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IN THE COMPETITION APPEAL TRIBUNAL

Case No: 1299/1/3/18

Victoria House
Bloomsbury Place
London WC1A 2EB

12 November 2019

Before:

PETER FREEMAN CBE QC (Hon)
(Chairman)
TIM FRAZER
PROFESSOR DAVID ULPH CBE

Sitting as a Tribunal in England and Wales

BETWEEN:

ROYAL MAIL PLC

Appellant

- v -

OFFICE OF COMMUNICATIONS

Respondent

- and -

WHISTL UK LIMITED

Intervener

Heard at Victoria House on 10-13, 17-21, 24-28 June and 1, 8, 15-17 July 2019

JUDGMENT (NON-CONFIDENTIAL VERSION)

APPEARANCES

Mr Daniel Beard QC, Ms Ligia Osepciu and Ms Ciar McAndrew (instructed by Ashurst LLP) appeared on behalf of the Appellants.

Mr Josh Holmes QC, Ms Julianne Kerr Morrison and Mr Nikolaus Grubeck (instructed by Ofcom Legal) appeared on behalf of the Respondent.

Mr Jon Turner QC, Mr Alan Bates and Ms Daisy Mackersie (instructed by Towerhouse LLP) appeared on behalf of the Intervener.

Note: Excisions in this Judgment (marked "[✂]") relate to commercially confidential information: Schedule 4, paragraph 1 to the Enterprise Act 2002.

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A. SUMMARY

1. This case concerns events that took place mainly in 2013-15. Royal Mail plc, formerly the state-owned monopoly provider of mail services in the UK, was at the relevant time (and still is) the designated provider of the universal postal service throughout the UK. In January 2014, Royal Mail announced the introduction of differential prices for bulk mail operators for access to its final delivery service, without which they could not operate. The price differential depended on the extent to which the bulk mail providers matched Royal Mail's own delivery patterns.

2. Whistl UK Limited (formerly TNT Post), a bulk mail operator, planned to set up its own final delivery service and establish an end-to-end bulk mail service in competition with Royal Mail. Whistl complained to Ofcom, the relevant regulatory authority, that the new differential access prices made its end-to-end operations and future plans uneconomic.

3. Royal Mail's new prices were suspended, in accordance with their terms, when Ofcom announced its decision to open an investigation in February 2014, and were formally withdrawn the following year. Ofcom's investigation led to a decision in August 2018, in which it found that Royal Mail had abused its dominant position contrary to Article 102 TFEU and Chapter II of the Competition Act 1998. It imposed a penalty of £50 million. Royal Mail appealed to the Tribunal.

4. Royal Mail did not contest the finding of dominance but did contest the finding of abuse and the penalty. It claimed that the new prices, although announced, were never applied in practice; that they were not improperly discriminatory; that they did not cause a competitive disadvantage; and in any case were objectively justified either in themselves or to preserve the financing of the universal postal service. Royal Mail also objected to an aspect of Ofcom's procedure and to the principle and size of the penalty.

5. Whistl was allowed to intervene in the appeal in support of Ofcom.

6. A hearing was held in June and July 2019 which clarified the issues in dispute and examined in detail the arguments and evidence put forward by the parties and the legal and economic issues involved. Although all the issues raised had their own importance, a central issue was the extent to which competition law prevented a dominant undertaking from charging prices that might exclude competitors less efficient than itself and whether such a theoretical position, even if it could be established in this case, which was disputed, could over-ride actual evidence of exclusionary intent and activity.

7. For the reasons set out in the judgment that follows, we found that Royal Mail's case failed on all the grounds of appeal it had raised and, accordingly, Ofcom's decision must stand.

B. INTRODUCTION

8. On 14 August 2018, the Office of Communications ("Ofcom") issued a decision entitled "Discriminatory pricing in relation to the supply of bulk mail delivery services in the UK" ("the Decision") addressed to Royal Mail plc ("Royal Mail"). In the Decision, Ofcom found that Royal Mail infringed the Chapter II prohibition under the Competition Act 1998 ("CA 1998") and Article 102 of the Treaty on the Functioning of the European Union ("TFEU"). Ofcom imposed a fine of £50 million on Royal Mail.

9. On 12 October 2018, Royal Mail appealed against the Decision under section 46 of the CA 1998. Following a case management conference on 7 November 2018, and by an Order of the Chairman of the same date, Whistl UK Limited ("Whistl") was granted permission to intervene in support of Ofcom.

10. This is the judgment on Royal Mail's appeal.

C. FACTUAL BACKGROUND

(1) The Appellant: Royal Mail

11. Royal Mail operates a UK and international parcel and letter delivery business. It provides collection, sortation, transportation and delivery services. Royal Mail is the leading delivery company in the UK. In 2017-18, Royal Mail handled 1.2 billion parcels and nearly 14.4 billion letters in the UK.

12. Royal Mail's UK business is complemented by its international parcels business, General Logistics Systems ("GLS"). GLS operates a ground-based deferred parcel delivery network in continental Europe, covering 41 countries and, following recent acquisitions, seven states in the western United States and Canada.

13. Royal Mail operates its UK business through its UK Parcels, International and Letters ("UKPIL") division. It operates under the brands 'Royal Mail' and 'Parcelforce Worldwide' (which is a leading provider of express parcel delivery services). UKPIL collects and delivers parcels and letters through two networks: the Royal Mail core network and the Parcelforce network.

14. Royal Mail is the designated provider of the universal postal service in the UK (see paragraph 26 below), which it discharges through UKPIL.

(2) The Intervener: Whistl

15. Whistl, before 2014 known as TNT Post UK Limited, is a postal services company that distributes addressed mail (including bulk mail and parcels) in various forms throughout the UK. For ease of reference we use the name Whistl throughout.

16. In 2004, Whistl entered the business of bulk mail access with the intention in due course of developing its own end-to-end bulk mail capability. In 2008, it carried out a small-scale trial of delivery in Liverpool and in April 2012 it

launched a pilot bulk mail delivery service in West London, subsequently expanded to other parts of London.

17. At the time of the events that give rise to the present dispute (2013-14), Whistl was the largest access operator in the UK involved in the distribution of around 3.8 billion addressed letters in the UK, that is around a quarter of all inland addressed mail volumes. The development of its business up to and after that time is described in more detail later in this judgment.

(3) The position prior to 2012

(a) The regulatory regime under Postcomm

18. Prior to the Postal Services Act 2000, Royal Mail held a statutory monopoly in the handling and delivery of the great majority of letters, i.e. those weighing less than 350g and costing less than £1.[1] 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).

19. 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.

20. EU law promoted gradual liberalisation through successive postal services directives from 1997, which provided for a "reserved area" (to be progressively reduced in scope) in which Member States could appoint a "universal service provider"; a choice of methods for securing the universal service in a liberalised market; and an obligation to appoint an independent regulator.

21. In 2006, the final restrictions on the activities of postal competitors were removed and the market was fully liberalised, with the result that a postal

[1] British Telecommunications Act 1981, section 66, and the Postal Privilege (Suspension) Order 1981.

competitor could bypass Royal Mail's network in areas where it had set up its own delivery network 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. In practice, however, any end-to-end operator active on the retail market across the UK would rely heavily on access to Royal Mail's network (see paragraph 182 below).

22. Postcomm supported the development of wholesale (or downstream access) competition, by requiring Royal Mail to offer access to its inward mail centres to competing postal operators for letters and large letters, but not parcels. Access competition allows competing postal operators to collect letters from their customers (typically businesses, such as banks, which send large volumes of mail to their customers), sort and transport them (the upstream activities) before handing them over to Royal Mail at a mail centre for final delivery to end-recipients (the downstream activities). Access services have been provided by Royal Mail since 2004, when it negotiated the first access services contract with UK Mail.

23. In 2006, Postcomm introduced its 2006-2010 price control. This included a 'headroom' price control on mandated access services, as a safeguard to stop Royal Mail squeezing out competitors through the way it priced its retail and access services.

(b) Explanation of the universal service

24. The concept of universal service is explained in the EU Postal Services Directive as "a universal postal service encompassing a minimum range of services of specified quality to be provided in all Member States at an affordable price for the benefit of all users, irrespective of their geographical location in the Community".[2]

25. The relevant EU requirements were transposed into UK law by the Postal Services Act 2011 (the "2011 Act") which set out the minimum requirements

[2] Directive 97/67/EC of 15 December 1997 (the Postal Services Directive), as subsequently amended.

for the universal postal service.[3] These requirements include the Monday to Saturday delivery and collection of letters at affordable prices in accordance with a uniform public tariff throughout the UK, together with other requirements relating to registered post, insured items and free postal services to the visually impaired. There are similar, slightly less stringent, requirements for parcels.

26. Ofcom, which in 2011 replaced Postcomm as postal services regulator, designated Royal Mail as the UK's universal service provider and imposed regulatory conditions requiring it to provide the universal service. Royal Mail fulfils its universal service obligations ("USO") by providing certain services, including 1st class and 2nd class mail up to 20kg, Special Delivery, Signed For, and Articles for the Blind. The universal service, and hence Royal Mail's USO, does not extend to all types of mail. In particular, at the relevant times, Royal Mail has had no universal service obligations in relation to bulk mail, which is the subject of the Decision.

(c) Market changes in 2005

27. Until the early 2000s, Royal Mail's postal volumes tended to rise and fall broadly in line with changes in the UK economy, in particular GDP growth. From around 2002-03, changes in mail volumes became less directly correlated with GDP growth. The main structural factor causing this was the start of the substitution of paper-based communication with electronic communication, called 'e-substitution'.

28. From 2005 onwards, letter volumes started to decline, as e-substitution became more prevalent. Royal Mail's revenues also suffered as customers switched from premium products such as 1st class mail to less expensive products such as 2nd class mail. At the same time, access volumes began to increase significantly.

[3] Postal Services Act 2011, section 31.

(d) Economic impact on Royal Mail

29. The combination of declining letter volumes and increased access competition had a significant impact on Royal Mail's finances, which had not been predicted at the time the 2006-2010 price control was set.

30. In 2007-08, Royal Mail Letters (later renamed UKPIL) reported its first operating loss (£357 million loss on its £6.8 billion revenue). In 2008-09, Royal Mail Letters was again loss-making, reporting an operating loss of £126 million. It continued to make losses in 2009-10, despite selective price increases and significant cost reductions.

31. In 2010-11, Royal Mail was, in terms of its balance sheet, insolvent and cash negative. UKPIL reported an operating loss of £168 million, down from a £25 million operating profit in the previous year. By this point, access volumes had reached seven billion items.

32. During this period, Royal Mail had extensive discussions with Postcomm, including detailed submissions in December 2004 and in March 2007, explaining why it considered that Postcomm should act in response to Royal Mail's requests to mitigate some of the risks to its ability to finance the universal postal service.

(e) The Hooper Reports

33. In December 2007, the Government announced an independent review of the UK postal services sector, led by Mr Richard Hooper, to recommend policies needed to maintain the universal service in the light of market developments and market liberalisation.

34. Mr Hooper's first report was published in December 2008.[4] This emphasised the importance of the universal service and noted it was under serious threat, principally from the unprecedented decline in letter volumes, due to the

[4] Richard Hooper et al., *Modernise or Decline – Policies to Maintain the Universal Postal Service in the United Kingdom,* 16 December 2008.

explosion of digital media. It found that there was a general consensus that the status quo was untenable and that the universal service could not be sustained under present policies.

35. The report recognised that Royal Mail was the only company capable of providing the universal service. It also recognised that Royal Mail desperately needed to modernise its network and become more efficient, and that the pace of this change needed to accelerate quickly. It identified that, to do this, Royal Mail needed the confidence to make decisions about modernisation on a commercial basis, to gain access to capital and to corporate experience, and to embark on a strategic partnership with one or more private sector companies with demonstrable experience of transforming a major business.

36. The report concluded that the maintenance of the universal service was at risk because of the state of Royal Mail's finances, which were being undermined by:

    (1) the continuing decline of the market and of Royal Mail's market share;

    (2) the failure of the company to tackle to the necessary extent, and speed, modernisation;

    (3) the unsustainability of the Royal Mail pension deficit; and

    (4) the regulatory regime.

37. As regards the growth in access competition, the report concluded that, while access competition had brought some benefits to consumers in the form of keener prices, the way it was regulated needed to be reviewed. In particular, the report recommended that the regulator should review the relationship between the regulated access headroom margin and Royal Mail's costs, the incentives that regulation provided Royal Mail for efficiency, and the need for improved cost transparency. The report noted that very few other countries mandated access in the same way as the UK and, in particular, no other country operated a comparable system of headroom access.

38. The report did not accept that liberalisation of the market had threatened the universal service; instead it found that competition brought benefits from encouraging efficiency and saw the threat as coming from developments in the

wider communications sector rather than within the postal sector. The report said at paragraph 193:

> "In conclusion, we believe that competition brings benefits for consumers in the postal market, as it has in the wider communications sector. By creating pressure on companies to be more efficient and create new streams of revenue, it will support the universal service."

39. The report further stressed the need to apply regulation in a balanced way so that Royal Mail was encouraged to become more efficient; competition was in principle beneficial, but some care was needed to avoid competitors exploiting Royal Mail's USO burdens. It observed (at paragraph 195) that while there was much scope for reducing the costs of Royal Mail's national network:

> "If it becomes clear that the potential for efficiency gains is slowing in the longer term, and the tensions between competition and the universal service become more pronounced, it may be that the Government will need to consider introducing a new funding methodology, such as a compensation fund or direct government subsidy, in order to maintain the current specification of the universal service. But that is neither necessary nor desirable now, while there is significant scope to reduce the costs of the national network."

40. The key recommendations included:

(1) a new regulatory regime to place postal regulation within the broader context of the communications market;

(2) transferring responsibility for regulating the postal sector to Ofcom, an experienced regulator, with a primary duty to maintain the universal service and that Ofcom should promote competition "where appropriate";

(3) The regulator should take an approach which balanced the benefits of competition with the risks to the universal service. Preserving the universal service should remain the regulator's primary duty;

(4) strengthened parliamentary accountability for providing the universal service;

(5) the Post Office should remain wholly within public sector ownership; and

(6) the Government should address Royal Mail's historic pension deficit.

41. The Government accepted all of the report's recommendations and sought to implement them via a new Postal Services Bill introduced in the House of Lords during the first half of 2009. Before it could enter the House of Commons in June/July 2009, the Government decided to put the legislation on hold, stating that market conditions in the European postal sector had made it impossible to conclude the process to identify a strategic partner on terms that the Government could be confident would secure value for the taxpayer.

42. Mr Hooper was asked by the Government to update his report and he published an updated report in September 2010.[5]

43. The second report found that the universal service continued to be under threat and that most of the concerns previously identified had got worse. It concluded that "Royal Mail will not survive in its current form and a reduction in the scope and quality of the much-loved universal postal service will become inevitable." (pages 7-8). It confirmed that Royal Mail still needed private sector capital, as it was unlikely to generate sufficient cash to finance the modernisation required, but this had to be linked to resolving the pension deficit issue and the need to transform the postal regulatory regime.

44. The second report stated that "the current regulatory framework is clearly no longer fit for purpose" (page 30) and recommended that the overall burden of regulation should be reduced by:

    (1) focusing regulation on sustaining the universal service;

    (2) ensuring that inappropriate competition did not undermine the universal service and Royal Mail's ability to finance it;

    (3) introducing a new access regime which would ensure the right balance between competition and the financial sustainability of the universal service; and

    (4) focusing regulation where there was a monopoly and removing regulation much more quickly from the competitive parts of the market.

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[5] Richard Hooper: *An Update of the 2008 Independent Review of the Postal Services Sector*, September 2010.

45. The second report also stated (at pages 28 to 29):

> "The overarching question on regulation today appears to be whether there is a point at which protection of the universal postal service (along with its financial sustainability) comes into direct conflict with the promotion of competition, and what is the appropriate balance between the two regulatory aims…
>
> Critics of Postcomm assert that, historically, the regulator has been too encouraging of competition to the detriment of the universal postal service. It can be argued instead that, given Royal Mail's refusal to, or inability to, modernise historically, competition was needed to force the pace. It is insufficient modernisation not too much competition that really undermines the universal postal service."

(f) The different pricing plans

46. It is helpful to outline the origin of the pricing plans, the subject of the dispute in this case.

47. In February 2004, Royal Mail and UK Mail entered into the first access arrangement in the UK. This was followed in April 2004 by an identical agreement with Whistl. 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.

48. 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, later reduced to four cost-based zones, based on the delivery characteristics of that sector, each of which was then associated with a different price.

49. In December 2006, Whistl complained to Postcomm that the combination of national profile requirements, termination rights and surcharges made it impossible to move from downstream access to end-to-end competition and that the 2004 zonal pricing arrangement was not commercially viable either.

50. Postcomm asked Whistl to seek resolution with Royal Mail before it would consider a formal investigation and in January 2007 Whistl confirmed it would suspend its complaint while it did so. 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. As a result, in December 2007 Whistl asked Postcomm to set appropriate terms of access based on Whistl's previous request to Royal Mail.

51. In August 2008, during this process, Royal Mail consulted on two changes to its access arrangements:

(1) for 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; and

(2) for 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 sector 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).

52. As a result of this, Postcomm delayed 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.

53. Following its consultation, Royal Mail requested that Postcomm vary its licence to enable it to make the changes it had proposed to the zonal structure and to align the national price to the weighted average of the new zonal structure. Royal Mail also noted that the proposed changes 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). Postcomm consulted on these changes in February 2009 and issued a decision in May 2009

to vary Royal Mail's licence to change the zonal structure. Postcomm welcomed Royal Mail's proposed changes to the national pricing arrangement and agreed that Royal Mail should introduce the changes through the variation procedures set out in those contracts.

54. 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. 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 sent to each Postcode sector to a system based on the proportion of mail sent to each of the zones. This was the genesis of price plan 'APP2'.

55. In February 2011, Royal Mail sought consent from access operators to vary their contracts to incorporate the new national pricing framework. 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.

(4) The position after 2012

(a) The Postal Services Act 2011

56. Following the commencement of the 2011 Act, Ofcom replaced Postcomm as the regulatory authority for postal services on 1 October 2011. Operators were now permitted to provide postal services without the need for any licence or prior regulatory authorisation from Ofcom. The previously applicable system of *ex ante* licensing was abolished and section 28 of the 2011 Act provided Ofcom with powers to impose a defined list of regulatory conditions on postal operators in given circumstances.

57. By a decision of 27 March 2012, Ofcom exercised its powers under section 41 of the 2011 Act 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). This condition did not require any authorisation from

Ofcom but required an operator to give Ofcom three months' advance notice if it was planning – in the quarter following the notification period – to:

(1) enter the market and deliver more than 2.5 million letters in the UK, or

(2) increase the volume of letters it is carrying by more than 2.5 million.

58. The 2011 Act provides, in summary, that Ofcom:

(1) is required to carry out its functions in a way which it considers will secure provision of the universal postal service;

(2) may designate one or more universal service providers. (Ofcom has designated Royal Mail as the UK's universal service provider);

(3) Must, if so directed by the Secretary of State, require persons to provide advance notification of their intention to provide a letters business on a specified scale or to expand a letters business by a specified extent;

(4) may impose "general universal service conditions" on postal operators providing a service within the scope of the universal postal service, to secure the provision of a universal postal service in accordance with the required standards;

(5) may review the extent of the financial burden for a universal service provider of complying with its universal service obligations; and

(6) must, after such a review, determine whether it is or would be unfair to require the provider to bear, or to continue to bear, that burden; and, if so, recommend action to the Secretary of State to deal with the burden.

(b) Royal Mail's engagement with Ofcom over its concerns regarding direct delivery

59. Royal Mail had extensive discussions with Ofcom about the possible impact of direct delivery. These started when Ofcom first became the postal sector

regulator and continued beyond the issuing of the Contract Change Notices in January 2014.

60. Ofcom viewed the development of end-to-end competition as a key feature of its 2012 regulatory framework. Royal Mail considered that end-to-end competition presented a direct threat to the financial sustainability of the universal service.

The March 2012 Statement

61. 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").[6] The March 2012 Statement introduced a new regulatory framework that departed 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 – in particular by reducing the notification, publication and pre-approval requirements for product changes and new services.

62. In the March 2012 Statement, Ofcom acknowledged the need for a balance to be struck between: (i) the benefits of end-to-end competition; and (ii) the potential risks that such competition could pose to the sustainability of the universal service:

> "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." (paragraph 1.53)

63. As part of the new regulatory framework, Ofcom set the Universal Service Provider ("USP") Access Condition. This condition required Royal Mail to

[6] Ofcom, *Securing the Universal Postal Service – Decision on the new regulatory framework*, 27 March 2012.

grant access at its inward mail centres for the provision of retail D+2 and later than D+2 letters and large letters on fair, reasonable and not unduly discriminatory terms. 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.

The July 2012 Guidance

64. On 25 July 2012, Ofcom issued further guidance[7] to the effect that it was not necessary to impose any regulatory conditions on end-to-end operators to secure the provision of the universal service. It considered that Royal Mail had options to respond competitively to Whistl's end-to-end entry.

The March 2013 Guidance

65. On 27 March 2013, Ofcom published further guidance[8] on its approach to assessing the effect of end-to-end competition on the universal postal service in which it said it would take account of Royal Mail's financial position, the likely scale of end-to-end competition and its impact on Royal Mail; and the potential for commercial responses by Royal Mail (subject to the need to comply with competition law and regulatory conditions). In a separate document, Ofcom made clear that it did not at that time consider end-to-end competition was a threat to the universal service.

(c) The Access Letters Contract

66. On 8 October 2012, Royal Mail began a process to replace the existing access agreements with a new form of contract. It said in its discussion document for customers that this was because these agreements were out of date and in need of fundamental reform.

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[7] Ofcom, *Update on Ofcom's position on end-to-end competition in the postal sector*, 25 July 2012.
[8] 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.

67. 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 matching Royal Mail's profile across Standard Selection Codes ("SSCs") and between zones. In return, prices for all committed volumes would be lower than those charged under the zonal pricing plan. However, in announcing its final terms on 21 January 2013, Royal Mail largely retained the structure of the price plans that it had developed over the preceding eight years. Those final terms were set out in the Access Letters Contract ("ALC"), and were still in place in January 2014.

68. The new ALC 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 access operators. Royal Mail explained to access operators that this unilateral power to vary was subject to a number of limitations.

    (1) First, Royal Mail would be required to provide minimum periods of notice before it could implement the effects of a variation. 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' notice whereas changes to the pricing structure required 190 days' notice.

    (2) Second, the number of tariff changes that Royal Mail could carry out would be limited to twice in a financial year.

    (3) Third, any contract change notices that became the subject of an investigation by Ofcom or any other regulatory or competition authority would be suspended pending resolution.

69. Royal Mail said that it would price the new contracts at 2.44% less than the existing agreements to provide customers with an appropriate incentive to switch. The vast majority of customers switched immediately and began to operate on the new terms from April 2013.

(d) Royal Mail's access arrangements

70. Royal Mail's delivery network is based on geographical administrative areas. The delivery network is organised around the postcode system (alphanumeric codes attached to every UK delivery address that allow Royal Mail and other postal operators to sort and sequence mail accurately). 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.

71. Postcodes are aggregated by Royal Mail into postcode groupings of different levels of granularity:

(1) 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 contiguous areas;

(2) Five-digit SSCs are used to aggregate postcode sectors into approximately 1,500 contiguous areas; and

(3) Three-digit SSCs, represented by the first three digits of the five-digit SSCs, are used to aggregate five-digit SSCs into 83 larger contiguous areas.

72. Separate from 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: (i) London, (ii) urban, (iii) suburban and (iv) rural.

(e) The price plans in the Access Letters Contract

73. As a result of this process, by January 2014, the ALC offered access operators a choice of three price plans:

(1) a uniform price plan called National Price Plan One ("NPP1");

(2) a uniform price plan called Averaged Price Plan Two (Zones) ("APP2");9 and

(3) a price plan containing separate prices by delivery location called Zonal Price Plan ("ZPP3").

74. 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. We explain briefly the terms of these price plans as they are central to the dispute in this case.

National Price Plan 1 (NPP1)

75. 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 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'.

76. The National Spread Benchmark required access operators to post a similar distribution of bulk mail to each SSC across the whole of the UK (excluding the Channel Islands and Isle of Man) as that delivered by Royal Mail. It was based on Royal Mail's combined geographic delivery profile of bulk mail across each of the 83 three-digit SSCs. 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.

77. 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. This applied to

[9] Previously this price plan was known as "National Price Plan Two (Zones)" ("NPP2"). In the interests of clarity, we refer to this price plan exclusively as APP2.

SSCs outside London and was based on the proportion of access and bulk mail delivered by Royal Mail to postcodes that had been allocated to the urban zone.

78. 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 and in a pattern similar to that of Royal Mail. Eligibility to use NPP1 was subject to certain specific conditions. These included a requirement to use all reasonable endeavours to meet both the National Spread and Urban Density Benchmarks, subject to a degree of tolerance, but with the possibility of Royal Mail imposing a surcharge for non-compliance. The conditions of eligibility and the manner of their enforcement by Royal Mail are matters of dispute between the parties.

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

79. Under APP2, Royal Mail offered an alternative 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 meet a zonal profile. For the purposes of this plan, Royal Mail allocated postcodes to one of four zones - rural, urban, suburban and London - 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.

80. 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. As this profile measured volumes in four non-contiguous zones, APP2 did not require operators to send mail across the whole of the UK, a key difference from NPP1.

81. APP2 operators were subject to a requirement to show to Royal Mail's reasonable satisfaction that they were reasonably likely to conform to the Zonal Posting Profile benchmark. As with price plan NPP1, if they failed to meet the profile by more than a specified amount, Royal Mail was entitled to impose a surcharge. Again, this is a matter of dispute between the parties.

82. 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 surcharging measures.

83. As set out above, Royal Mail had in place a system of 'zones' which aggregated 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:

(1) NPP1 prices were determined by Royal Mail;

(2) APP2 prices were derived from NPP1 prices by applying an increase of 1.2%; and then

(3) 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.

84. 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 zones.

85. Under the price plans in place up to 2014, the application of the zonal tilt 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.

86. Under the changes to the zonal tilt announced in 2014, the notified 2014-15 ZPP3 prices for urban and London zones were to be significantly reduced compared to 2013-14 prices, while the prices for suburban and rural zones were significantly increased. As the zonal prices were derived from APP2 prices, they were also to be increased as a result of the price differential to be introduced between NPP1 and APP2.

87. Historically, all access arrangements, whether under NPP1, APP2 or ZPP3, have been priced at an equivalent rate. For example, 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 Zonal Posting Profile), it would pay an average price that was the same as NPP1.

(5) The preparation of the 2014 Contract Change Notices

(a) Royal Mail's development of the January 2014 price changes

88. Royal Mail made significant changes to the contractual framework for D+2 Access in January 2013. As noted above, 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 ALC.

89. Royal Mail started working towards introducing new price changes in the spring of 2013, when Royal Mail launched a project, the early stage of which involved the preparation of presentations to the Chief Executive's Committee ("CEC") in May 2013 and to the Royal Mail Group Board in June 2013. These set out Royal Mail's overall strategy in the letters markets (referred to 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.

90. At the same time, a project was initiated, by way of a proposal in May 2013 to Royal Mail's Pricing Strategy Board ("PSB"), which was a decision-making forum to review pricing strategies and proposals, to develop the detailed pricing proposals that would be used to implement the Letters 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 proposals involving the development of options for pricing changes, including a proposal to introduce a price differential between NPP1 and APP2/ZPP3.

(b) Royal Mail's finalisation and approval of the January 2014 Contract Change Notices

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

92. On 16 December 2013, the PSB discussed the proposed price changes for April 2014, including a consideration of the price differential. The paper that was submitted to the PSB was later submitted in substantially the same form to the CEC on 18 December 2013.

93. On 18 December 2013, the CEC approved the proposed price changes for April 2014. This included a proposal to introduce a price differential between the prices Royal Mail's customers were charged under NPP1 and APP2/ ZPP3. A price differential in the range of between 0.2 and 0.5 pence per item was considered.

94. The CEC delegated approval of the level of the differential to the Disclosure Committee, one of its sub-committees. On 3 January 2014, a paper was circulated to members of the Disclosure Committee in advance of it meeting on 6 January 2014. That paper proposed that Royal Mail implement a 0.3 pence differential between NPP1 and APP2/ZPP3. The paper contained a detailed set of justifications for the introduction of the price differential.

95. At its meeting on 6 January 2014, the Disclosure Committee did not approve the 0.3 pence differential but at a further meeting on 8 January 2014, it agreed to a revised price differential of 0.25 pence (approximately 1.2%).

96. On 10 January 2014, Royal Mail published Contract Changes Notices 002, 003, 004 and 005 ("the CCNs"). As we have described, the CCNs introduced a differential between price plans NPP1 and APP2 and changes to the zonal tilt.

97. Royal Mail confirmed that the changes would come into effect on 31 March 2014. Royal Mail informed Ofcom that the price differential reflected the cost benefit Royal Mail would gain by being able to plan more accurately at a local

level and deliver greater efficiencies and that the differential reflected a new feature of the NPP1 pricing plan (not contained in plan APP2) which required customers to provide monthly volume forecasts including significant changes for up to two years ahead, based on a national mail profile across 86 local districts.

(c) The Contract Change Notices

Contract Change Notice 001

98. Prior to issuing the January 2014 CCNs, Royal Mail had already issued Contract Change Notice 001 on 15 November 2013. It introduced three changes to APP2:

(1) It reduced the tolerance applied to the zonal posting profile from 7.5% to 2%.

(2) It reduced the automatic transfer threshold from 15% to 10%.

(3) It changed the name of the plan from "National Price Plan Two (Zones)" to "Averaged Price Plan Two (Zones)."

The notice period for these changes would have concluded on 31 March 2014. However, following the opening of Ofcom's investigation, the implementation of the changes was suspended on 21 February 2014.

Contract Change Notice 002

99. Royal Mail issued Contract Change Notice 002 on 10 January 2014. It introduced price changes to the access prices for all three price plans. The notice referred to full details of the unilateral changes on the Royal Mail Wholesale Website and included details of the prices for "key services" under the NPP1 contract.

100. 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):

(1) A general price increase across all price plans, which Royal Mail described as an RPI-linked price increase.

(2) 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.

(3) Price changes resulting from the price differential between NPP1 and APP2 and the revised zonal tilt.

101. The notice period for these changes was to conclude on 31 March 2014. However, Royal Mail suspended the relevant changes on 21 February 2014 and on 4 March 2014 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 between NPPI and APP2 and the revised zonal tilt).

102. 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

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). It introduced three changes to NPP1:

(1) 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.

(2) 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.

(3) Changes to the structure of the tolerances relating to the National Spread Benchmark so that Scotland and Northern Ireland would be measured as separate regions, rather than a single region. This also had the effect of changing the specific variances allowed in Scottish and Northern Irish SSCs.

103. The notice period for these changes would have concluded on 4 August 2014. However, due to the opening of Ofcom's investigation, the implementation of these changes was suspended on 21 February 2014. This Notice was withdrawn in its entirety on 11 March 2015.

Contract Change Notice 004

104. Royal Mail issued Contract Change Notice 004 on 10 January 2014. It introduced four changes to NPP1:

(1) It reduced the tolerance for National Spread Benchmark compliance from six failed SSCs in England and Wales to five failed SSCs.

(2) 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.

(3) Following on from Notice 003, it specified the level of volume decline in SSCs that would trigger the requirement to provide a forecast.

(4) 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.

105. 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 Ofcom's investigation on 21 February 2014. This Notice was withdrawn in its entirety on 11 March 2015.

Contract Change Notice 005

106. Royal Mail issued Contract Change Notice 005 on 10 January 2014. It introduced two main changes, one to APP2 and one to ZPP3:

(1) a price differential between NPP1 and APP2 prices, under which APP2 prices were set to be approximately 1.2% higher than NPP1 prices. 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.

(2) a change to the zonal tilts on the basis of which ZPP3 prices were set.

107. The notice period for these changes would have concluded on 31 March 2014. As with the other CCNs, they were suspended on 21st February 2014 and withdrawn on 11th March 2015. CCNs 002-005 are the focus of the present dispute and their fate is described in more detail in subsequent paragraphs.

(d) Developments in relation to Whistl

108. We now briefly describe the effect of these developments on Whistl's plans for expansion of its direct delivery business.

109. By 2013, Whistl had commenced end-to-end delivery in four SSCs (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) and had established a business model and roll-out plan which were designed to enable it to develop further its own delivery network. The key features of this plan (called Project Luke by Whistl) were as follows:

(1) **Conversion of customers.** To establish a viable delivery business it was necessary to 'convert' Whistl's existing retail customers (handling about 3.8 billion letters in 2013) 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 customers, and (b) 'regional' accounts, which accounted for 25% of its volumes and related to SME, local government and mailing house customers. Whistl was able automatically to convert most volumes from its regional accounts, but it was required to seek consent from national customers to switch their volumes. By May 2013, Whistl had converted around 50% of volumes in the areas where it was operating end-to-end.

(2) **Alternating delivery days.** Whistl's business model was based on delivering to each postcode three times per week on alternating days.

(3) **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 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 postcodes (mostly in suburban, London and urban delivery areas) and deliver nearly 1.5 billion letters per year.

110. 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.

111. On 25 February 2013, Whistl's parent company, PostNL announced that the pilot had been successful and that it would be seeking to launch a full end-to-end service. It noted that PostNL had "cash constraints" and that, accordingly, it was receptive to an investment partner to contribute to an overall investment of €50 to €80 million.

112. In May 2013, Whistl produced an investment memorandum to support PostNL's aim of securing a funding partner. This set out in 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, and projected growth in EBIT from £10 million in financial year 2012 to £67 million in financial year 2018.

113. On 5 August 2013, PostNL repeated, in an analysts' 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".

During this period PostNL was negotiating with LDC, the private equity arm of Lloyds Banking Group.

114. In October 2013, LDC appointed Pricewaterhouse Coopers LLP (PwC) to carry out due diligence activities on the proposed deal.

115. 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 December 2013 to formalise LDC's investment in Whistl. 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).

(e) Whistl's and its investors' responses to the Contract Change Notices

116. On 27 November 2013, Whistl wrote to Royal Mail expressing concerns that its customers were being approached by one of its competitors, who was stating that there would be a differential price introduced by April 2014 and requesting confirmation that Royal Mail would not introduce such differential pricing.

117. On 6 December 2013, Royal Mail confirmed to Whistl that it had made a decision in principle to introduce a price differential but that the precise amount was still to be decided.

118. Whistl considered that a price differential could have a material detrimental impact on its end-to-end business. It was also noted that the expected publication date of the CCNs would, in relation to the LDC agreement, fall between exchange and completion raising questions of material adverse change. On 7 December 2013, Mr Wells, the CEO of Whistl, wrote to a director of PostNL noting the unfortunate timing and raising the question of how to approach this with LDC. On 8 December 2013, Whistl's legal advisers advised that this development should be disclosed to LDC before signature.

119. 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; that it was having to underwrite the differential in upstream price; and that its access business would be loss-making with a differential of only c.1.2%.

120. After Royal Mail's announcement on 6 December 2013, an additional 'material adverse effect' condition ("MAE Condition") was included in the investment agreement. This was confirmed by LDC, who explained to Ofcom that the proposed prices changes could have an adverse impact on the viability of Whistl's roll-out plans and consequently have an adverse impact on the value of its proposed investment.

121. LDC told Ofcom that it had instructed its lawyers to draft an MAE clause and a first draft of this was produced on 10 December 2013. On 11 December 2013, PostNL's legal advisers circulated a revised draft of the MAE Condition which was eventually incorporated into the agreement. On 13 December 2013, Whistl's management provided a disclosure letter to LDC.

122. On 16 December 2013, LDC and PostNL announced that they had reached an agreement (the "LDC Agreement") to establish a joint venture for an end-to-end postal delivery service. Alongside 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"). The bank had the right to withdraw these funds in the event that there was a material change to Whistl's business.

123. Completion of the LDC Agreement was conditional on two events - a requirement for merger control clearance, and the MAE Condition. There were also a number of other standard specified events which entitled LDC to terminate.

124. The MAE Condition (clause 4.2) provided that completion 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."

125. Clause 4.3 set out that if clause 4.2 was not satisfied by the long stop date, 13 June 2014, then each party could terminate the agreement.

126. Similarly, clause 5.6 set out a list of events which would entitle LDC to terminate the agreement. These included:

> "(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" (Clause 5.6.6).

A "Material Adverse Effect" was defined as any event which caused a material change in the business, operations, assets, position (financial, trading or otherwise), profits of the Group, taken as a whole.

(f) The formal introduction of the Contract Change Notices, delay to Whistl's external investment, and Whistl's complaint to Ofcom

127. On 17 December 2013, Whistl met with Royal Mail. Whistl repeated its complaints but Royal Mail said there were ways in which Whistl could mitigate any harm, including by switching to price plan NPP1. The meeting did not lead to any agreement.

128. On 8 January 2014, Whistl wrote to Royal Mail setting out its position. Whistl explained that Royal Mail's plan to include a price differential could make its existing end-to-end business and its proposed expansion unviable, and threaten the continued support of its investors, Post NL and LDC. Whistl said that Royal Mail's plans would constitute an abuse of dominant position and contravene relevant law and regulatory rules.

129. Nevertheless, on 10 January 2014, Royal Mail published CCNs 002, 003, 004 and 005 and on the same day replied to Whistl's letter expressing disagreement with its content.

130. Whistl began to analyse the impact of the CCNs and consulted with PostNL and LDC. On 13 January 2014, Whistl issued a statement to its staff regarding the price differential to be used in communications with customers who Whistl senior management felt would benefit from clarification and reassurance as to Whistl's position.

131. On 14 January 2014, Whistl prepared an internal strategy presentation on 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.

132. 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. Whistl's complaint was supported by an economic paper prepared by Frontier Economics.

133. At the same time, Whistl reviewed its expansion plans, developing several scenarios for delayed or cancelled roll-out. In line with this strategy, Whistl continued with its roll-out to Harrow in February 2014 and Liverpool in March 2014.

134. On 30 January 2014, merger clearance from the European Commission (the "Commission") was received.

135. On 2 February 2014, LDC 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.

(g) Ofcom's decision to open an investigation and Royal Mail's response

136. On 21 February 2014, Ofcom announced that it was opening an investigation into Royal Mail's prices and terms and conditions following the CCNs. Ofcom explained to Whistl by letter of the same date that it was considering whether it was more appropriate to use its regulatory enforcement powers or its CA 1998 enforcement powers to handle the investigation.

137. On the same day, Royal Mail issued a statement on the London Stock Exchange regulatory news service ("RNS") in response to Ofcom's announcement that it would investigate the issues raised by Whistl's complaint. 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 triggered the suspensory provisions relating to the CCNs.

138. On 4 March 2014, Royal Mail wrote to access customers to confirm that it was suspending the notice periods for Change Notices 001, 003, 004 and 005 for all access customers.

139. On 9 April 2014, Ofcom announced that it would be using its powers under the CA 1998 to investigate the issues raised by Whistl and announced a review of the regulatory framework for access pricing. On the same date, Royal Mail issued a statement on the RNS, in response to Ofcom's decision to open a CA 1998 investigation.

140. 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. Royal Mail said that it was using the commercial freedom allowed to it under the current regime to respond to increased competition and the need to support the financing of the USO. The suspension of the price changes meant it was unable to respond commercially as it needed to, and that this situation could continue for a long period.

141. In November 2014, as part of a briefing for analysts, Royal Mail's Chief Executive expressed the view that the price changes were in line with Ofcom's 2012 guidance and that the issue needed to be resolved, one way or the other, soon.

(h) Whistl's and LDC's agreement to a revised MAE condition and further delay to Whistl's roll-out progress

142. Meanwhile, on 17 June 2014, clause 4.2 of the LDC Agreement was replaced by a modified provision referring to possible Ofcom guidance on the access regime and taking account of the effects of delay in completion and clause 4.3 was varied to permit termination ahead of the "longstop date", which was itself eventually extended to 19th December 2014.

143. Following its expansion to Liverpool in March, Whistl's final planned step for 2014 was to expand end-to-end operations to Edinburgh. In June 2014, Whistl delayed its expansion to Edinburgh to Q2 2015 (i.e. a total delay of 12 months) and brought forward its proposed roll-out to Oldham, Bolton and Stockport by 6 months to Q4 2014.

144. By June 2014, the state of Whistl's roll-out plan was: (i) a total of six SSCs already achieved (ii) three SSCs (see above) brought forward by six months in 2014 (iii) Edinburgh and East London deferred by 12 months in 2015 and (iv) six further SSCs deferred by six months through to Q4 of 2015. By October 2014, however, the Oldham/Bolton/Stockport expansion had been postponed until Q3 2015.

145. On 3 November 2014, PostNL, in a briefing for analysts, said that it would continue end-to-end operations in all the cities where it was delivering end-to-end, but would stop further roll-out until the outcome of the Ofcom investigation.

(i) Further events

Ofcom's consultation on a revised regulatory framework

146. On 2 December 2014, Ofcom consulted on a revised USP access condition which would have regulated Royal Mail's provision of access services. Ofcom said that this review arose from concerns that Royal Mail's current behaviour could discourage or even prevent competition in bulk mail delivery, leading to reduced pressure on Royal Mail to deliver efficiency improvements and a risk of excessive pricing.

147. The consultation contained proposals for two major changes related to the prices introduced in the CCNs. Ofcom did not ultimately proceed with these proposals.

Royal Mail's withdrawal of the Contract Change Notices

148. On 11 March 2015, Royal Mail announced that it had decided to withdraw the already suspended CCNs. It said this was because it thought an appropriate access pricing framework could be achieved through regulation by Ofcom rather than a competition law investigation and that withdrawing the CCNs would help a constructive dialogue with Ofcom.

LDC's withdrawal of its offer of investment

149. In late April 2015, LDC informed PostNL it had decided not to proceed with its investment in Whistl. LDC informed Ofcom that this was because of declining postal volumes and ongoing regulatory uncertainties. On 30 April 2015, PostNL announced that LDC had terminated its discussion with PostNL on investment in Whistl's operations.

Whistl's closure of its bulk mail delivery service

150. On 6 May 2015, PostNL announced a strategic review of its international activities prompted by the withdrawal of LDC and continuing regulatory uncertainties in the UK and the other countries in which it operated.

151. On 11 May 2015, Whistl announced the suspension of its current bulk mail delivery operation, citing the need for an extensive review of the end-to-end business and the need to stem losses. This was followed, on 10 June 2015, by the announcement that it was ceasing its bulk mail delivery operation, saying there was no viable alternative solution that would ensure a sustainable future for the current service. The announcement stated:

> "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."

D. THE DECISION

152. On 9 April 2014, Ofcom announced that it would proceed with an investigation under the CA 1998, following a formal complaint submitted by Whistl on 28 January 2014. That investigation culminated in the Decision.

153. The key findings in the Decision for the purposes of this appeal are, in broad outline, as follows:

(1) The infringement period was at least the period from 10 January 2014, being the date on which the CCNs were issued, until at the earliest 21 February 2014, being the date on which the CCNs were suspended once Ofcom opened its investigation.

