amount to an infringement, if Royal Mail demonstrates that the conduct was objectively necessary; or that the conduct produced substantial efficiencies which outweighed any negative effects

¹¹⁰⁴ Royal Mail explains that this analysis was carried out using the methodology from Oxera’s annex to Royal Mail’s response to the Access Pricing Review Consultation dated 24 February 2014 (*Ofcom’s Access Policy Review consultation: economic assessment, 24 February 2015.*) (RM2364)

¹¹⁰⁵ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 165, paragraph 9.50. (RM2386)

¹¹⁰⁶ *Ibid.*, page 166, paragraph 9.54. (RM2386)

on consumers. For the defence of objective justification to succeed, the dominant undertaking must show that the conduct pursues a legitimate objective (other than the creation of efficiencies which is a separate defence) and that it is necessary and proportionate to the pursuit of such an objective. Examples of potentially legitimate objectives are compliance with health and safety, technical or commercial requirements.¹¹⁰⁷ However, a dominant undertaking cannot justify infringing EU and UK competition law in pursuit of an objective which is already addressed through legislative intervention. See *Hilti AG v Commission*, in which the Court of First Instance (now the General Court) rejected an attempt by Hilti, a manufacturer of nail guns, to justify conduct foreclosing third party manufacturers of cartridge strips for its guns on the basis that it was necessary to protect users' safety, holding that "*it is clearly not the task of an undertaking in a dominant position to take steps on its own initiative to eliminate products which, rightly or wrongly, it regards as dangerous or at least as inferior in quality to its own products*".¹¹⁰⁸

- 8.13 The Commission's Article 102 Guidance¹¹⁰⁹ reflects this case law and provides additional guidance. It states that the question of whether conduct is objectively necessary and proportionate must be determined on the basis of factors external to the dominant undertaking - e.g. it is not a legitimate objective to gain market share and profits by excluding a competitor using the dominant position.
- 8.14 In *Purple Parking*¹¹¹⁰, a discrimination case, Mann J considered the appropriate test for objective justification, noting that:
- a) if it can be shown that the actual motivation of the dominant undertaking was to suppress competition, then the plea of objective justification is not open to it;¹¹¹¹
 - b) the objective justification put forward by the dominant undertaking can be tested by reference to whether the evidence shows that the justification was indeed the basis on which the dominant undertaking acted;¹¹¹² and
 - c) the law requires a high degree of necessity if objective justification is relied on to justify what would otherwise be forbidden anti-competitive conduct: "*the factor or factors relied on must therefore be justified in that sense – not merely that it is a solution to the relevant problem, but that it is the solution to the problem. If there are other solutions then the conduct is not justified...*".¹¹¹³

¹¹⁰⁷ See, e.g., Case T-30/89 *Hilti v Commission*, EU:T:1991:70 paragraphs 118-119; Case T-83/91 *Tetra Pak v Commission*, paragraphs 83-84 and 138; and Case 311/84 *CBEM v CLT*, paragraphs 26-27.

¹¹⁰⁸ *Ibid.* at paragraph 118

¹¹⁰⁹ European Commission, *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty [now Article 102 TFEU] to abusive exclusionary conduct by dominant undertakings*, OJ C 45, 24.2.2009, p. 7–20.

¹¹¹⁰ (1) *Purple Parking Limited* (2) *Meteor Parking Limited v Heathrow Airport Limited* [2011] EWHC 987 (Ch) ('*Purple Parking*')

¹¹¹¹ *Purple Parking* at paragraph 183

¹¹¹² *Ibid.* at paragraph 185

¹¹¹³ *Ibid.* at paragraphs 234-235, citing the Commission's decision in *Flughafen Frankfurt/Main AG* (34.801 OJ [1998] L72/30. These principles were endorsed in *Arriva the Shires v. Luton Airport* [2014] EWHC 64 (Ch) at paragraph 134.

- 8.15 Royal Mail has not articulated a clear objective necessity defence in its submissions. It states generally that a “*key motivation*” of the Contract Change Notices was “*the desire to protect the USO, in particular, by protecting the volumes delivered through the Universal Service*” (see the longer quote from Royal Mail’s submissions cited above). The contemporaneous documentary evidence on the case file refers to the need to protect the USO as Royal Mail’s motivation for reviewing its pricing and ultimately issuing the Contract Change Notices, but the key question for the purposes of objective justification is whether acting in a way that would otherwise be contrary to competition law was objectively necessary to achieve that aim or whether there were other solutions available.
- 8.16 We have assessed Royal Mail’s argument that it needed to introduce the CCNs to secure the provision of the universal service in the legal and economic context of a fully liberalised postal services sector in which:
- a) there is a regulatory regime and competent authority (Ofcom) in place charged with a primary duty of securing the provision of a universal service, having regard to its financial sustainability and efficiency, with the ability to impose regulation to protect the universal service;
 - b) through ongoing monitoring, and the carrying out of detailed and comprehensive assessments, Ofcom had consistently satisfied itself on numerous occasions that there was no imminent threat to the universal service posed by Whistl’s delivery activities;
 - c) in making those assessments, Ofcom (unlike Royal Mail) had full access to the relevant information, including highly confidential information regarding Whistl’s roll out plan; and
 - d) Royal Mail did not legally challenge Ofcom’s conclusions that there was no immediate threat to the Universal Service.
- 8.17 Royal Mail has not provided any new evidence in relation to the claimed threat to the universal service (that was not already submitted to Ofcom as part of the contemporaneous regulatory assessments). The fact that Royal Mail disagreed (based on its inferences relating to Whistl’s business plan) with Ofcom’s conclusions did not entitle the company to use its dominant position to harm competition.
- 8.18 Our finding is that it was not objectively necessary or proportionate for Royal Mail to engage in discriminatory conduct to address a perceived threat to the universal service. Securing the universal service was properly the role of the appointed regulator, Ofcom. Ofcom exercised its regulatory powers and repeatedly made decisions finding that there was no immediate threat to the universal service, which Royal Mail made no attempt to challenge. Ofcom encouraged Royal Mail to engage in competitive responses to roll out (for example, lawful zonal tilt price changes / improving efficiency). But that did not, contrary to Royal Mail’s claim, sanction Royal Mail to take any action it considered necessary to attempt to remove any perceived threat to the universal service.
- 8.19 As such, the objective of excluding or marginalising a competitor in order to preserve Royal Mail’s market share and revenues in bulk mail delivery, even if those market share and

revenues support the universal service, is not a legitimate objective that may be relied on to justify conduct that would otherwise amount to an abuse of a dominant position. The regulatory framework was, and remains, in place to secure the financial sustainability of the universal service and it is through that mechanism that appropriate and proportionate measures may be taken.

Efficiencies

- 8.20 A dominant undertaking may also justify conduct leading to foreclosure of competitors on the ground of efficiencies that are sufficient to guarantee that no net harm to consumers is likely to arise. The recent case law on the efficiencies defence broadly embraces the Commission's Article 102 Guidance and requires that four cumulative conditions are met:¹¹¹⁴
- a) the efficiencies have been, or are likely to be, realised as a result of the conduct. They may, for example, include technical improvements in the quality of goods, or a reduction in the cost of production or distribution;
 - b) the conduct is indispensable¹¹¹⁵ to the realisation of those efficiencies: there must be no less anti-competitive alternatives to the conduct that are capable of producing the same efficiencies;
 - c) the likely efficiencies brought about by the conduct outweigh any likely negative effects on competition and consumer welfare in the affected markets; and
 - d) the conduct does not eliminate effective competition, by removing all or most existing sources of actual or potential competition. In the Commission's view, exclusionary conduct which maintains, creates or strengthens a market position approaching that of a monopoly cannot normally be justified on the grounds that it also creates efficiency gains.¹¹¹⁶
- 8.21 Royal Mail has provided no evidence to substantiate an efficiencies defence, other than an assertion that it would otherwise have been required to raise its prices. In any event, we do not consider that an efficiencies defence would be applicable in this case given that Royal Mail's argument regarding the threat to the universal service is concerned with preserving its own market share and revenues and not about the creation of new efficiencies that would lead to consumer benefits.
- 8.22 In relation to Royal Mail's claim in its oral submissions that *"by mitigating the rise in average unit costs as volumes dropped, Royal Mail was seeking to minimise price rises*

¹¹¹⁴ Case C-209/10 - *Post Danmark A/S v Konkurrencerådet* (Post Danmark I), paragraph 42.

¹¹¹⁵ With regard to indispensability, the Court in *Post Danmark I* interpreted this to mean that *"such conduct is necessary for the achievement of those gains in efficiency"* (paragraph 42), which appears to be a lower test than establishing that the conduct was indispensable to achieve those gains. The caselaw takes precedence over the Commission's non-binding Article 102 Guidance.

¹¹¹⁶ Paragraph 30 of the Commission's Guidance. This is based on the Commission's approach in the context of Article 101(3) TFEU, as set out in its *Guidelines on the application of Article 81(3) of the Treaty [now 101(3) TFEU]*, OJ C 101, 27.4.2004, page 97.

through the realisation of efficiencies”, we have explained in Section 7 that Royal Mail’s conduct was not capable of generating the efficiencies claimed.

- 8.23 Finally, the conduct was not indispensable or necessary to the realisation of the efficiencies claimed given that the legal framework that was in place and Ofcom’s consistent findings regarding the threat posed to the universal service by Whistl’s end-to-end entry (as explained above).

The exemption for Services of General Economic Interest – legal framework

- 8.24 Royal Mail has also argued in its written representations that the price differential was necessary to create economically acceptable conditions for the performance of its universal postal service obligations, and has contended that the Article 106(2) defence therefore applies. Article 106(2) states:

“Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.”

- 8.25 As regards the burden of proof in relation to the Application of Article 106(2) TFEU, it is for the undertaking seeking to rely on that provision to show that the conditions for its application are fulfilled.¹¹¹⁷
- 8.26 Universal postal services have been recognised in EU case law and decisional practice as services of general economic interest (or “SGEIs”) for the purpose of Article 106(2).¹¹¹⁸ The Article 106(2) safe harbour must, however, to be seen in its wider context: it is an exemption from a general prohibition against Member States favouring their national incumbents, and as such must be interpreted strictly.¹¹¹⁹ In order to benefit from the Article 106(2) exemption, the dominant undertaking must have been entrusted with a SGEI and its conduct must meet the proportionality test that is embedded within the Article.
- 8.27 Based on relevant case law, the proportionality test within Article 106(2) is fulfilled when the following three requirements are met:
- a) a causal link exists between the measure and the objective of general interest;
 - b) the restrictions introduced by the measure are balanced by the benefits to the general interest; and

¹¹¹⁷ Case T-556/08 *Slovenska Posta* – paragraph 358 and the case law cited therein.

¹¹¹⁸ This stems from Recital 8 of the Third Postal Directive. There are also EU precedents involving postal services incumbents, for example Case C-340/99 *TNT Traco* (see paragraph 53), Case C-320/91 *Corbeau* (see paragraph 15) and Case T-556/08 *Slovenska Posta*.

¹¹¹⁹ See, e.g., Case T-128/98 *Aéroports de Paris*, paragraph 227.

- c) the objective of general interest cannot be achieved through other less restrictive means.¹¹²⁰
- 8.28 The concept of “*obstruct[ing] the performance, in law or in fact, of the tasks assigned to them*” has been interpreted by the EU courts to mean that it is sufficient that, in the absence of the conduct at issue, it would not be possible for the undertaking to perform the particular tasks entrusted to it, defined by reference to the obligations and constraints to which it is subject, or that the conduct is necessary to enable the dominant undertaking to perform tasks of general economic interest which have been assigned to it under “*economically acceptable conditions*”.¹¹²¹
- 8.29 Any submissions relating to proportionality must be supported by robust economic evidence. In *Slovenska Posta*,¹¹²² for example, the Commission and ultimately the Court found that the incumbent had failed to provide a satisfactory cost analysis in order to meet the Article 106(2) test.¹¹²³
- 8.30 Royal Mail has submitted that a dominant undertaking’s conduct can be exempt even if it could have achieved economically acceptable conditions by less restrictive measures.¹¹²⁴ This is not correct as a matter of law. The relevant case law is clear that the dominant undertaking is still required to “[*set*] out in detail the reasons” why the restriction of competition is necessary.¹¹²⁵ A competition authority may reject an incumbent’s unpersuasive or insufficient arguments and point out realistic, alternative, less restrictive measures.
- 8.31 Royal Mail has also submitted that a dominant undertaking’s conduct can be exempt even if it leads to the elimination of competition (where necessary). We note that the cases in which the EU Courts have exempted conduct which led to the elimination of competition are extremely rare and relate to incumbent undertakings which (i) had been granted exclusive rights by their Member State in compliance with EU law; and (ii) operated on a strong social solidarity basis at the time.¹¹²⁶ In contrast, the postal services sector has been fully liberalised in the UK since 2006.

¹¹²⁰ See, e.g., Faull & Nikpay, *The EU Law of Competition*, 3rd Edition, 2014, Chapter 6.

¹¹²¹ See, e.g., Case C-437/09 *AG2R Prévoyance v Beaudout Père et Fils SARL*, paragraph 76.

¹¹²² Case T-556/08 *Slovenska posta v European Commission* [2015] 4 CMLR 17. The General Court’s judgment was appealed (not in relation to the requirement to provide robust economic analysis) and dismissed by the Court of Justice in its entirety (Case C-293/15 P, Order dated 30 June 2016).

¹¹²³ In that case the incumbent chose to carry out an assessment by reference to the Commission’s Guidance on calculating the net cost, if any, of universal service set out at Annex I of the Third Postal Directive. That is not to say that the guidance in the Third Postal Directive is not a useful tool for the purposes of the proportionality test under Article 106(2). In this particular case the incumbent failed to properly apply the guidance it had itself chosen to follow.

¹¹²⁴ Citing Case C-157/94 *Commission v Netherlands* [1997] ECR-I-5699.

¹¹²⁵ Case C-157/94 *Commission v Netherlands*, paragraph 58.

¹¹²⁶ Joined Cases C-115/97, C-116/97 and C-117/97 *Brentjens* [1999] ECR I-6025 (pension scheme with uniform tariffs regardless of the work’s risk profile); Case C-475/99 *Ambulanz Glockner* [2001] ECR I-8089 (universal service in patient transport services provided by loss-making not-for-profit organisations).

Our assessment of the SGEI exemption

- 8.32 The table reproduced above, table 8.1, shows Royal Mail’s analysis of the impact on its revenues assuming various levels of roll out by Whistl. It asserts that with the CCNs in place – and therefore Whistl limited to 6 SSCs – its EBIT margin for the Reported Business would remain above 5%. At other levels of roll out without the CCNs, Royal Mail says that the revenue implications are such that its EBIT for the reported business¹¹²⁷ would be less than 5% and this means that it would not be able to provide the universal service under economically acceptable conditions.
- 8.33 As a primary point, we do not accept Royal Mail’s argument that an EBIT of 5-10% is “*the target EBIT in order for Royal Mail to operate the universal service under economically acceptable conditions.*”¹¹²⁸ This is merely one indicative metric among others used by Ofcom in its regulatory role to assess Royal Mail’s performance and the financial sustainability of the universal service.
- 8.34 As explained above in Section 7B, there is a regulatory framework in place which is charged with securing the provision of the universal service including with regard to its financial sustainability and the need for it to be efficient. As a result of this framework, Ofcom comprehensively assessed, on an ongoing basis, the potential impact of Whistl’s entry on the security of the universal service and determined that there was at no point an imminent threat (see paragraphs 7.29 to 7.40 in Section 7 *Abuse of dominance*). While Ofcom acknowledged that circumstances could change, this was addressed by its ongoing monitoring of the issue and its commitment to intervene in the event of it finding a problem.
- 8.35 If Ofcom had concluded that there was a threat to the financial sustainability of the Universal Service, regulatory action may have been appropriate in accordance with the terms of the Postal Services Act 2011 and in conformity with EU and UK competition law. It was not therefore necessary or proportionate for Royal Mail to abuse its dominant position to ensure that it did not lose revenue to competitors such as Whistl.
- 8.36 Accordingly, our finding in this regard is that, by adopting the price differential (or the other changes contained in the CCNs), Royal Mail was not acting in pursuance of an objective of general interest. Moreover, it cannot be said that Article 102 was obstructing Royal Mail’s performance of the universal service, given that the EU and UK legislative/regulatory rules for the postal sector established a regime in which the universal service would be protected in a manner consistent with competition law in appropriate circumstances.

¹¹²⁷ The ‘reported business’ is a regulatory construct which describes a subset of Royal Mail group’s activities; this includes all universal services, retail bulk mail services, access services and parcels services (which use the same network as the universal service products). Ofcom monitors Royal Mail at this level in order to assess the underlying financial position of the part of the business most closely aligned to the ongoing provision of the universal service.

¹¹²⁸ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 163, paragraph 9.47. (RM2386)

9. Decision

- 9.1 On the basis of the analysis in the preceding sections of this document, Ofcom has decided that Royal Mail plc (company number 08680755) contravened section 18 of the Competition Act 1998 (the Chapter II prohibition) and Article 102 TFEU in at least the period from 10 January 2014, being the date on which the CCNs were issued, until at least 21 February 2014, being the date on which the CCNs were suspended once Ofcom opened its investigation. We have not found it necessary to reach a finding on whether Royal Mail's conduct continued to amount to an abuse in the period to 11 March 2015, being the date on which Royal Mail formally withdrew the CCNs. We have, however, concluded that the price differential was reasonably likely to have continuing effects after the date of suspension.
- 9.2 Under section 33 of the Act, where Ofcom makes a decision that conduct infringes the Chapter II prohibition or Article 102 TFEU, it may give to such person or persons as it considers appropriate such directions as it considers appropriate to bring the infringement to an end. As the CCNs have been withdrawn by Royal Mail we consider that no directions are necessary. We would expect, however, Royal Mail to have full and proper regard to the findings in this decision in its ongoing conduct, including in relation to its D+2 access services.
- 9.3 Ofcom's decision to impose a financial penalty and the level of that financial penalty is set out in Section 10.

10. Financial penalty

Legal framework

Threshold for imposing a financial penalty

- 10.1 Under section 36 of the Competition Act 1998 (the “Act”), on making a decision that conduct has infringed the Chapter II prohibition or Article 102, Ofcom may require the undertaking concerned to pay a penalty in respect of the infringement. Ofcom may impose a penalty if it is satisfied that the infringement has been committed intentionally or negligently by the undertaking.¹¹²⁹
- 10.2 The Competition Appeal Tribunal has provided the following guidance on the interpretation of these terms:
- “...an infringement is committed intentionally for the purpose of section 36(3) of the Act if the undertaking must have been aware, or could not have been unaware, that its conduct had the object or would have the effect of restricting competition. An infringement is committed negligently for the purposes of section 36(3) if the undertaking ought to have known that its conduct would result in a restriction or distortion of competition. The OFT is not, however, obliged to decide whether an infringement is committed intentionally or negligently...”¹¹³⁰*
- 10.3 This guidance is consistent with the approach taken by the CJEU, which has confirmed:
- “...the question whether the infringements were committed intentionally or negligently... is satisfied where the undertaking concerned cannot be unaware of the anti-competitive nature of its conduct, whether or not it is aware that it is infringing the competition rules of the Treaty.”¹¹³¹*
- 10.4 The European Courts have also further confirmed that: *“an undertaking is aware of the anti-competitive nature of its conduct where it is aware of the essential facts justifying both the finding of a dominant position on the relevant market and the finding by the Commission of an abuse of that position”*.¹¹³²

¹¹²⁹ Section 36(3) of the Act.

