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IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1299/1/3/18

Victoria House,
Bloomsbury Place,
London WC1A 2EB

17 June 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

- and -

OFFICE OF COMMUNICATIONS

Respondent

- and -

WHISTL

Intervener

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HEARING – DAY 5

APPEARANCES

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

Mr Josh Holmes QC, Ms Julianne Kerr Morrison and Mr Nikolaus Grubeck (instructed by Ofcom) 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.

Monday, 17 June 2019

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(10.30 am)

THE CHAIRMAN: Good morning, everybody. Good morning,
Mr Beard.

MR BEARD: Good morning, Mr Chairman. Good morning
Mr Frazer, Professor Ulph.

We are now moving into the factual evidence stage,
and it lies with us to call our witnesses. Just to be
clear, we won't be calling Mr Simpson unless
the tribunal actually has particular questions for him,
in the light of the observations made by Mr Holmes last
week that he had no questions for Mr Simpson, and we
would therefore be asking that his evidence be treated
as unchallenged evidence, and of course submissions can
be made on it in due course. Obviously if the tribunal
has questions for Mr Simpson he can be made available,
but we were not intending to do so; but I just wanted to
make that clear.

THE CHAIRMAN: We have obviously read Mr Simpson's evidence
very carefully, but we don't have any questions.

MR BEARD: I'm grateful. We will therefore not have him
attend court.

In the circumstances, then, the first witness we
intend to call is Ms Sue Whalley.

THE CHAIRMAN: Good morning, Ms Whalley, try and make

1 yourself as comfortable as you can.

2 MS SUSAN WHALLEY (sworn)

3 THE CHAIRMAN: Thank you.

4 Examination-in-chief by MR BEARD

5 MR BEARD: The arrangements have been made that a solicitor

6 from Ashurst will assist in finding the files for

7 Ms Whalley.

8 Ms Whalley, good morning.

9 A. Good morning.

10 Q. If you could be provided with core bundle C2, please.

11 (Pause). Then can you be provided with RM2A, please.

12 If you could turn to tab 1 in that bundle, please. If

13 you could -- you see on the first page it says "First

14 statement of Ms Susan Whalley". If you could turn on

15 through to page 70, is that your signature, Ms Whalley?

16 A. It is.

17 Q. Is this your witness statement?

18 A. It is.

19 Q. And is it true to the best of your knowledge and belief?

20 A. It is.

21 Q. Ms Whalley, I just have one question in relation to it.

22 If you could turn back to page 2, in the introduction

23 you set out some of your history and experience, your

24 work at McKinsey and then your various roles at

25 Royal Mail.

1 Ms Whalley, are you still employed at Royal Mail?

2 A. No, I am not.

3 MR BEARD: I'm grateful. I don't have any further

4 questions. It's simply an update as to Ms Whalley's --

5 THE CHAIRMAN: Are we allowed to ask where you are employed,

6 if it's not a rude question?

7 A. I am currently in a career transition.

8 THE CHAIRMAN: Right, thank you.

9 MR BEARD: I don't have any further questions. Ms Whalley,

10 Mr Holmes will have questions for you.

11 Mr Chairman, members of the tribunal, I have
12 indicated previously to Ms Whalley -- and indeed to
13 Mr Holmes -- that if there are any issues in relation to
14 confidential material that Ms Whalley would like to
15 refer to in answer, she should indicate that, and we
16 will try and deal with it by perhaps postponing the
17 answer to that question to a closed session later.
18 Mr Holmes has indicated he will try to ask questions
19 that avoid the need to have any private session, but we
20 leave it like that for the moment.

21 THE CHAIRMAN: Hope springs eternal.

22 Cross-examination by MR HOLMES

23 MR HOLMES: Thank you, sir.

24 Good morning, Ms Whalley.

25 A. Good morning.

1 Q. Thank you for joining us today. You joined Royal Mail
2 in 2006; that's correct, isn't it?

3 A. That is correct.

4 Q. You are an experienced businesswoman with 17 years of
5 prior experience working as a consultant at
6 McKinsey & Company?