(2) Ofcom did not find 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 but concluded that the price differential was reasonably likely to have continuing effects after the date of suspension.

(3) The relevant market was a national (UK) market for bulk mail delivery, which consisted 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.

(4) Royal Mail held a dominant position in the relevant market.

(5) Royal Mail had abused its dominant position. In reaching this conclusion, Ofcom determined the following.

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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, led Ofcom to conclude 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.

(6) Royal Mail's conduct was not objectively justified under Article 102 TFEU (or section 18 CA 1998) or Article 106(2) TFEU.

(7) Royal Mail acted at least negligently in committing the infringement and it was appropriate to impose a financial penalty on Royal Mail (taking into account the seriousness of the infringement and the importance of deterrence). Accordingly, Ofcom imposed a financial penalty of £50 million.

E. THE APPEAL

(1) Overview

154. The relief sought by Royal Mail in this appeal is:

(1) for the Decision to be annulled in its entirety or in part; or alternatively

(2) an annulment or reduction in the penalty imposed on Royal Mail.

155. Royal Mail also seeks an award of its costs incurred in connection with this appeal and a grant of any other relief as may be required.

156. There are six grounds of appeal raised by Royal Mail in its notice of appeal. In summary, they are as follows:

(1) **Ground 1** - Ofcom erred in law and in fact by concluding that, when Royal Mail issued the Contract Change Notices, prices were applied for the purposes of Article 102(c) and section 18(2)(c) CA 1998. The price differential was never applied.

(2) **Ground 2** – Ofcom erred in concluding that transactions undertaken between Royal Mail and all of its different access customers are equivalent in all material respects, and that the price differential could not be justified. Royal Mail did not apply dissimilar conditions to equivalent transactions, and it had a cost justification for introducing the price differential. There was no improper discrimination.

(3) **Ground 3** - Ofcom erred in its assessment of whether the price differential was likely to give rise to a competitive disadvantage and/or a restriction of competition because it failed to have proper regard to the impact of the conduct on an 'as efficient competitor'. There was no competitive disadvantage.

(4) **Ground 4** - Ofcom erred in finding that any abuse was not objectively justified under Article 102 and/or Article 106(2) TFEU by reference to the need to preserve the viability of the universal service under economically acceptable conditions.

(5) **Ground 5** - Ofcom committed a fundamental procedural error by basing its findings of a likely competitive disadvantage in the Decision on evidence and analysis that was not previously included, or relied upon,

in the Statement of Objections ("SO"), or otherwise put to Royal Mail during the administrative phase.

(6) **Ground 6** – Ofcom erred in imposing a £50 million fine on Royal Mail. No fine should have been imposed in the light of the novel and unforeseeable application by Ofcom of Article 102 to the act of issuing the CCNs. Alternatively, the fine should be very significantly reduced.

(2) Factual witnesses

157. Royal Mail offered three factual witnesses, Ms Susan Whalley, Mr Stuart Simpson and Dr Helen Jenkins.

(1) Ms Whalley was Royal Mail's Regulation and Government Affairs Director from 2010 to January 2014 and was then Chief Operating Officer until October 2018, when she left the company "with immediate effect", but in fact worked under notice until February 2019.

(2) Ms Whalley was closely involved in the planning and events leading up to the issuing of the CCNs and provided a written witness statement that described that process and the events in question. In her oral evidence under cross examination Ms Whalley was less helpful than we might have expected, given the senior and central positions that she had held, often being very hesitant in her replies, being unable to comment on particular documents shown to her and sometimes having an uncertain recollection of the events. She appeared in some instances to be giving rather formulaic answers and to be more concerned with defending a particular line of argument than recalling facts. Whilst she provided confirmation on a number of key points, we were unable to place great reliance on the generality of her evidence.

(3) Mr Simpson is currently Royal Mail's Chief Finance Officer, who was employed by Royal Mail from 2009 as Financial Director of Operations and, from January 2014, Deputy Chief Operating Officer. He said he was not involved in the development of the CCNs that were the subject

of the decision. He provided written evidence of Royal Mail's financial position, some features of the market, its accounting practices and its reporting obligations. Ofcom did not wish to cross-examine him and he was not called to give oral evidence.

(4) Dr Jenkins is an economic consultant, currently a managing partner of the economics consultancy Oxera, but, somewhat unusually, in this case was offered as a witness of fact. She provided a witness statement describing the involvement of herself and her Oxera colleagues in the development and formulation of Royal Mail's business strategy in relation to the bulk mail sector and its response to the emergence of direct delivery competition. Her written evidence described these matters, including Oxera's role in advising Royal Mail and the advice it had provided.

(5) Factual evidence given by someone who would normally be giving expert evidence can be problematic. In some cases, the distinction between what Dr Jenkins had advised and what was her current opinion was not clear and we have taken care to disregard any of her evidence that might be seen as opinion rather than fact. In oral evidence under cross examination, Dr Jenkins was open and helpful, although careful in what she said. Although Dr Jenkins was in charge of the Oxera team she was absent (on leave) for a particular time in October 2013 when some important matters were considered and was not able to give direct evidence on those matters.

158. Ofcom did not call any witnesses of fact at the hearing and relied on the contents of the Decision.

159. Whistl offered Mr Nicholas Wells and Mr Nigel Polglass as factual witnesses.

(1) Mr Wells was the Chief Executive of Whistl and led the management buy-out of Whistl in October 2015. He was closely involved in the development of Whistl's bulk mail business in the UK and its proposed expansion into end-to-end service. His written evidence described these

matters from Whistl's point of view, including the development of Whistl's strategy, its relations with its customers, Royal Mail and Ofcom, and its attempts to raise investment finance. In oral evidence under cross-examination, Mr Wells was a little more hesitant and less exact in his recollections, and some of his assertions about Royal Mail's behaviour could not be sustained.

(2) Mr Polglass was Whistl's Chief Operating Officer and had also been closely involved in Whistl's operations and plans at the relevant time. His written evidence concentrated on Whistl's strategy and commercial approach and the effect of Royal Mail's pricing practices on Whistl. In oral evidence, under cross examination, Mr Polglass was forthright and clear in his statements but, as with Mr Wells, seemed occasionally to let his frustration at what he perceived as unfair business behaviour by Royal Mail colour the objectivity of his recollection.

(3) Subject to these reservations, we found both Mr Wells and Mr Polglass to be generally reliable witnesses.

(3) Expert witnesses

(a) The parties' experts

160. Royal Mail's expert witnesses were Mr Neil Dryden, Executive Vice President of Compass Lexecon, and Mr Greg Harman, Senior Managing Director and Partner in the Economic and Financial Consulting Practice of FTI Consulting LLP.

(1) Mr Dryden provided five written reports (three of which had been prepared for the administrative phase before Ofcom). His evidence covered the overall substance of the case, including aspects of the penalty calculation, but concentrated on the estimation of competitive disadvantage and the use of an as-efficient competitor ("AEC") test. In oral evidence, under cross examination, Mr Dryden was careful and precise, competently seeking to explain and justify the approach he had

adopted on the economic issues in the case whilst being careful not to be drawn on matters outside the scope of the evidence he had provided. We found Mr Dryden to be an impressive witness, but that is not to say that we accepted everything he was saying.

(2) Mr Harman provided six written reports (three of which had been prepared for the administrative phase before Ofcom). His evidence was directed mainly to the significance of the CCNs and their subsequent suspension, to the materiality of the effects of the alleged infringements and the practical application of the AEC test devised by Mr Dryden. Mr Harman was unable to give oral evidence (see paragraph 165 below).

161. Ofcom's expert was Mr David Matthew, an Economic Director at Ofcom. Mr Matthew had not been involved in the original assessment of the CCNs and the Ofcom investigation and was not one of Ofcom's 'decision makers' in the case. From 2017, he had been involved in assessing the need for an AEC test in this case and in examining that put forward by Royal Mail. No objection was taken to his being put forward as an expert witness, despite his being a member of Ofcom's staff. Mr Matthew provided a written report in response to the matters raised by Mr Dryden and Mr Harman. In oral evidence, under cross examination, Mr Matthew appeared honest and straightforward, if occasionally somewhat laconic, stressing the need for a practical and pragmatic approach without excessive emphasis on theory. We found him a convincing witness on the matters covered by his evidence.

162. Whistl's expert witness was Mr David Parker of Frontier Economics. Mr Parker provided a written report and some additional calculations. His written evidence covered: the questions of implementation and suspension of the price changes; what, if any, AEC test was feasible or appropriate in this case; and a response to Mr Harman's evidence on materiality. In oral evidence, under cross examination, we found Mr Parker clear and convincing and willing to offer sensible economics-based comments on the issues before him, although as with Mr Dryden, we did not feel obliged to accept everything he said.

163. The four expert witnesses between them provided two separate joint expert opinions. The first, covering the general issues of the case and the analytical approach to be adopted, in particular as to the appropriateness or otherwise of an AEC test, and some particular issues between Mr Parker and Mr Dryden, was given by Mr Dryden, Mr Matthew and Mr Parker. The second, covering the issue of materiality and Mr Harman's approach to it, as well as the correct approach to foreclosure and applying an AEC test, was given by Messrs. Harman, Matthew and Parker. We found both these written exercises to be of significant benefit to the Tribunal in identifying what was common ground between the experts, what was not, and why.

(b) Concurrent evidence

164. We held one 'hot tub' session of contemporaneous expert evidence, in which the Tribunal's examination was led by Professor Ulph, to develop the evidence given by Messrs Dryden, Matthew and Parker. Again, we found this exercise very helpful in understanding what each expert was arguing and in establishing certain key points in the analysis, as will be seen from the subsequent parts of this judgment.

(c) The evidence of Mr Harman

165. During the course of the oral hearing, Mr Harman was unfortunately taken ill before he was due to give oral evidence. Mr Harman had provided six substantial expert reports. Despite efforts made by the parties to re-arrange the timetable to accommodate Mr Harman's indisposition, it was not possible to do so within the envelope of time allocated by the Tribunal to hear this appeal. Royal Mail accordingly proposed an adjournment of the hearing until such time as Mr Harman would have recovered sufficiently to give evidence. Ofcom and Whistl argued against an adjournment and said that Mr. Harman's written evidence should stand, and should be addressed in written submissions, without the need for oral examination of Mr. Harman. The Tribunal ruled that the hearing should not be adjourned. After hearing the parties' submissions on the best course of action to take, given the need to conduct a fair process, and with both Ofcom and Whistl agreeing in the circumstances to waive their right to

cross examination, we decided to proceed without hearing oral evidence from Mr Harman, relying on the contents of his detailed written statements and his contribution to the second Joint Expert Opinion. The full background to this issue and our reasons are set out in the Tribunal's ruling: [2019] CAT 19 (see also paragraph 600 below).

F. THE LEGAL FRAMEWORK

166. Article 102 TFEU provides as follows:

> "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.
>
> Such abuse may, in particular, consist in:
>
> (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."

167. The wording of the Chapter II prohibition set out in section 18 CA 1998 is materially the same as that in Article 102 TFEU, save that it applies to conduct that may affect trade within the UK. Ofcom found that the necessary effect on trade was made out in this case on the basis that the infringement may have affected trade within all or part of the UK and that Royal Mail's dominance in the national UK market meant that it had the potential also to affect trade between Member States. Royal Mail did not contest these findings and we do not consider this question further in our judgment.

168. Under section 60 CA 1998, questions concerning the Chapter II prohibition in relation to competition within the UK must be dealt with in a manner which is consistent with the treatment of corresponding questions under EU law in relation to competition within the EU. In particular, the Tribunal must determine

questions concerning the Chapter II prohibition consistently with the approach of the Court of Justice of the European Union (formerly the European Court of Justice) (the "Court of Justice") to Article 102 TFEU. The Tribunal must also have regard to any relevant decision of the Commission.

169. Pursuant to section 54 CA 1998, Ofcom has concurrent powers (set out more fully in section 371 of the Communications Act 2003) with the Competition and Markets Authority (the "CMA") to apply the provisions contained in Part 1 of the CA 1998. Part 1 contains all of the relevant provisions referred to in this judgment.

170. Paragraph 3(1) of Schedule 8 CA 1998 requires the Tribunal to determine this appeal on the merits by reference to the grounds of appeal set out in the notice of appeal filed by Royal Mail. Pursuant to paragraph 3(2) of Schedule 8, the Tribunal may:

> "…confirm or set aside the decision which is the subject of the appeal, or any part of it, and may –
>
> (a) remit the matter to [Ofcom],
>
> (b) impose or revoke, or vary the amount of, a penalty,
>
> (c) …
>
> (d) give such directions, or take such other steps, as [Ofcom] could itself have given or taken, or
>
> (e) make any other decision which the [Ofcom] could itself have made."

171. The legal burden of establishing an infringement of Article 102 and Chapter II CA 1998 is on Ofcom and the standard of proof is the civil standard of the balance of probabilities. We must also take account of the presumption of innocence under Article 6(2) of the European Convention for the Protection of Human Rights and Fundamental Freedoms (the "ECHR") to which Royal Mail is entitled in a case such as this involving an alleged infringement of the CA 1998 that may result in the imposition of a financial penalty. That presumption is also a general principle of EU law under Article 48(1) of the Charter of Fundamental Rights of the European Union (the "Charter").

G. ECONOMIC AND LEGAL CONTEXT

172. Before considering Royal Mail's grounds of appeal, we examine and give our findings on a number of contextual issues which bear generally on our consideration of the case. These are:

(1) The market conditions for the disputed conduct;

(2) The relevant market: bulk mail delivery;

(3) Royal Mail's dominant position;

(4) Ofcom's consideration of the USO and the possible threat from direct delivery; and

(5) Royal Mail's strategic intention.

(1) Market conditions for the disputed conduct

173. The following description of the market is drawn from sections 2 and 6 of the Decision. Section 2 of the Decision sets out some background, while section 6 of the Decision sets out Ofcom's findings on market definition and dominance. In addition, it is informed by the argument and evidence in this appeal and represents our findings on the matters described.

(a) Background

174. This appeal relates to "bulk mail". This is a type of addressed letter sent out in bulk, e.g. bank statements, utility bills, council tax statements and advertising mail. Of the 13 billion letters delivered by Royal Mail in 2014, 10 billion were bulk mail items. Bulk mail customers are typically large companies, government departments and advertisers.

175. There is a retail market in which Royal Mail and other suppliers compete to offer such customers an end-to-end service, involving the collection, sortation

and delivery of bulk mail. This market is referred to as the "retail market for bulk mail services".

176. All suppliers on the retail market for bulk mail services are able to undertake collection and sortation. However, with the one exception of Whistl, only Royal Mail has ever sought to undertake the delivery of bulk mail on any material scale. Other suppliers on the retail market buy in their delivery needs from Royal Mail, which has a unique nationwide delivery network.

177. The retail market for bulk mail was (and remains) competitive with tight margins. Royal Mail's access charges are the principal input cost 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%. Competition between access operators takes place within this small margin.

178. In addition to the retail market for bulk mail services, there is a separate wholesale market for bulk mail delivery, on which Royal Mail supplies the delivery service, which is an indispensable input for suppliers on the bulk mail retail market.

179. In economic terms, the wholesale bulk mail delivery market is upstream (and the retail bulk mail market is downstream, given that the output of the former is an input for the latter). In the postal sector, however, the terminology is often reversed so as to reflect the physical flow of mail from sender to recipient. The wholesale market is therefore described as the downstream market, because it involves the final stage of delivery; and the retail market is referred to as the upstream market, as operators (other than Royal Mail) typically undertake only the prior activities of collection and sortation.

180. The relevant wholesale service for present purposes is known as "D+2 access", which involves Royal Mail delivering operators' bulk mail on the next working day, enabling the operators to provide a retail service for delivery within two

days. This is the market on which Royal Mail was found by Ofcom to be overwhelmingly dominant, with a market share of 98% or more.

181. Suppliers on the downstream retail market who purchase delivery from Royal Mail on the wholesale market are known as "access operators". The two largest access operators in the UK by volume are Whistl and UK Mail.

182. Access operators on the retail market depended on Royal Mail for wholesale delivery services. This dependence derives from the following factors:

(1) **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 government departments, advertisers, utility companies, etc.

(2) **In practice, rolling out bulk mail delivery can only be done gradually.** 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 for an entrant to launch bulk mail delivery services across a large geographic area simultaneously. Postal delivery is a very labour-intensive activity and any new entrant would have to recruit a large number of new staff. A more plausible entry strategy is to begin by providing a service in a limited geographic area and then gradually expand the areas covered.

(3) **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 required 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 coverage rate.

(4) **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. 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.

(b) The decline in bulk mail volumes

183. 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. Total addressed mail volumes fell from 16.1 billion items in 2009-10 to 12.8 billion items in 2013-14, a total decline of 21%. 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.

184. In 2013-14, Royal Mail's access volumes declined by 1.0% to 7.2 billion items. This was the first time that 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%.

(c) The tight profit margins in the retail market for bulk mail

185. As already observed, Royal Mail's access charges are the principal input cost 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%. 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.

186. 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 £245 million in its mail business. Similarly, in 2014, Whistl reported an underlying operating profit of approximately £9.6 million on revenue of approximately £575 million.

(2) The relevant market: bulk mail delivery

187. Royal Mail did not challenge Ofcom's findings on market definition (other than in relation to the calculation of the penalty) or dominance as set out in the Decision. This was confirmed by Mr Beard QC for Royal Mail in his oral submissions at the hearing. We therefore deal with the market definition relatively briefly.

(a) Product market

188. Ofcom defined 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.

(b) Geographic market

189. As to the geographic market, Ofcom concluded that there was a single UK market for bulk mail delivery.

190. Moreover, Ofcom found that, even if it had defined separate local geographic markets as argued for by Royal Mail during the administrative phase, this would not have had an impact on its finding in relation to dominance.

(3) Royal Mail's dominant position

191. In the Decision, Ofcom concluded that, as at January 2014, Royal Mail held a dominant position in the relevant market. In particular Ofcom found that:

(1) As at January 2014, Royal Mail held a very high market share in the bulk mail delivery market, assessed to be 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 announced, up to and including the date of the Decision);

(2) 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 (see paragraph 182(3) above);

(3) 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. These included:

(i) **Sunk costs**: A significant amount of the infrastructure investment required to compete in delivery takes the form of sunk costs which cannot be fully recovered if entry is unsuccessful given the highly specialised nature of the investment. Sunk costs increase the risks associated with attempting entry. Examples are the costs of sorting machines, IT systems, and converting premises, but also intangible sunk costs, such as those incurred in training a new workforce and gaining experience in running a bulk mail delivery network;

(ii) **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;

(iii) **Economies of scope**: Royal Mail also benefited from significant economies of scope, in that it delivered single-piece mail (such as 1st class and 2nd class stamped mail) and parcels as well as bulk mail, providing it with a further significant source of cost advantage over rivals;

(iv) **Large retail customer base**: To realistically contemplate entry into the delivery market, a company would require a sufficiently large customer base in the retail market to ensure it had adequate volumes and economies of scale to justify the investment required. 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 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);

(v) **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;

(vi) **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; and

(vii) **No countervailing buyer power:** Neither access operators (Whistl and UK Mail) nor large individual customers such as banks and other financial services providers held sufficient countervailing buyer power to effectively constrain Royal Mail's conduct.

192. In terms of possible market entry, there were few companies other than Royal Mail itself 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: (1) UK Mail had indicated in its 2012 Annual Report that it did not currently see end-to-end entry as an attractive option to pursue; and (2) 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. It had sought investment to proceed with its roll-out, reflecting the significant costs associated with entering the bulk mail delivery market. As at January 2014, Whistl had achieved a less than 2% national market share, and at most a 25% market share in the individual SSCs which it had already entered.

193. As with market definition, Royal Mail did not challenge Ofcom's finding that it held a dominant position at the relevant time so that the above description of the market conditions giving rise to that dominant position may also be taken as not contested by Royal Mail.

(4) Ofcom's consideration of the USO and the possible threat from direct delivery

194. Ofcom assessed on several occasions whether Whistl's planned end-to-end delivery operations posed a threat to the universal service (see generally the discussion in paragraphs 59 to 65 above). First, in the March 2012 Statement, Ofcom acknowledged 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.

195. Ofcom stated that it would assess the provision of the universal service on an ongoing and forward-looking basis, and that it would continue to monitor the market. If Ofcom 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.

196. Second, in the July 2012 Guidance, Ofcom issued an update regarding end-to-end competition following Whistl's commencement of its end-to-end delivery trial in west London.

197. Ofcom examined Whistl's confidential business plans and modelled the likely impact of its roll-out on Royal Mail's financial position, taking into account representations from Royal Mail itself and from others. The modelling included a sensitivity analysis, which considered how the impact would be affected: (a) if Whistl were more or less successful than anticipated in its plans; (b) if additional competitors were to enter the market; or (c) if other key modelling assumptions were to change (e.g. market volumes or Royal Mail's achieved efficiency levels).

198. Based on that analysis, Ofcom decided that no regulatory intervention was needed in order to secure the ongoing provision of a universal postal service. 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.

199. 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.

200. 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. In that regard, Ofcom had considered instances where intervention might be required to protect the universal postal service. Consequently, Ofcom committed to continue to monitor the postal market carefully. 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.

201. Third, in the March 2013 Guidance, following consultation, Ofcom provided 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:

(1) Royal Mail's financial position absent end-to-end competition;

(2) the likely scale of end-to-end competition and the incremental impact on Royal Mail's financial position; and

(3) the potential for commercial responses by Royal Mail to mitigate the direct impact of increased competition. Ofcom explained, however, that Royal Mail's flexibility to negotiate changes to its contracts was subject to competition law and ex ante regulatory conditions on access.

202. Ofcom also published a response to the consultation in which it confirmed that Ofcom did not consider end-to-end competition was a threat to the universal service at that time.

203. In addition to these statements, Ofcom also confirmed publicly in November 2012, July 2013, November 2013 and April 2014 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 that would warrant any regulatory action.

204. In June 2014 (five months after it had issued the CCNs), Royal Mail submitted a further request for Ofcom to review Whistl's activities. Ofcom carried out a

further review and, on 2 December 2014, concluded that there was still no immediate threat to the universal service.

(5) Royal Mail's strategic intention

205. In this section we examine the important question of Royal Mail's strategic intention. We discuss the key contemporaneous documents that were before the Tribunal and draw on the discussion of those documents that arose in the course of the oral hearing and the explanations provided in the written witness evidence. Some of the discussion covers ground already described in Section C above, which may also be referred to.

(a) Introduction

206. Ofcom found that Royal Mail's conduct reflected a deliberate strategy to limit delivery competition from Whistl, its first and only significant competitor. This finding had important implications for the Decision as a whole. An intention to restrict competition does not establish an infringement of Article 102 but it profoundly affected Ofcom's assessment of the actions of Royal Mail, whose dominance in the relevant market was not disputed, and the effects of those actions. The existence or otherwise of a strategic intention to exclude competition affects our own consideration of all Royal Mail's grounds of appeal, save possibly ground 5, and is therefore no less important.

207. The Decision (see section 4) begins its chronology of events in 2012, when Whistl launched its own limited pilot final delivery service. However, our description of the factual background (see Section C above) shows that the present dispute can be traced at least as far back as the Postal Services Act 2000 and the subsequent decision by Postcomm, the then postal regulator, to allow competitors to Royal Mail to handle bulk mail. As we have seen, it did this by allowing access to mail producers (i.e. customers), subject to certain conditions, and provided that these mailings were delivered to the final recipients through Royal Mail's delivery network. This led to the emergence of a competitive market for bulk mail 'upstream' access with some major players, principally UK Mail and Whistl.

208. From 2006 to 2010, Royal Mail's access prices were subject to regulation, which, according to Ms Whalley, made it difficult for Royal Mail to compete with the emerging access operators, partly on account of the required price 'headroom'. As we have said at paragraph 23 above, the purpose of these measures was to prevent Royal Mail from harming emerging access competitors.

209. From 2011, Royal Mail's pricing was no longer subject to direct regulation. We described in Section C the development of Royal Mail's pricing plans in the light of its new commercial freedom to set its prices, subject to requirements to give prior notification to access customers.

210. In the meantime, as we also described in Section C, Whistl was proceeding with its end-to-end plans. In February 2013, its parent company PostNL announced an intention for Whistl to offer a more extended service and to seek outside investment. The investment memorandum issued by Whistl in May 2013 was a detailed 90-page document setting out a phased four-year roll-out plan for up to 33 SSCs. There is no reason to think that these plans would not have appeared credible both to potential investors and indeed also to Royal Mail.

211. The investment memorandum had identified as a possible risk that Royal Mail might change its pricing to favour Plan NPP1 (which Whistl said it could not access). In response, Whistl said it thought it unlikely Ofcom would allow such a change. Royal Mail had already attempted to alter its pricing structure in October 2012, in the form of price reductions in return for volume reductions, prompting Whistl to complain to Ofcom and to hold discussions with Royal Mail, following which Royal Mail withdrew its proposals.

212. By summer 2013, PostNL had identified two possible investors and one, LDC, in October 2013 appointed the firm PwC to conduct due diligence. PwC's draft report of 25 October 2013 went into considerable detail but concluded (on page 8) that "the pricing structure (price plans/surcharges) is unlikely to change" and that "extreme" pricing policies "will not be allowed by Ofcom".

(b) The Development of Royal Mail's strategy

213. Against this background, we consider the evidence as to Royal Mail's underlying intentions. This is addressed in the Decision and was covered at some length by Mr Holmes QC for Ofcom in his opening submissions at the oral hearing.

214. Mr Holmes QC described the PSB paper of 10 May 2013 from a Royal Mail executive to Ms Whalley and Stephen Agar as the genesis of the price differential. This requested a project to review "our pricing structures" together with various "threats and challenges", including e-substitution, direct delivery and the risk of losing VAT exemption on access. The paper noted that Whistl had announced its plan to extend direct delivery to all SW postcodes, increasing its weekly volume from 600 thousand to one million and that it "remained on a national access contract". In oral evidence, Ms Whalley denied this was the genesis of anything, saying Royal Mail had been considering its options for some time before, but we do not think anything turns on this.

215. There followed a Group Board 'Letters Strategy' document of 26 June 2013 which discussed in some detail the issues facing Royal Mail across the range of its activities. In relation to bulk mail, considered as part of the broader 'letters' business, the document assumed no major direct delivery expansion or regulatory change, but included a flow chart showing different levels of increased direct delivery risk if certain events occurred in combination. In particular, "[Whistl] remains focussed on upstream only (as is)" was positioned as a "reduced risk to plan" but "Direct Delivery risk increases" was positioned as an "increased risk to plan".

216. The document further noted the opportunity given by new access contracts to adopt "different pricing for different price plans" but noted the need to avoid disputes during "a transaction" which we take to refer to the impending IPO. Under a heading "managing the risk of direct delivery" it was noted that the aborted attempt to change pricing terms in 2012-13 had "sent a signal" to the market on "commitment-based pricing."

217. In cross examination, Mr Holmes QC took Ms Whalley through aspects of the Board document. She agreed with the statements that the letters business was crucial to achieving the desired revenues to drive the planned EBIT level, and that the context included "further consolidation in the Wholesale market which triggers direct delivery competition". Ms Whalley was, however, reluctant to be drawn on whether the reference to "successfully managing the letters decline" equated to concern about increased direct delivery competition and said Royal Mail's wish to be the "letters carrier of choice" did not mean it would be the only carrier.

218. The PSB paper of 23 July 2013 referred more explicitly to the "risks from competitive direct delivery" and the options to meet it. Under the heading "Defend downstream mail volumes against the threats of Direct Delivery and VAT", the key business objectives were said to be to "ensure 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" and to "avoid consolidation of the upstream market and ensure there is robust competition between several operators." We note the first draws a direct connection between the USO and direct delivery and the second indicates that Royal Mail felt threatened by the possible emergence of a single major access operator able to leverage that position into direct delivery.

219. The paper discussed six "pricing options", the first of which was to introduce a price differential between the two national price plans. This would create a financial incentive for providing national mail distribution but identified the risk that "it is difficult to cost justify a price difference". The remaining options included various incentive possibilities for "access providers" and other measures dismissed as too complex but did include "increasing the zonal differential".

220. Ms Whalley, questioned by Mr Holmes QC, denied that Royal Mail simply did not want to lose the volumes and said it also wanted to match its resources to the decline. She agreed, however, that the pricing differential was more about making customers distribute nationally rather than reducing costs and that Royal Mail benefited from having a national distribution of mail. She also agreed that

there was at that time little commercial interest in obtaining forecast volume information and instead a concern to incentivise national distribution. Ms Whalley was at pains to stress, however, that a possible cost justification for different price levels was under consideration as part of a possible mix of measures.

221. The next PSB paper was dated 21 August 2013. "Key Question A" was said to be how Royal Mail should focus its attention on wholesale pricing options to protect the USO and increasing rate-card prices as part of the annual tariff. This was a reference to the next annual price change scheduled for April 2014, which would have to be announced 70 days in advance, i.e. in January 2014. Three options "to protect the USO" are described, the first being again to create a price/financial incentive to commit to a national distribution of mail. The second was a minimum payment commitment for each geographical area and the third a mix including a greater price difference between zones and reducing advertising prices. These last measures were thought not to drive value to a sufficient extent. Only the first two options were seen as feasible by April 2014 and Oxera (who were by now again involved) were said to be examining them, to see if a cost justification could be produced.

222. Ms Whalley was questioned by Mr Holmes QC on this document also. She explained the two propositions under option 3 as having been said by Oxera in 2012 to be "competition law compliant" and modelled by Oxera to assess their contribution to a 5% EBIT margin. She also agreed that they did not add sufficient value to the letters business to be worth pursuing. Cutting advertising prices, she said, "took revenue straight out of the top line of the business" and she agreed with Mr Holmes QC that "cutting prices in response to competition reduced revenues and profits" and for that reason was not pursued.

223. On the second option of a minimum payment, Ms Whalley agreed this would have had a similar effect as a price differential but said Royal Mail did not think it was feasible to proceed with it.

224. On the first option, to introduce a price incentive to distribute nationally, Ms Whalley gave a lengthy explanation of how Royal Mail realised that any

measure to protect the USO would potentially have an impact on the costs of another player in the market. She attributed this to the overall market decline and said Royal Mail debated this issue "long and hard". She declined to accept Mr Holmes QC's proposition that harm to competitors was inherent in such measures rather than being a collateral effect. Ms Whalley further explained that the references to producing a cost justification "to secure regulatory co-operation" were part of Royal Mail's pre-existing search for a robust cost justification for a price differential, on which Oxera was by then engaged.

225. Discussion of a letters pricing strategy was resumed at the 30 September meeting with Oxera for which another detailed set of slides was prepared. The proposed actions were then in three categories: first, those to be implemented in April 2014 along with the annual tariff increases; second, those to be implemented by April 2014, subject to consultation; and third, those to be implemented later as volume patterns developed. Category 1 comprised three 'Actions'. Action 1 proposed additional requirements and tighter tolerances on NPP1, to differentiate it as a national plan. Action 2 proposed a 0.3p price differential between NPP1 and the other two plans, and Action 3 proposed changing the zonal tilt. Further Actions under Category 2 included a 'one price plan only' obligation to combat arbitrage, discontinuing APP2 altogether and changes to zones and volume commitments.

226. Action 1 (within Category 1) was explained in more detail as being required partly to give a clearer differentiation but partly also to justify Action 2, the price differential. The risk of complaint was said to be low. Action 2 described the commercial rationale for the price differential and estimated the cost to Whistl as some £9 million. The risk of complaint was estimated to be high. Possible justifications referred to the *value* to Royal Mail of the certainty from forecast volumes but said that it was difficult to justify in terms of cost savings. It also mentioned the value of flexibility to APP2 customers, and that the differential might be expressed as being too small to matter to a direct competitor with cost advantages. A 'small' direct delivery operator could remain on NPP1 and any wider roll-out would trigger intervention by Ofcom. Each proposed action was elaborated, and a detailed assessment given of the likely impact on Royal Mail's customers. That relating to Whistl set out in detail

the effect of reducing the SSC tolerance of error under the price plan from 6 to 5 (part of Action1) but also the possible impact of a one plan only rule. Curiously, the impact assessment ignored any effect of the price differential, but the paper assumed Whistl's direct delivery "ambitions" would be "dented" by having to switch to NPP1 in order to compete (as an access operator) with UK Mail.

227. Attention thereafter focused on the CEC (Chief Executive's Committee). Ms Whalley presented a paper for a meeting of the committee on 1 November 2013. Under the heading "Our Agenda" the key objective was said to be to "safeguard the USO in the face of increasing competition". It noted that Whistl's plan was to achieve 40% UK coverage, that Ofcom would not intervene before 2015 and that there were "significant legal and competition law risks should Royal Mail take commercial action to respond to the threat". Key initiatives included a best-case commercial response that did not reduce revenues, e.g. a zonal tilt, a review with Ofcom to gauge prospects for a competition case and asking Ofcom to be more pro-active towards direct delivery competition. The desired outcomes were listed as, in the short term, to support a commercial pricing response in the face of likely regulatory challenge, then to persuade Ofcom to be more active and, finally, to secure "lasting regulatory protection" against the threat of direct delivery.

228. It may be noted that this document made no direct reference to any price differential. While it mentioned the possibility of a "competition case", it appeared to assume that any intervention by Ofcom concerning direct delivery competition would be to attenuate its effects on Royal Mail. It looked for "lasting regulatory protection" from direct delivery.

229. Mr Holmes QC referred in detail in his opening submissions to the draft discussion document "Options for protecting the USO". This was apparently prepared for presentation at the 13 November 2013 Chief Executive's Committee. Page 10 of this document, which was a slide presentation, was referred to by Mr Holmes QC as the 'traffic light slide' in view of its colour coding of preferred Royal Mail options. The minutes of its 15 November

meeting record that the Board supported the progression of the strategy as presented.

230. The document referred to the threat to Royal Mail's addressed mail volumes of direct delivery competition (10% within five years), stressed the damage to Royal Mail's ability to "deliver the USO which Ofcom has an obligation to protect" and set out an immediate set of commercial actions. It was on those proposed actions that the discussion focused. Some of its contents were redacted on grounds of legal professional privilege, but the discussion of options was left intact.

231. The document as a whole set out the direct delivery problem as seen by Royal Mail, taking care to express the position of Ofcom and the regulatory framework generally. There were references to the need to be mindful of regulatory conditions and competition law. It outlined the different strategic positions, which ranged from doing nothing to restricting access to direct delivery operators. One potential strategic position, highlighted in the document, was to launch a package of initiatives without reducing average prices. This would be achieved by introducing revised terms and conditions for NPP1 and a "price recognition for a national profile" (i.e. a price differential) together with a revised zonal tilt. The assumptions underlying this strategic effect (expressed in the document as "[w]hat do we have to believe?") were: no revenue dilution; direct delivery operators would move to price plan NPP1 to avoid surcharges; direct delivery would not expand in a way that would damage Royal Mail's commercial return; Ofcom would eventually intervene if competitors' direct delivery volumes increased to a "tipping point"; that tipping point may come sooner if "DD" (i.e. direct delivery) received external investment; and the proposals were defendable to Ofcom and this Tribunal.

232. The document noted the benefit to Royal Mail of a 0.3 pence differential for NPP1 customers, but the cost benefit of greater volume certainty was said to be "difficult to quantify". The justification for APP2 customers was the value of greater flexibility. The differential was said not to prevent direct delivery competition although "a roll out beyond 6 SSCs would attract surcharges." Whilst there was discussion of a proposed adjustment of the London zonal price

(then thought to be encouraging entry by being too high), the emphasis was on the price differential. This, expressed as part of a series of actions that would "send a clear signal to the market that we will compete effectively to protect the USO", nonetheless led to detailed consideration of how "a DD operation" would respond; for example "a larger scale direct delivery operator would need to move to a zonal plan to minimise surcharges".

233. The recommended course of action (coloured green on the traffic light slide) was to apply a "moderate 'value' justified incentive on NPP1" and adjust the London zonal price. This was said to result in a 1.4% market share loss and £40 million revenue loss "by 2014" and the likely outcome for "Direct Delivery operator" was that it would "switch to [N]PP1 and stay there […] It is not profitable for DD operator to switch back to [A]PP2 at any point". We observe that the term "value justified incentive" referred to is another way of describing a price differential.

234. We also note that the only candidate "Direct Delivery operator" was Whistl. The document went on to assess the impact of Scenario 2 on Whistl. Ms Whalley said this was illustrative only, but we are satisfied that Royal Mail's principal objective was to devise a strategy that would limit direct delivery competition from Whistl. Ms Whalley was also questioned by Mr Holmes QC about an earlier version of this slide, which she denied having seen, which we consider below when discussing the involvement of Oxera in Royal Mail's planning process.

235. The impact assessment of "Scenario 2" (set out on page 11 of the slide pack), was in the form of three graphs with different possible scenarios. Whilst there was some dispute as to what the three graphs showed, there seems to be little doubt that they illustrated the likely impact of the proposed measures, depending on the extent to which Whistl obtained outside investment and/or was willing to incur losses or forego a normal profit margin (described as "foregoing a reasonable rate of return") to build up scale. Mr Holmes QC, arguing that Royal Mail clearly had Whistl as its intended target, said that graph 1 showed Whistl's progress absent any price differential, graph 2 showed the effect of limiting its direct delivery plans in response to a price differential and

graph 3 showed the effect of obtaining investment combined with short term losses. Ms Whalley (and also Dr Jenkins) disputed this. Indeed, Ms Whalley maintained under cross examination that the three graphs in question merely modelled speculation by Royal Mail and that it did not know which option Whistl would take or what external investment it might be able to draw on. We find this unconvincing. In any event, it is clear that graph 2 shows Whistl's roll-out being restricted and graph 3 shows it foregoing a reasonable rate of return.

236. A formal decision on Royal Mail's pricing strategy was put off until the December 2013 meeting of the Chief Executive's Committee. In the meantime, on 27 November 2013 Whistl informed Royal Mail that a retail competitor (in fact UK Mail) was telling Whistl's customers that a price differential was to be introduced next April; Whistl asked for clarification. Stephen Agar of Royal Mail confirmed to Whistl on 6 December 2013 that Royal Mail had decided "in principle" to introduce a price differential between price plans NPP1 and APP2, although it had not decided the amount. This was followed on the same day by a communication to all of Royal Mail's access customers in similar terms.

237. That the precise figure was still under consideration was shown by an internal Royal Mail communication of 2 December 2013 from Stephen Agar to Ms Whalley referring to the views of another senior Royal Mail executive as follows:

> "[Matthew Lester] 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 0.5p. 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…"

238. Royal Mail met Ofcom on 10 December 2013 to explain its intentions (Whistl had met Ofcom the previous day.) We have seen Ofcom's note of that meeting (in an email from Chris Rowsell dated 8 January 2014) and Royal Mail's own note. The differences are more in emphasis than substance. Royal Mail offered two presentations, based on the documents we have described, one being "Action to protect the USO" and the other "2014 Access pricing" which was similar in terms to documents described above but without giving any amount

for the "small" price differential. The discussion covered whether Royal Mail's modelling of Whistl's possible direct delivery plans was correct, the timing of any Ofcom action, the justifications claimed by Royal Mail for the price differential (value to customers and cost savings to Royal Mail), whether Royal Mail would accept volume forecasts from APP2 customers in return for a lower price and whether the differential was consistent with Ofcom's requirement that the weighted average of zonal access prices and national access prices should be broadly comparable. There was also mention of the proposal to reduce the London zonal price.

239. Ofcom appears to have been non-committal about its attitude to Royal Mail's proposals but said it was important "that they [i.e. Royal Mail] had satisfied themselves they were fully compliant with their obligations". Royal Mail's note explained this as saying it must undertake its own due diligence, that this was a competition issue as well as a regulatory one and that Royal Mail should discuss the proposals with all its customers, not just those on NPP1, as customers may switch between plans. The question of whether customers on APP2 could provide volume forecasts was answered as: "Royal Mail said this wasn't how the price plan 2 worked" (Ofcom's note) and "Royal Mail explained that this was not a feature of the NPP2 contracts and it would be very odd to receive this type of information but [if] this eventuality arose we would reflect on the appropriate treatment." (Royal Mail's note).

(c) Royal Mail's decision to introduce the CCNs

240. The Royal Mail Board of Directors met on 11 December 2013 and approved the proposed pricing strategy, delegating its execution to a sub-committee of the CEC. The CEC itself met on 18 December 2013. A price differential of between 0.2 and 0.5p was proposed to reflect value to customers and cost benefits to Royal Mail, the final amount to be ratified by the Disclosure Committee prior to announcement on 7 January 2014. It was said that the "costing analysis" was still under review. The minutes contain the following passage:

> "[Stephen Agar] pointed out that introducing a price differential between the two different price plan(s) 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 information that the business would obtain. Sue Whalley would write to Oxera to obtain written confirmation that they were in agreement with this" (paragraph 9(g)).

241. Mr Agar's warning was certainly justified as Whistl had made clear at a meeting with Royal Mail the previous day that it would contest the introduction of a price differential "through legal and regulatory means, using the full force of competition law." At this meeting, according to Whistl, Mr Agar denied that Royal Mail had considered any specific impact on Whistl, saying Royal Mail had looked at all customers, said that the proposals had been examined by lawyers and economists, that he believed they were justified and that a competition law ruling "may be useful as it may provide helpful guidance as to what was or was not permitted". He also accepted that Whistl did not engage in deliberate arbitrage and offered Royal Mail's assistance in moving Whistl to price plan NPP1 to benefit from the lower prices.

242. The Disclosure Committee first considered the price announcements at a meeting on 6 January 2014. We were shown a paper (labelled "draft" but said to be final) prepared for this meeting. This lengthy document appears to be the definitive justification advanced by Royal Mail for its pricing proposals. It stated the differential as 0.3 pence and claimed this was "a proportionate commercial response to 'cherry-picking' competition from direct delivery operators" and that "Royal Mail welcomes competition, but believes it needs to be on a level playing field."

243. The key benefit to Royal Mail was stated to be the ability to remove costs by receiving advance notification of customers' mailing intentions. Customers on APP2 "will not provide forecasts at the specific locality or SSC level". The cost justification was based solely on calculation of the cost benefits to Royal Mail, not the hitherto asserted value to APP2 customers of additional flexibility; a detailed explanation was given in Annex B. Annex C described the possible value to customers of greater flexibility, but this was not adopted. The justification for the zonal price changes was given as a partial response to inefficient, cherry-picking, competition and reducing the risk of "inefficient arbitrage". A detailed economic analysis of competition and regulation issues

was annexed. We were told that legal advice was also provided but we have not seen this. The document stated:

> "4.3 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, undue discrimination or a breach of our margin squeeze test […]
>
> 4.4 Notwithstanding our analysis of the soundness of our position, there is a high likelihood of a complaint under 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.
>
> 4.5 Any investigation is likely to take some time […]
>
> 4.6 Any complainant […] would [...] seek to characterise Royal Mail's actions as 'the big fish seeking to force the little minnow out of the pond' and try to build a case evidencing a sustained campaign against them."