¹¹³⁰ *Argos Limited and Littlewoods Limited v OFT* [2005] CAT 13, at paragraph 221. See also *Napp Pharmaceutical Holdings Limited v Director General of Fair Trading* [2002] CAT 1, paragraphs 456 and 457.

¹¹³¹ Judgment in Case C-280/08 P *Deutsche Telekom v Commission*, EU:C:2010:603, paragraph 124, referring to judgment in Case 96/82 *IAZ v Commission*, EU:C:1983:310, paragraph 45, and to judgment in Case 322/81 *Nederlandsche Banden-Industrie Michelin v Commission* (*‘Michelin I’*), EU:C:1983:313, [1983] ECR 3461, paragraph 107.

¹¹³² Judgment in Case T-336/07 *Telefónica SA and Telefónica Espana SA v Commission*, EU:T:2012:172, paragraph 320, referring the judgment in Case 322/81 *Nederlandsche Banden-Industrie Michelin v Commission*, EU:C:1983:313, [1983] ECR 3461, paragraph 107 and Joined Cases T-259/01 to T-264/02 and T-271/02 *Raiffeisen Zentralbank Österreich v Commission*, EU:T:2006:396, paragraphs 207 and 210.

- 10.5 Where Ofcom finds that an infringement has been committed at least negligently it is not necessary for it to determine whether the infringement was committed intentionally or negligently.

Statutory maximum

- 10.6 Section 36(8) of the Act provides that a penalty imposed under that section may not exceed ten per cent of an undertaking's worldwide turnover in the last business year preceding the date on which the infringement decision is taken.¹¹³³

Statutory objectives and the Penalties Guidance

- 10.7 Section 36(7A) of the Act sets out that, in fixing a penalty, Ofcom must have regard to:

- (a) the seriousness of the infringement concerned, and*
- (b) the desirability of deterring both the undertaking on whom the penalty is imposed and others from —*

(i) (...)

(ii) engaging in conduct which infringes the Chapter 2 prohibition or the prohibition in Article [102].

- 10.8 In accordance with section 38(8) of the Act, Ofcom must have regard to the guidance on penalties issued by the Competition and Markets Authority ("CMA") under section 38(1) of the Act in relation to determining the amount of a penalty (the "Penalties Guidance").¹¹³⁴
- 10.9 The Penalties Guidance reflects the statutory objectives in section 36(7A) of the Act.¹¹³⁵ The current version of that guidance was published by the CMA in April 2018. The Penalties Guidance adds that, where appropriate, the CMA intends to impose financial penalties which are severe, in particular, in respect of agreements between undertakings which fix prices or share markets, other cartel activities, and serious abuses of a dominant position.¹¹³⁶ The Penalties Guidance also recognises that it is important to ensure that penalties imposed on individual undertakings are proportionate and not excessive.¹¹³⁷
- 10.10 The Penalties Guidance sets out in detail the steps for determining the appropriate level of a penalty. This Section sets out how we have had regard to the Penalties Guidance in determining the level of the financial penalty we have decided to impose. It also sets out the key facts and information we consider to be relevant as well as our reasoning in determining the financial penalty.

¹¹³³ Calculated in accordance with The Competition Act 1998 (Determination of Turnover for Penalties) Order 2000 (SI 2000/309) (as amended by The Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2004 (SI 2004/1259)).

¹¹³⁴ CMA's guidance as to the appropriate amount of a penalty (CMA73, 18 April 2018).

¹¹³⁵ Ibid., page 2, paragraph 1.3.

¹¹³⁶ Ibid., page 3, paragraph 1.3.

¹¹³⁷ Ibid., page 3, paragraph 1.5.

Ofcom's margin of appreciation

10.11 Ofcom has a margin of appreciation in determining the level of a financial penalty in accordance with the Act subject to: (a) the penalty falling within the range permitted by legislation; and (b) the requirement that in determining the level of penalty it must have regard to the statutory objectives set out in section 36(7A) of the Act and the Penalties Guidance, as well as relevant legal principles.¹¹³⁸ Ofcom's decision on the level of penalty has to be on the particular circumstances of the case. Ofcom is not bound by previous decisions which it has taken on penalties, nor is it bound by previous decisions taken by the CMA, whether under competition law or in a regulatory context.¹¹³⁹

Decision to impose a financial penalty in this case

10.12 On the facts of this particular case, Ofcom concludes that Royal Mail ought to have known that by introducing the price differential, as part of the CCNs, its conduct would be reasonably likely to give rise to a competitive disadvantage and/or lead to a restriction of competition. In making this decision we have taken into account the following factors (as well as Royal Mail's representations, which are discussed in more detail below):

- a) Royal Mail ought to have known, and in fact could not have been unaware, that it held a position of dominance in the bulk mail delivery market in the UK given its very high market share, coupled with obvious barriers to entry and expansion and its role as an unavoidable trading partner for access operators. It should therefore have understood that it had a special responsibility not to allow its behaviour to impair genuine undistorted competition on the market. In reaching this view we note that Royal Mail expressly contemplated in internal contemporaneous documents the likelihood that it would be considered dominant as part of its decision-making process prior to issuing the CCNs.¹¹⁴⁰
- b) Royal Mail ought to have known, and in fact could not have been unaware, that by introducing the price differential between price plans NPP1 and APP2/ZPP3, it was applying dissimilar conditions to equivalent transactions with other trading parties and that its conduct was therefore discriminatory and did not amount to competition on the merits. In particular, we have found that Royal Mail ought to have known that the price differential would operate to apply a higher price to those access customers which sought to compete with Royal Mail in the bulk mail delivery market. In reaching

¹¹³⁸ *Argos Limited and Littlewoods Limited v OFT* [2005] CAT 13, at paragraph 168 and *Umbro Holdings Limited and others v OFT* [2005] CAT 22, at paragraph 102.

¹¹³⁹ See, for example, *Kier Group and Others v OFT* [2011] CAT 3, at paragraph 116 where the CAT noted that "other than in matters of legal principle there is limited precedent value in other decisions relating to penalties, where the maxim that each case stands on its own facts is particularly pertinent". See also *Eden Brown and Others v OFT* [2011] CAT 8, at paragraph 97, where the CAT observed that "[d]ecisions by this Tribunal on penalty appeals are very closely related to the particular facts of the case".

¹¹⁴⁰ Royal Mail, *Disclosure Committee 6 January 2014 – Changes to Access Pricing Plans: explanation and justification of Royal Mail's approach*, 6 January 2014, page 4, paragraph 4.1. (RM0124)

this view we note that Royal Mail expressly contemplated in its internal decision-making documents the possibility that the price differential was discriminatory.¹¹⁴¹

- c) Royal Mail ought to have known, and in fact could not have been unaware, that:
 - i) by introducing the price differential between price plans NPP1 and APP2/ZPP3, it would, at the point at which the entrant could not benefit from the lower price on NPP1 and would need to use APP2/ZPP3, significantly increase an end-to-end operator's access costs for the proportion of its mail that would continue to be delivered by Royal Mail, and that the resulting financial impact on an end-to-end operator's profitability would have been material; and
 - ii) the price differential would therefore increase the already high barriers to entry and expansion in the bulk mail delivery market and would reduce an operator's incentive to engage in such entry.
- d) Accordingly, Royal Mail ought to have known that the price differential would be reasonably likely to restrict competition/give rise to a competitive disadvantage to other trading parties, preserving, and potentially enhancing, Royal Mail's dominant position on the bulk mail delivery market. In reaching this view, we note that the evidence on the case file shows that Royal Mail expected that the price differential, when introduced together with the other changes in the CCNs, would have a material effect on operators entering the market in competition with Royal Mail. Indeed, we consider that the evidence shows that Royal Mail developed the price differential (together with the other pricing changes in the CCNs) as part of a deliberate strategy to limit Whistl's ambitions to expand its nascent bulk mail delivery operations.¹¹⁴² As a result, Royal Mail also could not have been unaware of the consequences of its actions.

10.13 Ofcom is therefore satisfied that Royal Mail acted at least negligently in committing the infringement and that it is appropriate to impose a financial penalty on Royal Mail. In making this decision, we have taken into account the fact that the infringement is serious (for the reasons set out in paragraphs 10.58 to 10.71 below) and deterrence is accordingly an important consideration in this case.

Royal Mail's representations

10.14 In its representations, Royal Mail argues that Ofcom may not, or should not, impose a financial penalty in this case. It provided submissions to support this argument:

¹¹⁴¹ Ibid., page 5, 5, paragraph 1.1. (RM0124)

¹¹⁴² See Section 7, sub-section D.

- a) Ofcom’s interpretation of Chapter II/Article 102 is said to be not reasonably foreseeable and/or novel. Accordingly, Royal Mail contends that Ofcom should impose no fine or at most a symbolic one;¹¹⁴³
- b) Royal Mail claims that its infringement of competition law was neither intentional nor negligent;¹¹⁴⁴
- c) Royal Mail alleges that Ofcom's own actions contributed to regulatory uncertainty;¹¹⁴⁵ and
- d) finally, Royal Mail contends that it is a relevant contextual consideration that the CCNs were issued with the purpose of supporting its universal service obligations.¹¹⁴⁶

10.15 Our position in relation to these representations is set out below.

Ofcom is not precluded from imposing a financial penalty for reasons of legal certainty

10.16 Royal Mail argues that, if its conduct in introducing the price differential is found to be abusive, such an abuse would be “*entirely novel*”¹¹⁴⁷ and “*unprecedented*”¹¹⁴⁸. It contends that Ofcom’s interpretation of Article 102/Chapter II “*was inconsistent with any reasonable interpretation of the text of the respective prohibitions, and was not reasonably foreseeable at the time of the alleged infringement. Royal Mail was therefore legitimately unaware that the conduct Ofcom has identified as engaging Article 102/Chapter II was liable to constitute an abuse.*”¹¹⁴⁹ Royal Mail argues that it would be contrary to the principle of legal certainty for Ofcom to impose a financial penalty.¹¹⁵⁰

10.17 Section 7 (*Abuse of a dominant position: legal and economic analysis*) contains a detailed consideration of Royal Mail’s infringing conduct. As explained there, by means of the price differential, which it introduced as part of the CCNs, Royal Mail leveraged its position as an unavoidable trading partner for operators active on the retail market for bulk mail so as to penalise those of its access customers who also sought to compete with it by undertaking end-to-end delivery activities. The price discrimination did not involve lowering any prices that provided benefits to consumers. We have found that there was no cost or other objective justification for such conduct. On the contrary, the price differential effectively penalised access customers that sought to compete in the bulk mail delivery market. The

¹¹⁴³ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 183, paragraphs 12.5 to 12.11 (RM2386); and Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 25 to 27, paragraphs 4.2 to 4.12, and pages 30 to 32, paragraphs 5.1 to 5.8. (RM2655)

¹¹⁴⁴ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 186, paragraphs 12.18 to 12.24 (RM2386); and Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 27 to 29, paragraphs 4.15 to 4.22 and pages 19 to 22, paragraphs 3.19 to 3.22. (RM2655)

¹¹⁴⁵ Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 185, paragraphs 12.12 to 12.14 (RM2386); and Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 22 to 24, paragraphs 3.23 to 3.40. (RM2655)

¹¹⁴⁶ Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 18 to 19, paragraphs 3.1 to 3.8. (RM2655)

¹¹⁴⁷ Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 26, paragraph 4.6 (RM2655); and Royal Mail, *Response to Statement of Objections*, 27 November 2015, , page 183, paragraphs 12.3 to 12.4. (RM2386)

¹¹⁴⁸ Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 26, paragraph 4.8. (RM2655)

¹¹⁴⁹ Ibid. (RM2655); and Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 183, paragraphs 12.3 to 12.11. (RM2386)

¹¹⁵⁰ Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 25, paragraphs 4.1(a) and 4.2 to 4.4. (RM2655)

purpose and effect of this conduct was to protect and preserve Royal Mail's position in the bulk mail delivery market by discriminating between its customers by reference to their chosen business model. For the reasons given at paragraphs 10.12 to 10.13 above, we have concluded that Royal Mail ought to have known that the price differential would have such an effect, and that its conduct was reasonably likely to distort competition.

10.18 We do not accept Royal Mail's contention that our analysis is "wholly novel" or that the nature of our infringement finding is such that it was impossible for Royal Mail to foresee that it would be found to have abused its dominant position by introducing the price differential. As we have explained above, Royal Mail's own internal contemporaneous documents make clear that it understood that the price differential was capable of having foreclosure effects.

10.19 Royal Mail's allegation of novelty rests on two main arguments:

- a) the price differential was never in fact charged to access operators due to its suspension after we opened our investigation; and
- b) Royal Mail could not therefore have known that by "*merely announcing*" the price differential its conduct would be classed as abusive.¹¹⁵¹

10.20 We have addressed these submissions above:

- a) At paragraphs 5.98 to 5.104 we explain why, as a matter of law, the fact that access operators did not in practice have to pay Royal Mail's access charges, as adjusted to reflect the price differential through the CCNs, by reason of Ofcom's intervention following Whistl's complaint, does not preclude Ofcom from finding that Royal Mail engaged in unlawful price discrimination.
- b) At paragraphs 7.217 to 7.220 above, we outline why we reject Royal Mail's categorisation of the price differential as a 'mere announcement'.
- c) At paragraphs 7.203 to 7.228 above, we explain why we do not accept that the suspension of the price differential, some six weeks after it was introduced, prevented it from being capable of having any anti-competitive effects in the market.

10.21 Further, we note that in assessing what Royal Mail ought to have known, the relevant question is what it should have known at the time when it introduced the price differential in January 2014. Royal Mail's submissions on foreseeability all turn on the contention that Royal Mail could not have known that the price differential would amount to unlawful price discrimination in circumstances where it was not in fact charged to an access operator. Royal Mail states:

"Ofcom has, contrary to Article 7 ECHR and the case law of the ECtHR and the European Courts, "extensively construed" the application of Article 102/Chapter II to the detriment of Royal Mail. Ofcom seeks to extend the application of Article 102(c) to the mere announcement of future price changes which, following their

¹¹⁵¹ Ibid., page 5, paragraph 1.23. (RM2655)

suspension, never became effective, would never be charged or paid, and were therefore incapable of causing any competitive disadvantage, even if they would have been discriminatory, which Ofcom has not established.”¹¹⁵²

10.22 Royal Mail then argues that:

“... Royal Mail's documents show that Royal Mail was concerned to ensure that the prices contained in the CCNs, including the price differential, when charged, would not infringe competition law or any of its regulatory obligations. Given the suspensory provision, Royal Mail was aware that any announcement of the CCNs would be suspended if an investigation by a regulatory body was opened as, indeed, were all other operators on the relevant markets. In addition, prior to taking the decision to announce the CCNs, Royal Mail knew of Whistl's intention to file a complaint and fully expected Whistl to do so. Accordingly, Royal Mail could not reasonably have foreseen that the mere act of issuing the CCNs in circumstances where they would be automatically suspended by operation of contract, before the date on which they were due to enter into effect (31 March), would constitute an abuse.

...

In light of the above, Royal Mail could not have foreseen that the mere act of announcing price changes in circumstances where they were likely to be suspended before the date on which they were due to enter into effect would "immediately affect competition" and thereby constitute an abuse of a dominant position under Article 102(c) or otherwise.”¹¹⁵³

10.23 However, there are two main problems with this analysis:

- a) First, it asks the wrong question. The question is not whether Royal Mail could have foreseen that its conduct would amount to an abuse of a dominant position on the assumption that the price differential would be suspended. What has to be assessed is whether, at the time it introduced the price differential, Royal Mail ought to have foreseen / could not have been unaware that it was reasonably likely to distort competition. We have explained above why we consider that Royal Mail ought to have foreseen, and there is evidence that it did in fact foresee, that: (a) the price differential would be reasonably likely to deter end-to-end entry; and, in any event, (b) there were likely to be immediate effects on the market as a result of its introduction.
- b) As a dominant undertaking, Royal Mail had a special responsibility to avoid impairing competition in the bulk mail delivery market. It cannot evade that responsibility by relying on a contractual suspension of its pricing decisions *if* third parties intervene. Under the Access Letters Contract, Royal Mail had the power, which it exercised in this case, to change unilaterally key terms and conditions on which access arrangements

¹¹⁵² Ibid., page 26, paragraph 4.7. (RM2655)

¹¹⁵³ Ibid., pages 26 to 27, paragraphs 4.11 and 4.13. (RM2655) Internal references omitted.

were provided. The notification period was included in the agreements in response to Royal Mail having this power so that: (a) operators could adjust to the unilateral changes; and (b) operators could raise a dispute. However, this ability to raise a dispute, and the consequent suspension of the new term does not relieve Royal Mail of its obligation, as a dominant undertaking, to avoid taking action which is reasonably likely to distort competition. On the contrary, that obligation is particularly important where it has the power unilaterally to vary terms.

10.24 We also note that Royal Mail is a large, well-resourced company with experienced internal and external legal, regulatory and economic advisers. The evidence on the case file shows that the decision to vary the terms and conditions of D+2 Access by issuing the CCNs was preceded by extensive oversight from senior management and detailed advice from legal and economic advisers. We consider that this documentary evidence indicates that, as part of or as a result of that oversight and advice, Royal Mail was in fact aware of the risks that its conduct might breach competition law, or at least that it ought to have been aware of these risks:

- a) Royal Mail's contemporaneous internal decision-making papers clearly articulate a summary of the legal position that is consistent with our findings: "*[t]he access pricing proposals involve price discrimination, i.e. RM is choosing to charge different customers different prices for the same services. Even for a firm deemed to be dominant in a market, price discrimination is allowable under competition law if it can be objectively justified.*"¹¹⁵⁴
- b) In addition, the contemporaneous economic advice that Royal Mail received from its external advisors (together with its own internal economic analysis) articulates the risk that Royal Mail's conduct may harm competition. For example, Royal Mail's external economic advice expressly warned it that the price differential "*does have the potential to give rise to an exclusionary effect by making it harder for an operator like [Whistl] to rollout direct delivery.*"¹¹⁵⁵ Royal Mail's external advisers also warned of the risks associated with relying on the cost justification argument, which Royal Mail ultimately relied on in its key decision-making papers as an answer to concerns about regulatory or competition law compliance:

*"...it is understood that the greatest commercial risk and therefore cost that Royal Mail faces is the potentially higher risk of volume loss/stranded costs that would materialise if [Whistl] remains on PP2 at current price levels and tolerances, and is therefore able to roll-out its direct delivery more widely. However, this cost argument is unlikely to be a valid objective justification in a competition law case for conduct [that] can have the effect of restricting efficient competition".*¹¹⁵⁶

¹¹⁵⁴ Royal Mail, *Disclosure Committee 6 January 2014 – Changes to Access Pricing Plans: explanation and justification of Royal Mail's approach*, 6 January 2014, page 5, paragraph 1.2. (RM0124)

¹¹⁵⁵ E-mail from [redacted] (Oxera) to [redacted] (Royal Mail), 11 October 2013, page 1. (RM1162)

¹¹⁵⁶ Oxera, *Economic assessment of the proposed actions on Access contracts*, 3 October 2013, page 9. (RM1134) A following sentence in the paragraph quoted is redacted on the basis that it is legally privileged.