7 A. Correct.

8 Q. At McKinsey you advised clients on business
9 transformation and on how to manage stakeholders?

10 A. Correct.

11 Q. Your work at Royal Mail quickly came to have a strong
12 focus on regulation, didn't it?

13 A. Yes.

14 Q. From 2008 to 2010 you led work on Royal Mail's response
15 to the Government's review of the postal industry?

16 A. I did.

17 Q. This is the review that led to the Postal Services Act
18 and the introduction of the present regulatory regime;
19 is that correct?

20 A. Yes.

21 Q. Thank you. From mid-2010 your job title was regulation
22 and government affairs director for the Royal Mail
23 Group, and that was the post you held at the time the
24 contract change notices were issued in January 2014; is
25 that correct?

- 1 A. Yes.
- 2 Q. As regulation and government affairs director, you were
3 responsible for ensuring that the CCNs were consistent
4 with the regulatory framework and with competition law?
- 5 A. That was part of my role, working with the executive
6 team at Royal Mail and the board.
- 7 Q. But you were specifically responsible for ensuring that
8 the CCNs were consistent with the regulatory framework
9 and competition law; you say so in paragraph 180 of your
10 witness statement. That's correct, isn't it? Do you
11 see that, in the second line?
- 12 A. Yes.
- 13 Q. Thank you. Immediately after the CCNs were issued, you
14 were rewarded with a promotion to the position of chief
15 operations officer for the group; is that right?
- 16 A. I was asked by the chief executive to take that role of
17 chief operations officer for the Royal Mail.
- 18 Q. In January 2014?
- 19 A. Yes.
- 20 Q. In January 2018 you became the chief executive officer
21 of post and parcels with a seat on Royal Mail's board?
- 22 A. Yes.
- 23 Q. That was the role you had held when you signed your
24 witness statement in October 2018?
- 25 A. Yes.

1 Q. In November 2018 you stepped down from the board with
2 immediate effect; that's right, isn't it, Ms Whalley?

3 A. Yes.

4 Q. And your employment ceased after a handover period in
5 March 2019; is that correct?

6 A. Yes.

7 Q. Did your separation arrangements deal with your role in
8 the present case in any way?

9 A. No, they did not.

10 Q. They did not require you to attend to give evidence
11 today?

12 A. I am here today as a witness for the court.

13 Q. But can you answer the question that I asked: did they
14 require you to attend to give your evidence today?

15 A. My understanding was that, having prepared a witness
16 statement and signed the witness statement, then there
17 was an expectation that I would attend the court today.

18 Q. Was there a contractual requirement to that effect?

19 A. It was an understanding in my settlement agreement that
20 I would attend the court today.

21 Q. Are there any arrangements in place for you to be paid
22 for your work in preparing to give evidence today and in
23 giving evidence today?

24 A. Absolutely not.

25 THE CHAIRMAN: Mr Holmes, is this really leading anywhere?

1 MR HOLMES: It's a question I would like to put, sir. It's
2 a fair question, sir.

3 THE CHAIRMAN: If Ms Whalley was still employed by the
4 Post Office, she would be being paid in the normal way.

5 MR HOLMES: Indeed, but if a witness gives evidence under
6 terms of payment it's legitimate for the advocate to ask
7 questions about that, that's absolutely standard in
8 court proceedings.

9 THE CHAIRMAN: I'm glad to hear it.

10 A. I am not being paid.

11 MR HOLMES: I am grateful, thank you.

12 Before you address the contract change notices in
13 your witness statement, you first explain how it was
14 that Royal Mail came to adopt them, and you make
15 a number of points. Can we agree that they include the
16 following three: first, you say that at the time of the
17 CCNs Royal Mail was in a fragile financial position and
18 was not making a sufficient rate of return on its
19 regulated business which was responsible for providing
20 the universal service?

21 Do you agree that that is one of the propositions
22 that emerges from your evidence?

23 A. At the time the finances of Royal Mail were in
24 a perilous position and had been in previous years
25 leading up to the time of the CCNs, and the return on

1 the reported business had been negative, with a loss in
2 the company of 168 million in 2010, and at the time of
3 the CCNs the financial performance of the company was
4 just starting to improve but still below the expected
5 rate of return that Ofcom had established in the
6 regulatory regime of 5% to 10%.