244. It may be observed, with reference to the later discussion of Royal Mail's second and fourth grounds of appeal, that the annexed economic analysis stated that the access proposals "involve price discrimination i.e. Royal Mail is choosing to charge different customers different prices for the same service" but said that this was allowable "if it can be objectively justified".

245. Mr Holmes QC drew attention to the failure to mention that Whistl, an APP2 customer, was also able to provide volume forecasts at SSC level and suggested this paper disguised the true purpose of the pricing proposals, which was to deter and curtail Whistl's direct delivery plans. He further suggested that Royal Mail had been careful generally to "curate" the documentary record to put its conduct in the best possible light. Royal Mail strongly denied that there had been any attempt to curate the record or give any misleading impression.

246. The Disclosure Committee asked for further consultations with advisers and the preparation of briefing materials. It met again on 8 January 2014 to approve the proposals. It considered an updating paper and considered accompanying advice, including legal advice from Herbert Smith Freehills (including skeleton Ofcom decisions to underline the legal risks involved). It decided to reduce the differential from 0.3 pence to 0.25 pence "in order to minimise the likelihood of an adverse finding and further demonstrate that this is a measured and reasonable level…", although it believed a differential of 0.4 pence could be

justified. It was expected that "this would trigger a complaint". The Committee accepted the proposals and agreed they would be announced on 9 January 2014 (in fact this occurred on 10 January 2014).

247. On 9 January 2014, Jon Millidge Royal Mail Company Secretary, emailed the Board to inform them of what was about to happen and attaching a letter of complaint received from Whistl. He acknowledged there was risk but expressed confidence that Royal Mail's case would prevail. He expected Ofcom to receive a complaint and for the price changes to be suspended either under the access contracts' suspensory provisions, or by a court injunction. He said he thought Whistl's claims were exaggerated but said also:

> "… it is possible 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 dispute ongoing".

248. The new pricing terms were announced on 10 January 2014.

249. Before drawing conclusions from the documents and events we have described, we consider briefly the involvement of Oxera in the preparation of Royal Mail's plans and what significance this may have.

(d) Oxera's advice to Royal Mail

250. Oxera had advised Royal Mail over a long period of time and was involved in many of the policy responses to the then postal services regulator Postcomm from 2003. Oxera was also involved in the preparation of submissions to Ofcom in connection with the October 2012 proposed changes to Royal Mail's access contracts, modelling the impact of direct delivery competition on Royal Mail's volumes and profits.

251. In September 2013, Oxera were again retained to advise on Royal Mail's proposed access contract changes and submitted a proposal to that effect on 22 August 2013. Dr Helen Jenkins was the Project Director during this period, working closely with three other colleagues in the project team, Felipe Florez Duncan, Dr Leonardo Mautino and another junior colleague. Dr Luis Correia

da Silva also deputised when Dr Jenkins was on leave for approximately five weeks from 23 September 2013 until the end of October 2013 (although she remained in charge of the project). Dr Jenkins told us that some of Oxera's advice took the form of notes and emails and oral advice on the telephone or at meetings:

> "The bulk of our advice and the way we worked with Royal Mail was quite integrated into their team, and sort of talking on the phone, discussing things…"
>
> "So we had a lot of background and we had a shared understanding on the Oxera side of what we thought the relative boundaries and issues would be…"

252. It is clear that the Oxera team were closely involved in the preparation and development of Royal Mail's access plans over the relevant period. Dr Jenkins said the content of Oxera's advice could be understood from the written materials available and from the papers prepared for the Disclosure Committee meetings in January 2014.

253. The Oxera proposal said that Royal Mail was considering a number of options to restructure the existing access contracts to "respond to the threat of direct delivery competition." This involved evaluating alternatives already scoped by Royal Mail (including a price discount on NPP1 as option A and targeted discounts as option E) and producing a short list of options by the end of September. Oxera referred to Royal Mail's existing work on commercial rationales and potential justifications and referred further to the preparation of "a robust case to defend the proposals in the event of a regulatory or competition investigation" as a separate exercise in October and November. Ms Whalley said she did not recall this document but did not dispute its contents.

254. There followed an access pricing workshop, which Dr Jenkins did not attend, but which Mr Florez Duncan did, which Dr Jenkins suggested would have taken the form of a "brainstorm". Ms Whalley, who did attend, said it was "to discuss the various options and to start the process of stress-testing our proposals". No note was apparently made of the workshop's discussions. Oxera's initial written work was to produce notes of advice on the price differential option A and the targeted discounts option E which were emailed to Royal Mail by Mr Florez

Duncan on 3 September 2013. Dr Jenkins described these as interim advice leading to the definitive note of advice of 3 October 2013.

255. The first draft of Oxera's note of advice on option E, targeted discounts, stated that they represented "a rational response to a competitive threat"; "could have a reasonable chance of being successfully defended"; but were "not free of competition risks" (paragraph 2). That summary view was based on selecting the SSCs for discount by reference to their impact on costs. However, even this approach was stated to be risky and possibly "abusive" if the discounts were based on the roll-out plans of Whistl, selected only in response to direct delivery entry and designed as part of a plan "that has the intent and is capable of eliminating competition". The note referred to the *Post Danmark I* case (see paragraph 341 below) and to Royal Mail seeking separate legal advice on the matter.

256. The note also said Oxera understood Royal Mail was considering removing the discounts once "the threat had been averted" (paragraph 2). It considered a scenario where discounts were targeted on SSCs in which Whistl had not started direct delivery (the discount would make staying with Royal Mail more attractive) and those where it had (where Whistl would have to calculate whether it remained worth continuing to expand its own delivery). The discounts would be set with two main objectives, namely "maximising the probability of Whistl not rolling out or even scaling back its current DD operations" and minimising the commercial impact on Royal Mail. Oxera thought this was "a relatively expensive way to deter entry".

257. Whether or not because of the advice given, Royal Mail did not proceed with this option. Ms Whalley said "it was considered not to be a viable option and therefore taken off the table". She was unwilling to say how seriously the idea of introducing targeted discounts and then withdrawing them after they had worked had been considered. Ms Whalley refused to be drawn on any of the matters mentioned in Oxera's draft note and would not accept that it reflected the general tone of Royal Mail's thinking at the time.

258. Oxera's initial note on how to justify and quantify a price differential between NPP1 and APP2 put forward two possibilities: cost benefits to Royal Mail from greater certainty of delivery volumes; and the value to customers on APP2 in a greater flexibility of distribution. The note set out in summary form possible methodology for both these approaches but offered no opinion on regulatory or competition issues. It did, however, point out that the ideal outcome for the cost justification would be "to show that the degree of forecasting accuracy of customers under NPP1 has been greater than under [A]PP2" (paragraph 3.1.1).

(e) Amending Oxera's advice

259. Mr Holmes QC referred to an exchange of emails between Royal Mail and Oxera on 3 September 2013, in which Royal Mail asked Mr Florez Duncan to "soften the wording" of both these preliminary notes to make it clear the intention was to "achieve pricing which is compliant with competition law"; in relation to time-limited pricing, Royal Mail requested "please remove the reference to responding to the threat of DD and then putting prices back up". The email from Royal Mail observed that "from a legal perspective", the Oxera notes "would not be legally privileged".

260. Mr Florez Duncan replied that, in relation to the advice on access pricing, Oxera sought to provide "an independent and objective view" on "whether the pricing option, as presented to us, can pose competition law problems from an economics perspective", and that if targeted discounting was not being considered as an option, it would be better to drop all reference to it. Mr Florez Duncan provided an updated version of his option E note on 4 September 2013. This went some way to alleviate Royal Mail's concern but retained the reference to the objective of maximising the probability of restricting Whistl's roll out. After a further request, Mr Florez Duncan produced a third version of the note without the offending wording.

(f) Oxera's definitive advice

261. Oxera's definitive note of advice was provided on 3 October 2013. This reviewed eight possible actions. Of these, the first three are of note: first, a

tightening of tolerances on price plan NPP1; second, a price differential of 0.3 pence between the two national price plans; and third, a change to the zonal tilt between NPP1 and APP2. Oxera said the risk of complaint against the price differential plan was very high but Ofcom would have to take seriously an argument that APP2 customers would derive value from having greater flexibility of distribution volumes. Oxera stressed the need to show an absence of exclusionary effect, which it described as "somewhat counter-intuitive from a commercial perspective, as ideally you would want to show the opposite". Actions 1 to 3 were said to be "time sensitive" for April 2014. Actions 4 to 8, which were less urgent, were not considered in detail.

262. Oxera stressed the danger of a multi-faceted approach in terms of triggering a complaint, and the need for a coherent commercial 'story' to explain and knit together what was proposed. It is not clear whether the proposed narrative represented Oxera's ideas, Royal Mail's actual intentions or a mixture of both. Oxera considered the proposed narrative to be clear and credible but admitted that the "devil is in the detail" on each individual proposal.

263. In the context of establishing Royal Mail's strategic intention, the advice sheds some light on what Oxera understood Royal Mail thought Whistl would do, faced with the price changes. Oxera says (at page 9, last paragraph) that:

> "We have been told by Royal Mail that [Whistl] would migrate to [N]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…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."

264. It may be noted that this thinking and its assessment that Whistl could continue with its current level of direct delivery roll-out (i.e. to no more than 6 SSCs) found its way into the so called 'traffic lights' document (on which Oxera also advised) to support the view that the proposed price differential would have "no impact" on Whistl, at least in the short term. On Royal Mail's suggestion that the proposed differential was "very small", Oxera pointed out it was a large proportion of access operators' upstream margin.

265. Oxera appears to have approached the price differential issue on the basis that the proposal was clearly a restriction of competition, but one that might have an objective justification. It was less optimistic than previously as to the prospect of convincing Ofcom on the novel concept of the value justification. Oxera explained:

> "The real question will be whether Ofcom, when investigating this practice under a competition law complaint, would be willing to accept that this argument can be an objective justification for conduct which may have the effect of restricting competition. It is difficult to provide [a] definitive answer to this question at this stage, partly because this would be a novel justification for which to our knowledge there are no competition law precedents. However, a key factor that is likely to influence Ofcom's willingness to accept the argument is the extent to which the level of price differential proposed (0.3p per item) will actually have a material impact on [Whistl]'s direct delivery plans."

266. On the cost justification, the advice was forthright:

> "we understand 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...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 [Whistl] shared its plans in advance with Royal Mail and committed to this profile, Royal Mail would in theory derive considerable value from this information." (Page 9 second paragraph).

267. Despite this assessment, as well as the dismissal of the argument that stranded costs and volume loss would justify the proposed conduct, Oxera opined that, subject to the need for further detailed modelling:

> "Royal Mail has a fighting chance of successfully arguing to Ofcom that a price differential of this kind would not have the effect of restricting genuine end-to-end competition." (Page 10 first paragraph.)

268. It did point out, however, that there was "no guarantee of a successful defence" and that Ofcom "may take a different view", as indeed proved to be the case. Also, the action was highly likely to provoke a complaint and was in essence the same proposal as that floated in 2012, which had caused Whistl to complain. Oxera also observed that Whistl's complaint then was about the principle of a price differential as Royal Mail's 2012 proposal was not calibrated. Oxera also stressed the need for work to show that the differential would not have an

exclusionary effect, repeating that this might be counter-intuitive commercially (page 10 penultimate and last paragraphs):

> "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)."

269. The paper also considered Action 3, the revised zonal tilt, and advised in outline on Actions 4 to 8. Its significance, however, for this discussion is in the forthright and very candid way in which it set out the risks involved in Actions 1 and 2 and the measures and evidence needed to overcome them. The essence of the advice was repeated in an email of 11 October 2013. Whilst a substantial amount of work appears to have been done over the weeks that followed, there is little sign in the documentary evidence that the real significance of what Oxera advised was appreciated by Royal Mail.

270. Dr Jenkins was questioned at some length on the contents of Oxera's note of 3 October 2013 and as to whether this advice, and the associated work, revealed an overall intention by Royal Mail to deter and exclude direct delivery competition. She maintained this was not the case, and that Royal Mail accepted the inevitability of such competition but believed it had to be "efficient" competition. Whilst this view may have seemed obvious to Dr Jenkins as an economist it is not clear from Ms Whalley's evidence what Royal Mail understood by this term.

(g) Oxera's further involvement

271. Oxera were involved in the preparation of the presentation which contained the slide referred to above as the 'traffic light slide'. As we have observed, that presentation reflects some of the contents of Oxera's note of advice of 3 October 2013. Ms Whalley was unable to recall seeing two draft slides sent to Royal Mail by Oxera (which included handwritten annotations which Ms Whalley also did not recognise). There is then a dearth of written material, from which we conclude that Oxera's continuing contribution took the form of oral advice by phone or in person. The Disclosure Committee meetings on 6 and 8 January 2014 refer to Oxera's advice and contribution at that point, although we have

not seen any express confirmation in writing from Oxera as requested at the 18 December 2013 Chief Executive's Committee meeting or any written advice provided to the Disclosure Committee following its 6 January 2014 meeting. We note that these items were not provided to Ofcom either (see the Decision, footnote 397).

272. Dr Jenkins confirmed in cross examination that the modelling of the direct delivery entrant's (i.e. Whistl's) cost in the latter half of 2013 was done by Royal Mail, not Oxera, and that Oxera was only asked to do a formal foreclosure analysis after the CCNs were issued in 2014. Dr Jenkins' evidence was that Oxera's final advice to Royal Mail was summarised in a paper for Ofcom submitted in February 2014 in response to a request for information.

273. Dr Jenkins was also concerned that Ofcom's Decision, particularly in its chronology of events in part 4, unfairly cited Oxera's advice as showing that Royal Mail had an anti-competitive strategy, saying that identifying a potential risk did not equate to an intention to infringe. She clearly thought Ofcom had been selective in its reference to Oxera's advice and had quoted various items out of context. She said it was not Oxera's view that the price differential would actually have an exclusionary effect and maintained that because of the tension between the USO and direct entry competition, Oxera's concern was how to reduce the impact of that entry on Royal Mail's business. In 2013, Oxera thought Whistl would suffer short term consequences but that these might be compensated by future profits. The price differential was, in her view, in pursuit of a legitimate objective. We give our view on the reasonableness of this position below.

(h) Our assessment of Royal Mail's strategic intention

274. We draw the following conclusions from this examination of the written and oral evidence on Royal Mail's strategic intentions.

275. We first note the conclusions Ofcom invited us to draw. These were as follows:

(1) First, that Royal Mail was motivated to introduce the price differential by Whistl's direct delivery plans;

(2) Second, that it thought these plans would be discouraged by a price penalty;

(3) Third, that it expected Whistl to abandon its plans;

(4) Fourth, that Royal Mail adopted a price plan that would most profoundly affect Whistl;

(5) Fifth, that other APP2 customers would not be affected;

(6) Sixth, that the price differential avoided Royal Mail having to incur price cuts and revenue dilution;

(7) Seventh, that Royal Mail knew the differential was discriminatory;

(8) Eighth, that the purported justifications were developed in conjunction with Oxera after the price differential had been decided on; and

(9) Ninth, the cost justification advanced was determined by reference to a model of Whistl's roll-out plans, although Whistl's actual forecast volume information was not sought.

276. Royal Mail's position, as set out in the evidence of Ms Whalley and Dr Jenkins, can best be summarised by saying that, given the overall market decline, the need to protect the USO and the threat to Royal Mail's volumes and profits represented by direct delivery competition, it was only natural and reasonable to examine options to limit the commercial damage to Royal Mail's business. The process of option assessment revealed in the documents was nothing more than prudent planning by a responsible organisation entrusted with tasks of general public importance. That a particular option was considered did not mean it was intended to be adopted. The pro- or anti-competitive nature of the

measures finally adopted must be judged objectively by reference to their final terms and their likely effects, not by the process which gave rise to them.

277. Attractive though this position might appear, we cannot accept it. In the first place, we do find it instructive to see what lay behind the pricing measures that Royal Mail finally announced. An example is the determination of the amount of the differential. This seems to have been decided at the last moment. On the one hand it was said that a larger differential (0.5 pence) could have been "justified" and there were calls to be more "assertive" (see paragraph 237 above). On the other hand, the final amount was decided on to provide the best chance of being justified. The process tells us something about the underlying purpose.

278. Secondly, the existence or otherwise of a strategic intention to exclude competitors is a very relevant factor in law in assessing the conduct of a dominant undertaking. Its possible existence must therefore be examined, even if it is not in itself determinative of abuse. In this case, however, Ofcom's view that such an intention existed was a key part of its approach to assessing competitive disadvantage and the methodology of assessment that was therefore required. We agree with this approach.

279. Thirdly, there is the question of credibility. Royal Mail has made a comprehensive attack on the Decision. It is at least informative to see how many of the objections now raised to Ofcom's approach can be traced back to the events of the time. In this regard, we note the general absence of any reference, in the various planning documents we have examined, to the likely suspension of any proposed pricing measures in the event of a complaint to Ofcom. If Royal Mail planned on the basis that no infringement would be possible because of the inclusion of suspensory wording in the CCNs, we would have expected this to feature more prominently in the discussion of the merits of the proposed measures. Instead, what we see in the contemporaneous documents is a serious attempt to put together a package of measures that would have some actual effect on Royal Mail's own position, not to mention the position of others. We see no reason to doubt that Royal Mail believed that its announced new prices would have some immediate effect on the market.

280. As an aside, we may note that, despite the emphasis placed in Royal Mail's appeal on the essential nature of an AEC test to allow dominant companies to act within the law, no such exercise was thought necessary in 2013. Oxera did not conduct such an analysis, did not advise that one was necessary and was not asked to conduct one. It is of course true that the jurisprudence on this issue has developed since 2013, but even at the time the function of an AEC test was well understood in professional circles; the Guidance on the Commission's enforcement priorities in applying Article [102] of the [TFEU] to abusive exclusionary conduct by dominant undertakings ("the Article 102 Guidance"), which refers to it and on which Royal Mail has placed some reliance, had been published some years before. As it was, Royal Mail modelled Whistl's roll-out costs and plans and appears to have used that model, rather than that of a theoretical 'as-efficient' competitor, in developing its pricing strategy. This sits a little uncomfortably alongside Ms Whalley's claim that Royal Mail "welcomed competition from efficient competitors."

281. In summary, we see strong indications in the factual evidence to support the following propositions:

(1) Royal Mail's overall approach appears to have been that its ability to earn a sufficient EBIT margin whilst having to support the USO was threatened by the introduction of competition into the bulk mail delivery market. The requirement to open its facilities to access competitors and then to direct delivery created a "tension" requiring action.

(2) Such action could have come from the regulatory authorities who, on one view, had created the tension in the first place. But Royal Mail did not have confidence that Ofcom would intervene in sufficient time or with enough vigour to assist it.

(3) Instead, Royal Mail believed that Ofcom expected it to use the lifting of direct price controls and its new commercial freedom to take steps itself to "protect the USO" by changing its prices.

(4) In considering what action to take, Royal Mail was most reluctant to engage in direct price competition with the new access operators. Such conduct would reduce its revenues and further undermine its ability to sustain the USO.

(5) Instead, it preferred to "compete effectively", first, by trying to prevent any one access operator from becoming too powerful, and, second, by manipulating its access price structure to make it as attractive as possible for access operators to continue to use Royal Mail's final delivery service. This had the inevitable consequence of making it harder for an access operator to engage in end-to-end delivery.

(6) There is no sign in the evidence we have seen that Royal Mail "welcomed" end-to-end competition. It may have seen it as inevitable, but it had no wish to encourage it. If it occurred on a large scale, Royal Mail thought this would compel Ofcom to intervene, either to restrict such competition, or to compensate Royal Mail in some way. Its claim to welcome "efficient" competition looks at best disingenuous.

(7) There was a clear realisation that direct delivery entrants would remain reliant on Royal Mail for a considerable part of their delivery requirements. None of Royal Mail's plans envisaged Whistl expanding to 100% of SSCs.

(8) There was little or no evidence of Royal Mail making significant use of volume forecasting to match resources to volumes in any systematic way. Oxera pointed this out and recommended further work. Dr Jenkins said she regretted this had not been further pursued. The cost justification for price plan NPP1 had all the hallmarks of an *ex post facto* exercise.

(9) The same applies to the idea that customers would place value on the greater flexibility offered by a zone-based pricing plan. There is no sign of Royal Mail asking its customers whether they wanted to pay extra for such flexibility and Whistl told them squarely that it did not. Attempts

to portray this as a justification for a price differential look unconvincing.

(10) Royal Mail was used to operating in a highly regulated environment and for its views to be taken extremely seriously by its regulator. This seems to have led Royal Mail to seek to take steps at the boundaries of what was permitted, because such steps would normally have emerged from, and be subject to, a regulatory process. This approach is harder to reconcile with the requirements of competition law and the special responsibility placed on dominant undertakings.

(11) There is little, if any, sign in the evidence that the inclusion of suspensory wording in the contract change provisions triggered by a complaint figured in Royal Mail's planning as to how to avoid any illegality until the very last moment, where it was referred to more in the sense of causing delay in implementation.

(12) It is not clear that the significance of the fact that measures to "protect the USO" were inherently likely also to harm entry or expansion by competitors was fully understood by those developing Royal Mail's strategy. For Oxera this was less of a problem as they appear to have seen their role as laying out options and explaining risks. For Royal Mail, it seems to have been thought that an appropriate balance would result from the operation of the regulatory process. The possibility of an adverse competition law finding and its consequences do not seem to have been fully appreciated. Mr Agar even told Whistl it would provide useful clarification.

(13) An aspect of this regulatory mind-set within Royal Mail is the concern about the documentary record. We saw clear evidence of a concern not to have documents on the record showing apparently anti-competitive intentions. We note that Oxera co-operated with this to an extent, but do not criticise them for it – the responsibility is Royal Mail's. At least around October/November 2013, Oxera was robust in its advice as to the risks of what was being considered. However, we are concerned that

we may not have seen a full account of what was discussed between Oxera and Royal Mail, which affects our ability to take seriously Royal Mail's claim that it did its utmost to comply with legal and regulatory requirements.

(14) Whether Oxera continued to be so robust in its advice is harder to say, as there is a significant dearth of written evidence around the time of the final formulation of the pricing plans in December 2013/January 2014. It appears that Oxera (and Herbert Smith Freehills) were asked to 'sign off' in writing on the final proposal. We have not seen clear evidence of their having done so.

(15) In summary, we believe the evidence supports the view that Royal Mail planned and intended to take actions which it either knew would harm Whistl's direct delivery plans or was reckless as to whether they would. Royal Mail knew about Whistl's intentions in sufficient detail to plan against them and clearly had Whistl in mind when preparing its plans. Royal Mail appears to have thought that its particular position under the USO, and possibly its wider public responsibilities, would justify such actions and in some way protect it from the application of competition law.

(16) Finally, and despite these reservations, Ofcom was clearly assisted in its assessment by having obtained sight of a considerable volume of advice provided by Oxera to Royal Mail and documents prepared and discussed between them. Oxera complained that Ofcom made selective use of these materials. But we consider that they show that Royal Mail was warned in very clear terms by Oxera that what it was proposing was surrounded with legal risk, would be quite hard to justify objectively, and was almost certain to provoke complaint. Royal Mail's claims that it did its utmost to comply with the law, that it did not know what it was doing could be illegal, and that it was confident its arguments would prevail in any proceedings, must be considered in this light.

282. We use these conclusions and propositions to help us consider Royal Mail's grounds of appeal, to which we now turn.

H. GROUND 1 - THE PRICE DIFFERENTIAL WAS NEVER APPLIED

(1) Introduction

283. Royal Mail contended, as Ground 1 of its Appeal, that Ofcom erred in law and in fact by concluding that, when Royal Mail issued the CCNs, it had either charged or applied discriminatory prices within the meaning of Article 102(c). This discussion of this ground should be read together with that of Ground 3, in which Royal Mail submitted that its conduct was not capable of giving rise to a competitive disadvantage. In consequence, there are a number of cross-references in the discussions to the two grounds of appeal.

(2) The parties' submissions

284. In Ground 1, Royal Mail contended that Ofcom's finding of a price discrimination infringement was fundamentally flawed, because price discrimination could not arise if none of the prices set out in the CCNs was ever charged or applied. It was Royal Mail's case that, to prove unlawful price discrimination, it is necessary to show that there was conduct by way of actual pricing. In reaching a contrary view, Ofcom had misread the wording of Article 102(c) and section 18(2)(c) and the meaning of the relevant case law. As Royal Mail put it in its Notice of Appeal:

> "…the essential anti-competitive vice at which Article 102(c) is aimed is a dominant undertaking causing rivals to expend resources so as to put them at a disadvantage. It is the actual expenditure – the deprivation of resources - required on an unlawfully discriminatory basis which is at the heart of this prohibition."

285. Put simply, according to Royal Mail, Article 102(c) only applies to conduct which has actually occurred. Moreover, the case law is all concerned with actual conduct which is implemented, operated or applied. In his opening arguments, Mr Beard QC submitted on behalf of Royal Mail that to accept that the CCNs

constituted unlawful price discrimination, even though the prices had not been applied:

> "would be a very long step forward for 102 and it is one that one would need to explore very carefully and have very clear evidence as to why it was that simply putting forward a change that had not yet occurred itself amounted to an abuse of 102." (Hearing transcript, Day 1, pages 38-39).

286. Royal Mail maintained in its written closing arguments that Ofcom was not assisted by "the fact that there is no case which expressly precludes proposed or intended conduct from being treated as having occurred for the purposes of assessing its effects." This was based on the "self-evident reason that there is a world of difference between saying one is going to do something and actually doing it."

287. Royal Mail contended that the fact that the prices were never charged and paid was sufficient to show that there was no case against it under Article 102(c). But it did acknowledge that the publication of the CCNs might be a sufficient form of conduct for Article 102 more generally. For example, in its skeleton argument, Royal Mail stated that it:

> "fully accepts that issuing the CCNs is a form of 'conduct' for the purposes of Article 102. […] Royal Mail's simple point is that, however else the issue of the CCNs might be analysed or categorised […] it cannot constitute abusive price discrimination as alleged in the Decision. This is because the prices set out in the CCNs were never '*applied*' (charged or paid)."

288. Royal Mail therefore acknowledged that the publication of the CCNs could be an infringement of Article 102, but it maintained that Ofcom had not taken such an approach. In its skeleton argument it stated:

> "If Ofcom had wanted to make such a finding, it would need to have shown not only that (i) the price differential contained in the CCNs would have been unlawful if implemented, but also (ii) that some aspect of the announcement itself was, absent implementation of the price differential, sufficient to amount to an abuse. Thus for the announcement of future prices to amount to an abuse, Ofcom would need carefully to articulate a threshold test which distinguishes a legitimate announcement from an abusive announcement. It has not done so because the Decision is concerned only with abusive price discrimination."

289. In the course of the hearing, Royal Mail broadened its arguments under this ground and contended that Ofcom's case had a "fundamental ambiguity" and appeared to comprise two separate cases. The first was that Royal Mail had

announced a price differential that was unlawfully discriminatory, had taken all the steps necessary to implement it, and the fact it was not implemented was irrelevant. Royal Mail argued in its written closing submissions that it was a:

> "key part of this case according to Ofcom that the suspensory provision which RM built in to the Access Letters Contract […] was actually a manifestation of Ofcom intervening, as a third party, to prevent what would otherwise have been the adverse effects of the price differential actually being implemented."

290. The second case was that the publication of the CCNs created uncertainty, which in turn led to the delay and ultimately the abandonment of Whistl's roll-out of its end-to-end delivery operation, and disruption to LDC's investment in that operation. Royal Mail characterised this as an "abuse by announcement," that had not been part of the Decision, or at least was not of the essence of the finding of infringement. According to Royal Mail, such a finding of abuse does not appear on a fair reading of the Decision as a whole and is contradictory to the principal finding of Ofcom, which was based on price discrimination. Royal Mail argued that, since no such category of abuse had previously been recognised in the case law, upholding the Decision on this basis would constitute new law on abuse of dominance.

291. Royal Mail also argued that such an abuse was one without limiting principle, since all types of announcements, actions or inactions by dominant companies can have the effect of creating uncertainty, such that the point at which the boundary between acceptable and abusive uncertainty is crossed would be inherently difficult to identify. If the mere creation of uncertainty were the benchmark for abuse, a dominant entity would be unable ever publicly to consider, propose or consult upon pricing changes, or undertake a range of actions which could create uncertainty in the market.

292. Relying on the judgment of the General Court in T-99/04 *AC Treuhand AG* ECLI:EU:T:2008:256 ("*AC Treuhand*") at paragraph 142, Royal Mail argued that a finding of abuse through the creation of uncertainty would be contrary to the fundamental principle of legal certainty, which requires that quasi-criminal penalties for infringements of competition law may only be imposed in accordance with laws that are sufficiently certain at the time of the relevant

conduct, and precludes the interpretation of the law in a way which was not reasonably foreseeable at that time.

293. In any event, according to Royal Mail, Ofcom failed adequately to analyse the actual or likely uncertainty-generating effects of the issuance of the CCNs. Such an analysis would have required Ofcom to identify the incremental uncertainty caused by the publication of the CCNs, isolated from the impact of other uncertainty-generating factors present on the market. This was referred to in the hearing as the "delta in uncertainty." Royal Mail argued that it would have been almost impossible, in the absence of any effects-based limiting principle to the "abuse by announcement" theory of harm, coherently to isolate the delta in uncertainty caused by the CCNs from a range of other uncertainty-generating factors that were present on the market prior to the publication of the CCNs.

294. Such factors would have included: a number of communications by Royal Mail during 2012-2013, in which it had indicated that it might seek to implement a price differential; Whistl becoming aware of market rumours that Royal Mail would seek to introduce a differential, which were circulating in November 2013 and which caused Whistl to contact Royal Mail for clarification; and Royal Mail's general announcement on 6 December 2013, in response to Whistl's enquiry of its decision in principle to introduce the price differential, which caused LDC to propose the inclusion of a MAE clause in its investment agreement with Whistl.

295. Royal Mail therefore argued that at least a very significant part of the uncertainty in the market had already been created by December 2013, in advance of the publication of the CCNs. Royal Mail referred to the cross examination of Mr Wells, in which he stated that "there was always a possibility that Royal Mail may try to introduce a price differential". It also argued that there was no analysis in the Decision of Whistl's perceptions of the likelihood of the price differential being implemented, which would have shown that, at the time of the publication of the CCNs, Whistl did not consider it likely that the price differential would come into effect.

296. Finally, Royal Mail argued that the Decision did not properly consider whether the delay in Whistl's roll-out was due to the publication of the CCNs or market factors other than a broader regulatory uncertainty, such as (i) the time taken by Ofcom in conducting its investigation; (ii) a recognition by Whistl that Royal Mail may seek to introduce further price changes in future, and (iii) difficulties Whistl was experiencing with its business plans.

297. Ofcom rejected Royal Mail's criticisms under Ground 1, relying on paragraphs 7.203-7.228 of the Decision to show that its finding that Royal Mail had infringed Article 102 was not based on the assumption that the differential prices had been put into effect, but rather in light of their suspension. It maintained that, by issuing the CCNs required to introduce the differential pricing, Royal Mail had engaged in conduct to which Article 102 is applicable.

298. Ofcom pointed in its Defence to a number of findings in the Decision that formed the basis of its conclusion that the infringement was based on the publication of the CCNs. These included, inter alia, (i) the CCNs were not mere announcements, as characterised by Royal Mail, but were formal contractual notifications of Royal Mail's decision to change the terms and conditions of access; (ii) Royal Mail's contemporaneous documents demonstrated an anti-competitive intention to exclude Whistl; (iii) the notification of the price differential in the CCNs "did in fact adversely affect Whistl's position, materially contributing to disruption to external investment and to Whistl's decision to reduce its roll-out plans"; and (iv) the suspension of the CCNs did not exclude the application of Article 102.

299. As to Royal Mail's argument that there could be no price discrimination without prices that were charged and paid, Ofcom maintained that Royal Mail's focus on Article 102(c) was misplaced, arguing instead that Article 102 was a broad provision, which applies to all conduct that is capable of adversely affecting competition in the market.

300. In response to Royal Mail's contention that Ofcom had adopted two cases during the hearing, Ofcom stated in its written closing arguments that the correct position was that the Decision first examined the likely effects of the price

differential once the discriminatory prices came to be charged and paid. Second, it considered the likely and actual effects of the price differential from the moment the CCNs were issued, and during the period following their suspension, and found that the introduction was reasonably likely to distort competition from the point at which the CCNs were issued. Third, Ofcom argued that the Decision demonstrated that the introduction of the price differential materially contributed to LDC's decision not to complete its investment in Whistl in January 2014, and Whistl's decision to reduce, and then suspend, its roll out plans. Fourth, Ofcom argued that the evidence supported Ofcom's conclusion that the introduction of the price differential had continuing anticompetitive effects despite its suspension - see, in particular, paragraphs 7.224(a) and (b) of the Decision.

301. Ofcom maintained that the Decision took proper account of Royal Mail's contemporaneous internal documents, and showed that, at the time the price differential was introduced, Royal Mail anticipated that, even though suspended, the price changes might have an impact on Whistl's ability to attract customers or secure an investment. Ofcom also referred to contemporaneous documents identified in the Decision which revealed an intention to send a "clear signal to the market that [Royal Mail] will compete effectively to protect the USO" and a "very assertive signal" to the market through the introduction of the price differential.

302. As to the impact on Whistl, Ofcom maintained that the Decision found that Royal Mail's initial communication of 6 December 2013 (which was prior to the Relevant Period) that a price differential would be adopted led to the inclusion of the MAE condition; and that the publication of the CCNs was a material factor in LDC's decision to invoke the MAE condition. It was also a material factor in Whistl's decision to reduce and then suspend further roll-out. Although the December communication pre-dated the publication of the CCNs, it confirmed only that Royal Mail had adopted a decision in principle to introduce a price differential. It expressly stated that the final price difference had not yet been fully decided.

303. Whistl argued that it was clear that the Decision found the abusive conduct to be the publication of the CCNs, which the Decision treated, correctly, as the culmination of the behaviour which had first been signalled to the market in December 2013. It further argued that the impact of the CCNs did not disappear when the suspension mechanism took effect but persisted because of Royal Mail's clear statements to the market that it would continue to pursue its proposals.

304. According to Whistl, the Decision did not pigeon-hole Royal Mail's conduct as being abusive price discrimination, and in any event abusive price discrimination was not limited to cases where prices are charged and paid, "as opposed to cases where prices are notified to the marketplace and thereby produce effects in the marketplace." Royal Mail was wrong to suggest that Ofcom proceeded on the false basis that the price differential had been implemented. Rather, Ofcom necessarily considered what the effect of the price differential would have been if implemented, before it could understand how the market was likely to respond to the notification in the CCNs.

305. Whistl argued that such an approach was logical and consistent with the actual conduct of Whistl at the time. Whistl could not decide how to respond to the CCNs without considering what effect the price differential would have if it was implemented. It was for this reason that Whistl put its roll-out on hold, LDC held off from making its investment, and Whistl's customers suffered a loss of confidence in Whistl's ability to provide an effective service. According to Whistl, these effects did not rest on an assumption that the price differential definitely would be implemented. The uncertainty caused by Royal Mail's notification to the market that it would pursue differential pricing in response to direct delivery competition was sufficient.

(3) Discussion

(a) General approach

306. In this section we assess the proper approach to the finding of an abuse in the specific economic and legal circumstances of this case.

307. Royal Mail argues that, because there can be no price discrimination without prices having been paid and charged, the Decision cannot stand. However, we find that the conduct complained of cannot be characterised as being wholly concerned with price discrimination, whether primary, secondary or hybrid. In contrast, this case concerns the notification by a dominant undertaking to its customers, one of whom was also a competitor, that a pricing scheme will, in the absence of an investigation by the regulator, be brought into effect following a notice period. The notice period was suspended following the opening of Ofcom's investigation, and the differential prices were never brought into effect.

308. In these circumstances, we find that the proper approach to the assessment of the relevant conduct is well described by Royal Mail in its skeleton argument, as set out in paragraph 288 above. Such an approach is twofold: first whether the notified prices would have been discriminatory within the meaning of Article 102(c) had they been charged; and secondly, if so, whether the price notification is itself a sufficient basis for the finding of an abuse. The latter would be the case if it was not competition on the merits, was likely to hinder the maintenance or the growth of competition on the relevant market, and lacked objective justification.

309. The two-part approach is necessary in the specific circumstances of this case, because, if the prices notified in the CCNs would not have been discriminatory in any event, it follows that the notification, taken in isolation, could not be an abuse. On the other hand, it is not enough only to find that the notified prices would have been unlawful discrimination had they been brought into effect; such a finding is a necessary, but not a sufficient, condition for finding that the notification was an abuse in this case. It would not be correct simply to attribute the unlawful nature of intended, but unapplied, prices to the notification of such prices – since neither Ofcom nor any regulator has *ex ante* jurisdiction under Article 102 or section 18. That is why it is also necessary to determine whether the notification of unlawful prices could, in itself, have a likely anti-competitive effect in the specific circumstances of this case.

(b) Did Ofcom take the correct approach?

310. In this section, we assess whether Ofcom took a proper two-part approach. We conclude that it did.

311. The wording of the Decision is not always as pellucid as it might have been. There are a number of passages which, if viewed in isolation, could reasonably be taken to mean that Ofcom had found an infringement on the basis that the differential prices had already been applied, rather than notified. Indeed, the title of the Decision - *Discriminatory pricing in relation to the supply of bulk mail delivery services in the UK* - suggests that Ofcom assessed only the unlawfulness of the notified prices rather than the price notification.

312. However, the proper basis of the Decision becomes plain when it is read in the round. The executive summary section of the Decision makes it clear that the Decision is concerned with the publication of the CCNs and is not based on the assumption that the notified differential prices have been applied. For example, paragraph 1.3 states:

> "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") on 10 January 2014 which introduced discriminatory prices." (footnote excluded).

313. Paragraphs 1.24 (h) and (i) of the Decision state:

> "(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."

314. Section 3 of the Decision describes Royal Mail's access arrangements and the CCNs; it is introduced by paragraph 3.1 which refers to the CCNs having "introduced" the terms upon which access services were to be offered by Royal Mail:

> "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."

315. Some confusion arises from the Decision's description of the differential prices as having been "introduced." It is sometimes unclear whether this is intended to refer to the notification of the prices or their application. Some passages in the Decision appear to use the word in the latter sense. For example, paragraph 7.7(a) summarises the findings of Section 7C of the Decision, which is entitled "The price differential amounted to discrimination against Royal Mail's competitors." Paragraph 7.7(a) states:

> "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."

316. Also, in Section 7 of the Decision – which contains Ofcom's legal and economic analysis, Part E is entitled "*The likely distortive effects of the price differential*"; this is introduced in paragraph 7.138, which states:

> "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 […] 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."

317. But an examination of the context in which the word "introduce" and its variants is used makes it clear that it is intended to refer to the publication of the CCNs, and not to the operation of the prices thereby notified. Further, there are very few incidents in which any serious ambiguity arises, and these should not be

interpreted out of context. The critical question for the Tribunal is whether Ofcom expressed itself in sufficiently clear terms to show the precise basis on which it found Royal Mail's conduct to be unlawful, thereby respecting Royal Mail's rights of defence. We find that it did.

318. There are many passages in the Decision that make it abundantly clear that Ofcom intended to take a two-step approach to the assessment of Royal Mail's conduct. The way Ofcom approached this process in the Decision was first to assess the lawfulness of the prices notified in the CCNs and, having found them to be discriminatory, to assess whether the suspension of the period of notice prevented an anti-competitive effect arising. This shows a clear separation between the two steps necessary to a finding of abuse in the circumstances of this case.

319. Ofcom's approach to the evaluation of the competitive effect of the publication of the CCNs is described in the introductory paragraphs to Section 7 of the Decision, the section detailing Ofcom's legal and economic analysis. It is necessary to set out some of these introductory paragraphs in detail:

> "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. […]. We have identified the following relevant factors in this case:
>
> […]
>
> (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:

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.[10]

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.

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.

[…]

7.9 **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)."

320. These passages make it clear that Ofcom has not erred in its approach. It determined that Royal Mail's conduct gave rise to a likely anti-competitive effect as at the date of the publication of the CCNs, taking account of all the circumstances relating to the market and the conduct itself.

321. Such approach is also made explicit in paragraph 7.224 of the Decision, in which it stated that the suspension of the price differential "does not mean,

[10] See our comments on the wording of this sub-paragraph above.

however, that the introduction of unlawful prices would be incapable of having any anti-competitive effects on the market." (emphasis in original). Ofcom based its conclusion on the features described in sub-paragraphs (a) and (b) of 7.224:

> "[…] 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.
>
> 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."

322. In light of the above, we find that Ofcom did take the proper approach to the assessment of Royal Mail's conduct. In particular, we do not agree with Royal Mail either that the Decision was concerned only with price discrimination under Article 102(c) or that Ofcom chose to shift the justification for the Decision during the course of the appeal to one based on two distinct cases.

(c) Does the case law prevent Article 102 applying to the publication of the CCNs?

323. We were not referred to any authority in price-related abuse cases to the effect that an announced, but unapplied, price plan can be abusive. However, we do not find that this inevitably means that Article 102 cannot apply in the

circumstances of this case. The absence of any discussion in the case law as to whether a price announcement can be an infringement of those laws is merely a reflection of the fact that the cases have so far concerned only situations where the dominant undertaking has plainly applied the relevant prices. No discussion of a hypothesis concerning the announcement of such prices was necessary or relevant.

324. In view of the basic principles of Article 102, as articulated by the Court of Justice over many years, the absence of such specific authority does not exclude the possibility that a dominant undertaking might abuse its position through the publication of intended prices that, had they been applied, would have been unlawful. See in particular *Hoffmann-La Roche & Co AG v Commission of the European Communities* EU:C:1979:36 ("*Hoffmann-La Roche*") and Case C-457/10 P *AstraZeneca AB and AstraZeneca plc v European Commission* EU:C:2012:770 ("*AstraZeneca*"), discussed in paragraphs 341 to 352 below.

325. Mr Beard QC in his opening arguments on behalf of Royal Mail, rightly admitted that there are no authorities that explicitly state that differential prices can be abusive only if charged and paid. He argued, however, that this must be inferred from principle and from the wording of Article 102(c). For example, in his discussion of the judgment of the Court of Justice in C-525/16 *MEO v. Autoridade da Concorrência* ECLI:EU:C:2018:270 ("*MEO*"), he rightly conceded that:

> "this is not an authority which says: and we are making clear explicitly that uncharged prices cannot be discriminatory. I must accept that. There are no cases that say that in terms." (Hearing transcript, Day 1, pages 55-56).

326. He went on to explain Royal Mail's argument in this respect:

> "What I'm saying is that the predicate of all of this analysis is there are charged prices, and then you look at the specific effects. And what you find when you're looking at the language of this case […] where it's saying, well, you do need to analyse the specific effects, and even if there are specific effects you can't assume a competitive disadvantage, we say the predicate of that is you must have the prices in place because otherwise how can you sensibly be answering the questions in the way that you are doing?" (Hearing transcript, Day 1, page 56).