- 10.25 Royal Mail also argues that there is no case dealing with the same type of infringement as found in this case. However, all cases relating to infringements of the Chapter II prohibition/Article 102 TFEU will turn on the relevant factual circumstances, and the precise nature of the conduct concerned, in each case, and therefore the nature of the infringement will differ on a case-by-case basis. It is well established that the ‘novelty’ of an infringement alone is not sufficient to justify the imposition of no penalty or a nominal penalty. The fact that conduct with the same features has not been examined in past decisions does not exonerate an undertaking where its conduct is manifestly contrary to competition on the merits.¹¹⁵⁷ On the facts of this case, Royal Mail was able to assess the compatibility of its behaviour with Article 102 TFEU / the Chapter II prohibition.¹¹⁵⁸
- 10.26 For these reasons we do not accept Royal Mail’s submission that Ofcom has adopted an interpretation of the competition law provisions prohibiting an abuse of dominant position that was not reasonably foreseeable to Royal Mail at the time of the infringement.

Royal Mail has at least negligently infringed competition law

- 10.27 Royal Mail has submitted that Ofcom cannot conclude that it intentionally or negligently infringed competition law.
- 10.28 Royal Mail submits that the correct legal test for finding intention or negligence in order to impose a financial penalty is that Royal Mail “*could not have been unaware*” of the *anticompetitive nature of its conduct*”.¹¹⁵⁹ Royal Mail submits that it was “*genuinely and legitimately unaware of the alleged anti-competitive nature of the announcement itself, and no penalty can therefore be imposed.*”¹¹⁶⁰ In particular, it argues that:
- a) it was unaware of any regulatory or judicial precedent in which a price announcement or maintenance of a suspended price list has been found to be anti-competitive in nature;
 - b) the announcement of the price changes in the CCNs in itself had no foreseeable effect on the relevant markets given the likelihood of suspension following a complaint by Whistl; and
 - c) the maintenance of a suspended list of prices, which were never charged or paid, had no foreseeable effect on the relevant markets.¹¹⁶¹
- 10.29 Royal Mail also argues that it took all possible and reasonable steps to avoid an infringement. In particular, Royal Mail states that these steps included:

¹¹⁵⁷ See the judgments in *Case 322/81 Michelin v Commission* EU:C:1983:313 [1983] ECR 3461, paragraph 107 and *Case T-321/05 AstraZeneca v Commission* EU:T:2010:266 [2010] E.C.R. II-2805, paragraph 901.

¹¹⁵⁸ This was not the case, for example, in *Duales System Deutschland*, referred to by Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 30, paragraph 5.3. (RM2655)

¹¹⁵⁹ Royal Mail, *Royal Mail, Response to draft penalty statement*, 8 March 2018, page 28, paragraph 4.19. (RM2655)

¹¹⁶⁰ *Ibid.*, page 28, paragraph 4.20. (RM2655)

¹¹⁶¹ *Ibid.*, pages 28 to 29, paragraph 4.22. (RM2655)

- a) consideration and review of the pricing proposals by a number of executive committees, which Royal Mail argued evidences Royal Mail’s “cautious and bona fide approach to assessing the legitimacy and legality of the price changes”;
- b) obtaining external economic and legal advice on the pricing proposals from the outset, which it said was intended to “ensure the CCNs were compliant with both its regulatory obligations and competition law, which was robustly stress tested”;
- c) its senior executives taking a “cautious approach to the level of the price differential”, selecting a price differential lower than the maximum level which it considered was cost justified; and
- d) “engaging openly with Ofcom, in the knowledge that the price differential was likely to be reviewed by Ofcom following a subsequent complaint”.¹¹⁶²

10.30 Royal Mail relies on its contemporaneous documents as showing that it considered the potential impact of the application of the price differential on Whistl based on the information available to it at the time, and concluded that the price differential was not capable of foreclosing competition. It alleges that the relevant documents demonstrate “the bona fide approach that Royal Mail took to ensuring that the prices contained within the CCNs would not lead to foreclosure and would therefore be lawful, if charged”.¹¹⁶³

10.31 Royal Mail also states that, although it informed Ofcom of its proposed changes to the price plans, including the concept of a price differential, Ofcom did not raise any objections to the changes. It said that Ofcom’s own record of a meeting which took place on 10 December 2013 records that Ofcom told Royal Mail that “it was important that they had satisfied themselves they were fully compliant with their obligations”¹¹⁶⁴, and that this “corroborates the fact that Royal Mail was fully aware of its regulatory and competition law obligations and that extensive steps were taken to avoid an infringement”.¹¹⁶⁵

10.32 We do not accept Royal Mail’s submissions for the following reasons.

10.33 First, with regard to Royal Mail’s submissions on the relevant legal test, we have set out the correct test above. Contrary to those submissions, our approach to the test of negligence is consistent with European Court case-law.¹¹⁶⁶ That case-law provides that the requirement that conduct is committed intentionally or negligently is satisfied where the undertaking “cannot be unaware of the anti-competitive nature of its conduct”, even if it was not aware that it was infringing the competition provisions of the Treaty. That does not mean that intentionality and negligence have to be assessed on the basis of the same knowledge standard. Rather, the point being made is that conduct is neither intentional

¹¹⁶² Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 19 to 20, paragraph 3.11. (RM2655) See also, Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 187, paragraphs 12.21 to 12.24. (RM2386)

¹¹⁶³ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 20 to 21, paragraphs 3.16 to 3.20. (RM2655)

¹¹⁶⁴ Ofcom, Email from [redacted] (Ofcom) to various re meeting with Royal Mail 10 December 2013, 8 January 2014 (RM2618)

¹¹⁶⁵ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 22, paragraph 3.28. (RM2655)

¹¹⁶⁶ See, for example, paragraphs 5.9-5.12 of the CMA’s decision in Galvanised steel tanks for water storage information exchange infringement, Case CE/9691/12, 19 December 2016.

nor negligent if the undertaking was unaware of the anti-competitive nature of its conduct. In any event, on the facts of this case, for all of the reasons given above, Royal Mail could not have been unaware of the anti-competitive nature of its conduct, in particular given its own internal analysis of this issue (see paragraphs 10.12 and 10.26 above).

- 10.34 Second, we do not agree with Royal Mail's position that the internal contemporaneous documents show that it adopted a cautious approach in developing the price differential aimed at avoiding it having any foreclosure effects. On the contrary, for the reasons explained in detail in Section 7, sub-section D, we have found that Royal Mail's conduct reflected a deliberate strategy to limit competition from its first and only significant competitor in the bulk mail delivery market.
- 10.35 We note, in particular, Royal Mail's claim that it had considered the potential impact of the application of the price differential on Whistl and concluded, having "*engaged in extensive modelling*", that the price differential would not lead to foreclosure by reference to an as-efficient competitor analysis.¹¹⁶⁷ In support of this point, Royal Mail relies on: (a) paragraph 8.84 of Royal Mail's submissions in response to the Statement of Objections, which refers to Royal Mail's, "Entrant Cost Model", and (b) the decision to reduce the price differential from 0.3p to 0.25p in order to adopt a "*conservative approach*".
- 10.36 However, we disagree that the evidence (set out below) shows that Royal Mail reasonably believed that the price differential was not capable of foreclosing competition for the following reasons:
- a) For the reasons outlined at paragraphs 7.182 to 7.202 above, the assessment of whether an 'as-efficient' operator as Royal Mail could have continued to operate in the delivery market, but for the price differential, is not a relevant assessment tool in this case.
 - b) The internal documents relating to the decision to introduce the price differential, outlined in Section 4 and analysed in Section 7, are inconsistent with Royal Mail's position. The paper submitted to the Disclosure Committee on 6 January 2014 stated that "*we would argue that the proposals would not result in any competitor or direct delivery entrant being excluded from the market*".¹¹⁶⁸ However, as we have explained at paragraphs 7.133 to 7.136, we have seen no evidence in support of this statement.
 - c) Contrary to Royal Mail's submission, we understand that the Entrant Cost Model was used during the decision-making process to create a proxy for Whistl's costs and, based on those observations, to calibrate the prices changes based on the likely impact on end-to-end entry generally and Whistl specifically, so that Royal Mail would select the combination of measures which would achieve the desired outcome.¹¹⁶⁹

¹¹⁶⁷ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 20, paragraph 3.18. (RM2655)

¹¹⁶⁸ Royal Mail, *Disclosure Committee 6 January 2014 – Changes to Access Pricing Plans: explanation and justification of Royal Mail's approach*, 6 January 2014, page 5, paragraph 1.4. (RM0124)

¹¹⁶⁹ See above figures 4.3 and 4.4.

- d) Specifically, as explained at paragraphs 4.46 onwards, we understand that, in developing its proposals for the price differential based on this model, Royal Mail recognised at the time that introducing such a price differential would either require that Whistl “foregoes [a] reasonable rate of return”¹¹⁷⁰ or would have to “switch to PP1 to continue to compete with UK Mail but that would then dent their direct delivery ambitions”¹¹⁷¹. The anticipated effect was that Whistl would opt to curtail its end-to-end expansion, minimising the loss of market share and revenue that Royal Mail otherwise anticipated suffering as a result of Whistl’s plans.
- e) The proposal of a 0.3p differential, and the subsequent move to a 0.25p level, does not affect the position. Royal Mail adopted the lower level of its modelled range of potential cost differences, but the modelled impact remained the same. As set out at paragraphs 4.46 to 4.53 and 7.123 to 7.126, ‘Scenario 2’, i.e. the modelled scenario selected by Royal Mail, considered the impact of a 0.2p price differential plus the zonal tilt, and it was that scenario which achieved the desired outcome, namely that a direct delivery operator would “switch to [N]PP1 and stay there.”¹¹⁷²
- f) Oxera, who were Royal Mail’s economic advisers at the time, warned Royal Mail of the risk that Royal Mail’s conduct would harm competition.¹¹⁷³

10.37 We understand that some modelling work was undertaken by Royal Mail for the purposes of developing a ‘cost justification’ for the price differential. We note that, although Oxera stated in its October 2013 advice to Royal Mail that “[w]ork and evidence demonstrating that the price differential will not have an exclusionary effect is ... of paramount importance”¹¹⁷⁴, the focus of the work on the cost justification was not concerned with demonstrating that competitors would not be foreclosed, but rather was intended to “prove that there is an **objective justification for the price changes**”¹¹⁷⁵ (emphasis in original). We have explained in Section 7, sub-section C, why we have rejected Royal Mail’s suggestion that the price differential was cost justified on the basis of the forecast information it expected to receive from NPP1 customers.

10.38 The contemporaneous documentation therefore supports the conclusions that Royal Mail ought to have been aware, or cannot have been unaware, of the risk that the price differential would lead to anti-competitive foreclosure of direct delivery competitors. As explained above, those documents also demonstrate that Royal Mail understood the risk

¹¹⁷⁰ Royal Mail, *Options for protecting the USO – Draft discussion document, October 2013*, 13 November 2013, slide 11. (RM0960) See Figure 4.4 above.

¹¹⁷¹ Royal Mail, Presentation entitled *Proposed actions on Access contracts to protect the USO*, 30 September 2013, page 25. (RM1126). See also Royal Mail, Spreadsheet *Working notes*, 17 October 2013, scenarios 1, 2, 3 and 6: which envisage that the direct delivery operator would “switch to PP1 to avoid differential.” (RM0840)

¹¹⁷² Royal Mail, *Options for protecting the USO – Draft discussion document, October 2013*, 13 November 2013, slide 10. (RM0960).

¹¹⁷³ See paragraphs 4.82 and 4.92.

¹¹⁷⁴ Oxera, *Economic assessment of the proposed actions on Access contracts – Note prepared for Royal Mail*, 3 October 2013, page 2. (RM1134)

¹¹⁷⁵ Royal Mail, *Disclosure Committee 6 January 2014 – Changes to Access Pricing Plans: explanation and justification of Royal Mail’s approach*, 6 January 2014, page 5, paragraph 1.4. (RM0124)

that the price differential could breach competition law, but decided to take that risk by proceeding in any event.

10.39 Third, Royal Mail's communications with Ofcom prior to issuing the CCNs do not affect the analysis.

- a) In this connection, Royal Mail met with Ofcom one month before it issued the CCNs to provide an update on its proposed changes. As explained in more detail below, Royal Mail's note of the meeting records that Ofcom advised that this was likely to be a competition issue. Indeed, during the meeting Ofcom emphasised that Royal Mail should take legal advice and provided no comfort to Royal Mail about the acceptability of its then proposed actions.¹¹⁷⁶
- b) As a dominant undertaking it was Royal Mail's responsibility to ensure that its actions were compliant with competition law. That responsibility was not discharged in circumstances where Ofcom did not indicate any approval of Royal Mail's conduct, and on the contrary, expressly noted the potential for this conduct to amount to a competition issue.

Royal Mail's submissions on regulatory uncertainty

10.40 Royal Mail argues that Ofcom's actions and/or inaction contributed to regulatory uncertainty. It argues that Ofcom made clear that it expected Royal Mail to use the commercial freedom it had been granted in 2012 to respond competitively to end-to-end competition, but Royal Mail had to do so without any detailed guidance from Ofcom as to how it would assess any such price changes.¹¹⁷⁷ It said that Ofcom did not provide detailed guidance to Royal Mail as to how it would assess whether any new terms or measures introduced by Royal Mail were compliant with its regulatory obligations, specifically the requirement for terms, conditions and charges to be fair and reasonable,¹¹⁷⁸ despite recognising the need for such guidance.¹¹⁷⁹ It argues that Ofcom's actions in this context led to uncertainty for Royal Mail and that it would be inappropriate for Ofcom to penalise the announcement by Royal Mail of price changes in circumstances in which Ofcom had promised, but failed, to provide guidance on such prices.¹¹⁸⁰

10.41 We do not accept Royal Mail's submissions for the following reasons.

10.42 First, in light of our findings set out in Section 7, and in particular, sub-section D of Section 7, we do not consider it to be sustainable for Royal Mail to argue that regulatory uncertainty resulted in, or contributed to, its introduction of the price differential. Royal

¹¹⁷⁶ See above paragraphs 4.106 to 4.111.

¹¹⁷⁷ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 122 to 123, paragraphs 3.29 to 3.30. (RM2655)

¹¹⁷⁸ Condition 3 of the Universal Service Provider Access (USPA) condition requires Royal Mail to offer D+2 Access on terms, conditions and charges that are fair and reasonable.

¹¹⁷⁹ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 23, paragraphs 3.33 to 3.35. (RM2655)

¹¹⁸⁰ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 23, paragraph 3.29 and page 30, paragraph 5.4 (RM2655); and Royal Mail, *Response to Statement of Objections*, 27 November 2015, page 185, paragraphs 12.12 to 12.14. (RM2386)

Mail's internal contemporaneous document demonstrated that Royal Mail understood the nature of the price differential's likely foreclosure effects.

- 10.43 Second, as at March 2012, Royal Mail's position was not that detailed guidance was required from Ofcom about how it would determine whether terms were 'fair and reasonable'. As noted at paragraph 10.47 of Ofcom's March 2012 statement, Royal Mail's position at that time was that it was:

*"...supportive of the principle that the terms and conditions of access should be set on a "fair and reasonable" basis. It argued that if there were a regulatory role, then it should be limited to providing broad guidelines on what constitutes: (a) "fair and reasonable"; and (b) an appropriate process for the principles and broad timescales to be adopted. Royal Mail argued that the guidelines should not include interventions, either explicit or implicit, in specifying contractual terms and conditions."*¹¹⁸¹

- 10.44 Third, it is correct that Ofcom decided that it was appropriate to wait before providing comprehensive guidance until after a period of time had elapsed to allow the new access regime to become established.¹¹⁸² However, contrary to Royal Mail's submission, Ofcom provided interim guidance on principles relevant to Royal Mail's access pricing, in order to address specific concerns raised by stakeholders.¹¹⁸³ In particular, Ofcom stated that, in setting access prices, Royal Mail should "*seek to ensure that the weighted average of zonal access prices is broadly comparable to the national access price.*"¹¹⁸⁴ Ofcom said that this principle – which is directly relevant to the price differential between NPP1 and APP2/ZPP3 which is at issue in this case – would be one to which it would have regard when considering whether a term (or a proposed change in terms) was fair and reasonable. It is therefore clear that Ofcom's guidance in its March 2012 statement was intended to set out high level principles and issues that Ofcom would be likely to take into account if assessing a dispute in relation to access pricing, and accordingly was not prescriptive as to how Royal Mail should go about ensuring that its weighted average of zonal access prices remained broadly comparable to the national access price.

- 10.45 There was therefore no relevant regulatory uncertainty at the time of Royal Mail's infringing conduct. Moreover, as explained above, it is clear from the contemporaneous documents that Royal Mail was aware of the obvious competition law risks which the price differential gave rise to.

- 10.46 Fourth, while Ofcom had previously indicated that Royal Mail should exercise its commercial freedom in responding to direct delivery entry, this cannot be relied upon in any way as justifying the introduction of the price differential.

¹¹⁸¹ See Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012, paragraph 10.62. (PD0025)

¹¹⁸² *Ibid.*, paragraph 10.64 and 10.153 (PD0025)

¹¹⁸³ *Ibid.*, paragraph 10.65 and 10.153 (PD0025)

¹¹⁸⁴ *Ibid.*, paragraph 10.153. (PD0025)

10.47 As noted by Royal Mail, in Ofcom’s final guidance on the approach to assessing the impact of end-to-end competition on the universal postal service, published in March 2013,¹¹⁸⁵ Ofcom explained that a consideration it would have regard to in determining whether there may be a threat to the universal service was the potential for commercial responses by Royal Mail to mitigate the direct impact of competition. In this context, Ofcom said that:

*“Royal Mail could change its commercial strategy (i.e. pricing and terms). In particular, under the current regulatory regime Royal Mail has the ability to change the prices it charges access operators. This includes the ability to change how access prices are set for different geographic areas (currently the “zonal access pricing regime”) to ensure they are reflective of relevant costs. This is particularly important given that in general an end-to-end competitor will still need to rely on access to Royal Mail’s network to offer its customers full coverage of all addresses in the UK. Royal Mail’s flexibility in setting zonal access prices can enable it to ensure that end-to-end competitors pay a cost reflective price for Royal Mail delivering mail in the areas where it has chosen not to enter (which may be the harder to reach, and hence less profitable parts of the UK). In this way, Royal Mail may be able to mitigate the impact on the universal service from an entrant ‘cherry picking’ by delivering in lower cost areas and handing over the rest of the mail to Royal Mail to deliver. In addition, Royal Mail has the flexibility to negotiate changes to its contracts both with its retail and access customers (**subject to competition law** and the existing ex ante regulatory conditions on access)”¹¹⁸⁶ (emphasis added).*

10.48 Through the price differential, Royal Mail was not seeking to set “cost reflective” zonal pricing of the sort envisaged in the 2013 guidance. As explained at paragraphs 7.99 to 7.122 above, we have rejected the purported ‘cost justification’ Royal Mail has advanced to seek to justify the price differential (which was linked to the fact that Royal Mail only sought forecast information from NPP1 customers). Ofcom also emphasised in its 2013 guidance that it was Royal Mail’s responsibility to ensure that it used its pricing flexibility in a manner which complies with competition law. This statement by Ofcom therefore cannot be said to have given Royal Mail the impression that Ofcom would consider it permissible for Royal Mail to use its commercial flexibility to introduce a price change which was reasonably likely to distort end-to-end competition. We have set out in detail in Section 7 why we have concluded that the price differential was intended and likely to act as a penalty on such operators seeking to engage in such competition.