7 Q. That's helpful, thank you.

8 Secondly, the second proposition, Royal Mail
9 perceived direct delivery as a significant and
10 increasing threat to the profitability of the regulated
11 business, and hence to the universal service.

12 (Pause)

13 So, Ms Whalley, I'm inviting you to confirm whether
14 that proposition was one that you recognised from your
15 evidence?

16 A. (Pause). Yes, we did see direct delivery as a threat to
17 the sustainability of the universal service.

18 Q. And that was because it threatened the profitability of
19 the regulated business; is that right?

20 A. The way that we saw it was that direct delivery would
21 have an impact on the ability of Royal Mail to make sure
22 that it could provide the universal service, the
23 universal postal service, in a sustainable way which was
24 a core part of Royal Mail's business, and indeed a legal
25 and regulatory obligation. We were the designated

1 universal service provider.

2 Q. And the threat that you perceived to the universal
3 service arose because of the impact you expected direct
4 delivery to have upon the reported business; that's
5 correct, isn't it?

6 A. (Pause). So there was a risk that direct delivery would
7 take volumes out of the universal service and the
8 universal service has a fixed cost to it, and therefore
9 there was a risk to the finances of the universal
10 service from additional competition in the market.

11 Q. You measured that risk by reference to the profitability
12 of the reported business within which the universal
13 service network sits?

14 A. The key point of reference that we used was the expected
15 return of between 5% and 10% which was the rate of
16 return that was established by Ofcom in its regulatory
17 framework in 2012, which was the expected rate of return
18 for the universal service to be sustainable. That was
19 the benchmark that we used.

20 Q. That's helpful, thank you, Ms Whalley. The rate of
21 return, 5% to 10% you referred to, is measured by
22 operating profit margin EBIT, earnings before interest
23 and taxation; that's correct, isn't it?

24 A. (Pause). I believe so, yes.

25 Q. I'm grateful.

1 Then the third proposition -- I'm going to explore
2 all of these propositions with you, so don't be alarmed
3 that you won't have an opportunity to expand upon your
4 answers.

5 Thirdly, Royal Mail sought regulatory intervention
6 by Ofcom, but Ofcom did not agree to intervene. It
7 said, among other things, that it wanted to observe how
8 Royal Mail responded to the competitive challenge, and
9 the CCNs were Royal Mail's commercial response to the
10 threat from direct delivery; that's correct, isn't it?

11 A. So we had had, the company, a dialogue with Ofcom
12 related to the competitive nature of the market and the
13 sustainability of the universal service, particularly
14 given that the core letters market is in structural
15 decline. There had been a number of consultations and
16 documents discussed with Ofcom where Royal Mail put
17 forward its concerns around the sustainability of the
18 universal service. By the time it got to March 2013,
19 and the final guidance from Ofcom on end-to-end
20 competition, it was very clear to Royal Mail that Ofcom
21 did not intend to provide any further guidance or
22 intervention, and indeed no further guidance on fair and
23 reasonable terms of access. And it was very clear to
24 Royal Mail that Ofcom expected the company to use its
25 commercial freedoms, as set out in the 2012 regulatory

1 framework, in order to mitigate the risks of increased
2 competition for the business and for the universal
3 service.

4 So it was in that context that Royal Mail examined
5 the various different options that it could use in order
6 to try and mitigate against this risk, and make sure
7 that there was a balance between the universal service
8 being sustainable and at the same time recognising that
9 there would be increased competition in the market.

10 Q. So I think that's a yes, isn't it?

11 A. Can you repeat the question?

12 Q. Royal Mail sought regulatory intervention by Ofcom but
13 Ofcom did not agree to intervene. It said among others
14 things that it wanted to observe how Royal Mail
15 responded to the competitive challenge, and the CCNs
16 were Royal Mail's commercial response to the threat of
17 direct delivery?

18 A. They were.

19 Q. I'm grateful.

20 So I would like to explore each of these points
21 further with you before we come to the events
22 surrounding the adoption of the CCNs, beginning with
23 financial position.

24 In your witness statement you describe Royal Mail's
25 financial position at various points in time, and you

1 begin with the period from 2006 to 2011, and you note
2 that the letters business was loss-making throughout
3 that period; that's correct, isn't it?