327. Mr Beard QC relied explicitly on paragraph 26 of the judgment in *MEO*, and argued:

> "If you had a situation where the prices weren't charged, it is difficult to understand how the test which is: was there an immediate disadvantage, is it enough to constitute a competitor disadvantage, immediately disadvantage coming from the pricing, how could that make sense as a test if it's not actually required to be linked to the pricing?" (Hearing transcript, Day 1, page 56).

328. These arguments were based on Royal Mail's contention that the Decision was entirely concerned with price discrimination under Article 102(c). We are not persuaded by these arguments. *MEO* is not relevant to the question of whether, and in what circumstances, a dominant undertaking will act unlawfully if it notifies prices that would, if applied, be discriminatory. As the operative ruling in *MEO* makes clear, the judgment concerns the situation where a dominant undertaking has indisputably applied prices that are allegedly discriminatory as between downstream customers. The fact that *MEO* concerned a situation in which the dominant undertaking had undoubtedly applied a pricing scheme does not make it authority for the contention that a price announcement cannot be unlawful in itself in the specific circumstances of this case.

329. Rather, the Court of Justice in *MEO* specified the matters to be taken into account in determining whether the dominant undertaking's conduct – i.e. the operation of prices in the downstream market - is capable of producing a competitive disadvantage. According to the Court of Justice, in examining all the relevant circumstances of the case, it is open to an authority or court to assess the undertaking's dominant position, its negotiating power in regard to the prices, the conditions and arrangements for charging them, their duration and amount, and the possible existence of a strategy aiming to exclude from the downstream market one of its trading partners which is at least as efficient as its competitors (see paragraph 28 of the *MEO* judgment, and paragraph 139 of the judgment of the Grand Chamber of the Court C-413/14 P *Intel v. European Commission* ECLI:EU:C:2017:632 ("*Intel*") and the cases cited there).

330. Thus, *MEO* is instructive as to what should be taken into account in the first step of the two-step approach – whether the prices notified in the CCNs would have been unlawfully discriminatory had they been applied. This appears to us to be

the approach adopted by Ofcom, particularly as set out in paragraph 5.69 of the Decision.

331. In addition to *MEO*, Royal Mail relied on the judgment of the Court of First Instance, as it then was, in T-228/97 *Irish Sugar plc v. Commission* ECLI:EU:T:1999:246 ("*Irish Sugar*"). The Court annulled part of the Commission's decision concerning the application of selective discounts by the dominant undertaking, on the grounds that it had not granted the discounts, contrary to the Commission's findings. The potential future conduct had been identified in an internal note of a sales director but had not been applied. Mr Beard QC argued that:

> "So what is being said there is that it is not good enough just to look at intent, at policy, you actually have to consider whether there were actual prices, and that fits precisely with the language of the case law preceding it." (Hearing transcript, Day 1, page 26).

332. We do not find this persuasive. Unlike in the present appeal, there was no allegation in *Irish Sugar* that the sales director's note had been published to affected customers as a notification of intended prices, and therefore no examination by the Commission as to whether the note itself could give rise to an abuse. The Court therefore found that the evidence adduced by the Commission in the contested decision did not prove the reality of the infringement in relation to this aspect of the dominant undertaking's pricing conduct.

333. Royal Mail argued that Joined Cases T-24,25,26,28/93 *Compagnie Maritime Belge,* EU:T:1996:139 ("*Compagnie Maritime Belge*"), and in particular paragraph 149, is authority for the proposition that the case law requires that allegedly abusive pricing practices must be actually implemented. But that paragraph of the judgment is authority for a quite different point, namely that:

> "where one or more undertakings in a dominant position actually implement a practice whose aim is to remove a competitor, the fact that the result sought is not achieved is not enough to avoid the practice being characterized as an abuse of a dominant position within the meaning of Article [102 TFEU]."

334. Royal Mail further relied on Case T-219/99 *British Airways plc v Commission of the European Communities* [2003] EU:T:2003:343 ("*British Airways*") at

paragraph 297 and Case C-23/14, *Post Danmark A/S v Konkurrencerådet,* EU:C:2015:651 ("*Post Danmark II*") at paragraph 65 to show that Article 102 requires that the alleged prices are "actually put […] into operation" and that their effects must not be "purely hypothetical" respectively. However, although those judgments do use the words quoted, in our view neither passage cited is support for the proposition put forward by Royal Mail.

335. The passage in *British Airways* is instead concerned with the same legal issue as dealt with in the extract from *Compagnie Maritime Belge*, quoted above. Thus, the Court said that where a dominant undertaking "actually puts into operation a practice generating the effect of ousting its competitors, the fact that the hoped-for result is not achieved is not sufficient to prevent a finding of abuse […]." The paragraph cited from *Post Danmark II* deals with still another point, but not the one claimed by Royal Mail. It is instead authority for the proposition that "the anticompetitive effect of a particular practice must not be of [*sic*] purely hypothetical."

336. As mentioned above, the fact that the cited cases refer to prices that have been implemented, applied or actually put into operation is merely a reflection of the particular circumstances of those cases. Royal Mail rightly conceded that there were no cases that explicitly required such implementation for a finding of abuse. Nor did Ofcom or Whistl seek to rely on any cases concerning pricing abuses that explicitly held to the contrary. However, all parties accepted the settled nature of the fundamental principles of an abuse set out by the Court of Justice in *Hoffmann-La Roche*, and unsurprisingly we find that case to be the most useful foundation on which to base the application of the law to the specific circumstances of this case.

337. In *Hoffmann-La Roche,* the Court held at paragraph 91 that:

> "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."

338. Contrary to Mr Beard QC's submission referred to above in paragraph 285, we find that, through an application of these settled principles to the specific circumstances of the current case, it would not be a "long step forward" to assess the publication of the CCNs under Article 102. Nor do we agree that the Tribunal should require "very clear evidence as to why it was that simply putting forward a change that had not yet occurred itself amounted to an abuse of 102." The Tribunal need only be satisfied that the Decision took account of all the relevant economic and legal circumstances of this case and correctly found, on that basis, that there was an abuse within the meaning of the fundamental principles in *Hoffmann-La Roche*.

339. It is settled case law that an authority or court may rely on the principles underlying Article 102, rather than on the narrower scope of the examples of abusive conduct it lists, as a means of assessing the lawfulness of the conduct of a dominant undertaking. See, for example, Mann J in in *Purple Parking Ltd v Heathrow Airport Ltd* [2011] EWHC 987 (Ch) ("*Purple Parking*") at paragraphs 78-79:

> "78. The basic wrong is that set out in section 18 itself. It is plain from the wording of the section that what follows in subsection (2) is a list of examples of factual situations in which an abuse is capable of existing, not an exhaustive list of such situations or an exhaustive list of criteria applicable to those examplar [sic] situations. As the ECJ said in *Deutsche Telekom v European Commission* Case C-280/08P:
>
> > '173 Furthermore, the list of abusive practices contained in Article 82 EC [an equivalent to section 18 for practical purposes] is not exhaustive, so that the practices there are merely examples of abuses of a dominant position. The list of abusive practices contained in that provision does not exhaust the methods of abusing a dominant position ...'
>
> "79. [Counsel's] submissions require one to treat each of those examples [..] as being individual pigeon-holes into which one must fit a case, and having thus fitted it to fulfil a list of criteria said to be applicable to that pigeon-hole. That is an erroneous approach. The statutory examples, and those developed by subsequent case law, are ways in which the basic wrong can be committed, but at all times an eye must be kept on the basic wrong itself […]"

340. Roth J acknowledged this in *Streetmap.Eu Ltd v Google Inc.* [2016] EWHC 253 (Ch) ("*Streetmap*") at paragraph 58:

> "It is well-established that the categories of abuse enumerated in Article 102 are not exhaustive: e.g. Case C-52/09 *TeliaSonera Sverige,* EU:C:2011:83, paragraph 26."

341. Underlying such principles is the special responsibility of a dominant undertaking not to allow its behaviour to impair genuine, undistorted competition on the internal market (see C-209/10 *Post Danmark A/S v. Konkurrencerådet* EU:C:2012:172 ("*Post Danmark I*") paragraph 23 and the cases cited there). That special responsibility is broad enough to cover any conduct envisaged by *Hoffmann-La Roche*. The application of those fundamental principles to the specific facts of this case is a sufficient and orthodox basis for a finding of infringement. In this regard, the Court of Justice in *AstraZeneca* expressly approved, at paragraph 166, the General Court's finding that the dominant undertaking's conduct was unlawful even though no previous case dealt with conduct of the same kind:

> "In so far as it consisted in misleading representations made deliberately in order to obtain exclusive rights to which AZ was not entitled or to which it was entitled for a shorter period, the first abuse of a dominant position quite clearly constitutes a serious infringement. The fact that that abuse is novel cannot call that finding into question, given that such practices are manifestly contrary to competition on the merits. Moreover, as the Commission observes, the fact that conduct with the same features has not been examined in past decisions does not exonerate an undertaking (see, to that effect, *Nederlandsche Banden-Industrie-Michelin* v *Commission* […] paragraph 107)." (T-321/05, *AstraZeneca v. Commission* EU:T:2010:266, [2010] ECR II-02805, at paragraph 901).

342. The Court of Justice also found that:

> "As regards the first part of that ground of appeal, concerning the novelty of the two abuses of a dominant position, it must be stated that those abuses […] had the deliberate aim of keeping competitors away from the market. It is therefore common ground that even though the Commission and the Courts of the European Union had not yet had the opportunity to rule specifically on conduct such as that which characterised those abuses, AZ was aware of the highly anti-competitive nature of its conduct and should have expected it to be incompatible with competition rules under European Union law. In addition […] the General Court was fully entitled to find that that conduct was manifestly contrary to competition on the merits." (At paragraph 164).

343. Mr Beard QC attempted to distinguish *AstraZeneca* on the basis that the dominant undertaking had clearly engaged in a form of conduct – namely, the submission of misleading information to public authorities – and not merely carried out preparatory acts, which is how the publication of the CCNs should

be characterised. He argued that nothing in *AstraZeneca* suggests that conduct which has not occurred can be treated as if in fact it had for the purposes of an assessment of its effects. In its written closing arguments, Royal Mail argued that:

> "insofar as the particular conduct in AstraZeneca was found to be an abuse warranting a penalty, it is clear that it was not "novel" insofar as it involved deliberately misleading behaviour. Whilst the court did not need specifically to find that the conduct was actually dishonest or deceitful, the misleading nature of the conduct meant that AstraZeneca could not but have known that it was acting improperly."

344. Distinguishing *AstraZeneca* from the present case, Royal Mail argued that:

> "The present case is wholly different: Royal Mail had put forward proposals for price differentials in 2012, it had made clear it was still considering them in its IPO documentation, it made clear in December 2013 prior to the CCNs that it would give notice of its intention to change prices in April 2014, it met with Whistl to discuss the change and also met with Ofcom. There was no deceit, dissembling or misleading by Royal Mail. Instead the Decision extends the application of Article 102(c) to the issuance of price change notices in relation to prices which were never charged or paid or (now) seeks to create the new abuse of creating market uncertainty by the announcement of future intention."

345. This submission on the differences between the forms of conduct found in *AstraZeneca* and the Decision respectively is not persuasive. A distinction based on the transparency of Royal Mail's conduct does not go to the essence of *AstraZeneca.* We have found at paragraphs 310 to 322 above, that the conduct relevant to the Decision was the publication of the CCNs and not the operation of the notified prices. The publication of the CCNs was a form of conduct for the purposes of Article 102 and section 18. This renders otiose Royal Mail's arguments to the effect that *AstraZeneca* cannot be relied upon to treat conduct which has not occurred as if in fact it had for the purposes of an assessment of its effects.

346. In this regard, we are not persuaded that the CCNs were merely preparatory acts, as argued by Royal Mail. They comprised a formal, definitive and public step necessary for the adoption of specific and detailed price and other changes to the access letters contracts. They were intended to, and did, cause customers to make appropriate changes to their activities, contractual and trading arrangements and price schedules. The notice period was necessary to render

this practicable. The publication of the CCNs had the express authority of the Board and senior management of Royal Mail Group and were the final outcome of a process of internal discussions, consultation and other market communications, as well as meetings and correspondence with Whistl. As indicated above, at paragraph 332, we do not find them to be analogous to the internal note of a sales director in *Irish Sugar*.

347. While Article 102 is concerned with the effects of the conduct of dominant undertakings, and not its form, it is important to have regard to all elements of conduct in assessing its tendency to give rise to anti-competitive effects. The importance of the CCNs in bringing about changes to the access letters contracts and the consequent impact on the opportunity for the maintenance and growth of competition cannot be ignored; it is a fundamental part of the context in which Royal Mail's conduct must be assessed. The publication of the CCNs was the only way in which the relevant price and other changes could be brought about. As such, it would inevitably tend to have a greater market impact than any other statement or conduct on the part of Royal Mail in relation to the access letters contracts.

348. If, as the Tribunal finds in paragraphs 362 to 368 below, Ofcom correctly found that the publication of the CCNs was not competition on the merits and was likely to exclude Royal Mail's only feasible competitor at the time, then there is nothing in the case law to prevent Ofcom treating such conduct as the basis of the finding of an infringement. Thus, Ofcom was free to find that the publication of the CCNs, notifying the introduction of a discriminatory pricing scheme, constituted abusive conduct within the meaning of the settled case law.

349. We also disagree with Royal Mail's argument that it would be contrary to the principle of legal certainty for Ofcom or the Tribunal to find that Royal Mail infringed Article 102 because the application of Article 102 to its conduct was not reasonably foreseeable at the time. Royal Mail relied for this on paragraph 142 of the General Court's judgment in *AC-Treuhand* (see paragraph 292 above). That paragraph was summarised and adopted by the Court of Justice in C-194/14 P, *AC-Treuhand AG v. European Commission* ECLI:EU:C:2015:717 at paragraphs 40-43.

350. The Court of Justice found that the principle of *nullum crimen, nulla poena sine lege* is satisfied where the individual concerned is in a position to ascertain from the wording of the relevant provision and, if need be, with the assistance of the courts' interpretation of it, what acts and omissions will make him criminally liable. The application of the law must be reasonably foreseeable at the time of the conduct, but the Court of Justice found that:

> "[a] law may still satisfy the requirement of foreseeability even if the person concerned has to take appropriate legal advice to assess, to a degree that is reasonable in the circumstances, the consequences which a given action may entail. This is particularly true in relation to persons carrying on a professional activity, who are used to having to proceed with a high degree of caution when pursuing their occupation. Such persons can therefore be expected to take special care in evaluating the risk that such an activity entails." (judgment in *Dansk Rørindustri and Othe*rs v *Commission*, C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P, EU:C:2005:408, paragraphs 219 and the case-law cited).

351. The Court of Justice concluded that, even though at the time of the infringements which gave rise to the decision contested in that case, the courts of the European Union had not yet had the opportunity to rule specifically on the conduct concerned, the undertaking should have expected, if necessary after taking appropriate legal advice, its conduct to be declared incompatible with the EU competition rules (in that case, Article 101), especially in the light of the broad scope of the terms used in it, as established by the Court's case-law.

352. We find that Royal Mail was in a position to ascertain from the wording of Article 102, and in particular with the assistance of the Court's interpretation of it in *Hoffmann-La Roche* and *AstraZeneca*, that the publication of the CCNs would be an infringement in the particular circumstances of this case. As to the submission that such application was not reasonably foreseeable, we find that it was reasonable for Royal Mail to take legal advice on the scope of the law. Given the nature of Royal Mail's activities, its position in the relevant market and its status as an inevitable trading partner for access services, it was obliged to proceed with a high degree of caution and can therefore be expected to take special care in evaluating the risk that its activity entails.

353. Royal Mail told the Tribunal throughout the process that it had taken legal advice from a leading law firm prior to the publication of the CCNs. It declined

to disclose such advice. It was perfectly entitled to do so, but in those circumstances the Tribunal is unable to make any inference as to the content of such advice – see *GlaxoSmithKline PLC and others v CMA* [2018] CAT 4 at paragraph 200; Royal Mail's submission that it took such advice does not therefore assist it to demonstrate that it was always concerned to act lawfully.

354. Royal Mail also sought economic advice from Oxera, a consultancy that it had retained for some period of time. However, as we found in considering Royal Mail's strategic intention (see Section G(5) above) we may not have seen a full account of what was discussed between Oxera and Royal Mail. Nonetheless, Dr Jenkins gave evidence that the role of Oxera was to seek economic justifications for a range of conduct – including a price differential – that Royal Mail was considering adopting. This is clear from the following exchange during her cross examination:

> "Q. […] You made very clear your position. If I can encapsulate it, it's that you were trying to find ways, the Royal Mail, in which it could lawfully retain volumes, measures that would retain volumes rather than seeing them lost to direct delivery competition. Is that fair?
>
> A. That's right. That would give its customers the benefit of the network that it had.
>
> Q. Yes. In relation to the other option, one of Oxera's first specific instructions following your engagement was to consider how such a price differential could be justified and quantified; that's correct, isn't it?
>
> A. That's correct.
>
> Q. So your primary focus in relation to the price differential, option A, was on consideration of objective justifications for the proposal and on helping Royal Mail work out how to quantify them; is that right?
>
> A. Yes, that's right."

355. We also found from the written and oral evidence submitted to us that Oxera alerted Royal Mail to the potential competition law related risks with their proposals. For example, Oxera advised that there would be such a risk should Royal Mail chose (as it did) to limit the forecasting requirement to NPP1 customers despite the broader potential benefits of receiving such forecasts from Whistl as an APP2 customer. Indeed, in her closing remarks in giving evidence, Dr Jenkins said:

> "With the benefit of hindsight, I think I would have been stronger in my advice around exploring why the price differential -- that the price differential should be about any profile commitment of SSCs, either exploring that in more detail

> with Royal Mail to really understand why their view was it wouldn't be attractive to its customers, or emphasising more strongly that that might be something they should consider." (Hearing transcript, Day 7, page 148).

356. In any event, even with the benefit of Oxera's advice, Royal Mail persisted in its plan to require SSC-level volume commitments – and to offer the consequent discounted rate – only to NPP1 customers. As we found in paragraph 281(8) above:

> "There was little or no evidence of Royal Mail making significant use of volume forecasting to match resources to volumes in any systematic way. Oxera pointed this out and recommended further work. Dr Jenkins said she regretted this had not been further pursued. The cost justification for price plan NPP1 had all the hallmarks of an ex post facto exercise."

357. As we also found in Section G above, the contemporaneous evidence shows that Royal Mail was aware that the publication of the CCNs would have an impact on the ability of Whistl to expand its end-to-end operations in competition with Royal Mail. For example, the email from S Agar to Ms Whalley on 2 December 2013:

> "Matthew [Lester of Royal Mail] approached me on Friday and made it very clear that he expected the PSB [Royal Mail's Pricing Strategy Board] 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 Moya's [a reference to Moya Greene of Royal Mail] risk appetite had changed in recent days and she was willing to be bolder."

358. Mr Beard QC argued that the "very assertive signal" referred only to the more aggressive price differential suggested there. Even if we accept that, the document shows that senior managers in Royal Mail were aware that the publication of the CCNs would send a signal to the market and that the price differential engaged legal risks.

359. The email from J Millidge to the Royal Mail Board on 9 January 2014 also makes it clear that Royal Mail was aware of the potential effect on Whistl of the publication of the CCNs:

> "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."

360. As we concluded in Section G(5):

> "… (W)e believe the evidence supports the view that Royal Mail planned and intended to take actions which it either knew would harm Whistl's direct delivery plans or was reckless as to whether they would. Royal Mail knew about Whistl's intentions in sufficient detail to plan against them and clearly had Whistl in mind when preparing its plans." (paragraph 281(15) above).

361. The outcomes conjectured in Mr Millidge's email did in fact occur. As described below (and in Section G above) the conversion of Whistl's retail customers to end-to-end services stalled, it felt obliged to offer contractual reassurances to retain their retail business, and the investment by LDC was delayed, and eventually withdrawn. We conclude that Ofcom properly treated the publication of the CCNs as relevant conduct for the purposes of Article 102 (and section 18), and that there is nothing in the case law to prevent that being the proper approach. In the next section we consider whether, in the specific circumstances of this case, the publication could be described as being competition on the merits.

(d) Was the publication of the CCNs competition on the merits?

362. We now consider whether the publication of the CCNs was "competition on the merits" in the specific circumstances of this case.

363. As the Tribunal held in *British Telecommunications PLC v. Ofcom* [2016] CAT 3 ("*British Telecoms*"), Article 102 is concerned with the protection of competition on the merits and the promotion of efficiency and, thereby, with the enhancement of consumer welfare in relation to features that include price, choice, quality and innovation.

364. The concept of competition on the merits was previously referred to as 'normal competition' and is central to the fundamental principles of *Hoffmann-La Roche.* The Tribunal assessed the scope of such concept in *National Grid plc v. Gas and Electricity Markets Authority* [2009] CAT 14, and in particular whether National Grid had put in place arrangements the foreclosing effects of which

were too severe to be justified by its desire to protect its revenue stream. The Tribunal found that:

> "In conditions of normal competition, a buyer will base his purchasing decisions on his assessment of who offers the best price and the best quality product or service. He might, on the basis of these criteria, choose the dominant firm's product and thereby maintain or increase the dominant firm's market share. That does not involve an abuse because the dominant firm has won that business because its product is the better overall offer from the customer's point of view. If the customer subsequently discovers that another company offers a better, cheaper product he will switch his custom to the new supplier – he may switch back again if the dominant undertaking then improves its offer.
>
> […]
>
> All *Hoffmann-La Roche* indicates is that a dominant firm is free to compete vigorously on price and quality and similar parameters." (at paragraphs 90-92).

365. The publication of the CCNs was not an attempt by Royal Mail to compete vigorously on price, quality or innovation or in a way that would enhance consumer welfare. Rather, as Royal Mail itself said, it was an attempt by Royal Mail to protect its universal service obligations by reserving to itself the revenue stream arising from end-to-end activities. The publication of the CCNs was the necessary first step in such a process and caused immediate and lasting anti-competitive effects through the exclusion of its only feasible competitor. In seeking to show that its conduct was objectively justified, Royal Mail acknowledged in its written closing arguments that it:

> "anticipated that, absent the price changes proposed in the CCNs, continued cherry-picking by end-to-end competitors would suppress its EBIT at below 5%, thereby jeopardising the viability of the Universal Service. In announcing the price differential, therefore, Royal Mail hoped to avoid the inevitable downward pressure on its EBIT which would result from increased end-to-end competition."

366. Based on certain working assumptions, the process initiated by the CCNs was calculated by Royal Mail to be the most effective option under consideration in constraining the activities of Whistl as a competitor in end-to-end delivery, and thereby to limit Royal Mail's revenue losses. The stated intention was to cause Whistl to switch to the NPP1 price plan, a move that would have constrained its ability to operate as an end-to-end competitor. The extent of such constraint was disputed between the parties, but it is hard to deny that Whistl would have been

constrained in its ability to roll-out as a result of the operation of the price plan and the other changes introduced through the CCNs.

367. Royal Mail's attempt to reserve to itself all or most of the relevant market through a modulation of the price plans and the other changes announced in the CCNs was therefore intended to reduce competition and not to enhance it. Whether or not that would have inured to the long-term benefit of consumers through the avoidance of duplicated fixed costs is not something that will render such conduct competition on the merits. Where a dominant undertaking engages in conduct that tends to deny its only competitor a portion of the market for which it might otherwise have competed, that cannot be characterised as competition on the merits within the meaning of settled case law. The publication of the CCNs was such conduct, and - as also discussed in our consideration of Royal Mail's third ground of appeal - we find that it had the effect of hindering the maintenance or growth of the degree of competition enjoyed by Royal Mail's only competitor.

368. Accordingly, we conclude that Royal Mail's conduct was not "competition on the merits" as that term is understood in competition law. We now turn to the question of anti-competitive effects.

(e) Was the publication of the CCNs likely to lead to anti-competitive effects?

369. Royal Mail argued that the economic effects felt by Whistl and other market participants were attributable not to the publication of the CCNs but to events and conduct that took place prior to the Relevant Period in the Decision. It further argued that the publication of the CCNs in itself could give rise to no such effects. Finally, it argued that the inclusion of suspensory wording also prevented any such adverse effects from arising. We cover the first two arguments in this section and consider the issue of the suspensory wording separately.

370. Royal Mail characterised Ofcom's case as being one based on 'abusive uncertainty' and argued that, to treat the publication of the CCNs as the

foundation of that was wrong in principle for a number of reasons, as summarised in paragraphs 284 to 296 above.

371. As part of this argument, Royal Mail contended that the impact of the publication of the CCNs must be assessed in light of the fact that Royal Mail had already announced its intention to introduce differential pricing in its market-wide communication of 6 December 2013. It was this that caused Whistl to reduce its long-term commitments, its customers to lose confidence and LDC to insist on an extended MAE clause in the draft investment agreement. The economic effects of Royal Mail's conduct were felt well in advance of the publication of the CCNs, thereby rendering Ofcom's exclusive focus on the CCNs themselves even more strikingly artificial. It argued in its written closing submissions that there is "no coherent reason why, on the facts of this case, the issuance of the CCNs should be regarded as the totem of uncertainty-generating announcements."

372. We do not accept that the events leading to the economic effects took place prior to the Relevant Period. Were we to accept this, it would cause an artificial wedge to be driven between the 6 December 2013 communication and the publication of the CCNs, and would require us to regard the earlier communication, and not the publication of the CCNs, to be a cause of the foreclosure of Royal Mail's only competitor. This would be contrary to the direction of the Court of Justice in *Intel* that it is:

> "appropriate to take into consideration the conduct of the undertaking viewed as a whole in order to assess the substantial nature of its effects on the market […].
>
> "[…] to do otherwise would lead to an artificial fragmentation of comprehensive anticompetitive conduct, capable of affecting the market structure within the EEA, into a collection of separate forms of conduct which might escape the European Union's jurisdiction." (at paragraphs 56-57).

373. The 6 December communication was the first public communication in which Royal Mail notified that it had taken a decision in principle to charge differential prices. It was not intended to be a final stand-alone statement of future prices, as its title ("Forthcoming Tariff Notice") and content made clear. It was sent to Royal Mail's customers after Royal Mail said it had become aware of

speculation following the receipt of a letter "from one customer" – i.e. Whistl. It stated:

> "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 Plan from next April. The final price difference has not yet been finally decided. […] We aim to publish our new Access tariff on the 7th January 2014."

374. No issue would have arisen had Ofcom treated 6 December 2013, rather than the publication of the CCNs on 10 January 2014, as the beginning of the Relevant Period. However, we do not find that Ofcom's selection of the publication of the CCNs as the start of the period of abuse requires us to treat the publication of the CCNs as having no, or no sufficient, relevance to the finding of abuse. Although it was rational for Whistl and others to take preparatory steps to limit their exposure to risk following the clear announcement "in principle" in the 6 December communication, it was only on the publication of the CCNs that it was possible for them to know whether such risk had eventuated. The 6 December communication contained no details of the actual tariff change, which had not at that date been finalised. Nor was it capable of bringing about any change in the access letters contracts: this required the publication of the CCNs.

375. Between 6 December 2013 and 10 January 2014, it was quite possible that the nature of the price differential would turn out to be such as to quieten the fears of the market participants, or alternatively to exceed such fears. It was not until the CCNs were issued that the precise nature of the price change became apparent. Importantly, there was also no indication in the 6 December communication of the other changes that were to be notified in the CCNs, i.e., in addition to the differential prices. The impact of the notified differential prices had to be assessed in the light of those other changes; this could not be done prior to the publication of the CCNs. The 6 December announcement was therefore inchoate in the absence of the later publication of the CCNs.

376. Having regard to the above, the fact that the 6 December communication had initiated the adverse effect on Whistl does not prevent the publication of the

CCNs being abusive conduct. We do not find that Ofcom erred in treating the publication of the CCNs as being the start of the Relevant Period.

377. Royal Mail also argued that the publication of the CCNs was not in itself likely to give rise to anti-competitive effects. We find that, to the contrary, given the nature of the conduct as described above, the publication of the CCNs was likely to lead to anti-competitive effects. This is discussed more fully in relation to Royal Mail's third ground of appeal and our conclusion is supported by Ofcom's finding that the publication of the CCNs had an immediate impact on the business of Whistl, the sole competitor. Specifically, it caused an interruption in the conversion of its customers to Whistl's end-to-end service, and it endangered Whistl's position in the upstream retail market.

378. Mr Polglass recounted in his written witness statement that:

> "With our big clients, we sat down with each of them and explained the complaint that we were making to Ofcom and what we hoped would happen next. To keep their business, we had to inform them that they would not be at a disadvantage. For some of them, we even put in place contractual guarantees, which are only just coming to an end now. Other customers were no longer prepared to commit to long-term contracts on the basis that, if the price differential came into effect, they couldn't afford to give us their mail.
>
> "After the price differential was introduced, our progress on customer conversion completely stopped. We had some customers who had agreed to trial our end-to-end services, but they held off after the price differential was introduced. It was difficult to convert customers while the e2e roll out was stalled and it was unsurprising that conversion rates were relatively static in 2014 given the uncertainty created by Royal Mail's CCNs."

379. UK Mail, Whistl's most significant competitor in the upstream retail market, used unspecified market leaks of a pending price change, the 6 December 2013 communication from Royal Mail, and the anticipated publication of the CCNs which that communication foreshadowed, as the basis for a campaign to capture retail business from Whistl. Whistl was forced to reassure its customers and, as indicated by Mr Polglass, to take steps to absorb any price disadvantage that its customers would otherwise have suffered. These included interim price guarantees and other assurances in order to retain their upstream retail business.

380. Whistl placed its roll-out plans on hold other than in areas where it had already made commitments that were irreversible in the short term. As Mr Wells indicated in his written witness statement:

> "… I didn't think that we should or could continue with the entirety of the original roll out planned for 2014 given the uncertainty caused by the CCNs. Our plan had been to roll out to an additional seven SSCs in 2014 but that would require large amounts of new investment, much of it wasted if the price differential was implemented and we had to stop e2e. That would have been a huge risk, which I wasn't prepared to take or to recommend to LDC and PostNL."

381. We accept the evidence of Mr Polglass and Mr Wells that the publication of the 6 December 2013 communication and the subsequent publication of the CCNs caused an abrupt cessation in the apparent willingness of customers to consider conversion – a change which led to the collapse of Whistl's potential for expanded end-to-end operations, and therefore its ability to compete with Royal Mail. It seems to us to be both credible and rational for Whistl's customers to take account of their own self-interest in view of (i) Whistl's likely inability to achieve sufficient coverage, and (ii) the possibility that their own charges would increase through a failure to accord with the new tolerances in the CCNs. For unconverted customers in particular, it is only necessary to observe that the CCNs – whether brought out of suspension or otherwise – tipped the balance away from conversion to Whistl at least in the short term.

382. We also heard from Whistl that LDC responded to the 6 December communication by requiring a MAE clause to be placed in the draft investment agreement; this was done on 10 December 2013. We have very little direct evidence of LDC's motivations because there were no witnesses proffered on behalf of LDC. We have no reason to doubt the indirect evidence of LDC's actions provided by Mr Polglass and Mr Wells, but they were able only to provide evidence within their own knowledge, which would inevitably not include all aspects of LDC's strategy and motivation. However, Ofcom submitted two documents from LDC, namely a response dated 21 April 2017 to a notice served on it by Ofcom under section 26 CA 1998 and an email between LDC and its PR agency dated 29 April 2015 concerning the draft public statement on LDC's withdrawal from the investment agreement.

383. In the first document, LDC confirmed that it supported the inclusion of the MAE clause in the investment agreement because:

> "the proposed price changed notified to [Whistl's] [i.e. the 6 December 2013 communication] 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."

Later in the same response it said:

> "Royal Mail's pricing proposals would have rendered the E2E roll-out commercially unviable."

384. The closing of the investment agreement was delayed and was eventually abandoned. According to the LDC response to Ofcom, LDC eventually decided not to enter into the investment agreement because "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." The regulatory uncertainty comprised not only the delay in Ofcom's investigation but also in the outcome to its access conditions regulatory framework review. LDC's reasons for an eventual decision not to invest were therefore based on a number of reasons, including – but not limited to – the uncertainties generated by the CCNs and the subsequent investigation.

385. The second document from LDC confirms that there were a number of reasons for the eventual withdrawal. The email dated 29 April stated: "If they [Whistl] want us to say we stopped the discussions we can include a full list of reasons why but not sure they will like the list!" We have no evidence as to why Whistl might not have liked such a list.

386. We therefore conclude that the publication of the CCNs was likely to have anti-competitive effects and that these effects could not be attributed to events taking place and uncertainties created prior to the date of the publication of the CCNs.

(f) Did the suspension of the notice period in the CCNs prevent any anti-competitive effects from arising?

387. Finally, we assess Royal Mail's argument that the suspensory clause in the contract change procedure was a self-limiting feature that prevented the

publication of CCNs from having any anti-competitive effects where a regulator opened an investigation as to their legitimacy under, inter alia, competition law. It also pointed to its own good faith in seeking an even broader suspension mechanism, triggered by mere complaint rather than by a decision of a regulator to investigate. Ofcom and Whistl argued that the suspensory mechanism was better described as Royal Mail claiming protection through the intervention of a third party, or through outsourcing the issue to Ofcom, which the case law makes clear is no defence.

388. We reject Royal Mail's argument for the reasons given below. We note, first of all, our comments in Section G(5) above that:

> "[…] the general absence of any reference, in the various planning documents we have examined, to the likely suspension of any proposed pricing measures in the event of a complaint to Ofcom." (paragraph 279 above).
>
> And:
>
> "There is little, if any, sign in the evidence that the inclusion of suspensory wording in the contract change provisions triggered by a complaint figured in Royal Mail's planning as to how to avoid any illegality until the very last moment, where it was referred to in the sense of a problem causing delay in implementation." (paragraph 281(11) above).

It does not therefore appear that the claims now made in relation to the suspensory clause were in the minds of Royal Mail executives at the time of the relevant conduct.

389. The points raised by Royal Mail would be relevant if the only question to be determined was whether the price differential had a likely effect on competition. However, by following the two-step approach described earlier, Ofcom determined a different, composite, question: if the price differential was capable of having a likely anti-competitive effect if introduced, whether the CCNs were also capable of having a likely anti-competitive effect. This made the suspension clause less relevant, because Ofcom had to decide whether the notification of the price changes, and not merely the intended changes themselves, had a likely adverse effect on competition. The notification was, of course, not suspended; it was only the notice periods in the CCNs that were frozen. The CCNs were withdrawn only later.

390. Moreover, even though the progress of the price change process could be interrupted through the suspension mechanism, this is really no different in principle from the possibility that *any* abusive conduct may be enjoined by regulatory or judicial authorities. The suspension clause removed the need for complainants to seek interim measures, and this was a useful counterpart to Royal Mail's ability to impose unilateral changes in the access contracts. It was not, however, fundamental to the assessment of whether the publication of the CCNs had an anti-competitive effect.

391. In addition, we consider that precisely because of the suspensory mechanism, the issuing of the CCNs had the effect of signalling Royal Mail's commitment to a policy of limiting entry into direct delivery. In other words, it reduced – rather than created – uncertainty. There are four considerations to be examined.

392. First, at the time that the CCNs were issued, there were a number of possibilities that could arise as to the future course of events. These related to: (i) whether Whistl would submit a complaint to Ofcom; (ii) if it did, whether Ofcom would open an investigation; (iii) if it did, whether Ofcom would assess Whistl's complaint under its regulatory or competition powers; (iv) in either event, how long such an investigation would take; (v) whether the decision Ofcom reached would be appealed and, if so, by whom; (vi) how long it would take the Tribunal to hear and decide the appeal; and (vii) whether, whatever decision was reached by the Tribunal, it would be appealed and, if so, assuming the appeal would be allowed, how long this appeal would take to be heard and resolved, and so on.

393. Second, at the time the CCNs were issued, the outcome of each of these eventualities was unknown, though naturally it would become known in the course of time. However, the uncertainty arising here related not to the outcome of random events, but to the actions and decisions of various undertakings and organisations, each of whom could be presumed to be acting rationally by pursuing its objectives in the best way possible. In particular, two of these undertakings – Royal Mail and Whistl – were strategically linked to one another in that the future profits of each organisation were linked to the actions and decisions of the other. Consequently, the 'delta of uncertainty' approach put forward by Royal Mail is not the appropriate way to view the effects of issuing

the CCNs and their subsequent suspension, in what was essentially a situation of strategic inter-action.

394. Third, all of these potential developments could impose significant costs on Royal Mail: (i) if Whistl complained and Ofcom opened an investigation, this could significantly delay the date on which the changes in access prices came into effect, causing Royal Mail to forego additional revenue; (ii) future appeals could lead Royal Mail to incur significant additional legal costs.

395. Fourth, the fact that Royal Mail was prepared to proceed with issuing the CCNs despite these additional costs could be expected to lead Whistl to conclude that, as a rational organisation, Royal Mail was signalling that it was committed to a policy of using its price-setting powers to limit direct delivery entry by Whistl. Evidence that it had this effect comes from the written testimony of Mr Wells, who said:

> "The withdrawal of the CCNs therefore did not give us or LDC certainty about whether a price differential would be implemented in the future. Royal Mail had shown how determined they were to prevent our e2e roll out with the publication of the CCNs and it seemed clear to me that they would not give up unless and until there was a decision from Ofcom that the price differential would not be permitted."

396. So rather than providing reassurance to Whistl that the suspensory clause in the contract change procedure was a self-limiting feature that prevented the publication of CCNs from having effect, we conclude that it could have had precisely the opposite effect. This further supports our conclusion that rather than increasing uncertainty the publication of the CCNs significantly reduced it at least as regards Royal Mail's intentions.

397. We therefore reject Royal Mail's claim that the inclusion of suspensory wording prevented the CCNs from having any anti-competitive effects.

(4) Conclusion

398. For these reasons, we conclude that Royal Mail's claims under Ground 1 must fail.

I. GROUND 2 – NO IMPROPER DISCRIMINATION

(1) Introduction

399. Under this ground of appeal, Royal Mail claimed that the price differential, whether or not it was actually charged or applied, did not amount to undue or improper discrimination within the meaning of Article 102.

(2) The parties' submissions

400. Royal Mail claimed that Ofcom was wrong to find that the price differential, assuming it was applied and paid (which Royal Mail disputed), amounted to improper discrimination under Article 102. Royal Mail said that Ofcom had conducted its analysis by reference to Article 102(c) and had made errors of law and assessment in doing so. In particular, Ofcom was wrong to find that the 'transactions' in question between Royal Mail and its customers were 'equivalent', as different customers had different posting requirements, and, second, it was wrong to conclude that the price differential did not reflect differences between different access customers.

401. As the case developed at the hearing, Royal Mail placed increasing emphasis on a development of this second aspect, namely that cost savings available to Royal Mail from certain access customers justified a cheaper access price (the 'cost justification'). Royal Mail also developed the argument that the price differential was not discriminatory because, viewed objectively, a direct delivery operator could expand its operation significantly (to up to 31 SSCs) whilst still remaining on price plan NPP1, by using 'arbitrage' with price plan ZPP3 and thereby limiting its exposure to surcharges.

402. Ofcom argued that the Decision was right to find the various transactions were equivalent. The different posting requirements, and the different costs to Royal Mail, were already taken into account in the design of the price plans. In particular price plans NPP1 and APP2 were designed to ensure that the overall costs to Royal Mail of serving customers on each plan did not exceed the common average price under each plan. The service undertaken by Royal Mail

was in each case the same, namely the handling and delivery of bulk mail to end recipients. Common sense indicated that the transactions were essentially the same.

403. On the issue of cost justification, Ofcom said Royal Mail's claimed cost savings from volume forecast information provided by NPP1 customers was not a differentiator, because similar cost savings could have been made if similar information was obtained from Whistl, on APP2. Whistl's direct delivery roll-out plans were precisely the information Royal Mail needed to take out costs, but it declined to seek it. Whistl was not able to move to NPP1 while continuing to expand its direct delivery operation. The true purpose of the price differential was to increase the cost of, and limit, that expansion.

404. On the question of whether a direct delivery entrant could remain on price plan NPP1 and still expand sufficiently, Ofcom said this was contrary to what a rational entrant would do, given Royal Mail's hostility to arbitrage and Royal Mail's ability to impose surcharges and eventually to move a customer off NPP1.

405. Whistl said Royal Mail's case on equivalence was that NPP1 and APP2 customers were not in equivalent positions because of the difference in the granularity of information provided by reference to the 83 SSCs (NPP1) and that relating to the four postal zones (APP2). Royal Mail then claimed APP2 customers obtained valuable flexibility and that it was harder to recover costs from APP2 customers. Whistl argued that both claims were wrong, and it disagreed strongly with Royal Mail's argument that Whistl could have successfully moved to NPP1 whilst continuing its direct delivery expansion or that the price differential was justified by the value to Royal Mail of volume forecasting information from NPP1 customers alone.

406. It follows that there are three essential issues to consider; first whether the transactions subject to the different price plans were 'equivalent'; second, whether the cost justification claimed by Royal Mail stands up to objective scrutiny; and, third, whether the price differential had no discriminatory effect because a direct delivery entrant could obtain the benefit of the more favourable

price plan whilst still expanding its direct delivery operations. Before considering each of these, we look at the applicable legal principles.

(3) Legal principles

407. The legal principles applicable to this particular ground of appeal are not seriously in dispute between the parties. The dispute lies in the way the principles have been applied, rather than their content. We can therefore review them relatively briefly.

408. The basic concept of improper discrimination is set out in Article 102(c) as follows:

> "…(A)pplying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage."

409. The issue of competitive disadvantage falls to be considered under Royal Mail's Ground 3. The issue of applying different conditions to equivalent transactions has formed the basis of numerous decisions in the European Union courts, in the courts of the UK and in those of other member states.

410. The Decision itself refers to two High Court cases, *Purple Parking* and *Arriva the Shires Limited v London Luton Airport* [2014] EWHC 64 (Ch) ("*Arriva the Shires")*, the European Commission's decision of 2 June 2004 in CASE COMP/38.096 *Clearstream* and the Court of First Instance's ("CFI") (now the General Court) judgment in *Irish Sugar*.

411. In *Purple Parking*, which concerned access to pick-up facilities at Heathrow airport, Mann J said that it was necessary to "take a realistic and common sense view of the transaction" and the fact that the parties each used that access for their own different purposes did not make the transactions non-equivalent. He thought that were this not so, it would be difficult to apply the concept of discrimination as:

> "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." (paragraph 135).

412. In *Arriva the Shires*, which again concerned access to airport transport access facilities, Rose J (as she then was) said the parties had clearly been treated differently; the question was:

> "…whether the arrangements…are equivalent transactions, or whether there is a relevant difference between (the parties) which justifies the difference in treatment." (paragraph 125).

413. The *Clearstream* decision is simply an example of the Commission viewing two sets of relevant services, in this case securities depositary services, as equivalent despite there being differences in the supply-side characteristics of the two sets of users. It establishes no new principle and we do not refer to it further.