10.49 Fifth, Royal Mail’s reliance on the fact that, on 10 December 2013 (one month before the CCNs were issued), it presented its plans (including the introduction of the price differential) to Ofcom for information is misplaced. Royal Mail’s own notes of this meeting record that Ofcom cautioned that “*Royal Mail must undertake its own due diligence on the price proposals and that this was not just a regulatory issue **but also likely to be a***

¹¹⁸⁵ Ofcom, *End-to-end competition in the postal sector – final guidance on Ofcom’s approach to assessing the impact on the universal service postal service*, 27 March 2013. (PD0018)

¹¹⁸⁶ *Ibid.*, page 16, paragraph 4.12. (PD0018)

*competition issue*¹¹⁸⁷ (emphasis added). Ofcom’s note of that meeting records that Ofcom again emphasised to Royal Mail that it was incumbent on it to ensure that its conduct was fully compliant with its regulatory and competition law obligations.¹¹⁸⁸ We have explained at paragraphs 10.34 to 10.38 why we consider that, although Royal Mail may have been cognisant of those obligations, it did not take all relevant steps to avoid an infringement.

- 10.50 Accordingly, we do not accept Royal Mail’s submission that there was any relevant regulatory uncertainty which would impact Ofcom’s ability to impose a penalty in this case.

Royal Mail’s conduct was not justified for the purposes of supporting the universal service

- 10.51 Royal Mail argues that Ofcom should take into account, by way of context, that “*the purpose of the CCNs was to support the Universal Service*”.¹¹⁸⁹ It argued in this regard that “*Royal Mail’s conduct was necessary to achieve the 5-10 per cent EBIT margin target identified by Ofcom as being consistent with the financial sustainability of the USO*”.¹¹⁹⁰
- 10.52 Section 8 (*Objective justification and Article 106(2) TFEU*) of this decision sets out why Royal Mail’s conduct was not objectively justified by the need to secure the provision of the universal postal service, and why we conclude that Royal Mail was not pursuing an objective of general interest so as to give rise to a defence under Article 106(2) TFEU. As explained at paragraphs 7.29 to 7.40, there is a regulatory framework in place for the purposes of securing the provision of the universal service, including with regard to its financial sustainability and the need for it to be efficient. Pursuant to this framework, Ofcom assessed, on an ongoing basis, the potential impact of Whistl’s entry on the universal service; and consistently determined that there was at no threat requiring any immediate regulatory intervention.
- 10.53 For these reasons, even if the motivation behind Royal Mail’s conduct was a desire to ensure its ability to fulfil its universal service obligations was not affected by the threat of end-to-end competition, that is not a justification for Royal Mail abusing its dominant position, nor is it a justification for concluding that it is inappropriate for Ofcom to impose a financial penalty in this case.

Summary of conclusions

- 10.54 Ofcom has concluded that:
- a) Royal Mail has at least negligently infringed the Chapter II prohibition and/or Article 102 TFEU; and

¹¹⁸⁷ See Royal Mail, *Note of meeting with Ofcom*, 10 December 2013, page 2: “*Ofcom set out that they did not have a view on the proposals. [Whistl] has already contacted Ofcom setting out that they believed Royal Mail’s proposals were likely to be exclusionary behaviour. Ofcom emphasised that Royal Mail must undertake its own due diligence on the price proposals and that this was not just a regulatory issue but also likely to be a competition issue.*” (RM2324)

¹¹⁸⁸ Ofcom, Email from [redacted] (Ofcom) to various re meeting with Royal Mail 10 December 2013, 8 January 2014, page 2: “[redacted] (Ofcom) thanked RM for the presentation and said it was important that they had satisfied themselves they were fully compliant with their obligations.”. (RM2618).

¹¹⁸⁹ Royal Mail, *Royal Mail, Response to draft penalty statement*, 8 March 2018, page 18, paragraph 3.2. (RM2655)

¹¹⁹⁰ *Ibid.*, page 19, paragraph 3.8. (RM2655)

- b) in light of the seriousness of the infringement and the desirability of deterring both the undertaking on whom the penalty is imposed and others from engaging in conduct which infringes the Chapter II prohibition and/or Article 102 TFEU, it is appropriate to impose a financial penalty on Royal Mail.

Calculation of financial penalty

10.55 The Penalties Guidance sets out a six-step process for determining the level of a financial penalty. These steps are:

- **Step one:** Calculation of the starting point having regard to the seriousness of the infringement and the relevant turnover of the undertaking;
- **Step two:** Adjustment for duration;
- **Step three:** Adjustment for aggravating or mitigating factors;
- **Step four:** Adjustment for specific deterrence and proportionality;
- **Step five:** Adjustment if the penalty exceeds the statutory maximum and to avoid double jeopardy; and
- **Step six:** Adjustment for leniency and/or settlement discounts.

10.56 In determining the amount of the penalty, Ofcom has had regard to the six-step approach for calculating a penalty set out in the Penalties Guidance. Table 10.1 sets out the financial penalty and a summary of Ofcom's reasons for determining this amount. This is set out in detail below.

Table 10.1: Summary of penalty calculation

Step	Adjustment	Penalty
Step one		
Starting point	20 per cent	
Applied to relevant turnover		[X]
Step two		
Adjustment for duration	none	[X]
Step three		
Adjustment for aggravating or mitigating factors		
	none	[X]
Step four		
Adjustment for specific deterrence and proportionality		
<i>Adjustment for proportionality</i>		£50,000,000
Step five		
Adjustment to ensure that the statutory cap is not exceeded and to avoid double jeopardy	none	£50,000,000
Step six		
Adjustment for leniency and/ or settlement	none	£50,000,000
Final penalty		£50,000,000

Step one: the starting point

10.57 As explained in the Penalties Guidance, the starting point for determining the level of financial penalty is calculated having regard to the seriousness of the infringement and Royal Mail's relevant turnover.

Assessment of seriousness

- 10.58 Having regard to Penalties Guidance, Ofcom's approach is to apply a starting point of up to 30 per cent of an undertaking's relevant turnover in order to reflect the seriousness of an infringement (and ultimately the extent and likelihood of actual or potential harm to competition and consumers).¹¹⁹¹ The actual percentage which is applied to the relevant turnover depends, in particular, upon the nature of the infringement. This assessment is made on a case-by-case basis, taking account of all the circumstances of the case.¹¹⁹²
- 10.59 In assessing the seriousness of the infringement, the Penalties Guidance states that it is appropriate first to consider the likelihood that the type of infringement at issue will, by its nature, cause harm to competition.¹¹⁹³ The Penalties Guidance indicates that:
- a) a starting point of between 21% and 30% of relevant turnover is generally appropriate for the most serious types of infringement, that is, those which the competition authority considers are most likely by their very nature to harm competition – for the Chapter II prohibition/Article 102, it is said this will typically include conduct which is inherently likely to have a particularly serious exploitative or exclusionary effect, such as excessive and predatory pricing;
 - b) a starting point of between 10% and 20% is more likely to be appropriate in relation to infringements of the Chapter II prohibition and/or Article 102 involving conduct which is less likely to be inherently harmful.¹¹⁹⁴
- 10.60 The Penalties Guidance also sets out a number of factors, which we have considered, that may be relevant to the extent and likelihood of harm to competition and ultimately to consumers, and which may indicate it is appropriate to adjust the starting point upwards or downwards to take account of specific circumstances of the case. These include: the nature of the product or service, the structure of the affected market, including the market shares of the undertaking(s) involved in the infringement, market concentration and entry conditions, the market coverage of the infringement, the actual or potential effect on competitors and third parties and the actual or potential harm caused to consumers (whether directly or indirectly).¹¹⁹⁵ The Penalties Guidance also provides that the assessment of the starting point should take into account, in relation to the particular infringement, whether it is sufficient having regard to the need to deter other undertakings from engaging in such infringements in the future.¹¹⁹⁶
- 10.61 In this case, we have found that Royal Mail abused its dominant position by introducing the price differential which amounted to unlawful price discrimination. In doing so, Royal Mail leveraged its position as an unavoidable trading partner for access operators active on the retail market for bulk mail to penalise those of its access customers who also sought to

¹¹⁹¹ Penalties Guidance, page 8, paragraph 2.4.

¹¹⁹² Penalties Guidance, page 8, paragraph 2.5 and page 9, paragraph 2.8

¹¹⁹³ Penalties Guidance, page 8, paragraph 2.6

¹¹⁹⁴ Penalties Guidance, page 9, paragraph 2.6

¹¹⁹⁵ Penalties Guidance, page 9, paragraph 2.8.

¹¹⁹⁶ Penalties Guidance, page 10, paragraph 2.9.

compete with it by entering the bulk mail delivery market and engaging in end-to-end activities. This conduct would have resulted in a material financial impact on an end-to-end operator's profitability. This material impact on profitability was reasonably likely to distort competition by increasing the already high barriers to entry and expansion in the bulk mail delivery market, thereby reducing an operator's incentive to engage in such entry, rendering it less likely to occur.

10.62 Royal Mail's conduct reflected a deliberate strategy to limit competition from its first and only significant competitor in the bulk mail delivery market, Whistl. Royal Mail identified this nascent competition as a threat to its position and developed the price differential as a direct response to the threat of competition from Whistl. The purpose and effect of this conduct was to preserve Royal Mail's position in the bulk mail delivery market.

10.63 It was foreseeable that this strategy would be reasonably likely to result in a competitive disadvantage and/or restrict competition. In our view, conduct of this nature constitutes a serious infringement.

10.64 In reaching this view, we have considered a number of other factors.

- a) **The nature of the product/services:** Ofcom has concluded that the relevant market comprises the UK-wide market for delivery of bulk mail letters and large letters, which is relied upon by a wide variety of important institutions, including financial services, government departments and charities, and is accordingly used directly or indirectly by all UK consumers.
- b) **The structure of the market and Royal Mail's market share:** The bulk mail delivery market is very highly consolidated with minimal levels of competition, which is exemplified by the fact that, as at January 2014, Royal Mail's market share was over 98% (and since Whistl's exit in June 2015, it has only increased since then).¹¹⁹⁷ Royal Mail was the former statutory monopolist and enjoyed significant structural advantages, including in particular a unique national network, giving rise to significant economies of scale and scope.¹¹⁹⁸ We have found that the infringement in this case (alongside the other pricing changes in the CCNs) was targeted at limiting the scale of competition by Royal Mail's first and only significant rival in bulk mail delivery, and was therefore designed to preserve Royal Mail's high market share in the bulk mail delivery market.¹¹⁹⁹
- c) **Entry conditions:** The bulk mail delivery market is characterised by high barriers to entry, in particular because the market is characterised by high fixed costs and substantial economies of scale and scope.¹²⁰⁰ In practice, Royal Mail was an unavoidable trading partner for its access customers and any entrant into delivery remained dependent on Royal Mail to satisfy the retail demand of national scale

¹¹⁹⁷ See paragraph 6.73(a).

¹¹⁹⁸ See paragraph 7.18.

¹¹⁹⁹ See Section 7, sub-section D.

¹²⁰⁰ See paragraph 6.93.

delivery.¹²⁰¹ We have found that the infringement involved Royal Mail leveraging its position as an unavoidable provider of wholesale network access. Royal Mail's access charges make up the considerable majority of input costs for operators using access to compete in the retail market.¹²⁰² By making entry and expansion significantly more difficult and reducing the financial incentive for potential rivals to Royal Mail's delivery service to engage in such entry, the introduction of the price differential made entry less likely to occur.¹²⁰³

- d) **Impact on competitors and third parties:** Ofcom has concluded that Royal Mail's conduct was reasonably likely to give rise to a competitive disadvantage and/or lead to a restriction of competition. As summarised directly above, the price differential made new entry and expansion significantly more difficult and reduced the financial incentive for access operators to compete with Royal Mail in the bulk mail delivery market. We have found our analysis is supported by developments observed in the market following the introduction of the price differential – namely that it was at least a material factor in the disruption of LDC's investment in Whistl and Whistl's reduction and then suspension of further roll-out.¹²⁰⁴ However, in assessing the impact of the infringement on competitors and third parties, we have taken into account the suspension and later withdrawal of the price differential (and the relevant CCNs), which meant that operators did not in fact pay higher charges. As explained in Section 7, sub-section I, we have found the infringement lasted at least until the suspension of the CCNs (i.e. at least 6 weeks). We have not found it necessary to conclude on whether the duration of the infringement lasted beyond the point of the suspension of the charges, although we consider that it was reasonably likely to have continuing effects extending beyond the suspension. These factual points are reflected in the relevant starting point figure identified below (and are also taken into account in our assessment of what a proportionate penalty would be in this case).
- e) **Impact on consumers:** Royal Mail's conduct, which was targeted at Royal Mail's first and only significant competitor in the bulk mail delivery market, reduced the likelihood of competition developing in the bulk mail delivery market. This is harmful for consumers as competition typically puts downward pressure on prices, encourages quality improvements, increases efficiency and incentivises investment in the development of new products and processes.¹²⁰⁵ Effective competition in the bulk mail delivery market would tend to increase the pressure on Royal Mail and potential rivals to reduce their costs and to pass the benefits of these cost reductions onto consumers in the retail market in the form of lower prices. Any benefit from greater innovation would also be expected to flow through to consumers of these services (see paragraph 7.169). In Section 8, we explain that Royal Mail presented no evidence to substantiate

¹²⁰¹ See paragraphs 7.24 to 7.26.

¹²⁰² See paragraph 2.32.

¹²⁰³ See Section 7, sub-section E.

¹²⁰⁴ See Section 7, sub-section F.

¹²⁰⁵ See paragraphs 7.167 to 7.171.

its claim of an efficiencies defence. We have identified no off-setting benefits to consumers from the price differential. It was not the result of more intensive competition that lowered prices for some consumers; rather, it involved charging higher prices to Royal Mail's customers that also competed with it for delivery.¹²⁰⁶

10.65 Ofcom has also taken into account the wider need to deter other undertakings from engaging in infringements of this nature in the future.

Royal Mail's representations

10.66 Royal Mail argues, with reference to the Opinion of Advocate General Wathelet in *Orange Polska*¹²⁰⁷, that "a proper assessment of capability to foreclose is essential to determine the seriousness of an infringement".¹²⁰⁸ It submits that there are a number of factors of relevance to assessing the seriousness of the infringement in this regard, and which are said to show that it would be wrong to treat Royal Mail's conduct as one of the "most serious" infringements of competition law, namely:

- a) the fact that the prices contained in the CCNs were never charged or paid; they were suspended such that the price differential was not put into operation and were ultimately withdrawn and therefore never entered into effect;¹²⁰⁹
- b) as a result of the suspension and withdrawal of the CCNs, the conduct of issuing the price differential did not have any actual effects on competition or cause injury to competition or consumers;¹²¹⁰
- c) Royal Mail's analysis in the form of a price/cost test shows that the proposed changes, including the price differential, would not have foreclosed an equally efficient competitor and therefore would not be capable of having anti-competitive effects;¹²¹¹
- d) the infringement was of short duration (see in this regard Royal Mail's arguments on duration at paragraphs 10.97 to 10.99 below);¹²¹²
- e) the infringement was not widespread, based on a proper analysis of the turnover affected (see in this regard Royal Mail's arguments on the relevant turnover at paragraphs 10.75 to 10.78 below);¹²¹³ and

¹²⁰⁶ The evidence set out in Section 3 clearly shows that the price differential operated as an increase to APP2 and ZPP3 in addition to the annual inflation related price increases that Royal Mail applied to all access products. This is reflected in the fact that suspension of the price differential resulted in a decrease to APP2/ZPP3 price and not an increase to NPP1 prices.

¹²⁰⁷ Case C-123/16 P *Orange Polska SA v European Commission*, Opinion of Advocate General Wathelet delivered on 21 February 2018. We note that after Royal Mail submitted its representations on the Draft Penalty Statement, on 25 July 2018, the CJEU handed down its judgment in this case, which did not follow the Advocate General's Opinion, and dismissed the appeal.

¹²⁰⁸ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 34, paragraph 6.9. (RM2655)

¹²⁰⁹ *Ibid.*, pages 35 to 36, paragraphs 6.11 to 6.18. (RM2655)

¹²¹⁰ *Ibid.*, pages 36 to 37, paragraphs 6.19 to 6.28. (RM2655)

¹²¹¹ *Ibid.*, page 37, paragraph 6.29. (RM2655)

¹²¹² *Ibid.*, pages 37 to 38, paragraphs 6.30 to 6.31. (RM2655)

¹²¹³ *Ibid.*, page 38, paragraphs 6.32 to 6.33. (RM2655)

- f) the Penalties Guidance states that a starting point towards the upper end of the 0-30% range will be used for the most serious abuses of a dominant position, and, having regard to the approach to penalties taken in other cases and the “*novelty of Ofcom’s case*”, the conduct in question cannot be said to be a “*very serious infringement*”.¹²¹⁴

Our assessment

10.67 We have addressed:

- a) Royal Mail’s submissions on the fact that the charges in the CCNs were never paid and were suspended, as summarised in points (a) to (b) above, at paragraphs 7.203 to 7.228 of this decision. To the extent relevant, we have also taken account of the fact that the price differential was suspended and later withdrawn in arriving at our conclusions on seriousness (see below) and in assessing what a proportionate penalty would be on the facts of this case;
- b) Royal Mail’s submissions on whether there is a need for a price/cost test, as summarised in point (c) above, at paragraphs 7.182 to 7.202 of this decision;
- c) Royal Mail’s submissions on duration, summarised at point (d), in our conclusion on duration in Section 7, sub-section I.; and
- d) the claim that our conclusions in this case are ‘novel’ at paragraphs 10.16 to 10.26. We have also considered the examples of previous decisions cited by Royal Mail in its response to Ofcom’s Draft Penalty Statement¹²¹⁵ and the conclusions reached in those cases on the appropriate starting point and/or overall level of the penalty.¹²¹⁶ However, we have set out below the reasons for our conclusion on seriousness by reference to the facts of this particular case and in accordance with the relevant guidance.

Ofcom’s conclusions on seriousness

10.68 We note that the CMA’s Penalties Guidance (introduced on 18 April 2018) indicates that a starting point of 21% or above is generally most likely to be appropriate for the “*most serious types of infringement*”, which are “*inherently likely to have a particularly serious exploitative or exclusionary effect, such as excessive and predatory pricing*”, while a starting point between 10% and 20% is more likely to be appropriate for infringements involving “*conduct which is less likely to be inherently harmful*”.