4 A. Yes.

5 Q. You attribute this in part to the growth in competition
6 from access operators from 2005 onwards; that's right,
7 isn't it?

8 A. Yes.

9 Q. You set out your view that this growth was artificially
10 inflated by inept regulation under Postcomm between 2006
11 and 2011; would that be a fair summary?

12 A. I don't believe that the words that you used are a fair
13 characterisation of the way in which I described it in
14 my witness statement. The market was liberalised and
15 opened up to full competition in 2006, and the first
16 part of that liberalisation was the opening up of
17 access, and by access I mean this was the ability of
18 other operators to inject mail into Royal Mail's network
19 for the final mile delivery.

20 One of the reasons for the difficult and
21 deteriorating financial position between 2006 and 2010
22 was that the rate of growth of access volumes was much
23 greater than Postcomm, the regulator, had anticipated at
24 the time.

25 Back in 2005/6, the regulator had anticipated that

1 there would be about 1.4 billion of access volumes by
2 2010. It then, a year later, adjusted its projections
3 to indicate that access volumes would be about 4 billion
4 by 2010. But in fact the way that the market developed,
5 access volumes were already 4 billion by 2008.

6 So the access market developed much faster than the
7 regulator had anticipated, and that was one of the
8 reasons for the deteriorating financial position.

9 If I could refer the panel to page 15, please, of my
10 witness statement, there is a graph on the top of
11 page 15 which is a comparison between the cash flows
12 that Postcomm had anticipated and projected for
13 Royal Mail at the time that it did its price control
14 back in 2006. Those are the blue bars on this graph.
15 The first set of bars is 2006/7, and then it goes up to
16 2009/10.

17 The red bars are the actual performance of the
18 company, and what you can see on this graph is that
19 there is a very big difference between what was forecast
20 by the regulator and what was actually achieved. The
21 total was about 3 billion cumulative cash gap, and that
22 was despite Royal Mail delivering its efficiency targets
23 as were expected by Postcomm during that price control.

24 So the development of the access regime during that
25 period was one of the reasons why the financial

1 performance of the company was in a perilous state by
2 the time we got to 2009/10.

3 Q. You also point to another feature of the regulatory
4 regime, and that is a requirement that was imposed by
5 Postcomm on Royal Mail to observe a fixed margin or
6 headroom between its wholesale access price and its
7 retail price, which was not based on Royal Mail's actual
8 costs of the non-access elements of retail provision,
9 don't you?

10 A. That is correct, and the way the company saw it at the
11 time was that that fixed headroom margin was one of the
12 reasons why the access competition and the access
13 volumes had developed much faster than the regulator had
14 predicted at the time.

15 Q. And your concern was that this fixed margin prevented
16 Royal Mail from competing vigorously by cutting its
17 prices at the retail level; is that correct?

18 A. The fixed headroom margin meant that if Royal Mail
19 reduced its retail prices, it would need to reduce its
20 access prices at the same level as it had reduced the
21 retail prices, because it was required to keep
22 a consistent fixed access headroom.

23 Q. And this restricted Royal Mail's ability to compete at
24 the retail level?

25 A. It did.

1 PROFESSOR ULPH: Can I just ask one question of
2 clarification?

3 MR HOLMES: Of course.

4 PROFESSOR ULPH: This margin, was it specified in absolute
5 terms or in percentage terms?

6 A. It amounted, because it varied by product, and it
7 amounted to somewhere between 20% and 80%. So it was
8 specified, it translated into fixed pence terms.

9 PROFESSOR ULPH: But it started out being specified as
10 a percentage and then translated into different ... or
11 was it just some combination of the two?

12 A. I apologise, I can't remember exactly how it was
13 originally characterised.

14 PROFESSOR ULPH: Right, thank you.

15 MR HOLMES: So as a result of this fixed headroom,
16 Royal Mail came to view the competition that it was
17 facing from Whistl and others as unfair and as a threat
18 to its financial position; is that correct?