414. *Irish Sugar* was relied on by Ofcom and Royal Mail, but for different purposes. Royal Mail said the case showed that differences in the nature of demand were relevant to assessing equivalence. Ofcom relied on it here to show the danger of drawing over-sophisticated distinctions between the nature and objectives of different customers, in that case whether the purchasers were competing sugar packers. In particular, the CFI said that such a distinction could not rest on whether a customer 'shared the economic objectives' of the dominant company. The CFI rejected the distinction which was sought to be drawn in this respect as it would mean that:

> "two buyers of the same product pay a different price according to whether or not they are competitors of their supplier on another market', and that the buyers were otherwise 'perfectly comparable at the commercial level'." (paragraph 164).

415. As authority for that proposition, the CFI cited paragraph 90 of the Court of Justice's seminal judgment in *Hoffmann-La Roche* where the Court of Justice found that the effect of the conduct in that case was to:

> "apply dissimilar conditions to equivalent transactions with other trading parties in that two purchasers pay a different price for the same quantity of the same product depending on whether they obtain their supplies exclusively from the undertaking in a dominant position or have several sources of supply."

(4) Discussion

(a) Issue 1: Equivalence

416. Royal Mail maintained that the price plans themselves were differentiated products, reflecting different distribution profiles and different demand from different customers. It said this arose from the different prices that the customers would pay and the degree of flexibility from which each customer would benefit. The flexibility meant APP2 customers did not have the cost and effort of trying to match their profile to that of Royal Mail and in contrast, Royal Mail found it harder to recover costs from APP2 customers. Royal Mail said that Dr Jenkins' evidence supported this view of product differentiation which was similar to the idea of the so called 'value justification' which Royal Mail had sought to advance at the time of the CCNs.

417. Ofcom took the broader view, consistent with the approach of Mann J in *Purple Parking,* which was that the service of delivering bulk mail was the same in each case and that the price differential applied different prices to the same transactions. Whistl agreed with this and was strident in its criticism of Royal Mail's attempt to re-introduce the 'value justification' which it had previously failed to substantiate.

418. Our assessment is that Ofcom was broadly correct in its approach. We heard no well-developed articulation of the idea of value, which seemed to be the essentially circular one that the value was set by the difference between the two price plans. It was not clear customers themselves saw any value in the flexibility. Rather, the value to customers consisted in the ability to compete with Royal Mail and not the ability to match Royal Mail's delivery pattern in any particular way. Ofcom described this as defining the ability to compete as if it were a differentiating feature of the services in question.

419. Even more telling on this point is the advice Royal Mail received and the view it took itself at the time it prepared the CCNs. This was examined in some detail in our consideration of Royal Mail's strategic intention (see Section G(5) above).

420. We noted in that consideration that Oxera's starting point was that the price differential was discriminatory, because it was applying different prices to essentially the same services. Oxera's efforts were directed towards finding a justification for the price differential in terms of cost savings to Royal Mail and value to the customer, not in showing that the two price plans were equivalent.

421. We heard no articulation of how the supposed value difference could be construed as an account of product differentiation, and indeed doubt that any convincing such account could be given. In any case, Oxera were unable in 2013-14 to substantiate or quantify any added value to APP2 customers as a justification for the proposed price differential, despite Royal Mail's public claims at the time of announcing the CCNs that this value justification existed.

422. We therefore turn to the question of the cost justification.

(b) Issue 2: Cost justification

423. Royal Mail maintained that the requirement on NPP1 customers to provide two-year forecasts of volume intentions by SSC enabled it to anticipate changes in the level of usage of its infrastructure and delivery operations, thus allowing it to take out costs and improve its efficiency. Ms Whalley explained that this was against a background of declining volumes and the need for greater efficiency in Royal Mail's operations. Royal Mail had for some time been exploring the idea of volume forecasts, and in 2012 had considered the possibility of 'commitment based' pricing, i.e. a price reduction in return for a commitment to place certain volumes with Royal Mail. She said Royal Mail was not used to the idea of using such forecasts to adjust the scale of its operations, a view which was shared by Oxera.

424. The possible benefit to Royal Mail from advanced notice of access customers' volumes should not really be in doubt. Subject to having in place the necessary procedures and mechanisms to translate the knowledge received into cost-saving actions, a price scheme even by a dominant company that allowed a reduction in return for such advance information would in principle be unobjectionable. We do not understand Ofcom (or Whistl) to disagree with this.

425. The problem with this argument, however, is that while this may in principle be a good justification for a volume-based price scheme, it does not justify a scheme that is constructed so as to exclude certain customers from benefiting from it, particularly where the most significant exclusion would have been Whistl, Royal Mail's only competitor. In the present case, Whistl would have been able to provide similar advance volume information to that available from NPP1 customers but, because it declined to move from APP2 to NPP1, was not eligible to do so. What Ofcom described as a 'design flaw' in the price plans therefore meant that the scheme did not simply offer customers price reductions in return for granular volume forecasts but was selective in the customers from whom it would accept forecasts. In other words, it was discriminatory in its operation.

426. Ms Whalley acknowledged in cross examination that Whistl would have had the necessary information at SSC level precisely because of its direct delivery planning.

> "Q: First, you accept that Whistl could have provided localised SSC by SSC information, don't you?
>
> A: We thought they probably could, yes.
>
> Q: You also accept that Whistl represented the overwhelming proportion of volumes that were on APP2 at this time: that's right, isn't it?
>
> A: I think that's right." (Hearing transcript, Day 5, page 122).

427. This flaw was pointed out by Oxera in its 2013 advice to Royal Mail (see Section G(5) above) but there is no indication that Royal Mail took this advice as it still maintains that the cost justification is valid. The original confusion appears to remain. The fact that it may be perfectly possible to elaborate and quantify a justification for differential pricing based on volume forecasts or even actual commitments does not justify a scheme where customers that wish to compete with Royal Mail cannot benefit. As we concluded in paragraph 281(8) above:

> "There was little or no evidence of Royal Mail making significant use of volume forecasting to match resources to volumes in any systematic way. Oxera pointed this out and recommended further work. Dr Jenkins said she regretted that this had not been further pursued. The cost justification for price plan NPP1 had all the hallmarks of an *ex post facto* exercise."

428. Apart from the issue of whether Whistl was, in fact, eligible to move to NPP1 while continuing its roll-out, which we cover below, there are several other issues to consider. The first is Ofcom's point that the main way in which Royal Mail could save costs by adjusting its operations to anticipated falls in demand was if it received advance information of the volumes to be handled by a direct delivery entrant. Royal Mail had indeed modelled the effect of Whistl's entry in Manchester to assess the likely value of advance volume forecasts. Royal Mail did not seek such advance information from Whistl, or at least appeared to make it subject to Whistl limiting its direct delivery plans so as to allow it to move to NPP1. This raised the question as to whether such strategy was designed to limit competition from Whistl.

429. Royal Mail argued that this would have required a bespoke contract for Whistl, that other APP2 customers were not able to provide SSC-level forecasts and that it was not obliged to offer plans to particular customers. That rather misses the point, which is that Whistl's plans and intentions in bulk mail delivery were well known to Royal Mail and it would not have been difficult to extend the forecast requirement to it nor would it have been necessary to offer bespoke pricing – a simple discount to those customers on APP2 willing to supply forecasts would have sufficed.

430. A further point is that it may not be appropriate for a dominant company to seek advance information about when, where and to what extent a new entrant plans to compete with it. This point was of some concern to us, and Mr Polglass of Whistl said he agreed that it was highly undesirable to have to disclose plans in advance in this way. We were told by Dr Jenkins that the issue would be dealt with within Royal Mail by internal information barriers so that only those concerned with operational matters would have the information, and that this was not unusual.

431. Whether or not such measures would be sufficient, and we have no way of knowing this, we do not think the possible danger that a proposed information requirement might allow an incumbent to anticipate where a new competitor might enter the market, and hence allow the incumbent to respond, justifies harming that competitor in some other and more direct way.

432. Ofcom also said that the size of the differential was calculated by reference to the amount of savings that would follow from volume declines arising from increased direct delivery. Royal Mail denied this, pointing to the extensive work undertaken by Oxera in 2013-14 to quantify the amount of the proposed differential. The results of this were set out in part in the papers provided to Royal Mail's Disclosure Committee in January 2014, which we examined in Section G above. Royal Mail said this contrasted with Ofcom's failure to consider how the differential had been calibrated.

433. Royal Mail also claimed the final level of the differential (0.25p per item) was decided by reference to the so called 'value justification', and that a differential range from 0.2-0.5 pence per item could have been defended. Our examination of the Disclosure Committee process (see Section G) however suggests that the level was set to give the greatest chance of justification to Ofcom, and to show that Royal Mail was being reasonable.

434. We do not see these points as decisive one way or the other. We think the cost justification as advanced by Royal Mail does not serve to overcome the essentially discriminatory nature of the price differential in the particular circumstances of this case.

(c) Issue 3: Eligibility

435. It appears to have been assumed in the planning within Royal Mail prior to the CCNs being published that Whistl, as an APP2 customer, would either have to switch to NPP1 and curtail its direct delivery roll out plans, or remain on APP2 and continue them at increased cost. In our consideration of Royal Mail's strategic intention (see Section G paragraph 281(15) above) we noted that:

> "In summary, we believe the evidence supports the view that Royal Mail planned and intended to take actions which it either knew would harm Whistl's direct delivery plans or was reckless as to whether they would. Royal Mail knew about Whistl's intentions in sufficient detail to plan against them and clearly had Whistl in mind when preparing its plans."

436. It is therefore interesting to see the argument advanced by Royal Mail that, in fact, Whistl misunderstood the nature and effect of the price plans being offered

and that continuing its direct delivery roll-out plan up to a significant number of SSCs was compatible with moving to NPP1. Indeed, Royal Mail said it offered to help Whistl make this change at the meeting between them on 17 December 2013 (see Section G above). We are not persuaded by Royal Mail's argument.

437. This argument is based on an interpretation of the criteria set by Royal Mail for switching to and/or remaining on price plan NPP1, analysis of the customer conversion ratio needed by Whistl, proposed use by Whistl of arbitrage via plan ZPP3 and the evidence of Mr Harman that such a roll-out was economically feasible and rational in business terms.

438. It may be recalled that Whistl was only able to benefit from the flexible price plan APP2 because it had complained to Postcomm about the inflexibility of plan NPP1 for a direct delivery competitor. At the time of the CCNs, it would have had to apply to Royal Mail to switch plans to benefit from the lower price on that plan.

439. Whistl argued strongly that the clear contractual terms for eligibility for NPP1 would have made Whistl's position hazardous. NPP1 required compliance with a national spread benchmark and an urban density benchmark. Significant breach of these requirements would involve surcharges, tending to negate the benefit of the lower prices. The permitted tolerances (which had allowed breach in 6 SSCs) were reduced to 5 SSCs by the CCNs (see Section C above). According to the terms of the plan, Whistl would have had to show there was a reasonable likelihood of it being able to meet these requirements in the future. There was, in addition, a right for Royal Mail to switch a customer to another plan if the total amount of surcharges exceeded 15% of total charges.

440. Royal Mail's case was that it was relaxed in its enforcement of these requirements and Whistl's calculation that it was ineligible to be on NPP1 as a direct delivery operator was simply wrong. Whistl's point was that what mattered was what it and its outside backer LDC actually believed and did, not what a theoretical argument might have supported. Moreover, it would have

involved in effect placing Whistl's commercial future into the hands of Royal Mail, which was not acceptable to Whistl.

441. Royal Mail also said that Whistl could have made use of 'arbitrage' possibilities to retain the benefit of NPP1, whilst varying its volumes sufficiently to stay within the permitted tolerances. There was considerable discussion before us about the merits and demerits, let alone the meaning, of this term, but it effectively means putting some volumes through the zonal price plan ZPP3 to balance the national spread of volumes remaining on NPP1.

442. Royal Mail said Whistl did this and could have done so to a greater extent. On the basis of Mr Harman's evidence there were several possibilities open to Whistl, operating as a rational business, to take advantage of the tolerance limits of price plan NPP1 in conjunction with arbitrage using price plan ZPP3 to allow it to continue to expand its end-to-end delivery operations to a significant extent without incurring excessive surcharges.

443. Whistl said, on the basis of Mr Polglass's and Mr Wells's evidence, that whilst it used price plan ZPP3 for customers with local needs, it used arbitrage only to a very limited extent and in any case at the relevant time (2014-15) did not have the necessary equipment or software to direct particular items of mail sufficiently precisely to particular zonal locations. It also said it agreed with Royal Mail's efforts to restrict arbitrage and that Royal Mail actively discouraged the practice.

444. Ofcom rejected Royal Mail's contention, both in the Decision and before us. It pointed out that none of the contemporaneous evidence showed any reference to arbitrage being used, and that Oxera had not examined this either. It also pointed to the evidence from Whistl that extensive use of arbitrage as a part of any serious expansion plan for direct delivery would have been foolhardy. As Mr Wells told the Tribunal:

> "It would have been completely foolhardy to base your business plan and roll-out plan based upon something that Royal Mail could effectively close very quickly through changing tolerances." (Hearing transcript, Day 10, page 61).

445. Mr Polglass also explained to the Tribunal that Whistl did not believe that arbitrage was a sensible route at all, not least because Royal Mail:

> "made it very clear for many, many years that they did not like the idea of arbitrage moving between contracts and taking the best price from each." (Hearing transcript, Day 8, page 95).

446. In our view, Ofcom was quite correct in this assessment. As shown by our examination of the evidence in Section G(5) above, there was no indication at the time that Royal Mail thought that direct delivery entrants would resort to arbitrage to retain the benefits of the price differential. Indeed, discussion of moving to a 'one price plan only' regime shows Royal Mail's concern to reduce or eliminate it. We were not convinced by an *ex post* argument based on economic and financial assumptions that were not considered at the time either by Whistl or Royal Mail.

447. Overall, it does not appear to us that Whistl could reasonably or safely have assumed that, by switching to NPP1 and making skilful use of surcharge minimalisation, whether by use of arbitrage or otherwise, it could continue with a serious expansion of its direct delivery operation. These arguments to the contrary, produced after the event are not convincing when set against the facts. Mr Harman's evidence, though no doubt correct in its own terms, is based on theoretical assumptions that do not appear to have reflected market reality at the time.

448. We do not therefore think that NPP1 would realistically have been available to a direct delivery entrant planning to expand to any significant scale, and that in this case it was not in practice available to Whistl.

(5) Conclusion

449. For all these reasons we conclude that Royal Mail's claim under this ground that the price differential did not amount to undue or improper discrimination must fail.

J. GROUND 3 – NO COMPETITIVE DISADVANTAGE

(1) Introduction

450. Under this ground, Royal Mail claimed that Ofcom was wrong to conclude that the price differential resulted in a competitive disadvantage. In particular, it argued that Ofcom had made errors of law and assessment in: (a) concluding that neither an as-efficient competitor test ("AEC test") nor other form of price-cost test, was a necessary, relevant or appropriate way to demonstrate the likely impact of the differential on a competitor; (b) failing properly to take account of the AEC test submitted by Royal Mail during the administrative process; and (c) concluding that the announcement of the price differential was a material factor contributing to decisions by Whistl to scale back its investment in direct delivery and ultimately withdraw from the relevant market.

(2) The parties' submissions

451. Royal Mail's submissions (summarised above) are developed in the discussion that follows.

452. Ofcom said that it had reached the correct Decision by taking into account all the circumstances of the market, in particular: (a) Royal Mail's overwhelming dominance and structural advantages in the market for the delivery of bulk business mail; (b) the high barriers to entry; (c) the dependence of any entrant on Royal Mail for some continued access services in the areas where the entrant does not perform complete end-to-end delivery; and (d) the highly competitive nature of the 'upstream' retail market. It characterised Royal Mail's conduct as amounting to an attempt to make entry costlier rather than offering better terms to its customers, and as a deliberate strategy to limit delivery competition from its first and only significant competitor.

453. Ofcom argued that, as a matter of law, it was not required to carry out an AEC test. It also argued that, as a matter of economics, it would not have been useful to do so, given the nature of the conduct – raising rivals' costs - and that in situations of overwhelming dominance, consumers will benefit from entry, even

if the entrant is not as efficient as the incumbent. In addition, it said that, because the AEC test provided by Royal Mail failed adequately to capture the realities of entry into the market and had a number of other flaws, it was right to conclude that it did not assist in evaluating the effects of the price differential.

454. Whistl supported Ofcom's position on this ground. In particular, it argued that the Decision went far beyond a simple consideration of the effect of Royal Mail's price differential on Whistl's profits and that its reasoning was that the differential was not only likely to make Whistl's roll-out of direct delivery more difficult but actually did so. It argued that the AEC test propounded by Royal Mail took as a benchmark an operator who was as equally efficient as Royal Mail and that such a benchmark was inappropriate and hence uninformative given the circumstances of this case.

(3) Legal principles: (1) the issue of the AEC test and its consideration by Ofcom

455. The parties' interpretation of the legal principles in the case law differed significantly; we therefore explain them in some detail.

456. At a general level, Royal Mail relied on several authorities to support its argument that Ofcom should have examined the results of Royal Mail's price-cost tests and accorded them a much greater weight. It argued that these authorities, taken together, contemplate the use of an AEC test or similar price-cost test as being at the very least highly relevant, if not determinative, of whether a particular pricing practice should be classified as abusive. As recorded in the Decision, Royal Mail's case was first:

> "if an EEO could compete profitably despite the application of the price differential, it is not open to Ofcom to find an abuse." (paragraph 7.182)

and secondly:

> "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." (paragraph 7.188).

457. It argued that the Court of Justice has found the AEC test to be an essential benchmark to determine whether pricing conduct is anticompetitive - in order to avoid the danger of treating competitive conduct as an abuse. The benchmark, essential in *all* pricing cases and not just so-called low-pricing ones, is necessary to enable dominant undertakings to tell if intended conduct is anticompetitive. In the absence of a quantitative test, dominant undertakings would be under an obligation to leave headroom of uncertain size to allow for inefficient entry. In such circumstances, there would be no meaningful distinction between foreclosure and anti-competitive foreclosure.

458. Royal Mail argued that *Intel* had resolved the case law relating to the necessity for an AEC test against the line of case law in *Post Danmark II* and the General Court in *Intel*, on which Ofcom had relied in its Statement of Objections. Royal Mail rejected Ofcom's conclusion in the Decision that *Intel* does not overrule *Post Danmark II* or address the finding in that case that there are circumstances where a price-cost test is not legally required or appropriate. To the contrary, Royal Mail argued in its written closing submissions that the absence of any mention of *Post Danmark II* in *Intel* was "highly instructive" as to the way in which the earlier case should be considered or relied upon: *Intel* is "clearly concerned" with why an AEC test is relevant in pricing practice cases and the Court found the relevant test for abusive pricing practices to be that Article 102 "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."

459. Royal Mail disagreed with Ofcom's and Whistl's argument that the expression "among other things" in that passage from the *Intel* judgment limited the relevance of the AEC or the application of the AEC test in any way. In particular, it contended that there was no justification for limiting the relevance of the AEC test to low pricing practices.

460. Royal Mail argued in its written closing submissions that a successful AEC test should be treated as definitive:

> "where an AECT is passed, it is difficult to understand on what basis the conduct could be seen to be anti-competitive foreclosure (if the AECT is failed

> other factors would need to be considered, such as the duration and market coverage of the practice, or whether an input is indispensable)."

461. Ofcom and Whistl relied strongly on *Post Danmark II* to support their argument that an AEC test was neither necessary nor appropriate in the circumstances of the present case, and on the proper construction of the authorities. More generally, Ofcom argued that the AEC test could not be regarded as being determinative, as this would render it unnecessary to take account of "all the circumstances" of the case as required by *Post Danmark I*:

> "In order to determine whether a dominant undertaking has abused its dominant position by its pricing practices, it is necessary to 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 (see, to that effect, *Deutsche Telekom v Commission*, paragraph 175 and case-law cited)."

462. Ofcom argued that *Post Danmark II* remained good law, as stated in paragraph 5.106(b) of the Decision. It was not overruled or even addressed in, and was fully consistent with, *Intel*. The latter was not authority for the proposition that an AEC test was determinative and relevant in *all* cases.

463. Whistl argued that it was "perfectly clear" that *Intel* did not lay down a new rule that an AEC test is the decisive basis for establishing an infringement in every kind of case, including those – like in *Post Danmark II* – where the test would not establish whether the competitive process had been distorted. In such circumstances, the application of an AEC test "will not establish either that the conduct at issue is not harmful to the competitive process, nor [sic] that the interests of consumers are protected."

464. Ofcom regarded the position following *Intel* to be: (a) the Commission must conduct a detailed examination of effects in all rebate cases, at least if foreclosure is contested; (b) it must consider all evidence provided by the dominant undertaking, including any AEC test; and (c) the results of an AEC test do not need to be regarded as determinative in the assessment of foreclosure.

465. On the question of whether Ofcom had dismissed the AEC test advanced by Royal Mail without sufficient consideration, Royal Mail said, on the basis of the *Intel* judgment, that it was not open to Ofcom to act in this way. Even if it declined to apply its own AEC test, it should have properly considered Royal Mail's AEC test, which, if not decisive, would have been informative. Ofcom said that, given that it was not obliged in law to rely on an AEC test in this case, it had given sufficient consideration to Royal Mail's test to establish that it would not assist it in reaching a decision. Whistl agreed with this view.

(4) Legal principles: (2) the assessment of materiality

466. Ofcom argued that its approach to the assessment of materiality had taken full account of the need to separate profitability and the distortion of competition and had done so in the Decision. It also rejected the argument of Royal Mail that the *TeliaSonera* case, (C-52/09 *TeliaSonera Sverige* EU:C:2011:83) ("*TeliaSonera*") required an AEC test to be carried out in all cases of margin squeeze.

467. Royal Mail argued that Ofcom could not properly rely on what happened to Whistl as evidence of the likely impact of the proposed price differential on a rational end-to-end entrant or Whistl in particular. It criticised Ofcom insofar as its assessment of likely anti-competitive effects was based on what actually happened to Whistl, on the grounds that: (a) exit was generally also consistent with the process of competition; (b) Ofcom's finding that the price differential was a "material contributing factor" to Whistl's suspension of its roll out and LDC's ultimate decision not to invest was insufficient to establish that the price differential actually led to Whistl's exit, even if actual effects were a relevant question to establish abuse (which Royal Mail denied); and (c) the evidence did not support the conclusion that Whistl's exit was prompted by the price differential specifically, but suggested that the impact on Whistl was a rational response to uncertainty relating to the implementation of the CCNs as a whole, and to Whistl's other business difficulties.

468. Royal Mail also argued that Ofcom failed properly to investigate the reasons for either LDC's or PostNL's decisions not to invest, which might have been due to declining postal volumes and other market and performance factors.

(5) Discussion

469. There are three broad questions to be considered under this ground of appeal. The first relates to the use of an AEC test, whether Ofcom was required to use and apply such a test, and if so in what form, and whether it properly considered the AEC test advanced in the administrative proceedings by Royal Mail. The second broad question concerns the way in which Ofcom assessed the competitive disadvantage arising from the abusive conduct it had found; in particular whether it placed too great a reliance on the actual fate of the market entrant, Whistl and whether the effect of the abusive conduct was sufficiently 'material' to amount to an infringement of Article 102. The third broad question is whether Ofcom correctly assessed the issues of anti-competitive foreclosure and competitive disadvantage in the light of all the circumstances, or "in the round". We deal first with the question of the AEC test.

(a) The AEC test

470. In relation to the applicability or otherwise of the AEC test, there are five issues that need to be considered. The first is whether there is a requirement on Ofcom to establish anti-competitive foreclosure by means of an AEC test in all pricing cases. The second is whether there is a clear class of cases whose potential anti-competitive foreclosing effects should be investigated by means of an AEC test, and, if so, whether this case falls into that class. The third is whether, in the particular circumstances of this case, the concept of a competitor equally as-efficient as Royal Mail is appropriate. The fourth is whether the particular AEC test submitted by Royal Mail had any problematic features, and, if so, how helpful the test was. The fifth is whether the consideration that Ofcom gave to the AEC test provided by Royal Mail was adequate.

Issue 1: is there a need to use an as-efficient competitor benchmark in all pricing conduct cases?

The law

471. In *British Telecoms*, an appeal under the Communications Act 2003, the Tribunal summarised the development of the case law on exclusionary abuses under Article 102 following the judgment of the Court of Justice in *Post Danmark I*, but prior to *Intel.* In paragraph 93, it found that the following general principles on such abuses derive from *Post Danmark I*:

> "(i) Article 102 is concerned with the protection of competition on the merits and the promotion of efficiency and, thereby, with the enhancement of consumer welfare in relation to features that include price, choice, quality and innovation.
>
> "(ii) Accordingly:
>
> (a) Article 102 does not prohibit conduct that constitutes competition on the merits even if it results in the acquisition of a dominant position or the exclusion or marginalisation of competitors that are less efficient or attractive to consumers than the dominant firm; but
>
> (b) Article 102 does prohibit conduct that has the effect of impairing competition on the merits, in particular where that conduct has the effect of strengthening the market position of the dominant firm or diminishing actual or potential competition to the detriment of consumers.
>
> "(iii) However, Article 102 does not apply to conduct that would otherwise be prohibited if it can be shown by the dominant firm to be either objectively necessary or indispensable to produce efficiency gains that yield benefits to consumers that outweigh the negative effects of the conduct in question without eliminating effective competition by removing all or most sources of actual or potential competition."

472. At paragraph 94, the Tribunal noted that in "the interests of effective enforcement and legal certainty" the above principles have to be rendered administrable through more precise legal standards, which it listed as:

> (i) Article 102 prohibits a dominant firm's pricing strategy where it does not constitute competition on the merits and has an anti-competitive effect […]: Case C-62/86 *AKZO v Commission* [1991] ECR I-3359 at [70]; *France Télécom* at [106]; *Deutsche Telekom* at [177]; *Post Danmark I* at [25].
>
> (ii) In general (but not invariably), the legality of a firm's pricing conduct should be assessed by reference to its own costs: *TeliaSonera Sverige*, at [41], citing *AKZO* at [74] and *France Télécom* at [108] and [45].
>
> (iii) The anticompetitive effect must be likely or probable but need not have materialised at the time of the decision: *Post Danmark II* at [65]– [66] and [69]-[74].

> (iv) In assessing whether that effect arises, it is necessary to examine all the circumstances of the case and specifically to investigate whether the practice impairs buyers' freedom of choice, forecloses competitors, discriminates amongst counterparties, or strengthens the dominant position by distorting competition: *TeliaSonera Sverige* at [28].

473. As the Tribunal therefore made clear in *British Telecoms*, a price-cost test is not an invariable test for the legality of the conduct of a dominant undertaking under the case law synthesized and restated in *Post Danmark I*. Rather, in assessing whether an anti-competitive effect is likely, all the circumstances of a case must be examined and specifically "whether the practice impairs buyers' freedom of choice, forecloses competitors, discriminates amongst counterparties, or strengthens the dominant position by distorting competition."

474. We find that, for the purposes of this appeal, the position has not changed since the Tribunal's summary in *British Telecoms*. In particular, the statement of the law in paragraphs 21 and 22 of *Post Danmark I* was adopted word-for-word in the Court's judgment in the later *Intel* case. Thus, in paragraphs 133 and 134 of *Intel*:

> "133 […] 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)."

475. These two paragraphs are linked by the word "[t]hus," and must be read together, in which case they demonstrate two important propositions. The first is that a less efficient competitor cannot simply claim the protection of Article 102 to preserve its position in the market if it is forced to exit as a result of any action on the part of a dominant undertaking. Article 102 does not "ensure" or guarantee its presence on the market.

476. This first proposition does not mean, however, that the possibility of abuse is inevitably excluded merely because affected competitors are less efficient than the dominant undertaking. Where there is sufficient evidence from the nature of the conduct and the other circumstances to demonstrate that a dominant undertaking had engaged in competition other than on the merits and has thereby allowed its conduct to impair genuine, undistorted competition, that is a sufficient basis for a finding of abuse, unless it is objectively justified.

477. The second proposition, which explains the first, is that no automatic assurance is afforded to less efficient undertakings because the exit of any competitor may be the natural effect of competition on the merits by the dominant undertaking. Such exit may result from the excluded undertakings being unable or unwilling to make an attractive counteroffer based on price, quality, choice or innovation. In those circumstances, there is no reason of policy to restrain the conduct of the dominant undertaking.

478. But this does not excuse a dominant undertaking from its special responsibility not to allow its behaviour to impair genuine, undistorted competition on the internal market: see *Post Danmark I,* paragraph 23 and the cases cited there. This special responsibility is not merely a threshold to determine whether or not to engage an AEC test; it is, rather, a minimum obligation on the part of a dominant undertaking in all circumstances. This is clear from the continuing validity of the fundamental principles developed in *Hoffmann-La Roche* and the subsequent case law. The Court in *Intel* confirmed this in the paragraph that follows immediately after the two core paragraphs cited in paragraph 474 above:

> "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)."

479. It was a matter of dispute between the parties in this appeal as to whether *Intel* had rendered the judgment in *Post Danmark II* less reliable. We discuss this in the following paragraphs.

480. The Court illustrated a dominant undertaking's special responsibility in paragraph 136 of *Intel*, in which it adopted its earlier finding in *Post Danmark I*, that "not all competition by means of price may be regarded as legitimate." To quote the paragraph in full:

> "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."

481. The significance of the words "among other things" is a matter of dispute between the parties. Advocate General Kokott discussed their meaning, as used in *Post Danmark I* and other cases, in her Opinion in *Post Danmark II*:

> "61. In my view, Article 82 EC does not support the inference of any legal obligation requiring that a finding to the effect that a rebate scheme operated by a dominant undertaking constitutes abuse must always be based on a price/cost analysis such as the AEC test.
>
> 62. It is true that the Court has on occasion called for an AEC test to be carried out in connection with pricing practices other than rebates, in so far as it has held that Article 82 EC 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. (Judgment in *Post Danmark* (C-209/10, EU:C:2012:172, paragraph 25); see also judgments in *Deutsche Telekom* v *Commission* (C-280/08 P, EU:C:2010:603, in particular paragraphs 177, 183, 196, 203 and 254) and *TeliaSonera* (C-52/09, EU:C:2011:83, in particular paragraphs 67, 73 and 94); the judgment in *AKZO* v *Commission* (C-62/86, EU:C:1991:286, in particular paragraphs 71 and 72) also relies, inter alia, on a price/cost analysis)
>
> 63. However, that case-law does not support the inference of an absolute requirement always to carry out an AEC test for the purposes of assessing price-based exclusionary conduct from the point of view of competition law. On the one hand, that case-law is specifically concerned with pricing practices by dominant undertakings, such as a low-pricing policy (loss leader pricing, for example) or margin squeezing through the reduction of the cost-price ratio, which are by their very nature closely related to the cost structure of the undertakings in question. On the other hand, the form of words chosen by the Court, 'among other things' (French: '*notamment'*), (Judgments in *Post Danmark* (C-209/10, EU:C:2012:172, paragraph 25) and *Deutsche Telekom* v *Commission* (C-280/08 P, EU:C:2010:603, paragraph 177, the German-language version of which renders the French '*notamment'* as '*u.a.*' (*inter alia*)) makes it clear that it cannot always be assumed that an abuse of a dominant position exists only where the exclusionary effect is felt by undertakings which are as efficient as the dominant undertaking."

482. The Court in *Post Danmark II* specifically adopted paragraphs 61 and 63 of her Opinion, and stated that:

> "it is not possible to infer from Article 82 EC 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." (at paragraph 57).

483. Further, the Court in *Post Danmark II* held that, there were circumstances where applying the AEC test "is of no relevance inasmuch as the structure of the market makes the emergence of an as-efficient competitor practically impossible" (at paragraph 59). Moreover, "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" (at paragraph 60). For those reasons, the Court concluded that the AEC test must be regarded "as one tool amongst others" in the assessment of dominance (at paragraph 61).

484. We do not agree that *Intel* must be read in a way that renders the above statement of the law in *Post Danmark II* less reliable. The judicial development in *Intel* was the requirement set out in paragraph 138 of the judgment, in which it "further clarified" earlier case law on rebate schemes in certain circumstances – namely 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." In such circumstances, the Commission must assess whether the rebate scheme was part of a strategy aiming to exclude competitors that are at least as efficient as the dominant undertaking from the market, and whether it had a capacity to do so. Where the Commission does so, "the General Court must examine all of the applicant's arguments seeking to call into question the validity of the Commission's findings concerning the foreclosure capability of the rebate concerned" (paragraph 141).

485. *Intel* does not provide authority for the proposition that conduct will always be compatible with Article 102 provided that the only undertakings affected by the conduct are less efficient than the dominant undertaking. This is clear from non-pricing cases such as *AstraZeneca*, where the concept of the AEC has no place. It is also clear from *Post Danmark II* that there is no point in seeking to establish

the lawfulness of conduct on the basis of an AEC test where the emergence of an AEC is "practically impossible".

486. We therefore do not agree with the argument of Royal Mail that, because the Court in *Intel* refrained from any mention of *Post Danmark II* while expressly adopting *Post Danmark I*, this changed the way in which *Post Danmark II* must be understood. We find that Ofcom did not err in this respect in the Decision.

487. In the light of that finding, we conclude that, as a matter of legal principle and precedent, there was no requirement for Ofcom to assess Royal Mail's conduct by carrying out an AEC test or other price-cost test. This is for the following reasons:

(1) The use of the AEC test, and the significance of the impact of the dominant undertaking's conduct on an AEC, can certainly be a critical element in distinguishing competition on the merits and anti-competitive conduct. Where the conduct comprises low prices, which on their face may have all the characteristics of competitive conduct, the use of an AEC test may be particularly useful in establishing such distinction. However, the Court did not require in Intel that the legality of low pricing may only be established through an AEC test, or that the impact of conduct on an AEC is the defining characteristic of abusive conduct.

(2) The fact that the test has been applied by the Court in low-pricing practices and margin squeeze does not mean that it must be used in the detection of an abuse where it is not necessary to do so.

(3) Once it is established that the dominant undertaking has engaged in competition other than on the merits and in dereliction of its special responsibility, its conduct will be an abuse if there is a likely adverse effect on competition and in the absence of objective justification. In some circumstances, it will either be helpful or necessary to use a price-cost test such as an AEC test to establish such a conclusion, but it is important to distinguish questions of methodology from the basic legal

responsibility of dominant undertakings that flows from Hoffmann-La Roche and the subsequent case law.

488. The conduct of a dominant undertaking that unfairly restrains a rival from competing on price, quality, choice or innovation will normally be an abuse under the principles of *Hoffmann-La Roche* unless it can be objectively justified. We can see this most clearly in *AstraZeneca*, where the Court held that:

> "[i]t follows [from the definition of abuse in *Hoffmann-La Roche*] that Article 82 EC prohibits a dominant undertaking from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the merits." (paragraph 75).

489. The Court did not limit this principle to cases where the conduct may lead to the elimination of an as-efficient competitor. A dominant undertaking must not depart from competition on the merits in a manner that allows its conduct to impair genuine undistorted competition. Thus, as the Court went on to find in *AstraZeneca*:

> "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 […] is legitimate and is part of the normal competitive process, provided that the conduct envisaged does not depart from practices coming within the scope of competition on the merits, which is such as to benefit consumers." (paragraph 129).

490. *AstraZeneca* was a non-pricing case, but the case law does not require an administrative authority or court, as a matter of principle, to assess pricing and non-pricing abuses differently – applying an as-efficient competitor standard to one and not the other. Of course, depending entirely on the facts of the case, it might be necessary *in practice* to use an AEC test to differentiate pricing conduct that is competition on the merits from that which is not. But if it is not necessary to do so, then the case law does not impose an obligation in principle to use an AEC test benchmark.

491. *Post Danmark II* is entirely consistent with this interpretation of the case law. It did not need to be either confirmed or differentiated in *Intel*. The Court found that it would be pointless to use the test where there was no possibility of an as-efficient competitor. In such circumstances, some other means must be used to ensure that the conduct complained of was not competition on the merits. As

the Court stated, the AEC test must be regarded as one tool amongst others for the purposes of assessing whether there is an abuse of a dominant position in the context of a rebate scheme. The Court refused to excuse the foreclosing conduct of the dominant undertaking on the basis that no AEC was shown to have been excluded. The Court found, in any event, that the presence of a less-efficient competitor would be consistent with the objectives of Article 102 in those particular circumstances.

492. There is some academic support for this interpretation. We note, for example, that Judge José Luís da Cruz Vilaça, writing in a non-judicial capacity, is also of the opinion that *Intel* and *Post Danmark II* continue to co-exist: "*The intensity of judicial review in complex economic matters - recent competition law judgments of the Court of Justice of the EU*", Journal of Antitrust Enforcement, 2018, 6, 173–188. He observes that the Court in *Intel* did not take a position on whether the application of an AEC test was, in itself, necessary or not in that case. Further, he observes that the meaning of the expression "all the circumstances" was not further clarified in *Intel*. For that reason he is of the view that it is proper to rely on the *Post Danmark II* listing of factors, in which the Court stressed the importance of taking into account not only the criteria and rules governing the grant of the rebate, already mentioned in Case 322/81 *Banden-Industrie-Michelin v Commission* EU:C1983:313 (paragraph 73) and in Case C-549/10 P *Tomra Systems ASA v Commission* EU:C:2012:221 (paragraph 71), but also the extent of the dominant position and the particular conditions of competition prevailing on the relevant market.

493. Further, and for completeness, additional support for the proposition set out at paragraph 57 of *Post Danmark II* can be found in the Opinions of Advocate General Wahl (as he then was) in *Intel* (see paragraph 167) and Case C-633/16 *Ernst & Young P/S v Konkurrencerådet* EU:C:2018:23 ("*Ernst & Young*") (see paragraph 96 and its footnote 35). Moreover, we note in this respect that the Opinion in *Ernst & Young* postdates the judgment in *Intel* and we were not taken to any other source or authority to the contrary.

494. For these reasons, we find that Ofcom did not err in law by declining to use a price-cost test during the course of its investigations as a means of determining the legality of Royal Mail's conduct.

The economics

495. Having found that there was no legal obligation on Ofcom requiring it to assess the conduct of Royal Mail by reference to an AEC test, we also find that there are no compelling reasons of economic principle that mandate such a test.

496. Royal Mail argued that "[t]he Decision's findings that an AEC test or price cost test is not necessary, appropriate or relevant is also inconsistent with accepted principles of competition economics." It cited Mr Dryden's reports in support of this proposition.

497. In his fourth Report, Mr Dryden set out three principal reasons for considering that an AEC test is the appropriate test for determining whether pricing behaviour is abusive. These are:

(1) Allowing dominant undertakings pricing freedom, subject to satisfying an AEC test, is likely to promote consumer welfare. That is because such a test ensures (by definition) efficient entry. Productive efficiency is in turn conducive to consumer welfare.

(2) An AEC test provides a predictable basis for applying ex post competition law and a feasible basis for dominant undertakings to assess the legitimacy of their conduct, since the rule is clear (at least in concept) and the relevant data are available to the dominant undertaking.

(3) An AEC test may be seen as an economic implementation of the legal concept of competition on the merits. In particular, if competition on the merits refers to competition on the attributes of the undertakings concerned, the AEC test gives effect to that because a dominant undertaking is not sanctioned if a less efficient rival is excluded but is forced to accommodate the entry of an equally, or more, efficient

competitor. By contrast, an approach that obligates a dominant company to accommodate a less efficient entrant does not allow the dominant company to compete on the basis of its own efficiency.

498. We will return to the third of these claims when we consider the third issue, but we now consider the first two claims regarding productive efficiency and legal certainty.

499. We first consider the link between productive efficiency and consumer welfare. We start by clarifying the concept of productive efficiency.

500. Productive efficiency relates to whether, for a particular industry comprising a number of different operators, the total costs of production across all operators are as low as possible. Productive inefficiency arises when this is not the case, and the degree of productive inefficiency can in principle be measured by comparing the prevailing total costs to the lowest possible total costs. However, under accepted economic principles such a measure of productive inefficiency would not be counted as part of consumer welfare, though it would be a component of total welfare, comprising consumer plus producer surplus.

501. There are two sources of productive inefficiency. First, some operators may have higher fixed or variable costs than others. This is the aspect that applies when reference is made to a "less efficient entrant". Second, even when all operators are equally efficient in the sense of having the same fixed and variable costs of production, productive inefficiency can arise because of the duplication of fixed costs.

502. There are two parts to the claim that an AEC test promotes consumer welfare: first that the use of an AEC test promotes efficient entry; and second that this in turn is conducive to improving consumer welfare.

503. How an AEC test might promote efficient entry was tested in the concurrent evidence process during the hearing. The essential points that were examined were as follows. If a dominant undertaking takes some action in the face of actual or potential entry by a rival, and if a competition authority is concerned

that the action is potentially abusive and investigates this possibility by carrying out an AEC test then: (i) if the test is failed (i.e. an AEC cannot profitably enter because of action taken by the dominant undertaking) the action will be deemed abusive; and (ii) if the test is passed (i.e. an AEC can profitably enter despite the action taken by the dominant undertaking) the action taken by the dominant undertaking must be deemed non-abusive and allowed.

504. However, if the test is passed by some margin, then there will in addition be a range of *less* efficient competitors that can also profitably enter. Anticipating all of this, a potential entrant that is *less* efficient than the incumbent may therefore decide to enter. For this reason, we conclude that the use of an AEC test by a competition authority does not *ensure* that all entry is efficient but merely serves as a possible means of protection for a dominant undertaking against charges of abuse.

505. Turning to the claimed link between entry and consumer welfare, we agree that economic principles imply that as a matter of theory (and as set out by Mr Parker but agreed by all the experts) entry could affect consumer welfare through three channels.

(1) *Allocative efficiency.* Having a greater number of competitors will exert a downward pressure on price and so improve consumer welfare.

(2) *Dynamic efficiency.* Increasing competition could spur operators to cut costs and hence price and/or produce better products all of which would improve consumer welfare.

(3) *Productive inefficiency.* To the extent that a new entrant has higher variable costs than existing incumbents there will be an upward pressure on price.

506. When the entrant is just as efficient as existing operators (incumbents) only the first two factors are in play, and entry benefits consumers.

507. In the case of inefficient entry, the upward pressure arising from productive inefficiency means that the price will be higher than if the entrant had been equally efficient. However, to establish whether the price will be higher than if no entry had taken place, the upward pressure arising from productive inefficiency needs to be balanced against the downward pressure of the other two forces to determine whether consumers benefit from entry.

508. When there are many existing operators, the net effect can in principle go in either direction and can be determined only by empirical investigation of the particular case. However, if, as in this case, there is a single dominant undertaking, i.e. a monopoly, then, as long as an inefficient entrant can profitably enter, the price will fall below the monopoly price.

509. So even though, as noted above, productive inefficiency is not a component of consumer welfare and so does not *directly* affect consumer welfare, entry by a less efficient undertaking can have an *indirect* effect on consumer welfare through its effect on the post-entry price.

510. However, Mr Dryden put forward the additional argument that "encouraging inefficient entry reduces productive efficiency and thus risks consumer welfare since prices may have to rise to cover the higher costs of the industry" (Mr Dryden's fourth report, paragraph 2.14). This points to a second channel by which inefficient entry might indirectly affect consumer welfare.