10.69 Based on our assessment of the nature of the infringement outlined above, we consider that the infringement is a serious infringement of competition law and that it is necessary

¹²¹⁴ Ibid, page 38, paragraphs 6.34 to 6.42. (RM2655)

¹²¹⁵ Ibid, pages 38 to 39, paragraphs 6.37 to 6.42. (RM2655)

¹²¹⁶ The CAT has recognised that: “*other than in matters of legal principle, there is limited precedent value in other decisions relating to penalties*”. *Kier Group v OFT* [2011] CAT 3, paragraph 116

to select a starting point that appropriately reflects the seriousness of the infringement. In reaching this view, we have in particular had regard to the following:

- a) we have found that the conduct reflected a deliberate strategy on the part of Royal Mail, approved by its senior management, to limit competition from its first and only significant competitor in the bulk mail delivery market, Whistl (as explained in detail in Section 4, sub-section B and Section 7, sub-section D);
- b) we have had regard to the potential for the price differential to harm competition given the particular factual circumstances of the bulk mail delivery market, which meant that competition in bulk mail delivery was vulnerable to exclusionary conduct on the part of Royal Mail (as explained in Section 7, sub-section B);
- c) for the reasons explained in Section 7, sub-section E, we consider that the price differential was reasonably likely to distort competition, giving rise to a harmful impact on consumers;
- d) we have found that the conduct was a materially contributing factor to the disruption of LDC's investment in Whistl and Whistl's decision to reduce and then suspend further roll out of its direct delivery operations (see Section 7, sub-section F); and
- e) finally, we have also taken account of the fact that the CCNs introducing the price differential were suspended after 6 weeks.

10.70 Having regard to all the above factors, while we consider the infringement to be serious, we do not consider the introduction of the price differential to be an example of the “*most serious*” type of infringement which an undertaking can engage in. Thus, we do not adopt a starting point of 21% or above. Instead, in the light of the particular facts of this case, we consider that it is appropriate to consider a penalty within the 10-20% range.

10.71 Taking all the factors above into account in the round, we consider that a starting point of 20%, at the top end of the 10-20% range, is appropriate.

Determination of relevant turnover

10.72 The Penalties Guidance defines the relevant turnover for the purposes of step one as the turnover of the undertaking in the relevant product market and relevant geographic market affected by the infringement in the undertaking's last business year (which is the financial year preceding the date when the infringement ended).¹²¹⁷ This is based on the relevant turnover as set out in an undertaking's audited accounts; however, in certain exceptional circumstances it may be appropriate to use a different figure.¹²¹⁸ Relevant

¹²¹⁷ *Penalties Guidance*, page 10, paragraph 2.11.

¹²¹⁸ *Ibid.*, page 1, paragraph 2.12. This refers to *Eden Brown Ltd and others v Office of Fair Trading* [2011] CAT 8 (the *Construction Recruitment Forum* judgment), paragraphs 44 to 59. We do not consider any such exceptional circumstances apply in this case.

turnover is calculated after the deduction of sales rebates, value added tax and other taxes directly related to turnover.¹²¹⁹

- 10.73 Using relevant turnover (i.e. the part of the turnover which derives from the goods or services that are the subject of the infringement) is generally intended to reflect the scale of a party's activities in the relevant market under investigation and, accordingly, to act as a proxy to reflect the potential scale and impact of the infringing activity on a given market.¹²²⁰
- 10.74 The assessment of turnover for the purpose of calculating the starting point for a penalty is not limited to turnover associated with those sales which are (and can be demonstrated to be) directly affected by the infringement, but can also encompass indirect effects beyond the specific part of the market to which the infringement applies.¹²²¹

Royal Mail's representations

- 10.75 Royal Mail argues that, if Ofcom considers relevant turnover on the basis of a UK-wide market for bulk mail delivery, Ofcom would be adopting an incorrectly broad approach to determining relevant turnover.¹²²² Royal Mail refers to a report prepared by its (current) economic advisers, Compass Lexecon, which argued that, in terms of the relevant product market:

"i. Relevant turnover is overstated in the product dimension, because it includes access revenues from faster downstream services which Whistl was not in a position to contest, and which were therefore unaffected by the infringement.

ii. In particular, the revenues identified by Ofcom include Royal Mail's access revenues associated with Whistl's Premier bulk mail services. This product guaranteed delivery within two days of posting (D+2, where D is the date of collection from the customer). However, Whistl could not offer a D+2 delivery service even in those areas in which it had (or would have) rolled out its own delivery network, as Whistl only delivered three days per week. Accordingly, Whistl Premier volumes were unaffected by the alleged infringement.

iii. In addition, Ofcom has included downstream revenues associated with premier-type demand (supplied by operators other than Whistl upstream and Royal Mail

¹²¹⁹ *Penalties Guidance*, page 10, paragraph 2.11, footnote 25.

¹²²⁰ See for example *Eden Brown* [2011] CAT 8, paragraphs 43-44 and 55. This is consistent with the approach taken by the European Commission (which has regard to the "value of...sales of goods or services to which the infringement directly or indirectly relates in the relevant geographic area within the EEA" in accordance with its Fining Guidelines) and recognised by the EU Courts, for example, Case C-101/15 *Pilkington*, paragraphs 17-19; Case C-227/14 P *LG Display v Commission*, paras. 50-53; Joined Cases 100/80 to 103/80 *Musique diffusion française and Others v Commission* [1983] ECR 1825, paragraph 121.

¹²²¹ See, for example, *Umbro* [2005] CAT 22, paragraph 116: "the OFT is entitled to take into account not only the turnover in the products or markets directly affected by the infringement, but also the turnover in neighbouring products or markets which may reasonably be considered to have been "affected by" the infringement, for example as to the prices charged".

¹²²² Royal Mail, *Royal Mail, Response to draft penalty statement*, 8 March 2018, pages 42 to 43, paragraphs 6.53 to 6.57. (RM2655)

downstream or by Royal Mail end-to-end), which Whistl would also have not been in a position to compete for downstream, and which were therefore also unaffected by the alleged infringement.

iv. A product market including these volumes, although potentially correctly defined as a market, fails to proxy the potential impact of the alleged infringement, and overstates that impact. I therefore consider it is more appropriate to make a simple adjustment to reduce the relevant turnover in respect of premier-type demand. The adjusted figure then fulfils its purpose of acting as a proxy to reflect the potential impact in the product dimension."¹²²³

10.76 According to Compass Lexecon's report, the suggested adjustment to remove D+2 volumes would mean that 88% of the market would be affected by the infringement.¹²²⁴

10.77 Compass Lexecon also argued that the relevant geographic markets are local and relevant turnover should be calculated on the basis only of those local markets which were contestable:

"i. Relevant turnover is overstated in the geographic dimension, because it includes access revenues from local delivery markets that were not affected by the alleged infringement, since those markets would not have been contested by Whistl.

ii. As a starting point, I agree with Ofcom that formal economic tests of market definition imply there are narrow (i.e., local) delivery markets. It also seems to be common cause with Ofcom that some of those local markets are contestable, and others are not.

iii. However, I disagree with Ofcom that – in circumstances where markets are localised and only some are contestable – it is appropriate to proceed as if there is a single UK-wide geographic market on the basis that the local markets are sufficiently similar to each other. On the contrary, local markets are not similar to each other, not least on the grounds that some would have been contested by Whistl and others would not have been, on Ofcom's theories of harm.

iv. The correct approach to determining relevant turnover is to only include those local markets that would have been affected by the announcement of the price differential on Ofcom's theories of harm.

v. In this report, I set out a number of approaches for identifying those markets, taking into account those local markets Whistl had entered or was considering entering, and conclude that the most reasonable assumption is that local markets comprising 20% of downstream volumes would have been affected."¹²²⁵

¹²²³ Compass Lexecon, *Assessment of the relevant turnover for penalty calculation*, 8 March 2018, pages 2 to 3, paragraph 1.10(a). (RM2654)

¹²²⁴ *Ibid.*, paragraph 3.21. (RM2654) Its adjusted turnover figure was [§<] the pre-adjustment figure was [§<].

¹²²⁵ *Ibid.*, pages 3 to 4, paragraph 1.10(b). (RM2654)

10.78 Royal Mail submitted that Ofcom should restrict relevant turnover to products and geographic areas affected by the infringement, as identified by Compass Lexecon, even if Ofcom defined a broader product and geographic market (i.e. the market for bulk mail delivery in the UK) for the purposes of assessing dominance.¹²²⁶ According to Compass Lexecon, adjusting the relevant turnover calculation in this way would result in a relevant turnover of [X], or [X] in combination with the product market adjustment.¹²²⁷

Our assessment of relevant turnover

10.79 Consistent with our statutory obligations to have regard to the Penalties Guidance, Ofcom has determined relevant turnover as the turnover of Royal Mail in the relevant product market and relevant geographic market affected by the infringement.

10.80 The Court of Appeal has held that: “*the market which is taken for calculation of the turnover relevant for Step 1 on a penalty assessment may properly be assessed on a broad view of the particular trade which has been affected by the proved infringement, rather than by a relatively exact application of principles that would be relevant for a formal analysis, such as substitutability or, on the other hand, by limiting the turnover in question to sales of the very products or services which were the direct subject of the price-fixing arrangement or other anti-competitive practice*”.¹²²⁸ It is therefore not necessary for the purposes of assessing a penalty to be definitive as to the precise scope of the relevant products or geographic areas which were directly affected by the infringement.¹²²⁹

10.81 Consistent with this case law, it is clear that “relevant turnover” is just the starting point for calculating a financial penalty and is only one of the relevant factors in determining an overall appropriate penalty. The other factors that Ofcom has to consider, as outlined in the Penalties Guidance and discussed below, are just as important for ensuring that the overall amount of the penalty is appropriate to reflect the seriousness of the infringement and has adequate deterrent effect, as well as being proportionate and not excessive.

10.82 Royal Mail argued that adopting the same product and geographic markets for the purposes of assessing relevant turnover in this case would erroneously broaden the scope beyond the products and areas “affected” by the infringement. We do not agree that it would be appropriate for us to depart from the market definition we have adopted in Section 6 on the facts of this case.¹²³⁰

¹²²⁶ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 43, paragraph 6.57. (RM2655)

¹²²⁷ Compass Lexecon, *Assessment of the relevant turnover for penalty calculation*, 8 March 2018, pages 2 to 3, paragraph 1.11. (RM2654)

¹²²⁸ *Argos Ltd v OFT* [2006] EWCA Civ 1318, paragraph 173.

¹²²⁹ The context for the *Argos* case was an infringement of the Chapter I prohibition, where there was no obligation for the OFT to carry out a formal market analysis for the purposes of finding an abuse. However, we consider this general point applies with all the more force in a Chapter II/Article 102 case where a formal market definition analysis has been carried out and the competition authority considers it to be appropriate to adopt this market definition as the starting point for assessing the financial penalty.

¹²³⁰ As set out in paragraph 6.2, the product market is the delivery component of bulk mail services associated with D+2 (or later) services for letters and large letters.

- 10.83 We consider that, in its submissions, Royal Mail adopts too narrow an approach to identifying the products and areas which were likely to be “affected” by its conduct.
- 10.84 The impacts that may flow from Royal Mail’s conduct, relative to the counterfactual where the price differential was not introduced, include the following:¹²³¹
- a) Deterring entry by a scale bulk mail delivery operator removes a source of downward pressure on the wholesale access prices that Royal Mail was able to charge, and on the related retail prices charged to bulk mail customers. Given that most wholesale prices are currently set on a nationwide basis, the loss of price pressure may have ‘spilled over’ into areas where entry has not occurred.
 - b) Deterring entry by a scale bulk mail delivery operator is also likely to result in fewer incentives for innovation and efficiency at the wholesale and retail levels. This detrimental impact may ‘spill over’ into other areas. For example, innovative ideas or more efficient operations and processes might be deployed nationwide or for other services (rather than just bulk mail).
 - c) If an operator was required to pay the price differential because it expanded beyond a small number of SSCs, such that NPP1 became unavailable in practice and so the operator had to rely on APP2/ZPP3, it would have to pay significantly increased access charges for *all* of the mail sent over Royal Mail’s network.
- 10.85 Royal Mail’s approach effectively disregards many of these impacts:
- a) On the product market, even if some bulk mail customers prefer a D+2 service (i.e. what Royal Mail term a “premier-type” product) to a D+3 service, these products may be substitutable.¹²³² Therefore, the presence of an operator that offered D+3 delivery could constrain the prices of D+2 services. In addition, even if there were inframarginal mail that would be highly unlikely to switch to an operator that offered D+3 delivery, prices could be constrained by the potential for marginal D+2 mail to switch (particularly if it would be difficult for Royal Mail to identify that inframarginal mail).
 - b) On the geographic market, Royal Mail disregards the downward pressure a competitor in bulk mail delivery would have on Royal Mail’s national wholesale and retail prices, and on its incentive to innovate and improve efficiency nationwide.¹²³³
 - c) On both the product and geographic market, the price differential applied to all bulk mail on a nationwide basis.
- 10.86 Moreover, even if we were of the view that the effects of end-to-end competition would only be felt in “contestable” areas (which is not the case), we disagree with the way in which Royal Mail’s advisers have identified such areas.¹²³⁴ Royal Mail’s advisers argued that

¹²³¹ Some of these effects will be stronger and/or more direct and/or occur sooner than others.

¹²³² While Compass Lexecon asserts that some bulk mail customers would not be willing to accept one day slower delivery in return for a lower price, it presented no evidence to support this claim.

¹²³³ In paragraphs 7.168 to 7.169 we explain these ‘spill over’ effects.

¹²³⁴ As described in paragraph 10.78, this was the larger of the adjustments to relevant turnover proposed by Royal Mail’s advisers.

the affected geographic area should be revised downwards to reflect uncertainty about the end point of Whistl's roll out, the impact of other changes which would reduce Whistl's roll out (e.g. the zonal tilt) and Whistl's "*historic underperformance*". They argued that a proportion of 20% is a reasonable estimate of the affected geographic market.

10.87 For the following reasons, we are of the view that 20% is a significant underestimate of the geographic area that could have been affected by Whistl's expansion into bulk mail delivery:

- a) **Full extent of Whistl's roll out:** Royal Mail's advisers characterise Whistl's "*maximum planned rollout*" as being either 42% or 30% of UK postcodes. However, this approach ignores the scope for further expansion of Whistl's delivery operations. For example, Whistl identified that it could potentially roll out to 68% of postcodes.¹²³⁵ This is consistent with Royal Mail's statement that its own "*analysis shows that around 70% of the addressed letters market by volume is contestable under [Whistl's] current business model.*"¹²³⁶ The diagram presented by Royal Mail's advisers, which ranks SSCs in order of average cost of delivery, shows that unit costs increase gradually, without any clear upward jumps, before costs begin to increase more sharply at around the 63rd SSC (out of a total of 83).¹²³⁷
- b) **Relevant time horizon:** Royal Mail's advisers consider it is more reasonable to look at roll out over only two and three years because "*maximum rollout estimates are highly speculative and could not be considered reasonably foreseeable.*"¹²³⁸ We agree that there is uncertainty around the maximum extent of Whistl's roll out – in practice it could have proved higher or lower than expected. However, we do not consider that applying an assumption of no further roll out after a certain point to be an appropriate way to adjust for uncertainty. It is likely to lead to an underestimate of the likely impact of the infringing conduct.
- c) **Use of Whistl's January 2015 business plan:** Royal Mail's advisers present scenarios based on Whistl's business plan from January 2015. They argue that this captures an important aspect of the counterfactual, which is that changes to zonal prices would have affected Whistl's business plan absent the price differential. However, as Royal Mail's advisers acknowledge, the revised forecast also takes into account the effect of the delay to Whistl's roll out following the introduction of the price differential.¹²³⁹ This means that Whistl's 2015 business plan is not a good basis on which to assess what Whistl's roll-out would have been had the price differential not been introduced, since

¹²³⁵ Whistl, *Project Luke – Investment Memorandum*, May 2013, slide 52. (WH0709)

¹²³⁶ Royal Mail, *Direct Delivery: A Threat to the Universal Postal Service Regulatory Submission to Ofcom*, 20 June 2014, page 37. (PD0043)

¹²³⁷ Compass Lexecon, *Assessment of the relevant turnover for penalty calculation*, 8 March 2018, page 20, Figure 1. (RM2654)

¹²³⁸ *Ibid*, page 14, paragraph 4.26. (RM2654)

¹²³⁹ In particular, Royal Mail's advisers include scenarios based on expected roll out two or three years after the CCNs were issued.

the price differential materially contributed to the reduction and suspension of Whistl's roll out.

- d) **Whistl's "historic underperformance"**: Royal Mail's advisers assume that because Whistl had rolled out to fewer SSCs than it expected by the end of 2012 and 2013, it "could be expected to under-achieve on its forecast rollout by at least 40% going forward." They not only assume this for particular points in time, but also conclude that Whistl's final roll out would be 40% lower than it expected. However, we do not consider that the extent of delay in the early stages of Whistl's roll out would necessarily reflect the eventual final scale of Whistl's roll out. Therefore, we do not consider that it is appropriate to make an adjustment of this size on the basis of this evidence.

10.88 Thus, having considered Royal Mail's submissions, we do not consider that it would be appropriate for us to adopt a different basis for calculating relevant turnover to that which corresponds with the market definition we have adopted in this Decision. We have therefore calculated relevant turnover by reference to Royal Mail's revenue associated with bulk mail delivery for all D+2, or later than D+2, services in all parts of the UK.¹²⁴⁰

10.89 In any event, Royal Mail has argued the relevant turnover should be [X].¹²⁴¹ Even if this figure were appropriate (which is not the case for the reasons set out above), this would not have a material impact on the overall level of the penalty. Although the starting point for the penalty calculation would be reduced, as explained below, we are in any event applying a significant reduction at step four in order to ensure that the level of the penalty is proportionate and not excessive. Accordingly, it would be appropriate to decrease the proportionality reduction at step four if the starting point was lower. Therefore, the final penalty would still be very similar.¹²⁴²

The relevant financial year

10.90 As noted above, the Penalties Guidance indicates that the appropriate financial year to consider for this purpose is the full financial year preceding the date when the infringement ended. Royal Mail operates financial years of differing lengths, largely based on either a 52-week year (i.e. 364 days) or a 53-week year (i.e. 371 days). We have found the infringement started on 10 January 2014 and continued until at least 21 February 2014.

10.91 The last complete financial year preceding 21 February 2014 was the 2012 to 2013 financial year (the 53-week period ending on 31 March 2013). However, we consider that it

¹²⁴⁰ We consider this to be consistent with the judgment of the CAT in *Balmoral Tanks Limited v Competition and Markets Authority* [2017] CAT 23, paragraph 142 in which the CAT rejected the argument that the CMA had failed to take into account the fact that the infringement only involved two out of numerous different sizes of tanks, on the basis that turnover is that earned in the "relevant market" and there was no challenge to the CMA's finding that the relevant market was the one they used for the purposes of calculating relevant turnover.

¹²⁴¹ Compass Lexecon, *Assessment of the relevant turnover for penalty calculation*, 8 March 2018, page 4, paragraph 1.11. (RM2654)

¹²⁴² In particular, applying our 20% starting point to Royal Mail's [X] figure implies the penalty at the end of step one is [X]. This is greater than the final penalty we conclude is appropriate, namely £50 million.

would be appropriate in the circumstances of this case to calculate relevant turnover on the basis of the 2013 to 2014 financial year (the 53-week period ending on 30 March 2014) during which we have found the infringement took place. We consider that using this financial year would provide an accurate reflection of Royal Mail's real economic situation at the time of the infringement, compared to using the 2012-13 financial year which ended 9 months before the infringing conduct commenced.¹²⁴³ We do not consider that it would make a material difference to the calculation of the level of the financial penalty whether we use Royal Mail's turnover in the 2012-2013 financial year or the 2013-14 financial year. We note, however, that the figure for the latter year is lower (the relevant turnover for 2012-2013 would be [X]), compared to [X] for the 2013-14 financial year). In these circumstances, we have decided to use the 2013-14 financial year for the purposes of calculating relevant turnover.