19 A. So the way that we saw it was that we actually -- and we
20 said this -- we welcomed competition, the company
21 welcomed competition, but thought that it needed to be
22 on a fair basis, and at the time -- and this was
23 highlighted by Richard Hooper in his report -- we did
24 not think that the headroom regulation was fair, because
25 we did not think it gave Royal Mail the opportunity to

- 1 compete fairly with its retail volumes.
- 2 Q. Thank you. In 2011 the regulatory regime changed with
3 the enactment of the Postal Services Act, didn't it,
4 Ms Whalley?
- 5 A. It did.
- 6 Q. In 2011 to 2012, UKPIL, which includes the core delivery
7 network, was in profit to the tune of 137 million;
8 that's correct, isn't it? You say that at paragraph 122
9 of your witness statement, if it assists.
- 10 A. So UKPIL was -- yes, indeed, generated 137 million in
11 2011/12.
- 12 Q. And a key driver of this return to profitability was the
13 new commercial freedom which Ofcom gave to Royal Mail to
14 set its prices; that's right, isn't it?
- 15 A. Price increases which we took in 2011/12 were one
16 element of the improvement in the financial performance,
17 and in addition we were in the middle of
18 a transformation programme in order to improve the
19 efficiency of the company as well.
- 20 Q. The return to profitability key driver was Ofcom's new
21 regulatory framework which gave Royal Mail commercial
22 freedom to set its prices; you say so in paragraph 122.
23 That's correct, isn't it?
- 24 A. Yes.
- 25 Q. Yes. Royal Mail used this freedom to introduce

1 a significant price increase for access services in
2 2011? (Pause). If you can't recall, do say,
3 Ms Whalley, but I'm just interested in your immediate
4 reaction to the question, if that's possible.

5 A. I'm not sure what question you're asking me. Perhaps
6 you could repeat the question.

7 Q. Let me repeat it. Royal Mail used this freedom to
8 introduce a significant price increase for access
9 services in 2011?

10 A. We did introduce price increases in 2011.

11 Q. And they were significant? You say so in your
12 statement, Ms Whalley, at paragraph 122:

13 "Following significant price increases to access
14 services in 2011 and 2012, these services were now
15 covering their costs and making a profit."

16 Do you see that?

17 A. One of the reasons we introduced a price increase at
18 this time --

19 Q. That wasn't the question, Ms Whalley. With great
20 respect, I would ask you to listen and attend carefully
21 to the questions that I'm asking you. The question
22 I asked was whether Royal Mail used its freedom to
23 introduce a significant price increase for access
24 services in 2011?

25 A. The company did use its freedom to increase prices in

1 2011 because, under the prior regulatory regime where
2 80% of the revenues were price controlled, the company
3 had not been able to make price increases and the loss
4 on access services was in the order of £100 million, and
5 so we did take the opportunity to make a price increase
6 in order to make sure that the revenues that we were
7 earning were covering the costs on access, and I refer
8 to the £100 million that we were losing on access within
9 my witness statement.

10 Q. Was that agreed by Postcomm at the time? Did they agree
11 with that £100 million estimate?

12 A. My recollection was that it was in the regulatory
13 financial statements.

14 Q. In 2012 to 2013 there was a further significant price
15 increase to access prices, wasn't there?

16 A. Yes.

17 Q. And profits increased further, didn't they?

18 A. (Pause). By 2012/13, profits did increase further, but
19 the return on the reported business was still below 5%.

20 Q. We will come to that in a moment.

21 A. From memory, it was just above 3.

22 Q. I will discuss that with you. Your evidence is that
23 access services were now covering their cost and were
24 making a profit in 2012; that's correct, isn't it?

25 A. Yes.

1 Q. So in 2012/2013, Royal Mail's key metrics were moving in
2 the right direction, reported group operating profit was
3 growing strongly, as was the operating profit margin;
4 that's right, isn't it?

5 A. It is right that the finances of the company were slowly
6 starting to improve, but they were still below the
7 expected rate of return.

8 MR HOLMES: I would like, at this point, to hand up, sir,
9 a small clip of cross-examination documents that I would
10 like to put to the witness. (Handed).

11 If you could turn within that bundle to tab 17,
12 please, Ms Whalley.

13 MR BEARD: Could you just pause for a moment, Mr Holmes,
14 until everyone has copies? Thank you.

15 MR HOLMES: Sorry, at tab 16.

16 (Pause)

17 We will come back to this, Ms Whalley, apologies.

18 Although you don't address it in your evidence, the
19 financial position continued to improve --

20 A. Sorry, do you want me to put this to one side?

21 Q. Yes please, if you would. I'm grateful.

22 A. Thank you.

23 Q. Although you don't address it in your evidence, the
24 financial position continued to improve in 2013/14, the
25 year of the CCNs; that's correct, isn't it?