511. This point was emphasised by Mr Beard QC in his oral closing arguments for Royal Mail, (Hearing transcript, Day 16, pages 140-141), where he stated that "Royal Mail doesn't actually exhibit many of the characteristics one would expect of a monopolist. It's certainly not in the business of making supra-normal profits." He went on to say "[i]n those circumstances, as Mr Dryden emphasised, the importance of considering the break-even criterion when you're assessing issues concerned with productive efficiency is particularly important."

512. We are not persuaded by this argument for the following reasons:

(1) The factors at work here derive from entry itself, because that reduces an incumbent operator's profits through the dual effects of (a) potentially driving down price and (b) taking market share/volume from an incumbent, thus driving up its average costs.

(2) These effects are likely to be weaker under entry by a less efficient competitor than under entry by an equally efficient competitor because, as stated above, entry by a less efficient competitor will typically exert a lower downward pressure on price but also because such a competitor will take less volume/market share and so exert less upward pressure on the incumbent's average costs.

(3) Consequently, there is nothing inevitable about this putative price increase and the forces at work could equally lead to subsequent exit by an over-optimistic entrant. One would need a much more detailed and careful elaboration of the mechanisms at work to understand how likely it is that such a price increase would arise.

513. The second general claim made by Royal Mail for the use of an AEC test in a case such as the present is that it provides a degree of legal certainty to a dominant undertaking that is responding to entry or threatened entry by a competitor and wants to know if the action could subsequently be found to be abusive.

514. Important though the principle of legal certainty may be, which is not to be doubted, it is only relevant if the use of an AEC test provides a significant element of certainty for the purpose of the competition analysis. In this regard, it is important to be aware that the design and methodology of an AEC test are not fixed or universal. Whether or not a dominant undertaking carries out an AEC test to self-assess prior to taking the action, it will face a degree of legal uncertainty about whether a competition authority will accept such a design and methodology and – if the authority decides to carry out its own AEC test - what the outcome of that test will be.

515. Equally, the fact that an incumbent takes a particular action having self-assessed legality on the basis of an AEC test, cannot give rise to any presumption that the action was not abusive.

516. Moreover, as noted in an academic article by Mr Derek Ridyard[11], (cited to us during the hearing by Royal Mail) "the apparent simplicity of the AEC principle hides an array of detailed questions regarding its practical implementation." (paragraph 18). In paragraphs 19 and 20 he goes on to identify issues surrounding the definition of what is meant by an "as efficient" competitor and the treatment of common costs as factors which "certainly leave a large range of discretion and uncertainty as to the level of calibration of Article 102 enforcement." (paragraph 21). Consequently, a competition authority might deem the dominant undertaking's test to be flawed in some way, run its own test and come to a different conclusion. This is particularly likely if the dominant undertaking's test demonstrated that an AEC's entry was only just profitable.

517. Furthermore, even if the competition authority investigating the conduct accepts the results of the dominant undertaking's AEC test, it might decide there was no prospect of an AEC emerging. In these circumstances, it might also decide that there would nevertheless have been a virtue in having entry by a realistic entrant who was acknowledged to be less efficient than the incumbent. In this case, whether by applying the dominant undertaking's AEC test or some other means, it might decide that the dominant undertaking's action was reasonably likely to have foreclosed such potentially beneficial realistic entry and find the action to be abusive - see the discussion on *Post Danmark II* above.

518. Royal Mail accepted these qualifications and in his oral closing submission Mr Beard QC said that an AEC test "provides a bright, or bright-ish, line given the fact that you can have debates about the metrics that are to be used in relation to AEC tests." (Hearing transcript, Day 16, page 181).

[11] D. Ridyard, "Calibration and consistency in Article 102: Effects-based enforcement after the *Intel* and *Post Danmark* judgements", Concurrences N°3-2016, pages 28-38.

519. In our view, therefore, the use of an AEC test as a self-assessment tool provides at best a very limited degree of legal certainty and, at worst, none at all.

520. There are two other considerations that need to be taken into account:

(1) There may be some deterrence value in having a degree of legal uncertainty. It is at least arguable that any margin of error in the assessment of abuse should fall on the side of compliance with the law;

(2) Because of the issues surrounding the treatment of common costs that we referred to above and will pursue further in considering issue 4 below, an AEC test constructed under the principles submitted by Royal Mail may lean too much towards giving too great a licence to incumbents to continue abusing their dominant position.

521. Finally, as we noted at paragraph 280 above, despite the advantages of an AEC test that Royal Mail advances in relation to its essential role in permitting a dominant undertaking to determine the legality of its conduct *ex ante*, it did not itself commission such a test at the time it was developing its thinking on the changes to access pricing arrangements introduced in the CCNs. Instead, it modelled the likely effect of its conduct on the principal market entrant.

Conclusion on issue 1

522. We therefore conclude that whether as a matter of law or economics it is not necessary to conduct an AEC test in all pricing cases.

Issue 2: Is there is a requirement to use an AEC test in the present case?

523. There are two questions to consider under this issue. The first is whether economic principles determine a clear class of cases where an AEC test should be used. The second is whether the present case falls into that category.

524. In paragraph 70 of his report, Mr Matthew said that:

> "in particular in 'low pricing' cases, normal and desirable competitive conduct by the dominant firm – setting a low price or otherwise legitimately exploiting its competitive advantages – has direct benefits for consumers but may also be liable to have an adverse impact, and potentially a foreclosure effect, on one or more of its competitors. Such cases call for a framework that seeks to have a practicable basis for balancing the risks and detriments associated with false positives (preventing conduct that does not impair the competitive process) and false negatives (allowing conduct that does impair the competitive process)."

He added (in paragraph 71), that "[i]n cases involving allegations of predation and margin squeeze, for example, I agree that using AECTs generally makes economic sense."

525. In the concurrent evidence session Mr Parker said, "AECTs, or price cost tests generally, are often used in those circumstances because they give you a guiding line as to when does good competition in terms of low prices become excessive competition in terms of predation or similar". (Hearing transcript, Day 11, page 43). He went on to identify a second canonical type of abuse: "raising rivals' costs strategies where for whatever reason the dominant incumbent has the ability to raise the costs of its -- any potential rival by virtue of the dominant position that it finds itself in." (Hearing transcript, Day 11, page 43).

526. Mr Parker relied heavily on the work of Professor Salop[12] on the raising rivals' costs paradigm, in both written and oral evidence. In paragraph 4.1.4 of his report he referred to 'conditional pricing practices', i.e. situations where dominant firms' prices are set conditional on "exclusivity or some other type of favouritism in a customer's purchases or input supplier's sales", as is true of the price differential in the current case. We also note that Professor Salop states that "[t]raditional rule of reason and antitrust injury analyses capture anticompetitive … consumer harm from CPPs [conditional pricing policies such as the price differential] better and more consistently than a price-cost test".

527. However, as the cross-examination of Mr Matthew suggested, trying to come up with a cast-iron allocation of practices into "low-pricing" or "raising rival costs" as a way of determining whether (a) a practice does or does not constitute

[12] Salop, S, *The Raising Rivals' Cost Foreclosure Paradigm, Conditional Pricing Practices, and the Flawed Incremental Price-Cost Test*, Antitrust Law Journal, Vol. 81, 371-421 (2017), page 372.

anti-competitive foreclosure; and, relatedly, (b) whether an AEC test is an appropriate way of assessing the practice, is fraught with logical difficulties. Royal Mail argued in its closing submission that "it is […] an utterly hopeless distinction" (Hearing transcript, Day 16, page 131).

528. Referring to the distinction between foreclosure and anti-competitive foreclosure, in the concurrent evidence session Mr Dryden said:

> "I agree with Mr Matthew's opening remark that it's difficult. Professor Vickers in his two articles[13], the 2005 and the 2007 one, says it's less than clear, he says it's surprisingly difficult, and he describes a quest for the answer." (Hearing transcript, Day 11, pages 44 and 45).

He went on to say that:

> "scholars and practitioners dwell for a little time on this question of what is the distinction as a matter of principle, conclude that it is less than clear, and then the debate shifts to choosing between tests -- objective tests. And that's not ideal because we prefer to have an absolutely clear principle that would define the test. The reality I think is the principle is not completely clear and so we look at tests and think about their respective pros and cons." (Hearing transcript, Day 11, page 45).

529. Consequently, our conclusion in relation to the first question is that, in the current state of economic thinking, there is no well-defined class of cases in which the use of an AEC test is the appropriate way of identifying anti-competitive behaviour. Consequently, trying to determine whether an AEC test should be performed by attaching a label to a practice, in an attempt to place it in a particular class of eligible cases, is not a sensible approach.

530. Turning to the second question, we observe that there are two important features of the access pricing proposals in the CCNs – particularly the price differential – which make them particularly difficult to classify under the conditional pricing practice heading referred to above.

(1) Since Whistl did not have the option of using any supplier other than Royal Mail to deliver the mail that it was not going to deliver itself, the

[13] Vickers, J. (2005), *Abuse of Market Power*, Economic Journal, 115, No 504, ppF244 -F261; Vickers, J. (2007), *Some Economics of Abuse of Dominance*, Oxford Economics Department Working Paper 376.

price differential could never be something that was used to achieve exclusivity or some other form of favouritism.

(2) There was no volume commitment attached to the price at which an access operator would be able to use one pricing package rather than another. Rather, to obtain the NPP1 price, an operator would have had to match Royal Mail's profile of percentages of mail delivered across 83 SSCs and the urban zone and commit to a requirement to forecast these up to two years ahead. To obtain the APP2 price, an access operator would have had to match Royal Mail's profile of percentages of mail delivered across four zones.

Conclusion on issue 2

531. We therefore conclude that the price differential in this particular case cannot be readily put into any of the existing categories of pricing practice that have been proposed for determining whether an AEC test is an appropriate method for determining whether or not it is anti-competitive.

Issue 3: Is an as-efficient competitor an appropriate concept in this case?

532. There are two reasons for thinking that the concept of an AEC is in any event inappropriate in this case. The first relates to the scale of entry and the second to certain advantages and disadvantages that have accrued to Royal Mail by virtue of its universal service provider status. We consider these in turn.

Scale of entry

533. It is common ground amongst the parties that no end-to-end competitor would seek to set up its own direct delivery operations in all 83 SSCs. Indeed, this is at the heart of a concern about cherry-picking which underlay Royal Mail's concerns about the threat from end-to-end competition.

534. In the First Joint Expert Statement, Mr Parker put forward the view that "a true AEC test in this case would be conducted only at Royal Mail's 100% level of

coverage. However, Mr Dryden does not carry out an AEC test (except where the entrant has full UK coverage), as he assumes that the entrant is only present in some SSCs and not others – in other words, the entrant is not 'as efficient' as the dominant firm."

535. Mr Dryden responded by saying that:

> "[a]s I explain in my first report, I implement the AECT at the level of individual areas and assuming a given level and sequence of roll-out. Implemented this way, the AECT ensures that an entrant that is as efficient as Royal Mail in a given area may enter profitably (even if less efficient in others), taking account of the non-linear prices it faces."

He went on to say:

> "[s]o while this is a departure from a strict AEC standard that might view the AEC as a clone of the incumbent it reflects the correct application of AEC principles to the case at hand as it defines anti-competitive foreclosure as the foreclosure of as efficient rivals at the local level."

536. However, elsewhere Mr Dryden stated that:

> "Unlike efficient entry however, with inefficient entry there is no guarantee that the entrant could take over RM's activities (including part or all of those covered by the USO) more efficiently." (Dryden, Fourth Report, paragraph 10.28).

In other words an efficient entrant would be capable of replacing Royal Mail.

537. Accordingly, we conclude that, in this particular context, the concept of an AEC, interpreted as a clone of Royal Mail, is not appropriate and that what is being tested for is the possible profitable entry of some other type of entrant that is as efficient as Royal Mail in a more localised sense.

Advantages and disadvantages of the USO

538. In his report, Mr Parker argued that Royal Mail enjoyed certain advantages that would not be available to any realistic entrant and proposes that, instead of an AEC test, one should examine instead the profitability of entry by what he called a slightly less efficient operator ("SLEO") who did not enjoy these advantages.

539. He stated (at paragraph 4.6.4):

> "[i]n considering whether a SLEO could be foreclosed by the CCNs, and the price differential in particular, I focus on areas where it is not realistic to expect that any entrant could replicate Royal Mail's advantages. These include: (a) the VAT exemption; (b) the economies of scope between bulk mail and USO services operated by Royal Mail; (c) and the economies of density that Royal Mail benefits from through its historic statutory monopoly position in downstream delivery (and ongoing near monopoly position)."

540. However, Royal Mail pointed out that "Royal Mail had a number of burdens that went with its position as well in relation to these matters." (Hearing transcript, Day 16, page 174). In her witness statement, Ms Whalley identified the cost advantages that a direct delivery operator would enjoy over Royal Mail as being: (a) delivery every other day; (b) freedom to choose where and what type of mail to deliver; (c) freedom from regulatory control over quality of service or customer protection; (d) not having to offer employment conditions of the same standard and cost as Royal Mail.

541. It may be noted that, since most of these advantages and disadvantages arise by virtue of Royal Mail's designation as the universal service operator, and since any entrant would not be so designated, this is not a situation where the dominant firm has achieved its position of dominance by virtue of its own efficiency and/or the quality of its products. As the Court of Justice said in *Post Danmark I* (at paragraph 23): "When the existence of a dominant position has its origins in a former legal monopoly, that fact has to be taken into account."

542. The question arises as to how to treat all these elements of costs advantages and disadvantages.

543. In relation to Royal Mail's VAT advantage, we are not persuaded by Mr Dryden's argument that it was not necessary to consider it because "an AEC would be, by definition, as efficient as Royal Mail and therefore also possess the tax advantage." In our view, this elevates logical consistency and technical purity above the reality that the VAT exemption is conferred only on the universal service provider – Royal Mail. It thereby runs the risk of making a false positive and allowing actions that could foreclose potentially beneficial entry.

544. In the concurrent evidence session, Mr Dryden put forward another argument for ignoring the VAT advantage which was that "assuming that the VAT is pursuing some policy objective, then unwinding that advantage through the application of the test may undermine the policy objective." (Hearing transcript, Day 11, pages 119 and 120). However, he recognised that this would involve the problematic exercise of "trading off of competition policy against other policies."

545. A further approach that Mr Dryden mentioned was to "to weigh any such disadvantages against any advantages. However, on Ofcom's approach, setting aside my other concerns about it, it would be necessary to consider RM's net advantage (if any) rather than its gross advantage."

546. Royal Mail was asked by the Tribunal if it would accept that it would in principle be possible to use the costs of the incumbent to capture the various advantages and disadvantages that a realistic potential entrant might possess and so capture Royal Mail's net advantage. (Hearing transcript, Day 16, page 185). Royal Mail agreed that in principle "it must be possible to do these things" though it raised the issue of what factors to incorporate. (Hearing transcript, Day 16, page 186).

547. We accept that the concept of an AEC is a hypothetical concept and does not describe any actual competitor in the market, and that the costs of an AEC should be calculated using the incumbent's costs. But we are also of the view that, *in the context of this particular case*, the incumbent has some advantages and some disadvantages that would not apply to any realistic potential competitor. In such a situation, the concept of an AEC becomes profoundly problematic, and instead it is important to assess what net advantage or disadvantage any realistic entrant might enjoy. Exactly what advantages and disadvantages should be included, how exactly the impact on the costs of any potential entrant is to be quantified and how these would be weighed to arrive at a concept of net advantage would be subject to considerable controversy and lead to a potentially wide range of estimates.

Conclusion on issue 3

548. For all these reasons our view is that the concept of an AEC is highly problematic in the context of this case.

Issue 4: problematic features of Royal Mail's AEC test

549. Royal Mail accepted in its written submissions and at the hearing (Hearing transcript, Day 16, page 186) that its AEC test, like others, was not perfect. In addition, it noted that:

> "in the very interesting discussion in the concurrent evidence session, there were a whole range of considerations raised as to what the benefits, detriments and difficulties might be of using an AECT and, more particularly, what it told you about total welfare or, more particularly, net consumer welfare." (Hearing transcript, Day 16, page 180).

550. Drawing on that discussion in the concurrent evidence session, we have four major concerns with the AEC test that Royal Mail performed. These are: the long run average incremental costs ("LRAIC") assigned to an AEC; the treatment of common costs; the dynamics of roll-out; and the use of net present value ("NPV") calculations.

LRAIC assigned to an AEC

551. As noted above in paragraphs 534 to 535, Mr Dryden conducted his AEC test at the level of individual SSCs. In conducting his test, the LRAIC assigned to the AEC setting up in any particular SSC is the LRAIC of Royal Mail operating at its current volumes in that area.

552. It was accepted by the experts that in general, because of economies of scale at the SSC level, the LRAIC facing an operator would be lower where the operator is operating with higher volumes. It was also accepted that if an entrant was as efficient as Royal Mail, then the relationship between its LRAIC and its volumes should be the same as that of Royal Mail.

553. While the beneficial effects of competition might drive some expansion in total volumes in that area, a major effect of entry by a competitor was to take business from an incumbent monopolist, so it is likely that, post-entry, the volumes

obtained by both Royal Mail and the entrant would be lower than those of Royal Mail when it served the area as a monopolist.

554. Consequently, the appropriate LRAIC to assign to the AEC should in principle be higher than that of Royal Mail at current volumes.

555. In the discussion, Mr Dryden pointed out that doing so introduced an element of productive inefficiency. However, as we noted in the discussion above, a measure of productive inefficiency is not itself a component of consumer welfare, and, while it might sometimes have an indirect effect on prices and hence consumer welfare, this would need to be demonstrated. In our view, this argument does not justify making an inappropriate assumption about costs.

556. Mr Parker pointed out that if there were no significant economies of scale at the SSC level, then the LRAIC would be independent of volumes and so the assumption on which the test was conducted might be acceptable. In the closing stages of the hearing, Royal Mail identified some evidence that it claimed suggested that economies of scale at the SSC level were rather small and consequently the assumption under which the test was conducted was acceptable (Hearing transcript, Day 16, page 182). However, this justification was not further substantiated by Royal Mail and we note that it was not made at the time the AEC test was originally submitted by Royal Mail.

557. Moreover, the extent of economies of scale at the SSC level depends on how common costs are allocated between bulk mail delivery and the USO delivery service. We have some concern that there was a degree of arbitrariness in how Royal Mail was doing this. Dr Jenkins, in cross-examination, explained that Royal Mail was using its flexibility to allocate these costs according to where it thought Whistl's costs were lowest. She stated:

> "[A]ctually the zonal tilt that was proposed in the CCNs was one that changed the ranking where London had been the more expensive one to one of the less expensive ones, and that ranking change was driven by the fact that Royal Mail was including in their decision process of where in this band competitive conditions, which included the entrant's costs, because they knew that entrant was more efficient than them in the London area, so they were taking the flexibility they could in this band; and that , that you see - - we were flagging that as potentially risky because that can be interpreted by a regulator as a

> targeting, because you are sort of picking the place with reference to the entrant." (Hearing transcript, Day 7, page 97).

558. For this reason we are not persuaded that the cost information to which Royal Mail alluded at the hearing would necessarily be fully reflective of Royal Mail's own costs and so would not adequately address the concern raised above as to whether the LRAIC ascribed to an as efficient entrant in the test proposed by Mr Dryden were the correct level of cost.

The treatment of common costs

559. As pointed out by Mr Parker in his report, in conducting the test, Mr Dryden operated on strict AEC test principles and treated bulk mail as a purely incremental activity, assigning all common costs to the USO. In reality, an entrant to bulk mail delivery would have to incur these costs.

560. This way of treating common costs encourages and allows the actions of incumbents to protect themselves against entry essentially on the productive efficiency grounds of avoiding the duplication of these common costs. As we have said above, this could be justified if one were using a total welfare standard and so were trading off the gains to consumers from competition against the loss of productive efficiency. However, under a consumer welfare standard there are concerns that by treating common costs this way one is over-excluding entry that could bring consumer benefits.

561. Accordingly, whilst we agree that some allowance should be made for common costs, as Mr Ridyard points out in the article to which we previously referred, there is a lack of general guidance as to how to do this. At the very least, it would be helpful to have some sensitivity analysis of the kind provided by Mr Parker to test the sensitivity of any conclusions drawn about the assumptions that had been made about what percentage of common costs were incurred by the entrant.

562. As Mr Ridyard also points out (in paragraph 18 of the article referred to), different approaches to how one addresses the practical challenges of

implementing an AEC test can lead to substantial shifts in the calibration of Article 102 enforcement.

Dynamics of roll-out

563. The analysis performed in the AEC test submitted by Royal Mail during the administrative procedure involved a comparison of the price that an entrant could have obtained with the LRAIC of the entrant conditional on entry having taken place in a given number of SSCs, where this given number varies from 1 to 83.

564. There is however a very important dynamic feature of roll-out of direct delivery across a number of SSCs that is present in this particular case but is missing from this analysis.

565. As explained by Mr Polglass, in order for Whistl's large customers to convert to using Whistl for direct delivery they had to undertake some investment to convert their mailing houses. For this to be worthwhile, they would have to be sure that a sufficient quantity of their mail could be delivered by Whistl, and, for that to be true, Whistl would have to have set up direct delivery services in a sufficiently large number of SSCs to account for a large fraction of the mail that these customers would need to have delivered. The coverage of SSCs to which direct delivery would have to occur to induce customers to convert would vary from customer to customer.

566. But this introduces a fundamental dynamic into entry decisions. If Whistl set up delivery in a small number of SSCs, the amount of mail that it delivered in those SSCs might be rather low because not many customers had converted to its end-to-end service. These low volumes may mean that profits were very low. However, as Whistl rolled out to more SSCS and as more customers consequently converted, this could raise the volume of delivery and hence the profitability of delivery in SSCs which Whistl had already entered.

567. So, the profitability of direct delivery entry into a small number of SSCs depends in a fundamental way on the number of future SSCs in which direct

delivery takes place. As Mr Polglass described it in his written evidence "[i]t was a bit of a chicken and egg situation." This fundamental dynamic is missing from the AEC test provided by Royal Mail, in which time plays no explicit role.

568. For all these reasons we think that the AEC test provided by Royal Mail has some serious limitations. The question might nevertheless arise as to whether, despite these limitations, it is still informative. This brings us to a final feature of the AEC test analysis conducted by Royal Mail

Use of net present value (NPV) calculations

569. In Section 9 of his Fifth Report, Mr Dryden considered the conclusions of the analysis conducted on the SLEO basis proposed by Mr Parker. He recognised that there could be ranges of values for the roll-out rate where price was below cost and so potentially roll-out at that scale was not profitable, while for higher levels of roll-out, price was above cost and so roll-out at that scale was profitable.

570. In paragraph 9.36 (b) he stated that "the AEC is highly likely to be profitable on an NPV basis (i.e., since, as they roll out over more SSCs, any period in the 'negative zone' would be outweighed by time in the positive zone)."

571. The implication is that, despite some of the limitations discussed above, the conclusions of the AEC test analysis is robust. However, there are three crucial features of the investment environment in which Whistl found itself that make the application of a simple NPV calculus inappropriate.

572. First, a significant amount of the investment it would have to make to establish its direct delivery network took the form of sunk costs, because the assets were highly specific, and would have almost no market value should Whistl have to withdraw from its direct delivery activities. The sunk nature of the investment was stressed by Ofcom in the Decision at 6.93 (a) and confirmed by Mr Polglass during cross-examination.

573. Second, there was a considerable amount of uncertainty surrounding its decisions on any further roll-out once the CCNs had been issued. So, there was uncertainty regarding: how Ofcom would treat any complaint it made; how long it would take Ofcom to reach a decision; the nature of Ofcom's decision; and whether or not there would be an appeal against the Ofcom decision, etc.

574. Third, much of this uncertainty would get resolved in the course of time merely through learning the actual outcomes of all these uncertain events.

575. Under these conditions, the modern theory of investment under uncertainty as set out in, for example, the text by Dixit and Pindyck[14], suggests that optimal investment behaviour takes the form of a step-by-step approach under which a certain amount of investment is made, then one waits to learn the outcome of some uncertain event before deciding whether to proceed with further investment. Moreover, this behaviour is no longer characterised by standard text-book investment rules such as whether NPV is greater than the value of investment (or equivalently, whether the Internal Rate of Return ("IRR") is greater than the cost of capital), because these rules fail to recognise the option value of waiting and learning.

576. Both Mr Dryden and Mr Parker were asked if they would accept this characterisation of the current theory of investment under uncertainty and both agreed that they did. (Hearing transcript, Day 12, page 129 and Day 13, pages 168 and 169).

Conclusion on issue 4

577. For all these reasons, we conclude that the AEC test submitted by Royal Mail during the administrative process may be less robust and hence less informative than Mr Dryden suggests.

578. If there are such regions of negative returns one would need considerably more analysis to conclude that this would not bring a planned roll-out programme to

[14] Dixit, A.K. and Pindyck, R.S. (1994), *Investment Under Uncertainty,* Princeton University Press.

a halt. This is particularly true if one combines these issues regarding uncertainty and learning with the dynamic factors in roll-out considered above.

Issue 5: did Ofcom give adequate consideration to Royal Mail's AEC test?

579. We now consider whether Ofcom was obliged, under the principles of *Intel* and from the general requirement to conduct a fair procedure, to take full account of the evidence submitted to it by Royal Mail to the effect that its conduct was not likely to foreclose, including the results of its own price-cost tests.

580. The only paragraph in the Decision in which Ofcom assessed the design of Royal Mail's EEO test and the sensitivity analysis is 7.200. Ofcom described this as being "brief observations", and it is indeed somewhat lacking in detail. Ofcom criticised Royal Mail's EEO test because it used benchmarks that are unrealistic in the particular market circumstances – namely Royal Mail's costs, which are unlikely to be similar to those of an entrant, and an assumed conversion rate of 100%. It criticised the sensitivity analysis on the basis of its roll-out profile and conversion rate, both of which were based on a modified version of Royal Mail's LRAIC.

581. Ofcom also criticised the tests on the basis that they fail properly to account for risk or for Royal Mail's advantages (such as reputation, experience and VAT status). In addition to its brief criticisms of the design of the tests, in paragraph 7.201 Ofcom observed that Royal Mail did not run such a test as part of the planning process for the intended introduction of the differential prices. Ofcom did not engage with the tests or the results in any more detailed way in any other part of the Decision, having rejected the relevance and appropriateness of any evidence on price-cost analysis. Ofcom maintained that its treatment of Royal Mail's tests in the Decision satisfies the requirement to consider Royal Mail's evidence during the administrative phase.

582. Ofcom gave a fuller explanation of these points in a memorandum submitted with its written closing submissions, towards the end of the hearing. Drawing on the discussion of the issue during the hearing, Ofcom set out in considerable detail three critical aspects in which it said the AEC test put forward by Mr

Dryden and modelled by Mr Harman was based on assumptions that did not reflect the circumstances that would apply to a real-world entrant. These were, first, that the hypothetical entrant's costs would be the same as Royal Mail's LRAIC, second, that the sequencing of the entrant's roll out profile would be based on the areas of lowest cost to Royal Mail, and, third, that the entrant would be able to convert 100% of its customers and did not capture the interdependence of roll out and conversion. It also did not take account of other factors such as Royal Mail's VAT advantage and the risks faced by a new entrant.

583. Royal Mail argued that Ofcom failed to engage properly with Royal Mail's AEC test and that the Decision was flawed on this basis alone.

584. We agree that the consideration given by Ofcom in the Decision to the AEC test submitted by Royal Mail was relatively brief and that it would not have taken a great deal of effort to produce a more detailed consideration, as reflected in the Ofcom memorandum later produced.

585. On the other hand, some of the points raised by Ofcom in paragraph 7.200 (c) of the Decision reflect our own concerns, for example whether, in this particular case the notion of an AEC was fully coherent; and whether the dynamics and uncertainties regarding roll-out had been adequately captured.

586. As we note at paragraph 582 above, during the hearing and in its written closing submissions, Ofcom engaged more fully with these concerns and with the assumptions, methodology and results of Royal Mail's AEC tests. Whilst a more detailed treatment in the Decision might have been desirable in terms of further explaining Ofcom's reasoning at the time, the essential issue is that Ofcom made it quite clear in the Decision that it did not see an AEC test as useful or necessary in this case and we do not see that it would have served any useful purpose for Ofcom to have devoted more time and effort in the administrative proceedings to examining the AEC test put forward by Royal Mail.

587. We note that in the *Intel* case, the Court of Justice criticised the General Court for not examining in detail the AEC test put forward by the defendant in that

case, which had previously been considered in detail by the Commission. Royal Mail appeared to suggest that, whenever a party accused of infringing Article 102 puts forward an AEC test in evidence, an authority is legally bound to consider it in detail. We do not think that proposition can be justified from the jurisprudence, particularly in cases where the authority is able conclude on the basis of all the available evidence that an AEC test would not assist it. Nor do we think it is appropriate to seek to equate the circumstances of this case with the very different circumstances at issue in the *Intel* litigation.

588. Moreover, we decided, in relation to Issue 1 above that the Court of Justice's ruling in *Post Danmark II,* namely that an AEC test was not always required in abusive pricing cases, was not invalidated or made any less reliable by its judgment in *Intel.* We have considered at some length whether, in the particular circumstances of this case, the carrying out of an AEC test would be necessary or informative and concluded that it was not. Having reached that conclusion, in which we are in full agreement with Ofcom, we note that Ofcom did examine the AEC test put forward by Royal Mail in the administrative proceedings, albeit not in great detail, but in enough detail to satisfy itself that carrying out such a test would serve no useful purpose in this particular case. There was, in consequence, no breach by Ofcom of any more general requirements of procedural fairness.

589. We also note, as already mentioned in paragraph 521 above, that Royal Mail did not attempt to conduct an AEC test before engaging in the conduct complained of, despite having access to expert economic and legal advice.

Conclusion on issue 5 and on the AEC test

590. We therefore conclude that Ofcom did give adequate consideration to the AEC test put forward by Royal Mail, in the particular circumstances of this case and that Ofcom was correct in its view that an AEC test was not necessary in this case.

(b) Materiality and the assessment of effects

591. We now turn to the second broad question, namely the assessment of the effects of the abusive conduct. We consider whether the conduct was likely to have had an anti-competitive effect, and whether that effect was 'material'.

Did Royal Mail's conduct have a likely anti-competitive effect?

592. As discussed by the Tribunal in *Socrates Training Limited v The Law Society of England and Wales* [2017] CAT 10 ("*Socrates*"), and by the High Court in *Streetmap*, the conduct of a dominant undertaking will constitute an abuse only if it may have an anticompetitive effect (paragraph 86, et seq.). As the Court held in *Streetmap*, "[t]he impugned conduct must be reasonably likely to harm the competitive structure of the market" (paragraph 88) and that "[i]n determining that question, the court will take into account, as a very relevant consideration, evidence as to what the actual effect of the conduct has been." (paragraph 90).

593. We have heard a considerable body of evidence concerning the actual effect on Whistl of Royal Mail's conduct, including the suspension of its roll-out plans, the suspension and then the abandonment of LDC's investment plans, and Whistl's eventual exit from the bulk business mail delivery market. We considered the evidence relating to these effects in our discussion of the Legal and Economic Context (see Section G(5) above) and in our consideration of Ground 1 (see paragraphs 306 to 398 above).

594. A consideration of the actual effects of Royal Mail's conduct is highly relevant in this case because, as shown particularly in our discussion of Royal Mail's strategic intention (Section G(5) above), Whistl was Royal Mail's only feasible competitor at the time, and Royal Mail's planning documents had anticipated the likely effect of potential elements of the CCNs. Whistl's actual conduct – leading to its withdrawal from the relevant market - has left Royal Mail unchallenged. That fact is clearly a relevant feature of the assessment of Royal Mail's conduct.

595. However, as pointed out by the Tribunal in *Socrates*, it is necessary to bear in mind that the degree to which conduct has actually had (or not had) an anti-competitive effect is only evidential; demonstration of a potential effect is sufficient, as the Court of Justice confirmed in the *TeliaSonera* case. For the reasons discussed at length in this judgment, we find there is ample evidence that Royal Mail's conduct had a *likely* effect on the structure of the relevant market in the sense that it was likely to exclude Royal Mail's only competitor. For the reasons given above in our discussion of the AEC test (paragraphs 470 to 548), we find it unnecessary to limit such effects to those likely to be felt by an as-efficient competitor.

Was the likely effect material?

596. Royal Mail objected to Ofcom's materiality analysis on the basis that it equated a reduction in profitability with competitive disadvantage, contrary to the judgment of the Court of Appeal in *Attheraces Limited v The British Horseracing Board Limited* [2007] EWCA Civ 38 ("*Attheraces*") that the two are distinct and sequential. It also sought to demonstrate that the judgment of the Court of Justice in *TeliaSonera*, in which the Court held that a margin squeeze would be anticompetitive where an AEC "may be able to operate on the retail market only at a loss or at artificially reduced levels of profitability," (paragraph 33) was not authority for the proposition that the materiality of anti-competitive foreclosure may be assessed through the impact of the dominant undertaking's conduct on profitability. Royal Mail argued that this only concerned situations where there was a negative margin (the retail price is lower than the wholesale price) or where the margin was insufficient to cover the specific costs of an AEC, which would thereby operate at a loss. It argued that the relevant passages in *TeliaSonera* had been interpreted by the Tribunal in *British Telecoms* at paragraph 95, to the effect that discussion of reduced profitability only became relevant if an AEC test was failed.

597. Ofcom asserted that the materiality assessment in the Decision was lawful and appropriate and was based on the correct test in the case law, namely by assessing whether Royal Mail's conduct was reasonably likely to restrict competition by making entry significantly more difficult. In its view, this fairly

reflected the approach set out in the case-law, including that of the High Court in *Streetmap,* in which Roth J referred to the use of market power by a dominant undertaking "to limit effective competitors' ability to compete by depriving or hindering their necessary access to inputs or customers…" (paragraph 63).

598. Ofcom also argued that the metrics used by it to assess the materiality of the price differential mirrored Whistl's real-world concerns about its impact on its ability to compete. Moreover, Whistl's actual reaction provides a good natural experiment as to the materiality of the price differential and was consistent with Royal Mail's expectations as to its likely impact.

599. Whistl argued that Ofcom's approach to materiality was sound, did not rely on a measure of profitability in isolation, and assessed whether Royal Mail's conduct "would have led a rational investor or operator to change its investment or operational decisions" (citing Mr Harman's 4th report). Further, Royal Mail was aware of the likely impact on Whistl, as indicated by its detailed modelling and strategic planning documents.

600. Whistl delivered a strong critique of Mr Harman's evidence in its closing submissions to the hearing. As emphasised in our Ruling on a possible adjournment ([2019] CAT 19), we did not feel that our consideration of Mr Harman's evidence would be impaired by his not having been subject to cross-examination. However, the criticisms made of his evidence by Whistl, if they were relevant to our decision, would be weakened by the fact that Mr Harman had been given no opportunity to respond to them. However, this is of little consequence as we see this aspect of Mr Harman's evidence as strictly irrelevant to the case advanced by Ofcom in defence of the approach taken in the Decision, namely that it did *not* rely on the actual impact of Royal Mail's conduct on Whistl in deciding that the conduct was likely to have an anti-competitive effect.

601. Mr Harman's detailed analysis of what a rational, and well managed, undertaking should have done, faced with the kind of alteration to its trading conditions that Whistl faced, as well as the likely reaction of a rational investor, therefore does not assist us in assessing the correctness or otherwise of Ofcom's approach to competitive disadvantage, given that this was on a different basis

from that assumed by Mr Harman. In other words, the questions of whether a rational undertaking, adopting a long term view of a sufficient return on capital, correctly assessed by reference to IRR standards, would not have abandoned its roll-out plans, and whether the withdrawal of its investor LDC was due to factors other than Royal Mail's price differential, are not relevant to the question of whether Royal Mail's conduct was likely to have an adverse effect on the ability of an undertaking such as Whistl (but not necessarily Whistl itself) to enter the end-to-end bulk mail delivery business and expand within it, in competition with Royal Mail.

602. We agree with Ofcom that the Decision (paragraphs 7.147-7.171) assesses separately the impact of Royal Mail's conduct on Whistl's profitability and the likelihood of such conduct unfairly to foreclose Whistl, consistent with the requirement set out by the Court of Appeal in *Attheraces*.

603. Finally, we do not agree with Royal Mail that the Tribunal interpreted the Court of Justice's judgment in *TeliaSonera* to mean that a discussion of reduced profitability is only relevant in a margin squeeze case if an AEC test is failed. Moreover, Ofcom did not assess Royal Mail's conduct as a margin squeeze.

604. The Tribunal dealt with the legal principles at paragraph 95 of its judgment in *British Telecoms*, which cannot properly be interpreted in the way suggested by Royal Mail – i.e., that a consideration of reduced profitability in a margin squeeze case is relevant only where the AEC test is failed. The Tribunal held:

> "(i) A margin squeeze has an anti-competitive effect where it is such that a competitor cannot trade profitably in the downstream market on a lasting basis (Deutsche Telekom at [252]-[253]), thereby preventing or restricting its access to or growth on that market: *Deutsche Telekom* at [234] and *TeliaSonera Sverige* at [70].
>
> "(ii) That condition has to be assessed by reference to the indispensability of the dominant firm's upstream product to operating on the downstream market and the intensity of the squeeze on the downstream competitor's margin: *TeliaSonera Sverige* at [69] and [73]. In that connection:
>
> "(a) Where indispensability is coupled with a negative downstream margin17 an exclusionary effect is probable: *TeliaSonera Sverige* at [70] and [73].
>
> "(b) Where indispensability is coupled with a positive downstream margin, an exclusionary effect arises where, by reason of reduced profitability or

> otherwise, it is likely that it would be more difficult for the downstream competitor to trade on that market: *TeliaSonera Sverige* at [70] and [74].
>
> […]" (paragraph 95, emphasis added).

Conclusion on materiality

605. For these reasons, we conclude that Ofcom did not err in its assessment of the materiality of the proposed price differential.

(c) Ofcom's consideration "in the round"

606. We now consider the third general question, namely whether Ofcom conducted a correct assessment of all the circumstances of the case to justify its findings of anti-competitive foreclosure and competitive disadvantage.

607. At paragraph 7.3 of the Decision, Ofcom stated:

> "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."

608. Ofcom said it had done this by reference expressly to the Court of Justice's rulings in *Intel* and *MEO* and had examined: the extent of Royal Mail's dominant position and its status as a former statutory monopolist; the share of the market covered by the price differential; the particular conditions of competition prevailing in the bulk delivery market and the associated retail market on which access operators were competitors, (including Royal Mail's unique structural advantages, high barriers to entry and long term decline, Royal Mail's status as an unavoidable trading partner for access operators, tight profit margins in the bulk mail retail market and Royal Mail's designation as the universal service operator); the conditions and arrangements under the various price plans; Royal Mail's strategy and objectives behind the price differential as evidenced by its internal documents; and how the introduction of the price differential impacted the bulk mail delivery market in practice.

609. Royal Mail did not dispute that Ofcom had conducted this analysis, although Mr Beard QC sought to persuade Mr Matthew, Ofcom's expert witness, that

Ofcom had not properly considered the counterfactual situation of there being no price differential imposed. Royal Mail's main complaint, however, was that the analysis was not sufficient or appropriate to establish that the conduct led to competitive disadvantage, as it failed to include any analysis of the putative 'as-efficient competitor'.

610. We have considered at some length, both under this ground of appeal and in relation to other grounds, particularly Ground 1, whether Ofcom's finding of infringement of Article 102 by Royal Mail was correctly based on the applicable law and supported by the relevant principles of economics. In particular, we have concluded that Ofcom was correct in its view that an AEC test was neither necessary nor informative in this particular case.

611. Ofcom instead based its Decision on a view that the overall circumstances of the case, including, in particular, its analysis of Royal Mail's overall strategic intention meant that the likelihood of an anti-competitive effect on possible entry and expansion into end-to-end delivery was significant. Identification of an 'as efficient' entrant was neither possible nor relevant, as entry by a 'less efficient' competitor would also benefit competition and consumers. Indeed, no possible entrant could match the advantages of Royal Mail, so setting the standard of allowable entry too high would simply mean that there could be no entry or expansion in the end-to-end business at all. We therefore do not see it as a valid criticism of the 'in-the-round' approach taken by Ofcom to say that it failed to include an AEC test. This is all the more so in the light of the difficulties in framing or performing an appropriate test in this case that we have described above.

612. We find that Ofcom carried out an analysis of all the relevant circumstances within the legal framework set by the Court of Justice for cases of this kind that was quite sufficient, even without the benefit of an AEC test, to justify its finding that an infringement had been committed.

613. In particular, we do not see there is any substance in Royal Mail's suggestion, emphasised during the hearing, that Ofcom's assessment did not carry out a counterfactual analysis, that is to say did not properly assess what would have

happened to competition in the absence of the price differential. There is, in our view, a reasonable level of consideration of the effects of the price differential on the position of Royal Mail's access customers (see for example Ofcom's consideration of Royal Mail's strategy, referred to in Section G above) on the clear assumption that the alternative was a situation where there was no price differential and we see this as quite sufficient. Failure to express this in terms of a counterfactual is a formalistic objection with no substance.

614. Nor do we see any substance in Mr Beard QC's criticisms of Mr Matthew's view that price plan NPP1 was the profit maximising price and that the price differential constituted a surcharge on it. By suggesting that Mr Matthew had not done the necessary analysis to show what would have been the situation absent the price differential, he sought to show that Ofcom did not know whether the price differential was a discount or a surcharge.

615. We note the following exchange:

> "Q. The question that we've got is that the prices were going to be higher in any event, and the question you had to ask was how much higher they would have been without the price differential; that's correct isn't it?
>
> A. …I don't think you need to ask that question. I think the relevant point here is that the intention behind the pricing strategy was not to lose revenue. Which to me takes you, given the mechanisms available using conditional pricing arrangements, to the use of a surcharge." (Hearing transcript, Day 14, page 59).

616. We find that Mr Matthew was justified in his view that the price differential represented a surcharge and that there is no substance in Mr Beard QC's criticism.

Conclusion on 'in the round'

617. We therefore conclude that Ofcom carried out a correct "in the round" analysis of anti-competitive foreclosure and competitive disadvantage.

(6) Conclusion

618. We conclude that Ofcom was correct in its finding that an AEC test was neither appropriate nor necessary in this case and that its analysis of the likely effects

of the conduct in question and its findings on competitive disadvantage were fully justified. We therefore dismiss this ground of appeal.

K. GROUND 4 - OBJECTIVE JUSTIFICATION/ARTICLE 106(2)

(1) Introduction

619. Royal Mail submitted that the introduction of the price differential, if it amounted to an abuse and therefore Grounds 1 to 3 are rejected, was: (a) objectively justified under section 18 of the CA 1998 and Article 102 TFEU; and/or (b) objectively justified and necessary to secure economically acceptable conditions for the provision of the universal postal service (a service of general economic interest or "SGEI") and therefore exempted from the application of competition law by virtue of Article 106(2) TFEU and paragraph 4 of Schedule 3 to the CA 1998.

(2) Legal principles

Objective justification under Article 102

620. As explained by Roth J in *Streetmap*, while there is no objective justification defence in the UK legislation, if a dominant company shows that the conduct impugned was objectively justified, that conduct will not amount to an abuse.