10.92 Accordingly, Ofcom has determined the relevant turnover to be the sum of:

- a) Royal Mail's revenue for the provision of D+2 Access [X];¹²⁴⁴ and
- b) The delivery component only of Royal Mail's revenue associated with the provision of end-to-end bulk mail delivery services [X].¹²⁴⁵

10.93 Ofcom therefore considers that, for the purposes of calculating a penalty for the infringement, Royal Mail's relevant turnover was [X].

Conclusion

10.94 Applying a starting point of 20 per cent to Royal Mail's relevant turnover of [X] results in a figure of [X] at the end of step one.

10.95 For the reasons set out above, we consider that a starting point of 20% is appropriate to reflect the seriousness of the infringement. However, we recognise that the calculation of relevant turnover results in a high figure. In this case, the bulk mail delivery market is characterised by very high volumes, high costs (relative to turnover) and relatively low margins.¹²⁴⁶ Referring only to relevant turnover may therefore, in the circumstances of this case, mean that a penalty at the level of the figure reached at the end of step one could be

¹²⁴³ We note that in the CMA's decision in Galvanised steel tanks for water storage information exchange infringement, Case CE/9691/12, 19 December 2016, the CMA departed from the approach in the Penalties Guidance and decided to calculate relevant turnover on the basis of the 12-month period immediately preceding the infringement on the basis that this would give a more accurate reflection of Balmoral Tanks' economic situation at the time of the infringement (see paragraphs 5.16-5.22). This approach was upheld by the CAT in *Balmoral Tanks Limited v Competition and Markets Authority* [2017] CAT 23, paragraph 141.

¹²⁴⁴ See Royal Mail, *Annual Regulatory Financial Supporting Statements - Full Year 2014-15*, undated, page 16. (RM2626) This is product profitability statement 1. We use the restated 2013-14 figure from the 2014-15 report because the 2013-14 report does not provide an appropriate specification of D+2 Access revenue.

¹²⁴⁵ See Royal Mail, *Annual Regulatory Financial Supporting Statements - Full Year 2013-14*, undated, pages 17, 20 and 21. (RM2627) This relates to product profitability statements 3 [X], 6 [X] and 7 [X].

¹²⁴⁶ For example, Royal Mail reported (in its Regulatory Financial Statements to Ofcom) that in the financial year it made an operating profit of [X] from a total revenue of [X] in relation to its D+2 Access services (i.e. an operating profit of [X]). See Royal Mail, *Annual Regulatory Financial Supporting Statements - Full Year 2014-15*, undated, page 16. (RM2626) This is product profitability statement 1. We use the restated 2013-14 figure from the 2014-15 report because the 2013-14 report does not provide an appropriate specification of D+2 Access revenue and operating profit.

disproportionate and/or excessive. We address this in step four below when we consider the proportionality of the penalty.

Step two: adjustment for duration

10.96 The Penalties Guidance sets out that the starting point at step one may be increased to take account of duration. For infringements that last for more than one year, the proposed penalty may be multiplied to reflect the number of years of the infringement, with a part-year being rounded up to the nearest quarter year (although, in exceptional cases, a part-year may be rounded up to the nearest full year).¹²⁴⁷ The Penalties Guidance also states that where the total duration of an infringement is less than one year, duration is treated as a full year for the purposes of calculating the number of years of the infringement, except in exceptional circumstances where the starting point may be decreased.¹²⁴⁸

Royal Mail's representations

10.97 First, Royal Mail argues that anti-competitive conduct never took place because the discriminatory prices were never paid by its customers; that is, because the CCNs were suspended before the effective date on which there were to commence (which was 31 March 2014) and that they were later withdrawn.¹²⁴⁹

10.98 In the alternative, Royal Mail argues that either the conduct was a one-off act, which took place on 10 January 2014, or that any conduct ended on 21 February 2014, when the CCNs were automatically suspended under the terms of the Access Letters Contract because Ofcom opened an investigation.¹²⁵⁰

10.99 Royal Mail therefore submitted that the infringement was “*of an extremely short duration*” such that use of a duration multiplier of 0.25 would be appropriate.¹²⁵¹ Royal Mail suggests that an alternative approach would be to reflect the short duration of the infringement by reducing the starting point percentage and / or applying a significant further reduction at step four for proportionality.

Our assessment of duration

10.100 As set out at Section 7, sub-section I, Ofcom considers that the infringement started on 10 January 2014 – being the point at which Royal Mail took formal steps that were capable of achieving the desired outcome by issuing the CCNs – and continued until at least 21 February 2014, being the point at which the CCNs were suspended under the terms of the Access Letters Contract as a consequence of Ofcom opening an investigation. We have not found it necessary to reach a concluded view on whether the infringing conduct continued

¹²⁴⁷ Penalties Guidance, page 11, paragraph 2.16.

¹²⁴⁸ Ibid.

¹²⁴⁹ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 44 to 45, paragraphs 6.60 to 6.68. (RM2655)

¹²⁵⁰ Ibid., pages 45 to 46, paragraphs 6.67 to 6.78. (RM2655)

¹²⁵¹ Ibid., pages 46 to 47, paragraphs 6.79 to 6.81. (RM2655)

beyond the suspension – e.g. to the point at which Royal Mail withdrew the CCNs in March 2015.

- 10.101 However, as we have explained in paragraph 7.271(c), the disruption to LDC’s investment in Whistl and Whistl’s suspension of its roll out were reasonably likely to have continuing effects extending beyond the point at which the CCNs were suspended.
- 10.102 The duration of the infringement is therefore at least 6 weeks, although we have also found that there was the potential for continuing effects extending beyond the point at which the CCNs was suspended.

Conclusion

- 10.103 In line with the Penalties Guidance,¹²⁵² we consider that it is appropriate in this case to treat the duration as a full year for the purpose of calculating the number of years of the infringement (i.e. applying a multiplier of 1). We do not consider that there are exceptional circumstances in this case to justify a multiplier of less than 1. Royal Mail suspended the CCNs in accordance with the terms of the Access Letters Contract as a consequence of Ofcom opening its investigation, but this did not mean that the effects arising from the CCNs were incapable of extending beyond that point. Royal Mail maintained a public position during the period of the suspension that it considered the price differential to be lawful and that it intended to implement the price differential as soon as it could do so.¹²⁵³ Royal Mail did not ultimately withdraw the CCNs containing the price differential until 11 March 2015.
- 10.104 We have, however, taken account of the suspension of the CCNs after 6 weeks as a relevant factor when assessing the overall seriousness of the infringement at step one, as explained above. We also take it into account below in assessing what constitutes a proportionate penalty on the facts of this particular case.

Step three: adjustment for aggravating or mitigating factors

- 10.105 The Penalties Guidance sets out that the basic amount of the penalty at step two may be adjusted by increasing it where there are aggravating factors, or decreasing it where there are mitigating factors.¹²⁵⁴

Assessment of aggravating or mitigating factors

Aggravating factors

- 10.106 We do not consider that it is necessary to adjust the penalty at this step to take account of aggravating factors.

¹²⁵² Penalties Guidance, page 11, paragraph 2.16.

¹²⁵³ See paragraphs 4.204 to 4.207.

¹²⁵⁴ Penalties Guidance, pages 12-13, paragraphs 2.17-2.19.

Mitigating factors

- 10.107 Royal Mail argues that there were a number of mitigating factors which would justify a reduction in the penalty, namely:
- a) Royal Mail's genuine uncertainty as to whether the conduct was an infringement;¹²⁵⁵
 - b) the steps taken by Royal Mail to ensure compliance with competition law and to materially increase its engagement and consultation with access customers;¹²⁵⁶ and
 - c) Royal Mail's termination of the infringement as soon as Ofcom intervened.¹²⁵⁷
- 10.108 For the following reasons, we do not agree that the factors identified by Royal Mail justify a reduction in the penalty in this case.
- 10.109 As explained at paragraphs 10.16 to 10.50 above, we do not accept Royal Mail's characterisation of its conduct as an infringement is "*entirely novel*" or that Ofcom's finding of an infringement was not reasonably foreseeable, nor do we accept that Ofcom's own actions created regulatory uncertainty. We therefore do not consider that there are grounds for reducing the penalty as a result of any "*genuine uncertainty*" on the part of Royal Mail as to whether its conduct was an infringement.
- 10.110 We note that Royal Mail has explained that it has an "*unambiguous*" commitment to competition law compliance and has sought to strengthen its compliance programme since Ofcom's investigation commenced and we also note Royal Mail's submissions about the steps it has taken to increase its engagement and consultation with access customers. However, for the following reasons, we do not consider it to be appropriate to apply a reduction in the level of the penalty in respect of Royal Mail's compliance activities or its engagement and consultation with its access customers:
- a) We have carefully considered the evidence Royal Mail has provided relating to its compliance activities. Royal Mail is a large company with significant resources and a long history of being subject to, and having to demonstrate compliance with, obligations deriving from applicable regulation and from competition law. We would therefore expect a company in Royal Mail's position to have an extensive focus on compliance.
 - b) We have also explained at paragraphs 10.34 to 10.38 above why we do not consider that Royal Mail's conduct in this case demonstrates that it took all reasonable steps to comply with competition law.
 - c) We welcome the steps that Royal Mail has taken to increase its engagement and consultation with access customers, but we would in any event have expected Royal Mail to engage and consult with its customers in good faith.

¹²⁵⁵ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, page 44, paragraphs 6.90 to 6.94. (RM2655)

¹²⁵⁶ *Ibid.*, page 44, paragraphs 6.95 to 6.102 and Annexes 2 and 3. (RM2655)

¹²⁵⁷ *Ibid.*, page 44, paragraphs 6.103 to 6.104. (RM2655)

10.111 We have considered Royal Mail’s representations on duration of the infringement at paragraphs 10.97 to 10.104 above. We have found that the infringement continued until at least 21 February 2014, being the point at which the CCNs were suspended, and we have not found it necessary to reach a concluded view on whether the infringing conduct continued beyond the suspension. However, we note that Royal Mail did not withdraw the CCNs until 11 March 2015 and publicly maintained its intention to implement the prices in the interim.¹²⁵⁸ We also consider that the effects arising from the CCNs were reasonably likely to extend beyond the point of suspension.¹²⁵⁹ We therefore do not consider it to be appropriate to treat the suspension of the CCNs as a mitigating factor in this case, although we have, as explained above, taken it into account in assessing the seriousness of the infringement at step one, and as part of our assessment of proportionality at step four.

Conclusion

10.112 We have not applied any adjustments to the level of the penalty in respect of aggravating or mitigating factors.

Step four: specific deterrence and proportionality

10.113 The Penalties Guidance sets out that, as a fourth step, an assessment should be made as to whether the overall penalty proposed is appropriate in the round. In considering whether any adjustments should be made at this step for specific deterrence or proportionality, Ofcom will have regard to appropriate indicators of the size and financial position of the undertaking, as well as any other relevant circumstances of the case. In considering indicators of the undertaking’s size and financial position, Ofcom will consider indicators at the time the penalty would be imposed; however, Ofcom may also consider indicators from the time of the infringement.¹²⁶⁰ In terms of relevant indicators, the Penalties Guidance lists total turnover, profitability (including profits after tax), net assets and dividends, liquidity and industry margins, as well as three year averages for profits and turnover.¹²⁶¹

10.114 The Penalties Guidance also states that “[w]here necessary, the penalty reached at the end of steps 1 to 3 may be decreased to ensure that the level of penalty is not disproportionate or excessive.”¹²⁶² This assessment should “have regard to the undertaking’s size and financial position, the nature of the infringement, the role of the undertaking in the infringement and the impact of the undertaking’s infringing activity on competition.”¹²⁶³

10.115 Accordingly, in step four, Ofcom has considered, in the round, whether imposing a penalty at the level indicated at the end of steps one to three would be appropriate to deter the

¹²⁵⁸ See paragraphs 4.204 to 4.207.

¹²⁵⁹ See paragraph 7.271(c).

¹²⁶⁰ Penalties Guidance, page 14, paragraph 2.20.

¹²⁶¹ Ibid.

¹²⁶² Ibid., page 15, paragraph 2.24.

¹²⁶³ Ibid., page 15, paragraph 2.24.

infringing undertaking from breaching competition law and whether it would be either disproportionate or excessive.

- 10.116 As set out above, the figure reached at the end of steps one to three above is [X]. In determining this figure, we have used the relevant turnover of Royal Mail which is attributable to the market affected by the infringement. In this case, Royal Mail's conduct occurred across a large market with high turnover, potentially giving rise to substantial levels of harm to competition and ultimately consumers.
- 10.117 However, as explained above at paragraph 10.95, the bulk mail delivery market is also characterised by high costs and low margins, and considering turnover in isolation may therefore overstate the potential impact of the infringement and lead to a risk that the penalty, based on relevant turnover alone, could be disproportionate and/or excessive by reference to Royal Mail's size and financial position.¹²⁶⁴ For example, as noted above, a penalty of [X] amounts to a very high proportion of Royal Mail's group profit for the year in the financial year 2017-18 [X]¹²⁶⁵ and average profit after tax in the last three years [X].¹²⁶⁶
- 10.118 Having reviewed the absolute level of the penalty in the round, we consider that imposing a penalty of [X] in this case would be excessive and disproportionate. We therefore go on to consider what proportionate level of penalty would still achieve an appropriate deterrent effect reflecting the seriousness of the infringement.

Assessment of a proportionate penalty

Royal Mail's representations

- 10.119 Royal Mail emphasises the need to ensure the level of the penalty to be proportionate, consistent with Article 49(3) of the Charter of Fundamental Rights of the European Union and EU case law.¹²⁶⁷ It argues that, in assessing proportionality, Ofcom should have regard to Royal Mail's size and financial position, as well as its arguments relating to the seriousness of the infringement, novelty, suspension and withdrawal of the price differential and relevant turnover.¹²⁶⁸ It also argues that Ofcom's assessment should proceed on the basis that Royal Mail derived no financial gain from announcing the price differential and that Ofcom should carry out a proper assessment of the capability of its conduct to foreclose (per the Advocate General's Opinion in *Orange Polska*).¹²⁶⁹

¹²⁶⁴ Ibid., page 14, paragraph 2.20.

¹²⁶⁵ See Royal Mail, *Annual Report and Financial Statements 2017-18*, 17 May 2018, page 106 (Reported Profit for the year from continuing operations). (PD0071) Please note that this does not include the tax credit recorded in Royal Mail income statement.

¹²⁶⁶ Ibid., Royal Mail, *Annual Report and Financial Statements 2016-17*, 25 May 2017, page 94 (Reported Profit for the year from continuing operations). (RM2630) and Royal Mail, *Annual Report and Financial Statements 2015-16*, 3 June 2016, page 89 (Reported Profit for the year from continuing operations) (RM2629).

¹²⁶⁷ Royal Mail, Royal Mail, *Response to draft penalty statement*, 8 March 2018, pages 53 to 54, paragraphs 6.105 to 6.114. (RM2655)

¹²⁶⁸ Ibid., page 55, paragraphs 6.115 to 6.115. (RM2655)

¹²⁶⁹ Ibid., page 56, paragraphs 6.119 to 6.123. (RM2655)

Ofcom's assessment

- 10.120 In accordance with the Penalties Guidance, and having considered Royal Mail's representations, we have assessed, in the round and taking account of all relevant factors set out in the discussion of steps one to three above, the level of penalty that would be appropriate and proportionate in the circumstances of this case. In doing so, we have taken into account, among other things, the nature and seriousness of the infringement as discussed in step one above, as well as our conclusions on duration and the fact the price differential's implementation was suspended.
- 10.121 In assessing the appropriate level of the penalty, we have considered Royal Mail's profit after tax, average profit after tax and its dividends, which we consider are appropriate indicators by which to assess the level of penalty that would achieve an appropriate deterrent effect on the undertaking concerned. Royal Mail had a reported profit for the year of £212 million¹²⁷⁰ in the financial year 2017-18, and an average of £236 million¹²⁷¹ in the last three years. It paid dividends of £231 million¹²⁷² in the financial year 2017-18 and an average of £227 million¹²⁷³ in the last three years.
- 10.122 Having carefully considered these indicators, we consider that it is appropriate to apply a reduction to the figure reached at end of step one, resulting in a penalty of £50 million. This equates to approximately 24% of profit after tax and 22% of dividends (both in relation to the financial year 2017-18).¹²⁷⁴
- 10.123 We have also considered the penalty against other aspects of Royal Mail's size and financial position (in addition to impact on profit after tax and dividends). This analysis shows that:
- a) A penalty of £50 million amounts to:
 - i) 1% of Royal Mail's net assets in the financial year 2017-18,¹²⁷⁵ and 1% of its average net assets in the last three years;¹²⁷⁶

¹²⁷⁰ See Royal Mail, *Annual Report and Financial Statements 2017-18*, 17 May 2018, page 106 (Reported Profit for the year from continuing operations). (PD0071) Please note that this does not include the tax credit recorded in Royal Mail income statement.

¹²⁷¹ See *ibid.*, Royal Mail, *Annual Report and Financial Statements 2016-17*, 25 May 2017, page 94 (Reported Profit for the year from continuing operations) (RM2630) and Royal Mail, *Annual Report and Financial Statements 2015-16*, 3 June 2016, page 89 (Reported Profit for the year from continuing operations) (RM2629).

¹²⁷² Royal Mail, *Annual Report and Financial Statements 2017-18*, 17 May 2018, page 109 (the sum of dividends paid to equity holders of the parent company and dividends paid to non-controlling interests). (PD0071)

¹²⁷³ *Ibid.*, Royal Mail, *Annual Report and Financial Statements 2016-17*, 25 May 2017, page 97 (the sum of dividends paid to equity holders of the parent company and dividends paid to non-controlling interests) (RM2630) and Royal Mail, *Annual Report and Financial Statements 2015-16*, 3 June 2016, page 92 (the sum of dividends paid to equity holders of the parent company and dividends paid to non-controlling interests) (RM2629).

¹²⁷⁴ In relation to the average figures over the last three years, the figure equates to 21% of profit after tax and 22% of dividends.

¹²⁷⁵ See Royal Mail, *Annual Report and Financial Statements 2017-18*, 17 May 2018, page 108 (Net assets at 25 March 2018). (PD0071)

¹²⁷⁶ See *ibid.* Royal Mail, *Annual Report and Financial Statements 2016-17*, 25 May 2017, page 96 (Net assets at 26 March 2017) (RM2630) and Royal Mail, *Annual Report and Financial Statements 2015-16*, 3 June 2016, page 91 (Net assets at 27 March 2016). (RM2629)

- ii) 0.5% of Royal Mail's group turnover in the financial year 2016-17,¹²⁷⁷ and 0.5% of its average group turnover in the last three years.¹²⁷⁸
- b) A penalty of £50 million is highly unlikely, even under conservative assumptions, to affect Royal Mail's credit rating or its ability to comply with its debt covenants.¹²⁷⁹ The penalty is a one-off financial impact that does not affect Royal Mail's underlying profitability.
- 10.124 Taking account of all of the above factors in the round, Ofcom considers a penalty of £50 million for this serious infringement of competition law appropriately and proportionately reflects the need to deter Royal Mail and others from infringing competition law in the future, without being excessive.
- 10.125 At the same time, we consider that imposing a penalty of £50 million would have a deterrent effect given both its absolute level and the reputational effect on Royal Mail of such a penalty.
- 10.126 As a matter of its regulatory functions, Ofcom must carry out its functions in relation to postal services in a way that it considers will secure the provision of a universal postal service. In performing that duty Ofcom is required to have regard to the need for the provision of a universal postal service to be financially sustainable, and we therefore monitor the financial sustainability of the universal postal service on a regular, ongoing basis.¹²⁸⁰ This duty is expressly disapplied where we are carrying out our duties under the Act.¹²⁸¹ However, for completeness we have considered whether this financial penalty is consistent with Royal Mail's ability to provide the universal service on a financially sustainable basis. Having regard to our regulatory approach to assessing the financial sustainability of the universal postal service,¹²⁸² we do not consider that the financial penalty will undermine the long-term financial sustainability of the universal service in view of Royal Mail's overall and current financial circumstances and the expected impact of the penalty on Royal Mail as described above.

¹²⁷⁷ See Royal Mail, *Annual Report and Financial Statements 2017-18*, 17 May 2018, page 106 (Revenue). (PD0071)

¹²⁷⁸ See *ibid.*, Royal Mail, *Annual Report and Financial Statements 2016-17*, 25 May 2017, page 94 (Revenue) (RM2630) and Royal Mail, *Annual Report and Financial Statements 2015-16*, 3 June 2016, page 89 (Revenue). (RM2629)

¹²⁷⁹ Specifically, we have considered the impact on Royal Mail's FFO/Net debt ratio and its Leverage Ratio (Net debt/EBITDA).

¹²⁸⁰ See by way of example Ofcom's *Annual monitoring update on the postal market – Financial year 2016-17*, 23 November 2017, Section 7, which sets out Ofcom's most recent analysis of the financial performance of the Reported Business (i.e. the part of Royal Mail's business which provides the universal postal service- it is part of Royal Mail's UK Parcels, International and Letters (UKPIL) business unit but excludes the activities and products of Parcelforce International and Royal Mail Estates Ltd).

¹²⁸¹ See section 371 (11) of the Communications Act 2003. By way of exception to this statement section 371(12) provides that Ofcom may nevertheless have regard to any of the matters in respect of which a duty is imposed by section 3(1) to (4) of the Communications Act 2003 or section 29 of the Postal Services Act if it is a matter to which the CMA is entitled to have regard in the carrying out of those functions.

¹²⁸² In assessing financial sustainability, we consider an EBIT margin range for the Reported Business of 5-10% and also monitor short to long term financial health metrics and indicators at the Relevant Group level, including cash flow, credit rating, funds from operations/net debt, net debt/EBITDA and EBITDA/interest. See Ofcom's *Statement Review of the Regulation of Royal Mail*, 1 March 2017, paragraphs 3.45 to 3.50 and 3.54 to 3.63 (PD0067) and Ofcom's Consultation, *Review of the Regulation of Royal Mail – Annexes 5 to 11*, 25 May 2016, paragraphs A6.65 to A6.59. (PD0068)

Conclusion

10.127 Ofcom considers that it is appropriate to reduce the penalty reached at the end of step one to £50 million.

Step five: adjustment if the penalty exceeds the statutory maximum and to avoid double jeopardy

10.128 Section 36 of the Act provides that no penalty may exceed ten per cent of an undertaking's worldwide turnover in the last business year preceding the date on which the infringement decision is taken.¹²⁸³

10.129 Ofcom has assessed the penalty against the threshold set out above and this assessment has not necessitated any reduction to the penalty. Ofcom is not aware that any adjustment needs to be made to the level of the penalty to avoid double jeopardy.

Step six: adjustment for settlement discounts

10.130 In this case and having regard to the Penalties Guidance, Ofcom's approach would be to apply reductions to the penalty in circumstances where an undertaking makes a full and unequivocal admission of liability and agrees to a streamlined administrative procedure.¹²⁸⁴

10.131 This case has not been settled and, accordingly, no adjustment is appropriate at this stage.

Final penalty

10.132 Having had regard to the Penalties Guidance and in light of all of the circumstances of the case, Ofcom has decided to impose a financial penalty of £50 million.

¹²⁸³ Calculated in accordance with The Competition Act 1998 (Determination of Turnover for Penalties) Order 2000 (SI 2000/309) (as amended by The Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2004 (SI 2004/1259)).

¹²⁸⁴ Penalties Guidance, page 16, paragraph 2.30.

A1. Glossary and defined terms

In this Decision, words and expressions have the following meanings:

“Access Letters Contract” or “ALC”	The terms and conditions offered by Royal Mail for the provision of D+2 Access.
“Access operator”	Postal operators that have their own upstream operational capability (including sorting) but who procure downstream capability from Royal Mail, such as UK Mail and Whistl.
“APP2”	Averaged Price Plan Two (Zones), previously known as National Price Plan 2 (Zones) or NPP2; in 2014 this was one of the three price plans offered by Royal Mail under the ALC. This price plan was used by Whistl.
“Bulk mail”	High volume mailings of often similar or identical mailing items being sent to addresses across the whole of UK or at least a substantial part of it.
“the Act”	The Competition Act 1998 c.41.
“CAT”	The Competition Appeal Tribunal.
“CJEU”	Court of Justice of the European Union.
“CMA”	The Competition and Market Authority.
“Compass Lexecon”	Compass Lexecon LLP, Royal Mail’s economic advisors.
“Contract Change Notices” or “CCNs”	Documents published by Royal Mail which give notices to access operators of impending changes to the terms and conditions of D+2 Access.
“D+2 Access”	Access provided by Royal Mail to its postal network at the Inward Mail Centre enabling access operators to offer D+2 and later than D+2 Letters and Large Letters retail services.
“Direct delivery operator”	A term used by Royal Mail to refer to postal operators who deliver their own letters (rather than using Royal Mail’s access services).
“End-to-end operator”	A term that refers to postal operators who deliver their own letters (rather than, or in addition to, using Royal Mail’s access services).

“FTI Consulting”	FTI Consulting LLP, Royal Mail’s economic advisors.
“IMC”	Royal Mail’s Inward Mail Centres.
“Letter”	A postal packet with a maximum size of 240mm x 165mm, a maximum thickness of 5mm and a maximum weight of 100g.
“Large letter”	A postal packet with a maximum size of 353mm x 250mm, a maximum thickness of 25mm and a maximum weight of 750g (and which is larger than a ‘letter’).
“LDC”	LDC Managers Ltd, a private equity firm and subsidiary of Lloyds Banking Group.
“MAC Clause” or “MAE Condition”	Certain clauses (material adverse change or material adverse effect) of the Share Sale and Purchase Agreement signed by Whistl, PostNL and LDC in December 2013.
“March 2012 Statement”	The Statement <i>Securing the Universal Postal Service – Decision on the new regulatory framework</i> published by Ofcom on 27 March 2012.
“NPP1”	National Price Plan One (SSCs); in 2014 this was one of the three price plans offered by Royal Mail under the ALC. This price plan was used by UK Mail.
“Oxera”	Oxera Consulting LLP; Royal Mail’s external economic advisors during the development of the price differential (and other price changes) during 2013.
“Penalties Guidance”	Guidance issued by the CMA on 18 April 2018 under section 38(1) of the Competition Act 1998: <i>CMA’s guidance as to the appropriate amount of a penalty.</i>
“Postcomm”	The Postal Services Commission, the former UK postal regulator, whose regulatory functions were transferred to Ofcom in October 2011.
“PostNL”	PostNL N.V., a postal service companies operating in the Netherlands and other parts of Europe. Whistl was a wholly owned subsidiary of PostNL until July 2015.
“Response to draft penalty statement”	Royal Mail’s written response of 8 March 2018 to the Draft Penalty Statement issued to Royal Mail on 8 February 2018.
“Response to letter of facts”	Royal Mail’s written response of 24 November 2017 to the letter of facts issued to Royal Mail on 12 October 2017.

“Response to Statement of Objections”	Royal Mail’s written response of 28 November 2015 to the Statement of Objections issued to Royal Mail on 2 October 2015.
“Royal Mail”	Means Royal Mail plc, a public limited company, and/or its wholly owned subsidiary Royal Mail Group Limited.
“SSC”	Standard Selection Codes; aggregations of postcodes used by Royal Mail to structure its delivery network.
“TFEU”	Treaty on the Functioning of the European Union
“TNT”	TNT Post UK Limited, the name of Whistl prior to 15 September 2014.
“UK Mail”	UK Mail Limited, one the largest access operators in the UK.
“Universal Service”	The provision of basic postal services to the UK population, as required under the Postal Services Act 2011 and as specified in the Postal Services (Universal Postal Service) Order 2012 (as amended), including delivery to any address throughout the UK six times per week, and a sufficient network of letter boxes and post offices or postal partner offices.
“USO”	The Universal Service Obligation, which are the requirements imposed on Royal Mail to provide the Universal Service under regulatory conditions set in accordance with section 36 of the Postal Services Act 2011 .
“USP Access condition”	A condition imposed on Royal Mail under the Postal Services Act 2011 which requires it to provide D+2 Access.
“Whistl”	Whistl UK Limited (formerly TNT Post UK Ltd); a postal services company operating as an access operator and, between 2012 and 2015, a letters delivery company.
“ZPP3”	Zonal Price Plan; in 2014 this was one of the three price plans offered by Royal Mail under the ALC.

A2. Arbitrage between price plans

- A2.1 In this section, we set out Royal Mail’s approach to dealing with concerns about arbitrage between price plans – that is, concerns that an operator could transfer volumes between NPP1, or APP2, and ZPP3 to achieve a lower average price than would be possible by using only NPP1 or APP2. Such arbitrage involves selectively streaming items with a lower zonal price (compared to the national price) to a ZPP3 contract while remaining within NPP1 or APP2 tolerances.
- A2.2 We refer to this material in Section 7 as part of our assessment of Royal Mail’s representations that arbitrage was a strategy end-to-end competitors such as Whistl could have employed to minimise any effect of the price differential.

Access operators have raised concerns about arbitrage

- A2.3 In June 2013, Royal Mail was contacted by [redacted] an access operator] which raised concerns about access operators using a form of arbitrage. [redacted] The access operator] stated that its negotiations with a customer had been affected by that customer being offered a zonal arbitrage solution by one of [redacted] the access operator's] competitors.¹²⁸⁵
- A2.4 [redacted] The access operator] presented Royal Mail with analysis “*showing that the pricing before surcharges of splitting Zone A Letters [Urban] and Zone A&B Large Letters [Urban and Suburban] out of the national price plan delivers an initial benefit of £284.8k.*”¹²⁸⁶ [redacted] The access operator] then estimated the zonal surcharges that could be expected to be applied under APP2 which [redacted] the access operator] found would amount to “£178k”. Thus, [redacted] the access operator] calculated this this approach would produce an overall arbitrage benefit of “*over £100k.*”¹²⁸⁷
- A2.5 [redacted] The access operator] said that this was a “*cost difference of nearly 2% which is an amount we can't absorb in our margin to compete whilst not offering our own arbitrage option (which is something we have always resisted).*”¹²⁸⁸
- A2.6 Royal Mail discussed the issue with [redacted] the access operator] and confirmed the mechanism by which [redacted] the access operator] believed arbitrage had taken place.
- “The customer in question posts circa [redacted]m items a year and apparently the carrier had taken all their Zone A items for letters and Zone A/B for large letters and moved it to their zonal account. This has resulted in a price difference of circa 285k compared to the national price offered by [redacted] the access operator].”*¹²⁸⁹
- A2.7 Royal Mail also recorded [redacted] the access operator’s] concern and its proposed remedy.

¹²⁸⁵ Royal Mail, *Email from [redacted] (Royal Mail) to [redacted] (Royal Mail) re: Zonal Arbitrage dated 27 June 2013*, page 2. (RM2345)

¹²⁸⁶ Ibid. (RM2345)

¹²⁸⁷ Ibid. (RM2345)

¹²⁸⁸ Ibid. (RM2345)

¹²⁸⁹ Ibid., page 1 (RM2345)

“[X The access operator] is concerned that if this is allowed to happen, they may have no choice but to use this practice themselves which they would not like to do as it’s not in the spirit of the national agreement which they have signed. Hence, they are keen to know what our response might be. He suggested amending the tolerance of 7.5% that is allowed on the PP2 which would offset some of the risk.”¹²⁹⁰

- A2.8 In July 2013, Royal Mail was contacted by another access operator, [X], to raise concerns about arbitrage. [X This access operator] explained that it had been approached by a Government Department who had, in turn, been approached by a third party that suggested that there would be significant benefits for the Government Department if it used a zonal service. [X The access operator] stated that this department sends mail to every household and that, as a result, it “*would not benefit from using Zonal unless they manipulated the data and separated the mailings into cheaper Zones and mailed the rest separately as National.*”¹²⁹¹
- A2.9 [X The access operator] stated that it viewed this practice as “*unethical and not in the spirit of the agreements*”¹²⁹² and that it “*would like to be able to tell them that it is in breach of Royal Mail guidelines and that action would be taken against them.*”¹²⁹³ [X The access operator] ultimately asked Royal Mail to confirm its position on this use of the price plans.

Royal Mail recognises the need for action to prevent and discourage arbitrage

- A2.10 Following these complaints, Royal Mail sought to reduce the potential for arbitrage on APP2 by issuing a Contract Changes Notices to vary the terms and conditions of access. As explained above, under the terms of the Access Letters Contract, Royal Mail has the contractual power to change unilaterally any term or condition of access without the consent of access operators. Accordingly, in November 2013, it issued a Contract Change Notice titled “*Access Contract Change Notice: Reducing the potential to arbitrage.*” Royal Mail explained that “*several customers separately brought to our attention the fact that some may be exploiting arbitrage opportunities between price plans.*”¹²⁹⁴ It added that “[w]e have looked into this and decided that we do need to take action to mitigate any exposure to this arbitrage risk.”¹²⁹⁵
- A2.11 Royal Mail continued:

“*Arbitrage between the price plans can occur where a customer selectively streams some mail from a national posting to the cheaper zones of the zonal price plan and*

¹²⁹⁰ Ibid., page 1. (RM2345)

¹²⁹¹ Royal Mail, *Email from [X] to [X] (Royal Mail) re: Zonal mailings dated 31 July 2013*, page 1. (RM2348)

¹²⁹² Ibid., page 1. (RM2348)

¹²⁹³ Ibid., page 1. (RM2348)

¹²⁹⁴ Royal Mail, *Letter to access operators*, 15 November 2013, page 1. (WH0100) Please note that this notice was suspended on 21 February 2014 alongside the January 2014 CCNs and was subsequently withdrawn in March 2015.

¹²⁹⁵ Ibid., page 1. (WH0100)

*puts the balance through the national price plan. Our analysis has shown that the posting profile tolerances of [APP2] creates an unintended opportunity for customers to use the permitted tolerances to exploit arbitrage which, if practised, can have a detrimental revenue impact on Royal Mail and ultimately reduce the targeted financial contribution of Access to Royal Mail's Universal Service."*¹²⁹⁶

A2.12 It added that "[w]e are also considering further changes that will look to prevent arbitrage, and we would like your feedback on those change proposals before we serve a further notice. We shall publish a discussion document with our further change proposals shortly."¹²⁹⁷

A2.13 On 26 November 2013, Whistl wrote to Royal Mail setting out its concerns that NPP1 was also being used for arbitrage and suggested that amendments to the tolerances and profile requirements of NPP1 should be considered to prevent this.¹²⁹⁸ Royal Mail responded:

"Thank you for highlighting the fact that [NPP1] is also being used for arbitrage. We have started looking into this and would welcome any further information/evidence you have of arbitrage on this plan. As mentioned in our letter, we are exploring other measures to reduce arbitrage and those measures would impact both price plans.

*... Our aim is to reduce the opportunity for arbitrage across all price plans and as a result, to ensure we receive a cost reflective price for the services we provide to our access customers."*¹²⁹⁹

Proposals to address arbitrage

A2.14 On 12 September 2016, Royal Mail consulted on a number of further changes it proposed to make to the Access Letters Contract, including changes to reduce opportunities for price plan arbitrage. Royal Mail restated its position on arbitrage:

*"We are opposed, however, to arbitrage activities by customers who are on national price plans that "exploit the Permitted Variances" of the national price plans by posting higher volumes of Suburban/Rural/London mail relative to their Urban volume on their national price plan and switch their Urban mail to the Zonal Price Plan and pay an overall lower average price."*¹³⁰⁰

A2.15 Royal Mail said that it had identified "that the volume of mail posted in the year 2015/16 by customers who use NPP1 or APP2 in conjunction with the Zonal Price Plan more than doubled, increasing from 7% to 18%."¹³⁰¹ It also noted that "[f]or some customers,

¹²⁹⁶ Ibid., page 1. (WH0100)

¹²⁹⁷ Ibid., page 2. (WH0100)

¹²⁹⁸ Whistl, *Letter to Royal Mail re: CCN 001*, 26 November 2013, pages 3 to 4. (WH0101)

¹²⁹⁹ Royal Mail, *Letter to Whistl re: CCN 001*, 9 December 2013, page 3. (WH0104)

¹³⁰⁰ Royal Mail, *Access contract change proposals – A discussion document on the impact of removing the requirement to print a zonal indicated on Mailmark zonal mail*, 12 September 2016, page 5, paragraph 5.2. (PD0072)

¹³⁰¹ Ibid, page 6, paragraph 5.4. (PD0072)

switching mail between their price plans to use the lower prices of the Urban Zone in order to bring down their overall average price has become the norm.”¹³⁰²

- A2.16 Royal Mail proposed certain changes to NPP1 in order to “address a flaw in the Urban Density calculation and reduce the opportunities to exploit price plan arbitrage.”¹³⁰³ It explains “[t]he current methodology enables customers to remove urban mail volume from the SSCs and, provided they do it proportionately across all SSCs, continue to meet the Urban Density Benchmark... This is a flaw in our methodology which we would like to correct.”¹³⁰⁴
- A2.17 To correct this flaw Royal Mail “propose[ed] to change the way we measure Urban Density under NPP1 for all customers. The benchmark would be set according to the percentage of urban mail relative to the volume of all mail at each SSC.”¹³⁰⁵ New permitted variances would apply to this benchmark depending on the use of price plans: if a customer only posts on NPP1 the tolerance will be a relative 40% at each SSC however if a customer posts on both NPP1 and ZPP3 the tolerance will be 0% at each SSC.
- A2.18 After a further consultation¹³⁰⁶ on the calculations associated with the new approach to measuring urban density under NPP1, Royal Mail formally notified operators of the new terms and conditions in September 2017.¹³⁰⁷

¹³⁰² Ibid, page 6, paragraph 5.4. (PD0072)

¹³⁰³ Ibid., paragraph 5.9. (PD0072)

¹³⁰⁴ Ibid., paragraph 5.9. (PD0072)

¹³⁰⁵ Ibid., paragraph 5.10. (PD0072)

¹³⁰⁶ Royal Mail, *Access contract change proposal – A new way of calculating the urban density measure of National Price Plan one (SSCs)*, 8 June 2017. (PD0073)

¹³⁰⁷ Royal Mail, *Decision document: a new way of calculating the urban density measure of National Price Plan one (SSCs)*, 5 September 2017. (PD0074)

A3. Ofcom's procedure

A3.1 This Annex sets out a summary of the main steps and key events in the investigation of the matters that are the subject of this Decision and the procedural steps that have taken place.