621. Summarising the guidance and case law on objective justification, Roth J put forward a number of propositions at paragraphs 143 to 146 of *Streetmap* including the following:

(1) In relation to objective justification two aspects are clear:

(i) it is open to the dominant undertaking to show that any exclusionary effect on the market is counter-balanced or outweighed by advantages that also benefit consumers; and

(ii) the conduct in question must be proportionate.

(2) As regards the first proposition above, Roth J stated (citing paragraph 42 of *Post Danmark I*):

> "… it is for the dominant undertaking to show that the efficiency gains likely to result from the conduct under consideration counteract any likely negative effects on competition and consumer welfare in the affected markets, that those gains have been, or are likely to be, brought about as a result of that conduct, that such conduct is necessary for the achievement of those gains in efficiency and that it does not eliminate effective competition, by removing all or most existing sources of actual or potential competition."

(3) As regards proportionality, the application of which has been stressed in the case law on abuse, the assessment is one of whether the conduct in question is indispensable and proportionate to the goal allegedly pursued by the dominant undertaking.

622. In *Purple Parking* Mann J considered the appropriate test for objective justification, noting that:

(1) 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; (paragraph 183)

(2) 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; (paragraph 183) and

(3) 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..." (paragraphs 234-5, emphasis in original, citing the European Commission's decision in *Flughafen Frankfurt/Main* - 34.801 OJ [1998] L72/30).

623. These principles were endorsed by Rose J (as she then was) in *Arriva the Shires* at paragraph 134.

624. We were also referred in argument to the case of Hilti (*Hilti AG v Commission* Case T-30/89 EU:T:1991:70) ("*Hilti*") in which the Court of First Instance (now the General Court) considered unfavourably the possible justification on grounds of public health and safety a restriction imposed by a manufacturer of nail guns on the purchase of nails for use with its patented cartridges. The Court observed:

> "118. As the Commission has established, there are laws in the United Kingdom attaching penalties to the sale of dangerous products and to the use of misleading claims as to the characteristics of any product. There are also authorities vested with powers to enforce those laws. In those circumstances 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."

The CFI's judgment was subsequently upheld on appeal by the Court of Justice: EU:C:1994:77.

Article 106(2) TFEU

625. Article 106 TFEU states:

> "1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.
>
> 2. 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 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.
>
> 3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States."

626. The three sub-paragraphs are directed at different aspects of the situation in which a Member State seeks to arrange for the provision of particular economic activities under a less stringent competition regime, whilst sub-paragraph 3

deals with the role of the Commission. We are concerned in this case only with sub-paragraph 2, which relates to the position of undertakings "entrusted with" the operation of "services of general economic interest". Whether Royal Mail was a "revenue producing monopoly" or whether the practices at issue in this case affected the "development of trade" were not matters of dispute between the parties and we do not consider them further. The main principles of the EU case law on Article 106(2) that need to be considered are as follows.

627. The provision is an exception to the application of the prohibitions contained in Article 102 (and 101) and must therefore be interpreted strictly. This has been confirmed in many judgments of the European Courts, including Case C-157/94 *Commission v Netherlands* EU:C:1997:499 ("*Commission v Netherlands*"), relied on by Royal Mail, which states (at paragraph 37) that "being a provision permitting derogation from the Treaty rules, Article [106]2 must be interpreted strictly" (see the *TNT Traco* case discussed at paragraph 631 below). This approach reflects the general principles of EU law and cannot seriously be doubted.

628. The provision allows a Member State to seek to justify national laws that exempt a qualifying undertaking from the rules of competition. The limitations arise from the provision referring to an undertaking being "entrusted" with a particular SGEI, for the performance of the "particular tasks assigned" to it to be "obstructed in law or in fact" by the application of the rules of competition. These terms were considered in the leading case of *Corbeau* (EU:C:1993:198), a case concerning the compatibility of an express delivery service in Liège with the postal monopoly of the Belgian post office, in the following terms:

> "14. That latter provision thus permits the Member States to confer on undertakings to which they entrust the operation of services of general economic interest, exclusive rights which may hinder the application of the rules of the Treaty on competition in so far as restrictions on competition, or even the exclusion of all competition, by other economic operators are necessary to ensure the performance of the particular tasks assigned to the undertakings possessed of the exclusive rights.
>
> 15. As regards the services at issue in the main proceedings, it cannot be disputed that the Régie des Postes is entrusted with a service of general economic interest consisting in the obligation to collect, carry and distribute mail on behalf of all users throughout the territory of the Member State concerned, at uniform tariffs and on similar quality conditions, irrespective of

> the specific situations or the degree of economic profitability of each individual operation.
>
> 16. The question which falls to be considered is therefore the extent to which a restriction on competition or even the exclusion of all competition from other economic operators is necessary in order to allow the holder of the exclusive right to perform its task of general interest and in particular to have the benefit of economically acceptable conditions.
>
> 17. The starting point of such an examination must be the premise that the obligation on the part of the undertaking entrusted with that task to perform its services in conditions of economic equilibrium presupposes that it will be possible to offset less profitable sectors against the profitable sectors and hence justifies a restriction of competition from individual undertakings where the economically profitable sectors are concerned.
>
> 18. Indeed, to authorize individual undertakings to compete with the holder of the exclusive rights in the sectors of their choice corresponding to those rights would make it possible for them to concentrate on the economically profitable operations and to offer more advantageous tariffs than those adopted by the holders of the exclusive rights since, unlike the latter, they are not bound for economic reasons to offset losses in the unprofitable sectors against profits in the more profitable sectors.
>
> 19. However, the exclusion of competition is not justified as regards specific services dissociable from the service of general interest which meet special needs of economic operators and which call for certain additional services not offered by the traditional postal service, such as collection from the senders' address, greater speed or reliability of distribution or the possibility of changing the destination in the course of transit, in so far as such specific services, by their nature and the conditions in which they are offered, such as the geographical area in which they are provided, do not compromise the economic equilibrium of the service of general economic interest performed by the holder of the exclusive right."

629. The term "economically acceptable conditions" (repeated in the *Ambulanz Glöckner* judgment referred to by Royal Mail, see paragraph 651 below) is thus to be seen as the ability to maintain an "economic equilibrium" by setting profitable activities off against unprofitable activities in circumstances where competing suppliers may not be subject to the same obligations. *Corbeau* also confirms that the operation of a universal postal service (in that case in Belgium) qualifies as an SGEI.

630. Paragraph 19 of the *Corbeau* judgment also suggests, however, that the main focus of the exemption should be on the services comprised within the SGEI and that it may not be justified in relation to other services, even if they are closely related, where they do not "compromise the economic equilibrium" of the SGEI.

631. This point was considered further in the judgment of the Court of Justice in Case C-340/99 *TNT Traco v Poste Italiane* EU:C:2001:281 ("*TNT Traco"*), concerning charges levied under the postal services monopoly in Italy. The question at issue was whether TNT Traco, which supplied an express mail service not part of the universal service, could be required to contribute to the revenues of Poste Italiane, the universal service provider, to enable it to carry out the particular task entrusted to it. The Court said:

> "55 To that end, it may prove necessary not only to permit the undertaking entrusted with the task, in the general interest, of operating the universal service to offset profitable sectors against less profitable sectors (see to that effect, in particular, *Corbeau*, cited above…) but also to require suppliers of postal services not forming part of the universal service to contribute, by paying postal dues of the kind at issue in the main proceedings, to the financing of the universal service and in that way to enable the undertaking entrusted with that task to perform it in conditions of economic stability.
>
> 56 It must, however, be observed that, since Article [106](2) is a provision which permits in certain circumstances, a derogation from the rules of the Treaty, it must be restrictively interpreted […]
>
> 57 Therefore, Article [106](2) of the Treaty does not allow the total proceeds from postal dues of the kind at issue in the main proceedings, which are paid by economic operators supplying an express mail service not forming part of the universal service, to exceed the amount necessary to offset any losses which may be incurred in the operation of the universal service by the undertaking responsible therefor."

632. It follows that whilst the scope of the derogation in Article 106(2) may extend beyond the performance of the SGEI in question, the extent to which this may be permitted will depend on the facts of the particular case, and should be carefully scrutinised, bearing in mind the need for a restrictive interpretation of the derogation.

633. There is, in addition, a requirement, in the operation of Article 106(2), of 'necessity' (i.e. that the dispensation from the rules of competition is necessary to enable the performance of the assigned task) which is, in turn, closely related to the requirement of proportionality (i.e. that the particular task cannot be fulfilled by other, less restrictive, means).

634. In Case C-203/96 *Dusseldorp and Others* [1998] EU:C:1998:316, which was decided after *Commission v Netherlands* and which concerned the grant of

exclusive rights in the Netherlands for the incineration and shipment of waste, the Court of Justice explained:

> "65. It follows from the case-law of the Court that that provision may be relied upon to justify a measure contrary to Article [102] of the Treaty adopted in favour of an undertaking to which the State has granted exclusive rights if that measure is necessary to enable the undertaking to perform the particular task assigned to it and if it does not affect the development of trade in a manner contrary to the interest of the Community (see, to that effect, Case C-320/91 *Corbeau* [1993] ECR I-2533, paragraph 14, and Case C-159/94 *Commission v France* [1997] ECR I-5815, paragraph 49).
>
> 66. The Netherlands Government submits that the rules in question are intended to reduce the costs of the undertaking responsible for the incineration of dangerous waste and thus to enable it to be economically viable.
>
> 67. Even if the task conferred on that undertaking could constitute a task of general economic interest, however, it is for the Netherlands Government, as the Advocate General points out at paragraph 108 of his Opinion, to show to the satisfaction of the national court that that objective cannot be achieved equally well by other means. Article [106](2) of the Treaty can thus apply only if it is shown that, without the contested measure, the undertaking in question would be unable to carry out the task assigned to it."

635. This approach is illustrated by the most recent substantive consideration of Article 106(2) by the Court of Justice in the context of competition law (albeit in the context of Article 101 TFEU) in Case C-1/12 *Ordem dos Técnicos Oficiais de Contas v Autoridade da Concorrência* EU:C:2013:127. In that case, the Court of Justice (at paragraph 106) re-affirmed the Court's approach in the following terms:

> "In any event, undertakings falling within the scope of Article 106(2) TFEU may rely on that provision of the Treaty to justify a measure contrary to Article 101 TFEU only if the restrictions on competition, or even the exclusion of all competition, are necessary in order to ensure the performance of the particular tasks assigned to them (see, to that effect, Case C-203/96 *Dusseldorp and Others* [1998] ECR I-4075, paragraph 65; Case C-320/91 *Corbeau* [1993] ECR I-2533, paragraph 14; and Case C-393/92 *Almelo* [1994] ECR I-1477, paragraph 46)."

(3) The Decision

636. Royal Mail's claim that its conduct was objectively justified was considered in Part 8 of the Decision. Ofcom summarised Royal Mail's case under Article 102 in the following way: the CCNs were intended to avoid, or at least to mitigate, the rise in average unit cost leading to inefficiency in the USO provision; the

price differential, which was intended to offer cost-reducing efficiencies, was intended to contribute to sustaining the USO; in its absence, Royal Mail would have had to raise prices for letters and/or other delivery services, which would harm consumers; a 43% coverage of SSCs by Whistl would produce a net revenue loss to Royal Mail of £260 million; and the CCNs, by avoiding or reducing the need for such price rises, would bring clear consumer benefits. (Decision paragraphs 8.5-8.7).

637. Royal Mail's case under Article 106(2) was that universal postal services were recognised as SGEIs; a dominant undertaking's conduct could be exempt from Article 102 even if it damaged or eliminated competition; measures to deter 'cherry-picking' by competitors had been approved in other cases; the conduct was justified to secure 'economically acceptable conditions'; and it was not necessary for Royal Mail to show that other measures would have achieved the same objective. (Decision paragraphs 8.8-8.11).

638. In relation to Article 102, Ofcom accepted that conduct may be justified where it pursued a legitimate objective and was necessary and proportionate to achieving that objective; and that if a claim of justification was raised, and supported with arguments and evidence, it was for the authority to disprove it. However, for Ofcom the *Hilti* case showed that objective justification could not be claimed if the objective was already addressed through existing legislation; and the *Purple Parking* case showed that the assessment must be made with reference to factors external to the dominant company.

639. The Decision found (at paragraphs 8.12-8.19) that Royal Mail had not produced any new evidence regarding an immediate threat to the USO. Royal Mail had merely asserted that the price differential was necessary to maintain the USO, but Royal Mail had not challenged Ofcom's repeated decisions – made in exercise of its regulatory powers - that it faced no immediate threat to the universal service. Ofcom concluded in the Decision that: (a) the price differential was neither necessary nor proportionate to the objective of securing the viability of the USO; and (b) the objective of excluding or marginalising a competitor in order to preserve Royal Mail's market share and revenues in bulk

mail delivery is not one that can be relied on to justify conduct that would otherwise be abusive.

640. The Decision dealt separately (at paragraphs 8.20-8.23) with the claim that the differential produced efficiencies which justified any market foreclosure. Again, it said Royal Mail had produced no convincing evidence to show that the price differential produced efficiencies, other than a general assertion that it would otherwise need to raise prices. Ofcom had already dismissed the claim that the CCNs produced efficiencies specifically attributable to the price differential, and the price differential was not indispensable to realising the efficiencies claimed.

641. The Decision (at paragraphs 8.24-8.36) dealt with Royal Mail's Article 106(2) claim by accepting that universal postal services could be of general economic interest but rejecting all Royal Mail's other arguments. Ofcom concluded that Article 106(2) was an exception to a prohibition and must be construed strictly; it was for the undertaking to prove that it applied; compliance was subject to a proportionality test that Royal Mail had not fulfilled, as it had not produced the necessary convincing evidence that the price differential contributed directly to achieving the objective of general interest and that the objective could not be achieved by other, less restrictive, means.

642. In particular, Royal Mail had asserted, but not proved, a direct link between Whistl's roll-out levels and the EBIT margins derived from its own overall business; it had wrongly asserted that Ofcom had somehow guaranteed it an EBIT margin of 5-10%. Ofcom had comprehensively assessed the sustainability of the USO and decided there was no imminent threat to it; if circumstances were to change, the appropriate course would be regulatory action by Ofcom, not action by Royal Mail to abuse its dominant position. Article 106(2) did not in this case permit an undertaking to act in purported protection of the USO by breaching competition law.

(4) The parties' submissions

Royal Mail

643. Royal Mail's pleaded case under this ground was summarised in opening submissions by Mr Beard QC as follows:

> "Royal Mail submits that the introduction of the price differential, if and only if it amounts to an abuse and therefore grounds 1 to 3 are rejected, was in fact justified under Article 106(2) of the Treaty or, alternatively, under 102 itself." (Hearing transcript, Day 2, pages 93 and 94).

644. In relation to objective justification under Article 102, Royal Mail argued that Ofcom had not carried out the necessary balancing exercise. The Court of Justice in *Intel* found that: (i) a balancing exercise was required to consider whether the advantages in terms of efficiency outweighed any disadvantages for competition; and (ii) that balancing exercise could only be carried out on the basis of an analysis of the capacity of the conduct to foreclose as-efficient competitors. Neither exercise had been undertaken by Ofcom and so it had no basis for asserting that the conduct in question was not objectively justified.

645. Further, Royal Mail argued that Ofcom erred in fact and in law in finding that any abusive conduct was not objectively justified under Article 106(2) TFEU. For Royal Mail, Article 106(2) permits an undertaking entrusted with performing a SGEI to undertake prima facie anti-competitive conduct on one market in response to the risk of cherry-picking on that market and use it to cross-subsidise beneficial activity in another market.

646. Royal Mail argued that its status as the universal service provider required it to: (a) deliver and collect specified products; (b) to and from all geographical areas of the UK; (c) at a uniform price, regardless of its varying costs. The costs of providing the universal service were high, did not fluctuate greatly in accordance with the volumes of mail being posted through it, and significantly exceeded the revenues which the service generates. For Royal Mail, in order to be viable, the universal service needed to be cross-subsidised by revenues from other parts of Royal Mail's business.

647. On the other hand, Royal Mail's competitors in the bulk mail delivery market were not constrained as to the locations to which they delivered mail, the products they offered, or the prices they could charge. Entrants such as Whistl were free to cherry-pick the most profitable areas and products, typically

choosing to focus on low cost areas with high population density, provided a slower and therefore cheaper service, and concentrated on the cheapest types of mail.

648. Royal Mail contrasted this with the assertion that, by 2012, Royal Mail's EBIT margin had been negative in each year since 2007-08. Royal Mail anticipated that, absent the price changes proposed in the CCNs, continued cherry-picking by end-to-end competitors would suppress its EBIT at below 5%, thereby jeopardising the viability of the universal service. Royal Mail argued that in announcing the price differential, therefore, Royal Mail hoped to avoid the inevitable downward pressure on its EBIT which would result from increased end-to-end competition.

649. In those circumstances, Royal Mail submitted that its conduct in introducing the price differential was objectively justified.

650. In relation to Article 106(2), Royal Mail sought to rely in particular on the judgments of the Court of Justice in Case C-475/99 *Firma Ambulanz Glöckner v Landkreis Südwestpfalz* EU:C:2001:577 ("*Ambulanz Glöckner*"), *Commission v Netherlands* and *TNT Traco*.

651. As regards *Ambulanz Glöckner*, at the hearing Mr Beard QC for Royal Mail took the Tribunal to the following passages:

> "56. However, Article [106](2) of the Treaty, read in conjunction with paragraph (1) of that provision, allows Member States to confer, on undertakings to which they entrust the operation of services of general economic interest, exclusive rights which may hinder the application of the rules of the Treaty on competition in so far as restrictions on competition, or even the exclusion of all competition, by other economic operators are necessary to ensure the performance of the particular tasks assigned to the undertakings holding the exclusive rights (Case C-320/91 *Corbeau* [1993] ECR I-2533, paragraph 14).
>
> 57. The question to be determined, therefore, is whether the restriction of competition is necessary to enable the holder of an exclusive right to perform its task of general interest in economically acceptable conditions. The Court has held that the starting point in making that determination must be the premiss [*sic*] that the obligation, on the part of the undertaking entrusted with such a task, to perform its services in conditions of economic equilibrium presupposes that it will be possible to offset less profitable sectors against the profitable sectors and hence justifies a restriction of competition from

> individual undertakings in economically profitable sectors (*Corbeau*, paragraphs 16 and 17)"

652. Royal Mail also referred to paragraph 61, which states:

> "61. Second, the extension of the medical aid organisations' exclusive rights to the non-emergency transport sector does indeed enable them to discharge their general-interest task of providing emergency transport in conditions of economic equilibrium. The possibility which would be open to private operators to concentrate, in the non-emergency sector, on more profitable journeys could affect the degree of economic viability of the service provided by the medical aid organisations and, consequently, jeopardise the quality and reliability of that service."

653. In relation to *Commission v Netherlands*, Royal Mail placed emphasis on paragraph 58 of the judgment:

> "58. Whilst it is true that it is incumbent upon a Member State which invoked Article [106(2)] to demonstrate that the conditions laid down by that provision are met, that burden of proof cannot be so extensive as to require the Member State, when setting out in detail, the reasons for which, in the event of elimination of the contested measures, the performance, under economically acceptable conditions, of the tasks of general economic interest which it has entrusted to an undertaking would, in its view, be jeopardised, to go even further and prove positively, that no other conceivable measure, which by definition would be hypothetical, could enable those tasks to be performed under the same conditions".

654. Mr Beard QC relied on *Ambulanz Glöckner* to argue that the need to protect Royal Mail's universal service obligations justified its conduct in this case in relation to bulk mail delivery; that the key phrase in the legal approach to Article 106(2) was "economically acceptable conditions"; and that the test of economically acceptable conditions to be applied to Royal Mail was an EBIT margin of 5-10%.

655. Mr Beard QC relied on the *TNT Traco* judgment to provide further support for the proposition that a measure such as the price differential was acceptable to allow Royal Mail to perform the USO under economically acceptable conditions.

656. In relation to *Commission v Netherlands*, Mr Beard QC argued that the case showed that Article 106(2) gave Royal Mail a margin of discretion to determine the steps that were necessary to secure economically acceptable conditions for

the delivery of the SGEI and that the existence of other, possibly less restrictive, means of protecting the USO did not affect this.

657. Royal Mail also argued that the suspensory provision ensured that, if objection was made to any announced changes and Ofcom opened an investigation, those changes would never enter into effect unless Ofcom were satisfied that they would not have adverse competitive effects. We deal with this argument under Ground 1.

Ofcom

658. Ofcom's case was, in summary, as follows. First, the regulatory framework ascribed to Ofcom the duty to protect the USO. This duty was performed against the backdrop of the legislative choice to liberalise the postal market, including direct delivery. Royal Mail lobbied against this framework but was unsuccessful. In those circumstances, it was not the task of Royal Mail, as the dominant undertaking, to usurp Ofcom's role and, because it disagreed with Ofcom's assessment, take steps on its own initiative to eliminate competition which it regarded as a potential danger to the USO. The *Hilti* case showed that an undertaking could not appropriate for itself a task properly assigned to the public authority. Ensuring the viability of the USO was an important public aim enshrined in law. Ofcom was the authority specifically tasked with pursuing the aim of ensuring the USO is protected and was vested with the powers do so. It was not for Royal Mail to step in and intervene because it took a different view to Ofcom.

659. Ofcom noted that all of the cases relied on by Royal Mail concerned actions taken by, or in conjunction with, the responsible national authorities, not by dominant undertakings acting alone. For example, in *Ambulanz Glöckner*, it was a measure by the German public authority responsible for regulating the public ambulance service that was being challenged: it was that authority, together with other responsible public authorities, who sought to justify it. Similarly, in *TNT Traco*, the measure under challenge was postal dues imposed by the Italian government and the justification under Article 106(2) was advanced jointly by Poste Italiane and the Italian government.

660. Second, as Royal Mail knew, Ofcom made it very clear that there was no imminent threat to the universal service and that no intervention was necessary. As we noted in Section G(4) above, Ofcom had consistently satisfied itself on numerous occasions that there was no imminent threat to the universal service posed by Whistl's delivery activities. Throughout further reviews, Ofcom's conclusion remained that it was not necessary for it to intervene to protect the USO. Ofcom considered Royal Mail's concerns regarding Whistl and 'cherry-picking' in detail.

661. Ofcom maintained that it was right to conclude that there was no immediate threat to the universal service and that no intervention was required. If Royal Mail disagreed with that decision, it should have appealed it at the time, rather than taking it upon itself to take unilateral steps against a competitor. It chose not to do so.

662. Third, Ofcom had not fixed any kind of bright line EBIT margin threshold, below which Royal Mail was entitled to take its own action.

663. Fourth, the fact that Ofcom encouraged Royal Mail to deal with increased competition by way of a *"*commercial response*"* did not imply that such a response could infringe competition law. Insofar as Ofcom gave examples of measures Royal Mail might take as part of a commercial response, these always related to prima facie lawful measures.

Whistl

664. Whistl generally agreed with Ofcom's position. It pointed out that Royal Mail had not shown that the infringing conduct was *necessary* to preserve the USO but had instead asserted that it was *permitted* to engage in otherwise infringing conduct. As to the meaning and intention of Article 106, it was clear that it was aimed at controlling the conduct of Member States, not undertakings, and Royal Mail could point to no case where an undertaking acting alone had successfully claimed justification on this basis.

665. Whistl dismissed Royal Mail's claim that it was acting in accordance with Ofcom's advice as not "sensible" and without any basis; Royal Mail appeared to equate a commercial response with stifling competition. Ofcom had examined Whistl's expansion plans and did not see these as threatening the viability of the USO.

666. Further, Whistl pointed out that Royal Mail had failed to adduce any evidence to establish that the application of competition law would 'obstruct the performance in law or in fact of the particular tasks assigned to it' as required by Article 106(2) but had merely made general assertions as to the possible effect on its business of more competition.

(5) Discussion

667. For Royal Mail to succeed under this ground, it would have to show, in relation to possible objective justification within the framework of Article 102, first that the price differential was instituted in pursuit of a legitimate objective, and that it was necessary, if not indispensable, to achieve that objective; alternatively, that the differential led directly to significant efficiencies that outweighed any restriction of competition.

668. In relation to possible justification under Article 106(2), Royal Mail would have to show, first, that it was an undertaking entrusted with operating an 'SGEI'; second, that application of Article 102 obstructed the performance in law or fact of the particular task assigned to it; third that its conduct was not disproportionate to the task and objective set, i.e. that the restriction of competition claimed was necessary to achieving the objective set and that the objective could not be achieved by other less restrictive means; and finally, that the exemption applied to actions taken by an undertaking acting against the assessment and policy of the national authority entrusted with the oversight of the SGEI in question.

669. These are significant hurdles to be overcome and we find that Royal Mail has not overcome them.

(a) Article 102

670. Although objective justification under Article 102 receded in importance as the case proceeded, on the basis that it added little to the argument on Article 106(2), we nevertheless give it appropriate consideration, not least because the underlying justification that was asserted by Royal Mail, namely its over-riding concern to 'protect' the viability of the USO, overlaps with the assessment of Article 106(2).

671. We examined in Section G(5) the evolution of Royal Mail's pricing plans and the great stress it laid on the possible effect of falling revenues and profits on the overall viability of the USO. Ms Whalley's evidence, written and oral, left us in no doubt that this was a genuine concern, but we were less convinced by the conclusions Royal Mail sought to draw from what it saw as the responsibilities placed upon it and the measures that could reasonably be taken to discharge them.

672. In particular, we noted that Royal Mail seemed unable to appreciate the basic incompatibility between measures 'to protect the USO' and measures that would harm entry or expansion by competitors. It assumed it was entitled to take measures to maintain volumes and profits; it was at best reckless as to the consequences of these measures; at worst it appeared (although Ms Whalley denied this) to deliberately target Whistl's expansion plans as the best way to prevent damage to its own revenues. We explained in Section G above that we consider that Royal Mail knew that Whistl was its principal, if not its only, competitor in end-to-end delivery.

673. What we see advanced under this ground of appeal is a slightly different emphasis. Here Royal Mail appears to accept that the challenge to its revenues, its overall EBIT and hence its ability to sustain the USO under economically acceptable conditions, came from Whistl, whose roll out plans were put forward by Royal Mail, to show what would happen without the price differential. Although Ground 4 is an alternative ground, which may be taken to assume that an infringement of Article 102 is otherwise made out, there is no attempt to deny that the differential was intended to, and was likely to, harm Whistl's end-to-

end plans as opposed to having a positive purpose only. Instead, Royal Mail claimed that it was fully justified in inflicting this harm, in the interests of protecting the USO, avoiding harmful general price rises and generating efficiencies to benefit consumers.

674. As we found in Section G(5), we accept that Royal Mail may well have had a genuine concern that the growth of end-to-end competition threatened the sustainability of its revenues and profits and the maintenance of an EBIT margin exceeding 5%. We do not however accept that this justified Royal Mail taking the measures that it did.

675. Whilst protecting the USO might well be seen as a legitimate objective, and its sustainability might well be affected by increased competition, we do not see the price differential as a necessary response to the threat of such competition. As Ofcom said, it had discussed with Royal Mail measures such as competing on price and quality with end-to-end competitors and seeking further efficiencies. Raising the access price to end-to-end competitors, who remained dependent on Royal Mail for the remainder of their bulk mail business, was not the only, and certainly not a necessary, response.

676. It is an irony of this case that Royal Mail argued that its USO obligations were a disadvantage and a cost burden, preventing it from competing effectively, whilst Whistl argued that it was an unfair advantage enjoyed by Royal Mail, enabling them to 'piggy back' bulk mail on the standard letter service and to cross-subsidise, both locally and nationally.

677. As shown in Section G, Royal Mail chose to avoid any revenue-diluting competitive response and instead chose to put its prices up on a selective and targeted basis. Other, less restrictive, measures were open to Royal Mail, but its reaction, as demonstrated by the contemporaneous evidence, was that it wished to limit competition to protect its revenues and profits in what it saw as a declining market in which it was saddled with an unfair burden.

678. Against this background, Royal Mail says that Ofcom failed to carry out a balancing exercise. This was put either as balancing the risk of harm from the

introduction of the price differential against the legitimate aim of protecting the USO or as a weighing of the claimed efficiency-enhancing effects against possible foreclosure. We do not think either of these is a fair criticism. Ofcom had already considered and dismissed the claim that the price differential could be justified by reference to efficiencies arising from the volume-forecasting requirements on price plan NPP1. It rightly refused to have this claim re-presented as an efficiency gain in the context of objective justification. On that basis, any broader balancing of favourable and unfavourable aspects of the price differential is beside the point.

679. On the specific claim that the price differential was justified by the pursuit of a legitimate objective, Ofcom found that, whilst protecting the USO might well be a legitimate objective for Royal Mail to pursue, the means chosen were neither necessary nor proportionate. We agree with this finding and we uphold it.

680. We therefore do not think the requirements of an Article 102 objective justification can be made out. We now turn to Article 106(2).

(b) Article 106(2)

681. We do not think it can be doubted in this case that Royal Mail is an undertaking to which the particular task of carrying out the universal postal service, as currently defined, in the UK has been entrusted, first by Postcomm and latterly by Ofcom. There are numerous cases in which universal postal services have been accepted as SGEIs and we see no dispute on that point in this case.

682. We do not accept the further claims by Royal Mail, however. In particular we do not agree with the interpretation placed by Royal Mail on the Court of Justice's judgments in *Ambulanz Glöckner*, *Commission v Netherlands and TNT Traco*.

683. First, as regards *Ambulanz Glöckner*, and the meaning of the term "economically acceptable conditions", Royal Mail does not appear to take sufficient account of the *Corbeau* judgment, which was the authority cited by

the Court of Justice at paragraphs 56 and 57 of *Ambulanz Glöckner* and which we referred to in our outline of the legal principles.

684. As we noted, the term "economically acceptable conditions" refers to the need for an undertaking validly entrusted with the performance of an SGEI to be able to maintain an economic equilibrium by balancing profitable and unprofitable activities, protected from competition by other undertakings not subject to the same obligations. This would suggest a balancing exercise that was initially focussed on different aspects of the services covered by the universal service in question.

685. In relation to other services, outside the universal service, the *TNT Traco* judgment, confirming *Corbeau,* shows that the extent to which any derogation under Article 106(2) may be justified is a question of fact in each case. Moreover, any such extension of the derogation must be scrutinised carefully, given that the derogation must be interpreted restrictively, and bearing in mind further that it is for the party claiming the benefit of the derogation to establish that it applies.

686. Applying those principles to the facts in the present case, we see substantial difficulty in the claim by Royal Mail that the over-riding need to protect the USO justifies the kind of commercial response represented by the price differential. It is clear, firstly, that the differential was to be applied to the price of a service (bulk mail delivery) that is outside the scope of the universal service. The fact that Royal Mail uses some of the same facilities and persons to deliver bulk mail and the letters which are within the scope of the USO does not in itself entitle it to prevent the development of competition in relation to end-to-end bulk mail services by imposing a differential charge. It is for Royal Mail to establish that this particular charge, as opposed to any other measure, is necessary to enable it to perform the USO, and it has not done so.

687. Secondly, it is not clear to us that *Commission v Netherlands*, supports Royal Mail's contentions that Royal Mail enjoys a substantial margin of discretion as to what is permitted under Article 106(2) and that the existence of other, less restrictive, measures is irrelevant. *Commission v Netherlands* was a case about

a restriction on free movement of goods contrary to Article 37(1) of the Treaty, arising from a national grant of exclusive rights to import and export electricity. In such a case, it was for the European Commission to establish an infringement of the Treaty by the Netherlands government, although it was for the Netherlands to establish that Article 106(2) applied.

688. The Court confirmed that at paragraph 51:

> "It is true that it is incumbent upon a Member State which invokes Article [106](2), as a derogation from the fundamental rules of the Treaty, to show that the conditions for application of that provision are fulfilled."

689. The Court then held that since in such proceedings brought by the Commission against a Member State it was incumbent on the Commission to prove that the Netherlands did not fulfil its obligations; it was for the Commission to put before the Court of Justice the information needed to enable it to determine whether the obligation had not been fulfilled, including information relating to the inapplicability of Article 106(2) (paragraph 59).

690. The Commission had confined itself essentially to purely legal arguments in rejecting the arguments put forward by the Netherlands under what is now Article 106(2) to justify maintenance of the exclusive rights (paragraph 61). Essentially, what the Court of Justice was saying in paragraphs 59-65 of the judgment was that, when Article 106(2) is invoked, it is not enough merely to recite legal principles but rather it is necessary to apply those principles to the facts of the specific situation.

691. That is far from the situation in the present case, where Ofcom referred in the Decision to the principles underpinning the application of Article 106(2) (at paragraphs 8.24 to 8.31 of the Decision) and applied them to the present factual situation (at paragraphs 8.32 to 8.36 of the Decision). It does not, in our view, establish that Royal Mail can claim that its role as operator of the USO gives it a substantial margin of appreciation under Article 106(2) in this case.

692. We consider Royal Mail's claims in relation to necessity and availability of other, less restrictive, measures under 'proportionality' below.

(c) Proportionality

693. The next issue is whether the restrictive measures are disproportionate to the objective sought. This has two aspects; whether the measures are 'necessary' and whether other, less restrictive measures, would achieve the same objective, as set out in the jurisprudence to which we have referred. But the two aspects are closely related and to a large extent overlap.

694. On the question of necessity, Royal Mail must show that restricting or excluding end-to-end competition is 'necessary' to protect the sustainability of the USO. We note that the conclusion Royal Mail invites us to draw is an extremely crude one, namely that any diminution of its revenues and profits will adversely affect its overall EBIT margin and hence its ability to support the USO. There is no consideration of other causative factors and no guarantee that bulk mail revenues will not go to support some other activity of Royal Mail. We are not convinced that, in those terms, the relevant conduct – which Ofcom correctly found to be an infringement of Article 102 - is 'necessary' to sustain the USO.

695. Even if that were the case, however, Royal Mail's claim must fail on the basis that less restrictive alternatives are available. Again, the jurisprudence is clear on this point, with the Court of Justice holding, for example in the *Dusseldorp* case to which we have referred, that the exemption only applies if the objective cannot be achieved equally by other, less restrictive, means.

696. As Ofcom argued, Royal Mail had been told by Ofcom that, in the face of likely end-to-end competition, whilst it had greater freedom under the new regulatory regime to alter its prices, this did not extend to the introduction of prices that would have infringed Article 102. Other responses envisaged included competing on price or quality or making further efficiency gains. Whether or not these measures were attractive to Royal Mail (and the evidence shows they were not), they were nonetheless available and would not have involved an infringement of the rules of competition. For example, Ms Whalley acknowledged during cross-examination that adjustments suggested by Ofcom included efficiency savings and changing the zonal tilt. We therefore reject Royal Mail's argument on this point.

697. Royal Mail argued, on the basis of the Court of Justice's ruling in *Commission v Netherlands,* that it should not be required to prove that no other conceivable, and therefore hypothetical, measure could enable it to carry out the tasks assigned to it. Ofcom said this was plainly wrong and was a misunderstanding by Royal Mail of the relevant law.

698. Whilst Royal Mail may have correctly quoted from *Commission v Netherlands*, as we observed previously, the Court in that case was addressing a different point, namely the extent of the burden of proof on a Member State to show that the restriction it had imposed was necessary. The Court said this did not extend to theoretical or hypothetical alternatives. Where, as in the present case, there are less restrictive alternatives that may achieve the same objective of preserving the USO, that are neither theoretical nor hypothetical but are readily available, then, in line with the Court of Justice's overall approach in *Dusseldorp* and in other cases, the requirement of necessity must apply, as part of the consideration of proportionality.

699. This view is entirely consistent with the general approach of the Court of Justice on measures that derogate from a central principle of EU law, including the rules of competition; is consistent with the approach taken in relation to objective justification under Article 102 itself; and is in accordance with the view of the Court of Justice that the derogation in Article 106(2) should be interpreted restrictively.

(d) Ofcom's opposition, Royal Mail's commercial freedom and the question of the EBIT margin

700. The next issue is whether Royal Mail, assuming it is an undertaking assigned the performance of an SGEI, can rely on Article 106(2) in the face of the opposition of the very authority that assigned that task to it. We think this is an extremely difficult argument for Royal Mail to sustain.

701. Royal Mail claimed (a) that it did not accept Ofcom's assessment that there was no imminent threat to the sustainability of the USO; (b) that it had been told by Ofcom that Ofcom considered an overall EBIT margin of 5-10% as being

necessary to sustain the USO; and (c) that Ofcom expected Royal Mail to exercise its new-found commercial freedom to this end and that it saw this as a pre-condition for any intervention by Ofcom itself.

702. We do not find any of these claims convincing.

703. As to Royal Mail not accepting Ofcom's assessment, Ms Whalley's evidence was that there was a continuing process of review and discussion between Ofcom and Royal Mail about the USO and its sustainability. Royal Mail clearly did not accept the regulator's assessment, but we were not told of any formal steps being taken by Royal Mail to contest Ofcom's conclusion that there was "no imminent threat" to the viability of the USO. As such, we consider Royal Mail was bound to respect it.

704. As to the claim that Ofcom had agreed that an EBIT margin of 5-10% was the benchmark for USO viability, this was disputed by Ofcom and the evidence for it is insubstantial.

705. In its closing submissions, Royal Mail referred to the March 2012 Statement where Ofcom stated at paragraph 5.41 that *"*the [EBIT] range of 5%-10% remains the most appropriate range to use in assessing medium-term financial sustainability". However, Ofcom also recognised at paragraph 5.42 that this range "does not however represent an implied cap on earnings".

706. We examined Ofcom's regulation of the postal sector at paragraphs 56 to 65 above and its specific consideration of Royal Mail's ability to sustain the USO in paragraphs 194 to 204 above.

707. In the March 2012 Statement, Ofcom emphasised the need for a holistic assessment and the fact that considering any one indicator in isolation might be misleading. Ofcom stated at paragraph 7.43 of the March 2012 Statement:

> "Our view is that to be effective, this will need to be a holistic analysis taking into account a range of indicators and data (and their impact on the provision of the universal service) over time. If we were to consider any indicator in isolation this might be misleading, due to the interactions between the measures. For example, significant cost savings might be considered positive

> for the provision of the universal service if viewed in isolation, but if they were as a result of severe quality of service degradation, this might raise concerns. Conversely, a significant increase in profitability above what would be considered a reasonable rate of return (as discussed in Section 5) might raise concerns if considered in isolation. However, if this were due to a significant reduction in costs (and was therefore a reward for such efficiency gains), then this could still be consistent with our regulatory duties in the short term. Therefore in order to effectively monitor market developments and Royal Mail's performance, it will be necessary to take all relevant factors into account to get a complete picture, and for this analysis to be regularly carried out over time."

708. Royal Mail argued that paragraphs 5.13 to 5.14 of the March 2013 Guidance clearly sets out the approach Ofcom would take towards assessing the financial sustainability of the universal service:

> "5.13. […] the appropriate basis for assessing the financial sustainability of the universal service, in relation to any assessment of the impact of end-to-end competition, would be to have regard to whether the expected EBIT margin for the reported business is likely to be within a range consistent with our view of financeability.
>
> 5.14. At present we consider that this level would be that set out in the March 2012 statement: an EBIT margin of 5% to 10% […]"

709. However, Ofcom made clear in its March 2013 Guidance that it considered EBIT was one factor of an in-the-round assessment of all the circumstances to decide whether Ofcom needed to intervene to protect the USO. Ofcom stated:

> "5.2. The first aspect we would consider in this respect is whether Royal Mail's profitability is expected to be below a level consistent with our view of financial sustainability. As this section sets out, we currently consider the appropriate indicative reference level to use for this assessment to be that which we set out in our March 2012 statement, namely a 5% to 10% EBIT/revenue margin. Additionally, we would also take into account the period over which profitability might fall below a level consistent with financial sustainability and whether it could subsequently be expected to return to a financially sustainable level within the plan period.
>
> 5.3. The second aspect relates to the potential presence and impact of perverse incentives. These could arise if it was believed that the regulator would intervene in relation to end-to-end competition if Royal Mail's profitability were to fall below a certain level, regardless of the circumstances. If this were the case, it might have an undesirable impact on Royal Mail's incentives to realise efficiency savings and could conflict with our duty to have regard to the need for the provision of the universal service to be efficient. We would also be concerned if this reduced Royal Mail's incentives to innovate in response to competition."

710. The March 2013 Guidance also set out the multiple factors that are relevant to whether Ofcom should intervene and the balancing exercise that will need to be undertaken:

> "6.10. Any decision to intervene at a particular point in time would need to take account of, amongst others: (i) the need to have sufficient confidence that the future financeability of the universal service is in doubt, so as to be able to meet the legal tests for intervention (which in general implies waiting longer before intervening); and (ii) the need to put in place any measures necessary in good time to offset that risk (which may imply earlier intervention). As well as our statutory duties in relation to post, any such judgment would take into account, among other things:
>
> - The assessment of the expected short- and long-term impacts of end-to-end competition;
> - An assessment (possibly qualitative) of the underlying forecasts and assumptions that make up our assessment of the long-term impacts and the uncertainty associated with these assumptions;
> - The expected time it will take to implement each intervention and for each intervention to take effect (discussed further in relation to each of the potential options below); and
> - The fact that we have the ability to intervene at any point in time, should our assessment reveal that intervention is necessary (e.g. through the monitoring regime)."

711. Furthermore, the Statement[15] accompanying the March 2013 Guidance, reiterated that the EBIT margin was *"indicative"*. Ofcom explained:

> "3.9. As we explained in our March 2012 Statement, a 5% to 10% EBIT margin is indicative of returns consistent with the financial sustainability of the universal service. We do not intend this range to guarantee a minimum or a maximum profitability, which seems to be [Whistl's] concern. This is further discussed in the following section under the heading "the basis for assessing financial sustainability.
>
> […]
>
> 4.7. We continue to consider that in any assessment of the impact of end-to-end competition on the provision of the universal service it is appropriate to determine whether the EBIT margin for the reported business is, on a forward looking basis, within the range we consider consistent with the financial sustainability of the universal service (i.e. the EBIT margin range used in the monitoring regime). We therefore consider that transient low profitability would not be likely to threaten the provision of the universal service. As

[15] 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.

discussed further below, this does not guarantee a return to Royal Mail within the 5% to 10% EBIT margin."

712. We therefore see no basis for Royal Mail's view that it had in some way been guaranteed any particular EBIT margin by Ofcom.

713. As to the claim that Ofcom expected Royal Mail to exercise its newly conferred commercial freedom, there is no indication that Ofcom intended Royal Mail to engage in exclusionary commercial activity. Instead, as we have seen, the emphasis rather was on competing on price or quality, or on further efficiency enhancements.