January 2014 to April 2014: opening the investigation

A3.2 In December 2013, Whistl informed Ofcom that it had concerns about the impending price changes that Royal Mail had announced it would impose in early 2014. Following the publication of the CCNs on 10 January 2014, Whistl contacted Ofcom to confirm it would be making a formal complaint.

A3.3 Ofcom met with Whistl on 20 January 2014 to understand its concerns. Whistl formally submitted its complaint on 28 January 2014, made up of:

- a) a written submission;¹³⁰⁸
- b) an economic report prepared by Frontier Economics setting out the impact of the CCNs on Whistl;¹³⁰⁹ and
- c) a witness statement prepared by Nick Wells, Whistl's CEO.¹³¹⁰

A3.4 Ofcom invited Royal Mail to comment on Whistl's complaint. Royal Mail provided comments on 10 February 2014.¹³¹¹ As part of its response, Royal Mail indicated that it had taken economic advice on an objective justification for changes set out in the CCNs. Ofcom invited Royal Mail to share a summary of that advice (which it did on 28 February 2014)¹³¹² and to share the underlying models upon which that advice was based (which it did on 10 March 2014). Royal Mail presented these models to Ofcom in a meeting on 25 March 2014.

A3.5 On 21 February 2014, Ofcom announced that it would be investigating the complaint but that it had not yet determined whether to proceed under the Competition Act 1998 or under its regulatory powers under the Postal Services Act 2011.

A3.6 On 9 April 2014, Ofcom announced that it had decided to proceed under the Competition Act 1998. This decision was based on its assessment that there were reasonable grounds to

¹³⁰⁸ Whistl, *Complaint submitted to Ofcom on behalf of TNT Post...*, 28 January 2014. (WH0128)

¹³⁰⁹ Frontier Economics, *Exclusionary effects of Royal Mail's pricing proposals*, 28 January 2014. (WH0121)

¹³¹⁰ Whistl, *Witness Statement of Nicholas Mark Wells*, 28 January 2014. (WH0132)

¹³¹¹ Royal Mail, *Enquiry in relation to proposed changes to the prices, terms and conditions on which Royal Mail plc ("Royal Mail") offers D+2 Access - Initial comments of Royal Mail*, 10 February 2014. (RM0011)

¹³¹² Oxaera, *Oxaera's preliminary economic analysis of Royal Mail's Access Contracts pricing proposals*, 28 February 2014. (RM0044)

suspect an infringement and, consistent the principle of primacy of competition law, Ofcom elected to proceed on that basis.¹³¹³

April 2014 to July 2015: information gathering

- A3.7 In order to carry out this investigation, we have gathered evidence from a number of parties. We have requested and/or collected this information in a number of ways, in particular:
- a) statutory Notices under section 26 of the Competition Act (“section 26 Notices”);
 - b) follow-up questions to responses to section 26 Notices; and
 - c) other non-statutory requests for information.
- A3.8 In some cases, Royal Mail and Whistl provided information concerning the investigation on their own initiative.
- A3.9 In addition to information gathered directly for the investigation we have also, where appropriate, had regard to, and in some cases relied upon, evidence requested by Ofcom for the purposes of other projects. In these cases, the relevant parties have provided consent for this.

Information gathering from Royal Mail

- A3.10 From April 2014 to July 2015 Ofcom issued a number of information requests to Royal Mail:
- a) 1st section 26 Notice issued on 28 April 2014 requesting certain internal Royal Mail documents (papers and minutes of meeting related to Royal Mail’s decision making) and seeking formal confirmation of previously submitted documents;¹³¹⁴
 - b) 2nd section 26 Notice issued on 15 May 2014 requesting documents related to Royal Mail’s LRIC model;¹³¹⁵
 - c) 3rd section 26 Notice issued on 1 August 2014 requesting documents associated with substitutability of certain mail products;¹³¹⁶
 - d) 4th section 26 Notice issued on 1 September 2014 requesting certain internal Royal Mail documents (email correspondence exchanged between senior Royal Mail decision makers);¹³¹⁷

¹³¹³ Before exercising our enforcement powers under Schedule 7 to the Postal Services Act 2011, we must consider if a more appropriate way of proceeding would be under the Competition Act. Where we decide that it is more appropriate to proceed under the Competition Act, we will state our reasons for doing so. See Schedule 7, para. 4 Postal Services Act 2011.

¹³¹⁴ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 28 April 2014. (RM0177)

¹³¹⁵ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 15 May 2014. (RM0232)

¹³¹⁶ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 1 August 2014. (RM0622)

¹³¹⁷ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 1 September 2014. (RM0686)

- e) 5th section 26 Notice issued on 31 October 2014 requesting information on mail volumes;¹³¹⁸
- f) 6th section 26 Notice issued on 20 November 2014 requesting certain internal documents produced for Royal Mail (documents and correspondence exchanged between Royal Mail and its external economic advisors) and seeking clarification on Royal Mail's board minutes;¹³¹⁹
- g) 7th section 26 Notice issued on 13 February 2015 requesting information and documents associated with NPP1 surcharges;¹³²⁰ and
- h) 8th section 26 Notice issued on 25 June 2015 requesting further documents from Royal Mail.¹³²¹

A3.11 On 15 October 2014¹³²², 3 November 2014¹³²³ and 24 November 2014¹³²⁴, Ofcom wrote to Royal Mail requesting further explanation of and justification for redactions made to the documents provided by Royal Mail in response to our information requests. Subsequent to these letters, Royal Mail re-provided all documents in unredacted form (save for redactions to legally privileged material).

A3.12 During this period, Royal Mail made a number of submissions:

- a) On 10 February 2014 Royal Mail provided comments on Whistl's complaint submissions;¹³²⁵
- b) On 28 February 2014 in response to an informal request by Ofcom of 26 February 2014, Royal Mail provided a note prepared by Oxera which described its advice to Royal Mail,¹³²⁶ and
- c) On 20 June 2014 Royal Mail provided a report prepared by Oxera titled *Do Royal Mail's access pricing proposals have exclusionary effects?*¹³²⁷

A3.13 We have had regard to evidence gathered for purposes other than the investigation:

¹³¹⁸ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 31 October 2014. (RM0860)

¹³¹⁹ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 20 November 2014. (RM0894)

¹³²⁰ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 13 February 2015. (RM1791)

¹³²¹ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 25 June 2015. (RM1927)

¹³²² Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 15 October 2014. (RM0814)

¹³²³ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 3 November 2014. (RM0864)

¹³²⁴ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 24 November 2014. (RM0902)

¹³²⁵ Royal Mail, *Enquiry in relation to proposed changes to the prices, terms and conditions on which Royal Mail plc ("Royal Mail") offers D+2 Access – Initial Comments of Royal Mail*, 10 February 2014. (RM0011)

¹³²⁶ Oxera, *Oxera's preliminary economic analysis of Royal Mail's Access Contracts pricing proposals*, 28 February 2014. (RM0044)

¹³²⁷ Oxera, *Do Royal Mail's access pricing proposals have exclusionary effects*, 20 June 2014. (RM0609)

- a) Royal Mail's response to a request for information issued to it under section 55 of the Postal Services Act, dated 2 June 2014 and issued in connection with Ofcom's *Royal Mail Access Pricing Review*;¹³²⁸
- b) Royal Mail's submission on end-to-end competition provided to Ofcom on 20 June 2014 and published the same day;¹³²⁹ and
- c) Royal Mail's public response of 24 February 2015 to Ofcom's Access Pricing Review consultation.¹³³⁰

A3.14 We have relied on information published on Royal Mail's website, in particular in relation to the contractual arrangements associated with access services.

Information gathering from Whistl

A3.15 On 1 August 2014 we issued a section 26 Notice to Whistl, together with an informal information request, seeking information and documents on a range of matters.¹³³¹

A3.16 We have had regard to evidence gathered for purposes other than the investigation:

- a) Whistl's response to a request for information issued to it under section 55 of the Postal Services Act, dated 10 July 2015 and issued in connection with Ofcom's *Royal Mail Access Pricing Review*.¹³³²

Engagement with Royal Mail

A3.17 On 15 December 2014 a state of play meeting was held with Royal Mail at which Ofcom outlined its emerging thinking and next steps.¹³³³ Following this meeting Royal Mail made a submission on 11 March 2015 in which it argued Ofcom should close the investigation.¹³³⁴

A3.18 On 16 June 2015 Royal Mail requested a further state of play meeting.¹³³⁵ On 22 June 2015, Ofcom declined Royal Mail's request on the basis that it did not consider it was necessary to hold such a meeting.¹³³⁶ Royal Mail referred this issue to Ofcom's procedural officer on 30 June 2015. Following separate oral hearings with Ofcom's case team and Royal Mail

¹³²⁸ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 2 June 2014. (RM0435) Ofcom sought Royal Mail's consent to use this information in connection with the investigation on 22 June 2015. (RM1911) Royal Mail provided consent on 24 June 2015. (RM1918)

¹³²⁹ Royal Mail, *Direct Delivery: A Threat to the Universal Postal Service Regulatory Submission to Ofcom*, 20 June 2014. (PD0043)

¹³³⁰ Royal Mail, *Response to Ofcom's December 2014 Consultation: "Royal Mail Access Pricing Review: Proposed amendments to the regulatory framework"*, 24 February 2015. (PD0045)

¹³³¹ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Whistl)*, 1 August 2014. (WH0250)

¹³³² Ofcom, *Letter from [redacted] (Ofcom) to company secretary (Whistl)*, 10 July 2014. Ofcom sought Whistl's consent to use this information in connection with the investigation on 12 June 2015. (WH0239) Royal Mail provided consent on 17 June 2015. (WH0385)

¹³³³ Ofcom, *State of play meeting with Royal Mail: File Note*, 15 December 2014. (RM1240)

¹³³⁴ Royal Mail, *Submission by Royal Mail Group Limited*, 11 March 2015. (RM1807)

¹³³⁵ Royal Mail, *Letter from [redacted] (Royal Mail) to [redacted] (Ofcom)*, 16 June 2015. (RM1906)

¹³³⁶ Royal Mail, *Letter from [redacted] (Ofcom) to [redacted] (Royal Mail)*, 22 June 2015. (RM1912)

together with its legal advisors, the Procedural Officer rejected Royal Mail's complaint on 9 July 2015.¹³³⁷

July 2015: statement of objections

- A3.19 On 28 July 2015, Ofcom issued to Royal Mail a statement of objections. On the same day Royal Mail granted access to file in accordance with Rule 6 of the Competition and Markets Authority's Rules.¹³³⁸
- A3.20 In the weeks following the issue of the Statement of Objections Royal Mail requested access to confidential information provided by Whistl which was referred to in the Statement of Objections and contained in redacted version on the file.
- A3.21 To respond to this request:
- a) on 26 August 2015, we disclosed confidential material to Royal Mail's named external legal and economic advisors subject to confidentiality undertakings;
 - b) on 18 September 2015¹³³⁹ and 16 October 2015¹³⁴⁰, we gave consent for confidential material to be made available to Royal Mail's named in-house legal advisors subject to confidentiality undertakings; and
 - c) engaged with Whistl, and other parties, to enable the disclosure of certain unredacted, or less redacted, material as the confidential status of certain information had changed.
- A3.22 Ofcom refused to agree to Royal Mail's request to provide unredacted material to its internal business advisors. On 17 September 2015, Royal Mail referred this matter to Ofcom's Procedural Officer.
- A3.23 On 2 October 2015, Ofcom reissued the Statement of Objections. On the same day, Ofcom's Procedural Officer wrote to Royal Mail and the Ofcom case team to confirm that, in light of the reissued SO, she had decided there was no further action to take.
- A3.24 Royal Mail provided written representations¹³⁴¹ on the Statement of Objections on 28 November 2015 and oral representations¹³⁴² on 23 March 2016. Royal Mail representations were supported by:
- a) a Report from Compass Lexecon; and¹³⁴³

¹³³⁷ Ofcom published a non-confidential version of the Procedural Officer's decision on 28 July 2015.

¹³³⁸ The Competition Act 1998 (Competition and Markets Authority's Rules) Order 2014, SI 2014/458.

¹³³⁹ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Ashurst)*, 18 September 2015. (RM2155)

¹³⁴⁰ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Ashurst)*, 16 October 2015. (RM2247)

¹³⁴¹ Royal Mail, *Response of Royal Mail plc to Ofcom's statement of objections dated 2 October 2015*, 27 November 2015. (RM2386)

¹³⁴² Ofcom, *Transcript of an oral representations meeting with Royal Mail*, 23 March 2016. (RM2462)

¹³⁴³ Compass Lexecon, *Economic assessment of Ofcom's theories of harm*, 27 November 2015. (RM2313)

b) two reports from FTI Consulting.¹³⁴⁴

A3.25 On 1 June 2016, Royal Mail provided written answers to certain questions asked by Ofcom during its oral representations and in subsequent correspondence.¹³⁴⁵

A3.26 Ofcom also disclosed a redacted version of the statement of objections to Whistl and invited it to provide comments. Whistl provided written comments on 4 November 2015.¹³⁴⁶

July 2015 to October 2017: further information gathering

Information gathering from [redacted] other access operators]

A3.27 On 1 March 2016, we issued a number of information requests to third parties:

a) a section 26 Notice to [redacted] an access operator] requesting more information associated with its correspondence with Whistl which had previously been provided to Ofcom by Whistl;¹³⁴⁷ and

b) a section 26 Notice to [redacted] an access operator] requesting more information associated with its correspondence with Whistl which had previously been provided to Ofcom by Whistl.¹³⁴⁸

Engagement with Royal Mail

A3.28 On 22 December 2016, Royal Mail made a further submission to Ofcom in light of the opinion of the Advocate General in the *Intel* case.¹³⁴⁹

A3.29 On 10 February 2017, a state of play meeting was held with Royal Mail at which Ofcom provided an update on the steps that had been taken in the period since receipt of Royal Mail's written and oral representations.¹³⁵⁰ This included an outline of the current thinking of Ofcom's decision makers and indicated that Ofcom was considering seeking additional information from third parties.

Information gathering from Whistl

A3.30 On 2 March 2017, we issued a 2nd section 26 Notice to Whistl requesting additional documents associated with development and closure of its bulk mail delivery business.¹³⁵¹

¹³⁴⁴ FTI Consulting, *Financial assessment of Ofcom's theories of harm*, 27 November 2015 (RM2314) and FTI Consulting, *Assessment of Whistl's business plans*, 27 November 2015. (RM2317)

¹³⁴⁵ Royal Mail, *Response of Royal Mail plc to the questions in Ofcom's letter of 18 May 2016*, 1 June 2016. (RM2471)

¹³⁴⁶ Whistl, *Comments from Whistl on the Statement of Objections addressed to Royal Mail*, 4 November 2015. (WH0642)

¹³⁴⁷ Ofcom, *Letter from [redacted] (Ofcom) to [redacted]*, 1 March 2016. (TP0054)

¹³⁴⁸ Ofcom, *Letter from [redacted] (Ofcom) to [redacted]*, 1 March 2016 (TP0055)

¹³⁴⁹ Royal Mail, *Voluntary submission of Royal Mail plc to Ofcom following its written reply of 27 November 2015 to Ofcom's statement of objections dated 2 October 2015 and its oral submissions dated 23 March 2016*, 22 December 2016. (RM2486)

¹³⁵⁰ Ofcom, *State of play meeting with Royal Mail: File Note*, 10 February 2017. (RM2507)

¹³⁵¹ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Towerhouse)*, 2 March 2017. (WH0699)

Information gathering from LDC

A3.31 On 23 March 2017, we issued a section 26 Notice to LDC requesting documents associated with uncompleted investment in Whistl's bulk mail delivery business.¹³⁵²

October 2017: letter of facts

A3.32 On 12 October 2017, we issued a letter of facts to Royal Mail which set out additional provisional factual findings and described how Ofcom proposed to rely on these findings in support of the case previously set out in the Statement of Objections.¹³⁵³ On the same day Royal Mail was given access to file in accordance with Rule 6 of the Competition and Markets Authority's Rules.¹³⁵⁴

A3.33 On 24 November 2017, Royal Mail provided written representations¹³⁵⁵ on the letter of facts. Royal Mail also provided oral representation on 21 May 2018 (in combination with its oral representations¹³⁵⁶ on the draft penalty statement). Royal Mail's representations were supported by a report prepared by FTI Consulting.¹³⁵⁷

February 2018: draft penalty statement

A3.34 On 8 February 2018, Ofcom issued a draft penalty statement to Royal Mail which set out its provisional decision on the appropriate level of a financial penalty (which it proposed to apply in the event of an infringement decision).¹³⁵⁸ On the same day Royal Mail was given access to file in accordance with Rule 6 of the Competition and Markets Authority's Rules.¹³⁵⁹

A3.35 On 8 March 2018, Royal Mail provided written representations¹³⁶⁰ on the draft penalty statement. Royal Mail also provided oral representations¹³⁶¹ on 21 May 2018 (in combination with its oral representations on the letter of facts). Royal Mail's representations were supported by a report prepared by Compass Lexecon.¹³⁶²

A3.36 On 5 July 2018, Ofcom issued a 9th section 26 Notice to Royal Mail requesting turnover information.¹³⁶³

¹³⁵² Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (LDC)*, 23 March 2017. (LDC001)

¹³⁵³ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Ashurst) – Annex 1*, 12 October 2017. (RM2548)

¹³⁵⁴ The Competition Act 1998 (Competition and Markets Authority's Rules) Order 2014, SI 2014/458.

¹³⁵⁵ Royal Mail, *Response of Royal Mail plc to Ofcom's letter of facts dated 12 October 2017*, 24 November 2017. (RM2581)

¹³⁵⁶ Ofcom, *Transcript of an oral representation hearing with Royal Mail*, 21 May 2018. (RM2690)

¹³⁵⁷ FTI Consulting, *Updated assessment of Whistl's Business Plans*, 24 November 2017. (RM2579)

¹³⁵⁸ Ofcom, *Draft penalty statement issued to Royal Mail*, 8 February 2018. (RM2632)

¹³⁵⁹ The Competition Act 1998 (Competition and Markets Authority's Rules) Order 2014, SI 2014/458.

¹³⁶⁰ Royal Mail, *Response of Royal Mail plc to Ofcom's draft penalty statement dated 8 February 2018*, 8 March 2018. (RM2655)

¹³⁶¹ Ofcom, *Transcript of an oral representation hearing with Royal Mail*, 21 May 2018. (RM2690)

¹³⁶² Compass Lexecon, *Assessment of the relevant turnover for penalty calculation*, 8 March 2018. (RM2654)

¹³⁶³ Ofcom, *Letter from [redacted] (Ofcom) to [redacted] (Ashurst)*, 5 July 2018. (RM2702)