714. Ofcom stated in its March 2013 Guidance:

> "3.15. "There are a number of potential benefits from other postal operators competing with Royal Mail in the delivery of mail. Most importantly entry can strengthen the incentives on Royal Mail to improve efficiency and reduce its costs.
>
> 3.16. In addition, if end-to-end competition results in lower prices for certain types of users, it may reduce the rate at which volumes decline for the whole industry. Competition may also benefit customers through increased innovation and value added services.
>
> […]
>
> 4.12. To understand fully the potential impact of end-to-end entry it would also be necessary to consider the potential for commercial response(s) by Royal Mail to mitigate the direct impact of increased competition. As discussed in Section 3, under the new regulatory framework, Royal Mail has significantly more commercial and operational freedom to set its prices and make product changes in a timely manner than was previously the case. There is a range of ways in which Royal Mail might respond to increased competition, for example:
>
> - 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).

- Royal Mail could have a stronger ability and incentive to improve efficiency at a rate higher in the face of end-to-end competition, than would otherwise be the case. This in turn could serve to mitigate, to some extent, the direct impact on Royal Mail's financial position of losing revenue to competitors.

4.13 In addition, greater competition potentially implies more innovation, partly because the incentives on all operators to innovate are greater, but also because there are more operators exploring new ways of doing things. Increased innovation could also help counteract the rate of decline in overall letter volumes. This similarly has the potential to mitigate the direct effect of competition on Royal Mail's financial position."

715. Ms Whalley claimed that Ofcom expected Royal Mail to do what it could to protect the USO on its own initiative before Ofcom would intervene. This claim also lacks any substantiation**.**

716. Nowhere in the March 2013 Guidance, or elsewhere, did Ofcom suggest that an otherwise unlawful response by Royal Mail might be justified by Royal Mail's own assessment that it was needed to protect the USO. Rather, the March 2013 Guidance set out how Ofcom would assess whether end-to-end competition was a threat to the financial sustainability of the USO which warranted regulatory intervention.

717. Insofar as Ofcom gave examples of measures Royal Mail might take as part of a commercial response, these always related to prima facie lawful measures and, as we have seen, there is no indication that Ofcom gave Royal Mail a free hand to infringe competition law.

718. We do not find any of these claimed justifications convincing and do not therefore consider that Royal Mail's reliance on Article 106(2) can be sustained.

(6) Conclusion

719. For all these reasons, we conclude that Royal Mail cannot claim either that its conduct was objectively justified under Article 102 or that it was exempt from the application of Article 102 by reason of Article 106(2). We therefore find

that the Decision was correct in its treatment of this issue and we reject Royal Mail's claims under this ground of appeal.

L. GROUND 5 - INFRINGEMENT OF ESSENTIAL PROCEDURAL REQUIREMENTS

(1) Introduction

720. Under this ground of appeal, Royal Mail claims that Ofcom withheld key parts of its materiality analysis during the administrative procedure, but both included and relied on it in the Decision. Royal Mail claims its ability to comment on this analysis was impaired and its rights of defence were infringed. Ofcom denies any procedural unfairness in fact or in law and claims that Royal Mail's ability to defend itself was not in any way impaired.

(2) Outline of the facts

721. The parties disagree on some of the relevant facts. The factual background that is agreed can be gleaned from the parties' submissions as follows.

722. During the administrative procedure leading up to the issue of the first Statement of Objections ("SO 1") on 28 July 2015, Ofcom sought to base its findings on competitive disadvantage on an assessment of the likely impact of the price differential on Whistl's profitability over the five years 2014-18. This included, first, an analysis of Whistl's additional access costs; second, a corresponding graph; third, a forecast of Whistl's profit; and fourth, the pre-tax real discount rate used to calculate the net present value. Ofcom redacted this evidence from SO 1 on grounds of confidentiality, although Royal Mail's advisers within the confidentiality ring that had been established were able to see it.

723. Royal Mail objected and complained to Ofcom's Procedural Officer. Before any formal ruling was given, Ofcom withdrew SO 1 and replaced it with a second Statement of Objections ("SO 2") on 2 October 2015, which did not contain the redacted material, but instead contained a more general statement about the impact on Whistl's costs and profits and in particular the forecast percentages

that were derived from the more detailed, redacted, figures. In a letter to Royal Mail accompanying SO 2, Ofcom said the removed detailed information itself was not relied on in SO 2.

724. Later in October 2015, Royal Mail obtained further disclosure of Whistl's plans, including the spreadsheets in its end-to-end business plan and descriptions of the relevant data. It was permitted to share this and the previously withheld information with three named in-house Royal Mail lawyers. The purpose of this was to enable Royal Mail's external advisers to discuss these issues with Royal Mail personnel.

725. Subsequently, in response to SO 2, Royal Mail made detailed submissions on Ofcom's assessment of the likely impact of the price differential on Whistl's costs and profits, providing three expert reports by Mr Greg Harman.

726. In the Decision as issued, much of the removed information was re-instated (see Decision paragraphs 7.147-7.160), although the conclusions Ofcom drew from it were similar to those in SO 2.

(3) The parties' submissions

727. Royal Mail said this chain of events made it difficult for it to comment effectively on Ofcom's assessment that an impact on Whistl's costs and profitability amounted to competitive disadvantage. It made clear at the oral hearing before Ofcom that it regarded Ofcom's limited observations on Whistl's costs and profitability contained in SO 2 were insufficient to show a breach of Article 102. When the more detailed analysis re-appeared in the Decision, Royal Mail had not had the opportunity to comment on it.

728. Royal Mail said that this assessment of the likely material impact on Whistl was the basis for a central finding in the Decision; Ofcom had not carried out any price/cost or AEC test and therefore relied on this alone for its finding of competitive disadvantage.

729. Relying on information that had been withheld from a party to make a finding of infringement against it was a breach of an essential procedural requirement, which could not be cured by subsequent disclosure in the course of the appeal process. Royal Mail said that the Decision could not stand in so far as it relied on the withheld information. It referred to EU jurisprudence, particularly Case C-265/17 P *Commission v UPS* [2019] ECLI:EU:C:2019:23 ("*UPS*"), which it said established that, if there was "even a slight chance" that an undertaking would have been "better able to defend itself", that could be fatal to any infringement finding.

730. Ofcom in response said, first, that SO 2 contained all the essential elements used in the case against Royal Mail and, second, that Royal Mail and its advisers had ample opportunity to make detailed submissions on the materiality analysis and had done so. The use of a confidentiality ring (with the effect that certain confidential information was made available only to advisers within the ring) did not make the procedure unfair in this case. Finally, Royal Mail had subsequently failed to identify any argument that it had been prevented from making before Ofcom because of the redaction of detailed cost and profit figures underlying the disclosed percentages and conclusions.

731. Whistl agreed with Ofcom but said in addition that this was not a case suitable for remittal to Ofcom for reconsideration on this ground. The Tribunal, hearing an appeal on the merits, could conclude that any procedural defect in the administrative procedure had been cured on appeal.

(4) Legal principles

732. It is well established that a company's right to defend itself is a fundamental principle of EU law. Article 48(2) of the Charter and the EU case law concerning the enforcement of Articles 101 and 102 TFEU requires those who may be subjected to competition law penalties to be given an opportunity to know the basis for allegations against them and to make representations.

733. Competition enforcement proceedings are considered criminal for the purposes of the protections conferred under Article 6 of the European Convention on

Human Rights and Fundamental Freedoms: see *Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading* [2002] CAT 1 ("*Napp*"), at paragraph 98 and *Tesco plc v Office of Fair Trading* [2012] CAT 6, at paragraph 10. Accordingly, high standards of procedural fairness apply.

734. EU case law has established that a failure to make documents containing inculpatory evidence available to a defendant constitutes a breach of rights of defence, if the undertaking concerned shows that the Commission relied on that document to support its objection concerning the existence of the infringement, and that the objection could be proved only by reference to that document: see Joined Cases C-204/00 P etc. *Aalborg Portland v Commission* EU:C:2004:6 at paragraph 71.

735. In Case C-109/10 P *Solvay v Commission*, EU:C:2011:686, the Commission found, inter alia, that Solvay had abused its dominant position by applying a system of loyalty rebates and discounts in the soda ash market. Before it adopted its decision imposing a fine, the Commission gave Solvay an opportunity to submit observations on its statement of objections. However, Solvay was not given proper access to the file; it was merely provided with copies of the inculpatory documents on which the Commission based its objections at that time. Solvay complained that its rights of defence had been infringed. The General Court rejected Solvay's complaint. However, the Court of Justice set aside the General Court's judgment and said this:

> "53. Observance of the rights of the defence in a proceeding before the Commission, the aim of which is to impose a fine on an undertaking for infringement of the competition rules requires that the undertaking under investigation must have been afforded the opportunity to make known its views on the truth and relevance of the facts alleged and on the documents used by the Commission to support its claim that there has been an infringement of the Treaty... Those rights are referred to in Article 41(2)(a) and (b) of the Charter of Fundamental Rights of the European Union.
>
> […]
>
> 55. Infringement of the right of access to the Commission's file during the procedure prior to adoption of a decision can, in principle, cause the decision to be annulled if the rights of defence of the undertaking concerned have been infringed…
>
> […]

> 57. Where access to the file, and particularly to exculpatory documents, is granted at the stage of the judicial proceedings, the undertaking concerned has to show, not that if it had had access to the non-disclosed documents, the Commission decision would have been different in content, but only that those documents could have been useful for its defence…"

736. In the *UPS* case, the Commission blocked UPS's proposed acquisition of TNT. The Commission based its decision on, inter alia, economic modelling which had been adjusted following the statement of objections, which adjustment had not been disclosed to the applicant so that it had not been able to make representations on it. The General Court found that this breached the parties' right of defence and annulled the Commission's decision. The Court of Justice agreed. It stated at paragraph 31 of its judgment:

> "31. Observance of the rights of the defence before the adoption of a decision relating to merger control therefore requires the notifying parties to be put in a position in which they can make known effectively their views on the accuracy and relevance of all the factors that the Commission intends to base its decision on..."

737. The Court of Justice endorsed what Advocate General Kokott said in her Opinion:

> "40. For the rights of defence to be observed, it is essential that the undertakings concerned be placed in a position in which they can effectively make known their views as regards all elements on which the Commission intends to rely in a merger control decision. It is not the Commission but rather the undertaking concerned itself which examines whether specific elements from the case file may be helpful for the purposes of its defence. In order that the undertaking can make this decision, it has to be made aware, without distinction, of all of the elements on which the Commission intends to rely. What is more, all of the elements identified by the Commission in the merger control proceedings must be made available, that is to say ultimately also elements on which the Commission for its part may not wish to rely."

738. In consequence, the Commission's decision was to be annulled:

> "… provided that it has been sufficiently demonstrated by the applicant not that, in the absence of that procedural irregularity, the [decision at issue] would have been different in content, but that there was even a slight chance that it would have been better able to defend itself (see, to that effect, judgment of 25 October 2011, Solvay v Commission C-109/10 P, EU:C:2011:686, paragraph 57)".

739. That does not mean that an infringement decision need be an exact replica of the Statement of Objections. The General Court summarised the position in *Schneider Electric SA (France, intervening) v Commission (Comité Central*

d'Entreprise de la SA Legrand and Another, intervening), EU:T:2002:254 as follows:

> "438. According to well established case law, the Decision need not necessarily replicate the statement of objections. Thus, it is permissible to supplement the statement of objections in the light of the parties' response, whose arguments show that they have actually been able to exercise their rights of defence. The Commission may also, in the light of the administrative procedure, revise or supplement its arguments of fact or law in support of its objections.
>
> …
>
> 440. None the less the statement of objections must contain an account of the objections cast in sufficiently clear terms to achieve the objective ascribed to it by the Community regulations, namely to provide all the information the undertakings need to defend themselves properly before the Commission adopts a final decision."

740. The requirements of fairness under domestic law are also designed to ensure that a person affected by a decision has an opportunity to make representations before it is taken, so that he or she has the chance to influence it: see *R v Secretary of State for the Home Department ex p Doody* [1994] 1 AC 531 at paragraph 560.

(5) Discussion

(a) The issue

741. As a general observation, it was clearly not desirable that Ofcom's Decision included, and purported to place reliance on, information and data that had been made available only to those external and internal advisers of Royal Mail that were within the confidentiality ring. Ofcom's obligations to maintain a fair administrative process would have been better served if these events had not taken place in this way.

742. Moreover, Ofcom had expressly stated to Royal Mail that it did not rely on the redacted material in SO 2. We must therefore consider whether a procedural unfairness arose out of the use of a confidentiality ring and/or Ofcom's use of information and data that it had assured Royal Mail it would not rely on in SO 2.

743. We note first that it is by no means unusual for the obligation of confidentiality owed to one party to conflict with another party's rights of defence. Authorities have sought various means to reconcile these conflicting requirements, including resort to confidentiality rings of the kind employed here. The relevant information was available at all relevant times within the confidentiality ring. The issue is whether Royal Mail's advisers' ability to obtain instructions on the information to which only they had access was impaired in a way that prevented Royal Mail from properly conducting its defence.

(b) What was withheld

744. As we have observed, the law on this matter is not in doubt. An undertaking's ability to defend itself must not be impaired. The application of this broad principle in any particular case is however a more context-sensitive matter, given the conflicting obligations that we have described.

745. We must first be clear exactly what it was that was withheld. The relevant material relates to paragraphs 7.89-7.90 of SO 2. At the hearing, Ofcom provided a red-line mark-up of the difference between SO 1 and SO 2, on the basis of which Mr Holmes QC argued that the differences were not significant.

746. A comparison of SO 1 and SO 2 shows that the essential differences were as follows:

SO 2 contained a new paragraph 7.89 which stated:

> "We have considered the present value of these additional costs in the period 2014-2018 using the access volumes in Whistl's business plan. These additional costs are significant in the context of Whistl's forecast profits, amounting to approximately 60% of forecast profit in Whistl's business plan, before the notified price increases".

and the following addition to footnote 548:

> "In 2015 Whistl reported in its annual accounts for the year ended 31 December 2014 an underlying operating margin (ie operating profit excluding the impact of end to end final mile delivery and exception items as a percentage of revenue) of 1.6% in 2014".

747. A statement that Whistl's additional cost in later years would have fallen slightly "but would nonetheless remain substantial" was added to paragraph 7.88 but specific operating margin figures, the pre-tax real discount rate used to calculate the present value of the additional access costs, and the net present value of those costs over the five years 2014-18 were redacted, as was the graph showing Whistl's likely actual increased costs from 2014-18, the precise forecast profit over that period and the net present value calculation of that profit in Whistl's business plan.

748. Ofcom said that, despite the redaction of the items described above, it was perfectly clear what was the basis of its finding that the price differential would have a material impact on Whistl's costs and profits, and that it was basing this finding on salient facts drawn from Whistl's business plan. There was, so it says, nothing in the redacted material that was needed to provide additional grounds for argument or objection by Royal Mail; and its external advisers were perfectly able to obtain the necessary instructions and to make detailed submissions.

749. In response, Royal Mail submitted that this missed the point. Procedural fairness was an over-riding requirement. It could not now be known whether its defence would have been different had it had full disclosure of the redacted material or whether that in turn would have caused Ofcom to change its Decision. The *UPS* judgment made clear that even a slight interference with its ability to defend itself could be fatal to a decision.

(c) What Royal Mail requested

750. That argument needs to be examined carefully. Royal Mail in its written pleadings did not seek annulment of the Decision on this ground. At the hearing we explored what conclusion Royal Mail wished us to draw from its claim. We were told, in essence, that we must put this material out of our minds in deciding whether Ofcom had made a valid finding on the materiality of the possible impact of the price differential; or, as Mr Beard QC put it:

> "Ofcom cannot rely on this material". (Hearing transcript, Day 2, page 148).

751. It was open to Royal Mail to take this as a preliminary point, and to ask for annulment or remittal of the Decision before the case came to trial; but it did not do so. When asked why it had not done so, Mr Beard QC, for Royal Mail said as follows:

> "No, well, we certainly wouldn't have suggested that in the circumstances where the entirety of these matters was being dealt with, that it was the most efficient way of the Tribunal disposing of these issues, because obviously we recognise that one of the issues you have to take into account when you are considering the impact of unfairness is looking at the decision as a whole." (Hearing transcript, Day 2, page 147).

752. As to why Royal Mail had not pursued the point further in the administrative proceedings, Mr Beard QC said it was "obviously more sensible" to include it in an appeal, rather than making interim applications. We note in this context that Royal Mail subsequently made submissions to Ofcom based on the unredacted information that its advisers had already seen.

753. We infer from this that Royal Mail was uncertain how important it would be for the validity of the Decision as a whole that Ofcom might not be able to rely on the redacted information. That could certainly be a relevant consideration. The main issue, however, is whether Royal Mail is right to claim that, given the information that was withheld and that which was available to it, there was "even a slight chance" that it would have been able better to defend itself.

(d) Whether Royal Mail's ability to defend itself was impaired

754. The applicable law is not really in doubt. In a case such as this, involving criminal or quasi-criminal liability, the defendant's right to defend itself fully and fairly is paramount. In that sense, the *UPS* judgment, on which Royal Mail relied, merely states the obvious. Nevertheless, the application of the law to the facts of a given case is not always straightforward and must take some account of context.

755. The first issue is how much information was actually withheld. We consider from the comparison between the two SOs that SO 2 conveyed the sense of the withheld information without giving all the underlying figures. Consequently, if Royal Mail's advisers within the confidentiality ring needed further

instructions from their client, this could only be in relation to any extra specific detail provided by the redacted figures, rather than in relation to the broad substance of Ofcom's position. We note that three Royal Mail in-house legal advisers were also given access to the redacted information, but it is not clear to us the extent to which they were or were not able to take meaningful instructions from other relevant personnel within Royal Mail.

756. However, bearing in mind the jurisprudence discussed earlier, we have to consider the effect of even a slight impairment in Royal Mail's ability to defend itself. One difficulty in assessing this is that it involves judging with hindsight. Ofcom says with some justification that Royal Mail personnel outside the confidentiality ring knew that Ofcom's assessment was based on Whistl's business plan and that it had assessed likely impact on forecast costs and profits and concluded, on the basis of a percentage assessment, that the effect would be substantial. Royal Mail claims this is a poorly based finding and rejects it (see Ground 3 above), but that is beside the point. What matters here is whether Royal Mail's advisers would have addressed this point in a better way, based on instructions obtained from better informed Royal Mail personnel.

757. As Royal Mail itself says, it cannot now be said how the defence might have differed. Therein lies the difficulty. However, a way of testing this is to see what points have been raised in the course of the appeal that differ in any marked respect from those advanced at the administrative stage. This is not to suggest that the appeal is in some way 'curing' the procedural defect, but merely to answer the '*UPS* question'.

758. Ofcom was emphatic that no arguments had been raised that differed in any notable respect from the points made by Royal Mail prior to the Decision. Whistl agreed. Royal Mail has not itself indicated any. It is true that Royal Mail submitted substantial additional argument and expert evidence on the issue of materiality, but as the discussion in Ground 3 shows, it is by no means clear that this relied to any significant extent on the withheld specific information, despite Royal Mail's claim to the contrary.

759. We therefore cannot see that Royal Mail would have been better able to defend itself than it has, and the claim that Royal Mail's rights of defence have been infringed must therefore fail.

(e) Other matters

760. We do not have to deal with the question of how important Ofcom's materiality analysis was for its overall finding and whether it could have found an infringement of Article 102 without relying on the specific redacted figures. Nonetheless, we note this issue has receded during the course of the appeal, and our own findings on Ground 3, to which this evidence would be directed, are not based on the correctness or otherwise of Ofcom's assessment of Whistl's business plan and Royal Mail's comments on that assessment and we did not find Royal Mail's additional evidence on materiality particularly useful or relevant.

761. Nor do we have to decide whether any defect in Ofcom's procedure could have been rectified by the operation of this appeal as argued by Whistl. It is not necessary for us to address this in view of our earlier finding.

762. We also do not have to decide on the fairness or otherwise of the confidentiality ring process established by Ofcom in this case. We note however that confidentiality rings play a very useful role in the conduct of competition cases, both at administrative and appeal levels, as they allow professional advisers subject to obligations of confidentiality to have free access to sensitive material, the disclosure of which would be otherwise problematic. They therefore contribute to a fair process. The conditions of a confidentiality ring and its operation in any particular case must, however, be subject to careful scrutiny to ensure that the operation of a fair process overall is not impaired.

(6) Conclusion

763. For all these reasons we conclude that, notwithstanding the paramountcy of an undertaking's ability to defend itself without procedural hindrance, Royal

Mail's ability to do so in this particular case has not been impaired. We therefore reject this ground of the appeal.

M. GROUND 6 - PENALTY

(1) Introduction

764. Under this ground, in relation to the penalty imposed by Ofcom, Royal Mail challenges: (i) Ofcom's power to impose a penalty in this case; and (ii) its calculation of the penalty.

(2) Legal principles

765. Section 36 of CA 1998, as amended, provides (so far as relevant) as follows:

> "[…]
>
> (2) On making a decision that conduct has infringed the Chapter II prohibition or that it has infringed the prohibition in Article 102, the CMA may require the undertaking concerned to pay the CMA a penalty in respect of the infringement.
>
> (3) The CMA may impose a penalty on an undertaking under subsection (1) or (2) only if the CMA is satisfied that the infringement has been committed intentionally or negligently by the undertaking.
>
> […]
>
> (7A) in fixing a penalty under this section the CMA 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-
>
> […]
>
> (ii) engaging in conduct which infringes the Chapter 2 prohibition or the prohibition in Article [102].
>
> (8) No penalty fixed by the CMA under this section may exceed 10% of the turnover of the undertaking (determined in accordance with such provisions as may be specified in an order made by the Secretary of State)."[16]

[16] This provision applies equally to Ofcom by virtue of it having concurrent powers: see paragraph 169 above.

766. The test under section 36(3) was discussed by the Tribunal in *Argos and Littlewoods v OFT* [2005] CAT 13:

> "221. […] 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."

767. In discussing the concept of 'intentional infringement' by a dominant undertaking, the Tribunal in *Napp* stated that:

> "456. […] While in some cases the undertaking's intention will be confirmed by internal documents, in our judgment, and in the absence of any evidence to the contrary, the fact that certain consequences are plainly foreseeable is an element from which the requisite intention may be inferred. If, therefore, a dominant undertaking pursues a certain policy which in fact has, or would foreseeably have, an anti-competitive effect, it may be legitimate to infer that it is acting "intentionally" for the purposes of section 36(3)."

768. The relevant order referred to in section 36(8) is 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). That provides that the turnover of an undertaking for the purposes of section 36(8) is the applicable turnover for the business year preceding the date on which the decision is taken or, if figures are not available for that business year, the one immediately preceding it.

769. Section 38 of the CA 1998 requires the CMA to prepare and publish guidance as to the appropriate amount of any penalty in respect of an infringement of the Chapter II prohibition or the prohibition in Article 102. That guidance must be approved by the Secretary of State and according to section 38(8) when setting the amount of a penalty, the CMA and the Tribunal must have regard to the guidance for the time being in force under this section. The guidance in force at the time of the Decision was: *Guidance as to the appropriate amount of a penalty* (CMA 73, April 2018) adopted by the CMA Board (the "Penalty Guidance").

770. Paragraph 3(2) of Schedule 8 to the CA 1998, as amended, provides that, on an appeal against penalty, the Tribunal may confirm or set aside the decision which is the subject of the appeal and may impose or revoke, or vary the amount of, a penalty.

771. The Tribunal's role in relation to penalty appeals was considered in *Balmoral Tanks Limited and another v Competition and Markets Authority* [2017] CAT 23 ("*Balmoral*"). Referring to, and applying the judgment in, *Kier Group plc and others v Office of Fair Trading* [2011] CAT 3 ("*Kier*"), the Tribunal in *Balmoral* explained at paragraph 134 that:

> "[…] the Tribunal has a full jurisdiction itself to assess the penalty to be imposed, particularly in view of the undertaking's right under Article 6(1) of the European Convention on Human Rights to have the penalty reviewed afresh by an impartial and independent tribunal. The Tribunal's comments in *Kier* that it would not be right for the Tribunal to ignore the CMA's own approach and reasoning in the decision under challenge and that it should recognise a margin of appreciation afforded to the CMA in the application of its guidance are still relevant. The Tribunal in *Kier* clarified that the reference there to the CMA's margin of appreciation is not intended to restrict the intensity of the Tribunal's review of the penalty decision. Rather it indicates that "the Tribunal's role is not minutely to analyse each step of the Guidance but rather to consider the matter in the round, and on that basis, assess whether the final penalty is appropriate.": see paragraph 75 of *Kier*. The Tribunal went on:
>
> > "76. The "margin of appreciation" to which the Tribunal there refers does not in any way impede or diminish the Tribunal's undoubted jurisdiction to reach its own independent view as to what is a just penalty in the light of all the relevant factors. In these circumstances any debate about the scope of any margin of appreciation becomes somewhat sterile. The Guidance reflects the OFT's chosen methodology for exercising its power to penalise infringements. It is expressed in relatively wide and non-specific language, which is open to interpretation, and which is clearly designed to leave the OFT sufficient flexibility to apply its provisions in many different situations. Provided the penalty ultimately arrived at is, in the Tribunal's view, appropriate it will rarely serve much purpose to examine minutely the way in which the OFT interpreted and applied the Guidance at each specific step. As the Tribunal said in Argos (above), the Guidance allows scope for adjusting at later stages a penalty which viewed in isolation at an earlier, provisional, stage might appear too high or too low.
> >
> > 77. On the other hand if, as in all the Present Appeals, the ultimate penalty appears to be excessive it will be important for the Tribunal to investigate and identify at which stage of the OFT's process error has crept in. Assuming the Guidance itself is unimpugned (and in the Present Appeals there has been no attack on it), the imposition of an excessive or unjust penalty is likely to reflect some misapplication or misinterpretation of the Guidance."

772. The Tribunal in *Balmoral* further explained at paragraph 135 that:

> "In *G F Tomlinson Group Ltd and others v Office of Fair Trading* [2011] CAT 7, the Tribunal described the role of the Tribunal in an appeal against penalty in the following terms:
>
> > "72 … In our judgment, the Tribunal's task is two-fold. The grounds of appeal pleaded by the Present Appellants raise a number of specific complaints about particular steps taken by the OFT in computing the fines imposed in the Decision. Part of our task is therefore to adjudicate on those specific complaints since it is important for the OFT and the parties to know where, if anywhere, we judge that the OFT has gone wrong in applying the Guidance in this case. But the other part of our task is, as the OFT accepts, to look at the matter in the round and form our own view about the appropriateness of the penalties imposed."

773. The approach in *Balmoral* was cited with approval (and applied) more recently in *Ping Europe Limited v Competition and Markets Authority* [2018] CAT 13 at paragraph 237. An appeal by Balmoral Tanks, including as to the penalty, was dismissed by the Court of Appeal (see [2019] EWCA Civ 162).

774. Royal Mail challenged both Ofcom's power to impose a penalty in this case, and its calculation of the penalty imposed. We deal with each of these in turn, having first reviewed the arguments of the parties.

(3) The parties' submissions

775. Royal Mail challenged Ofcom's power to impose a penalty on the basis, first, that Royal Mail did not intentionally or negligently infringe competition law and, therefore, the statutory pre-condition for the imposition of a penalty was not fulfilled; and, second, that the principle of legal certainty requires no penalty be imposed for an infringement based on a wholly unorthodox and unforeseeable interpretation of Article 102. Royal Mail said it had taken particular care to avoid any illegality by taking expert advice, liaising with Ofcom and suspending the operation of the price changes. Ofcom had put forward an unprecedented and novel formulation of an Article 102 infringement which Royal Mail could not have anticipated.

776. Royal Mail said Ofcom had also created regulatory uncertainty by failing to produce appropriate guidance in relation to Royal Mail's pricing freedom.

777. On Ofcom's penalty calculation, Royal Mail took issue with Ofcom's application of the Penalty Guidance. At Step 1, it said the starting percentage of 20% of relevant turnover was too high; as to the turnover, Ofcom was wrong to take Royal Mail's UK-wide turnover for D+2 and slower post. Relying on Mr Dryden's evidence, it argued that not all of the UK would be 'affected' by the alleged conduct and markets were local and non-homogeneous; Ofcom did not distinguish the effect of product differentiation or the possible response to more competitive conditions in the counterfactual of Whistl expanding its delivery operations. At Step 2, Ofcom's assumed duration of one year was unfair given that the infringement had, at most, lasted for six weeks. Finally, at Step 4, the reduction for proportionality was insufficient and did not take into account all the relevant circumstances.

778. Ofcom said it clearly had the power to impose a penalty in this case. The conduct found to be infringing was deliberately undertaken by Royal Mail with the intention of excluding a competitor and it could rely neither on the inclusion of suspensory provisions nor on the non-implementation of the price differential to avoid this. Ofcom had not failed to provide necessary guidance (which was limited to regulatory guidance in any case) and had always made clear to Royal Mail that it must observe competition law.

779. On the application of the Penalty Guidance, Ofcom had adopted a reasonable approach, fully in line with regulatory practice and jurisprudence, and had made a substantial reduction for proportionality.

780. Whistl said the penalty was insufficient for an infringement of this magnitude and should be increased. Royal Mail's senior management had clearly intended to prevent Whistl expanding into end-to-end activity and had reaped the benefits of a successful exclusionary tactic, which saved revenues many times the amount of the penalty. Royal Mail claimed it had relied on expert advice but declined to reveal the content of its legal advice and restricted its economic advisers to specific issues such as whether there was a cost justification. In any event Ofcom had made a very substantial proportionality reduction [✂] and the amount of the penalty was around 22% of the amount Royal Mail paid in annual dividends.

(4) Discussion

(a) Intentional or negligent infringement

781. We do not accept Royal Mail's contention that its infringement of Article 102 was not intentional or negligent. As we set out in Section G(5) above, the contemporaneous evidence strongly suggests that Royal Mail was fully aware that its conduct risked being in breach of Article 102 and that it was at the least reckless as to whether the price differential would infringe competition law.

782. What matters is not whether Royal Mail was aware of any specific legal characterisation of its conduct but whether it was aware of its anti-competitive nature. This is shown very clearly in the Tribunal's judgments in the *Argos and Littlewoods* and *Napp* cases, referred to in paragraphs 766 and 767 above. Moreover, as the General Court stated in Case T-472/13 *Lundbeck* EU:T:2016:449 (at paragraph 762):

> "[…] with regard to whether an offence was committed intentionally or negligently and is therefore liable to be penalised by the imposition of a fine in accordance with the first subparagraph of Article 23(2) of Regulation No 1/2003, it is settled case-law that that condition is satisfied where the undertaking concerned cannot be unaware of the anticompetitive nature of its conduct, whether or not it is aware that it is infringing the competition rules of the Treaty (see judgment in *Schenker & Co. and Others*, cited in paragraph 748 above, EU:C:2013:404, paragraph 37 and the case-law cited)."

783. The General Court also explained (at paragraph 834) that an undertaking that infringes competition law:

> "may not escape imposition of a fine where the infringement has resulted from that undertaking erring as to the lawfulness of its conduct […] (see judgment in *Schenker & Co. and Others*, cited in paragraph 748 above, EU:C:2013:404, paragraph 43)."

An appeal to the Court of Justice is currently pending but we do not see this as likely to affect the validity of the settled case law referred to by the General Court.

784. We have found that the contemporaneous evidence shows that Royal Mail was aware of Whistl's possible expansion into delivery, modelled the possible effect of this on its own revenues and profits and adopted the price differential as the

approach most likely to limit the damage to its own position. That it cloaked this with a concern of protecting the USO, possibly under the mistaken impression that this allowed it to behave anti-competitively, is beside the point, as Royal Mail was clearly reckless as to the damage to competition likely to be caused by its conduct.

785. Royal Mail's claim in this respect is essentially a re-presentation of its other grounds of appeal. However, we have rejected Royal Mail's argument based on the facts that the price differential was never implemented and that the prices were never charged or applied. We have also rejected Royal Mail's claims that its conduct was not discriminatory, that it caused no competitive disadvantage and was objectively justified or otherwise permitted by the operation of Article 106(2) TFEU.

786. As to Royal Mail's reliance on expert advice, it declined to disclose the content of its external legal advice; and the economic advice provided by Oxera that we have seen does not establish that Royal Mail could reasonably conclude that it was avoiding any infringement. For example, as we noted in Section G above, in discussing the advice obtained from Oxera by Royal Mail, far from raising doubts as to the applicability of the law on abuse of a dominant position, Oxera advised that whilst it might be possible to justify the price differential, "a key factor …is the extent to which the level of price differential proposed …will actually have a material impact on [Whistl's] direct delivery plans." (see Section G, paragraph 265 above).

787. In relation to Royal Mail's argument that the inclusion of suspensory wording was a mitigating factor, we found no evidence that this was seen by Royal Mail as protecting it from a finding of infringement. Instead it appears to have been seen more as a cause for delay in implementing the price changes that were necessary to protect Royal Mail's position, and its effect was noted fairly late in the process of setting the price differential: see Section G(5). As we concluded (paragraph 281(11)):

> "There is little, if any, sign in the evidence that the inclusion of suspensory wording in the contract change provisions triggered by a

> complaint figured in Royal Mail's planning as to how to avoid any illegality until the very last moment, where it was referred to more in the sense of causing delay in implementation."

(b) Novelty/legal certainty

788. Royal Mail claimed that the infringement in this case was novel, mainly on the ground that there was no precedent for a finding of infringement by creating uncertainty in the market place by means of a price announcement, and that the imposition of a penalty breached the principle of legal certainty. This approach is in our view wrong, for the reasons given in relation to Ground 1. We found the formulation of the infringement by Ofcom to be clear and understandable and we do not think that the essentially anti-competitive nature of Royal Mail's exclusionary conduct should be obscured by over-sophisticated categorisation. As the Court of Justice said in *AstraZeneca*:

> *"*…those abuses […] had the deliberate aim of keeping competitors away from the market […]. […] even though [the EU Commission and Courts] had not yet had the opportunity to rule specifically on conduct such as that which characterised those abuses, [AstraZeneca] was aware of the highly anti-competitive nature of its conduct and should have expected it to be incompatible with competition rules…" (paragraph 164).

789. Royal Mail sought to distinguish this case on the grounds that it involved dishonesty and deceit, but the Court made no such reservation and we do not accept this distinction.

790. We do not agree that the infringement in this case was novel and Royal Mail's claim that a penalty therefore infringed the principle of legal certainty falls away also.

(c) Absence of guidance from Ofcom

791. Royal Mail did not press its argument that Ofcom ought to have provided guidance on Royal Mail's freedom to vary its prices to protect the USO and to meet the threat of competition, although Ms Whalley gave evidence to the effect that Royal Mail felt such guidance was needed but would not come in sufficient time to assist Royal Mail. Ofcom said it had made its position clear to Royal Mail, (see the discussion of Ofcom's Statements in 2012-2013 in paragraphs 59

to 65 and 194 to 204 above) and that in particular it had stressed that Royal Mail should make its own assessment of compliance with competition law and should indeed comply with it.

792. We find there is no substance to Royal Mail's claim. The responsibility for complying with competition law was clearly on Royal Mail itself and could not be passed to Ofcom. Royal Mail was aware that it held a dominant position and therefore had a special responsibility to stay within the law. In our view, it failed to do so. Ofcom made it clear, not least at the meeting on 10 December 2013, (see Section G, paragraphs 238 to 239 above) that Royal Mail must take its own advice on compliance with competition law and not rely on guidance from Ofcom, which would in any case be in relation to regulatory, rather than competition, law.

793. We therefore conclude that it was within Ofcom's power to impose a penalty in this case. We now turn to its method of calculation.

(d) Ofcom's assessment of the amount of the penalty

794. Royal Mail concentrated its arguments on the way Ofcom had assessed relevant turnover, the starting percentage and the adjustment for duration. It also argued that the proportionality adjustment was insufficient and that the penalty was unfair overall. It did not raise any point on Steps 3 and 5 of the Penalty Guidance. Ofcom's Decision made no adjustments under Steps 3, 5 and 6 and we do not consider these further.

Step 1: calculation of the starting point

795. Ofcom assessed the starting point for the calculation, having regard to its seriousness, as 20% of Royal Mail's annual turnover in the UK, assessed by reference to the product and geographical markets used in the finding of infringement. (i.e. Royal Mail's revenue from UK D+2 access and the delivery component of Royal Mail's revenue associated with end-to-end bulk mail delivery services in the UK – calculated as [✂] million and [✂] million respectively, giving a total of [✂] million. In assessing the percentage at 20%,

Ofcom applied what it said was the top of the lower range (10-20%) in the Penalty Guidance.

796. In relation first to the assessment of seriousness, we find that Ofcom was entirely within its rights to place this infringement where it did. Whether 20% falls close to the cut-off point between the lower and upper categories is not material; Ofcom could have applied a percentage of up to 30% and we do not find 20% to be excessive in the light of our findings in relation to Grounds 1-5.

797. On the question of relevant turnover, dealing first with the product market definition, Royal Mail argued this was not sufficiently granular and assumed homogeneity of products. Ofcom said that a precise exercise was not required, as this was only the starting point for the calculation, and a broad view was in line with the Court of Appeal's approach in *Argos v OFT* [2006] EWCA Civ 1318. It criticised Royal Mail's objections, supported by Mr Dryden, as leading to a narrow view which disregarded factors such as the downward pressure on access prices, loss of innovation and other effects had the infringement not occurred.

798. On the geographic market, Royal Mail argued, on the basis of Mr Dryden's evidence, that only those SSCs in which Whistl's rollout was planned should be included in the turnover calculation. Again, Ofcom said this disregarded the wider consequences of the infringement.

799. We agree with Ofcom on this aspect. As the starting point for the calculation of the penalty, 20% of the relevant annual turnover in the product and geographic markets used to assess the infringement is appropriate.

Step 2: adjustment for duration

800. Ofcom made no adjustment to reflect Royal Mail's claim that the infringement lasted for less than one year. Ofcom said this was in line with the Penalty Guidance and there were no exceptional circumstances in this case. As we have shown in relation to Grounds 1 and 3 above, we do not think the duration of the infringement can necessarily be limited to the six-week period between

announcement and suspension of the price differential. Royal Mail continued to defend the differential before Ofcom and did not formally withdraw the price changes until the following year. In the circumstances, we find Ofcom's adoption of one year reasonable.

Step 3: adjustment for aggravating or mitigating factors

801. Ofcom made no adjustment under this head and Royal Mail raised no claim to the contrary. No further comment from us is required.

Step 4: adjustment for specific deterrence and proportionality

802. The penalty reached on the basis of steps 1-3 amounted to a very substantial figure ([✂] million), which Ofcom considered was more than was justified. It reduced the penalty to £50 million, having regard to factors including Royal Mail's financial position, but also to the characteristics of the bulk mail delivery market at the time of the infringement, including its high costs and low margins. Ofcom said that a penalty that provided an appropriate level of deterrence to Royal Mail was needed but that a substantial reduction was justified. It noted that the sum reached in the taking of steps 1-3 significantly exceeded Royal Mail's group profit for 2017-18 [✂] and its average profit after tax for the last three years [✂].

803. Royal Mail argued strongly that a penalty of £50 million was nevertheless too high for such a novel and uncertain infringement for which Ofcom could show no clear effects on competition. It repeated many of the arguments it had advanced in defence of its conduct under other grounds of appeal. We have on the whole already rejected these in considering the substance of the infringement, so they cannot carry any great weight in relation to the penalty either.

804. We note Whistl's observation that £50 million, although a large sum, is small in relation to Royal Mail's shareholder dividend, and Ofcom's observation that the savings that Royal Mail calculated would be made by the infringement amounted to some £130 million per annum by 2017. All this suggests to us that

the reduction for proportionality made by Ofcom is not unreasonable and we accept Ofcom's case on this aspect also.

805. Neither Steps 5 (statutory maximum) nor 6 (reduction for leniency, etc) were relevant to the calculation in this case and this was not disputed by any party.

(e) Our overall view of the penalty

806. As established by the jurisprudence of the Tribunal, the other part of our task, having assessed the steps taken by Ofcom to compute the penalty, is to look at the matter 'in the round' and to see whether we think the penalty is appropriate in all the circumstances of the case. Many of the factors that bear on the consideration of a proportionality reduction are equally relevant here.

807. We have to bear in mind that Royal Mail, although it is a large and substantial group, has not always enjoyed a strong financial position. Nevertheless, the penalty does not look disproportionate to its current revenues and profitability. We have not accepted Royal Mail's view that the infringement was novel, unclear or an inappropriate use of Ofcom's powers. We have also rejected Royal Mail's claim that it believed it was not engaging in infringing conduct, instead finding that it was at least reckless as to whether it was doing so. We have largely upheld Ofcom's position on the substance of the case and rejected Royal Mail's arguments under all other grounds of appeal.

808. In the circumstances we also take the view that a substantial penalty is justified. We have no reason to think that this is a case where the figure decided on by Ofcom is wrong and we see no reason to alter it.

809. We note, however, that if we did, we would in effect be substituting our own reduction for proportionality for that of Ofcom. Given that we have not been inclined to disagree with the way in which Ofcom has applied the Penalty Guidance in relation to Steps 1-3, the only scope for adjustment would be the very substantial reduction [✂], over 80%, made by Ofcom under Step 4. As proportionality assessments are by their nature subjective and discretionary, we would consider this an area better reserved for the regulator's margin of

discretion, and not one in which we would interfere unless we were clear, as we are not, that the decision on the amount of penalty was wrong.

(5) Conclusion

810. We conclude that the amount of the penalty, £50 million, applied by Ofcom in this case, was correct, and Royal Mail's appeal under Ground 6 fails accordingly.

N. OUR OVERALL CONCLUSION

811. We have reviewed with great care the terms of Ofcom's Decision, the six grounds of appeal put forward by Royal Mail; Whistl's intervention; the arguments and evidence put forward by all parties and the oral testimony of their respective factual and expert witnesses. From this review, and for all the reasons we have given, we are satisfied that Royal Mail's appeal must fail.

812. Accordingly, we dismiss the appeal. This judgment is unanimous.

813. We should like to express our thanks to all counsel involved for the thorough and courteous way in which the case has been presented and argued before us and in responding to our many questions; also to the Ofcom staff and to the parties' solicitors and other advisers for their careful preparation of this case.

Peter Freeman CBE QC (Hon)
Chairman

Tim Frazer

Prof. David Ulph CBE

Charles Dhanowa OBE QC (Hon)
Registrar

Date: 12 November 2019

O. GLOSSARY

"**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.
"CA 1998"	The Competition Act 1998.
"**CJEU**"	Court of Justice of the European Union.
"**CMA**"	Competition and Markets 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 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.

"GLS"	General Logistics Systems, Royal Mail's international parcels business which complements its UK business.
"**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').
"**Letter**"	A postal packet with a maximum size of 240mm x 165mm, a maximum thickness of 5mm and a maximum weight of 100g.
"**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.
"**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.
"Ofcom"	Office of Communications.
"**Oxera**"	Oxera Consulting LLP; Royal Mail's external economic advisors during the development of the price differential (and other price changes) during 2013.
"**Penalty Guidance**"	Guidance issued by the CMA on 18 April 2018 under section 38(1) of the Competition Act 1998: *CMA's guidance as to the appropriate amount of a penalty.*
"**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.
"**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.
"The 2011 Act"	The Postal Services Act 2011.
"**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.
"UKPIL"	Royal Mail operates its UK business through its UK Parcels, International and Letters division.
"**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 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.