- 1 A. The financial position did improve in 2013/14, yes.
- 2 Q. If you could turn to the witness statement of
3 Mr Stuart Simpson, which is in Royal Mail bundle 4, at
4 tab 1. Could we have a clean copy? So for others in
5 the court, the reference is Royal Mail bundle 4, tab 1,
6 or core bundle 2, tab 3.
- 7 If you could turn within this statement to page 14,
8 you have seen this figure before, haven't you,
9 Ms Whalley?
- 10 A. Yes.
- 11 Q. It differs from the metrics that you give in your
12 statement, in that it shows the EBIT margin specifically
13 for the reported business, which is a subset of UKPIL's
14 operations; that's right, isn't it?
- 15 A. Yes.
- 16 Q. It specifically covers the core delivery network,
17 including the universal service, retail bulk mail, and
18 access services; that's correct, isn't it?
- 19 A. Yes.
- 20 Q. Mr Simpson's evidence shows that the EBIT margin for
21 that business grew from 3.3% to 3.9% in 2013/2014 by
22 comparison with the previous year; that's right, isn't
23 it?
- 24 A. Yes.
- 25 Q. At the time of the CCNs, UKPIL and the reported business

1 that sits within it were therefore both profitable and
2 the levels of operating profit were rising; that's
3 correct, isn't it?

4 A. Yes.

5 Q. You note, however, that the EBIT margin for the reported
6 business was below 5% in the run-up to the CCNs, and
7 that it was therefore outside the 5% to 10% EBIT range
8 identified in Ofcom documents. Is that correct?

9 A. Yes.

10 Q. You describe that in your opening answers to my
11 questions as an expected rate of return that had been
12 established by Ofcom; do you recall that?

13 A. My recollection was that Ofcom had set out that it
14 expected a 5% to 10% return for the reported business
15 within its regulatory framework.

16 Q. And Royal Mail viewed this range as the target EBIT
17 margin for the reported business; is that correct?

18 A. Yes, we thought that the reported business needed to be
19 performing between 5 and 10% for the universal service
20 to be sustainable.

21 Q. The parameter, therefore, informed Royal Mail's
22 assessment at the time that the universal service was
23 under threat; that must follow?

24 A. Yes.

25 Q. Can I now consider with you a document in Royal Mail

1 bundle 2B, please, and if you could turn to tab 35.
2 This is a letter which you exhibit to your witness
3 statement, which was sent by the Secretary of State for
4 Business, Innovation and Skills to Ofcom on
5 15 April 2011 setting out the Government's intentions
6 for the new regulatory framework.

7 If you turn within it to the third page of the
8 letter, you will see that the letter considers the
9 requirement in the Act for Ofcom to have regard to the
10 need for a reasonable rate of financial sustainability;
11 do you see that? The heading at the top of page 231.

12 In the third paragraph under that heading it
13 observes:

14 "Obviously it is not within the gift of the
15 regulator to guarantee what returns Royal Mail can make.
16 That should depend on the market and the company's
17 performance. Nor will this requirement remove the need
18 to promote efficiency on the part of the universal
19 service provider."

20 So from the outset the Government made clear that
21 the intention was there should be no guaranteed rate of
22 return for Royal Mail in respect of its reported
23 business, but that this should depend on the market and
24 on the company's performance; that's right, isn't it,
25 Ms Whalley?

1 A. (Pause). Our understanding was that the expectation of
2 the Government inviting this letter was that the
3 regulator would take the steps in order to ensure that
4 the framework was in place that would give Royal Mail
5 a fair and level playing field to ensure that the
6 universal service was sustainable, recognising also that
7 Royal Mail needed to take steps on efficiency.

8 Q. So you have strayed slightly from the question that
9 I put. From the outset, the Government -- can we agree
10 that from the outset the Government made clear that the
11 intention was there should be no guaranteed rate of
12 return and this should depend on the market and on the
13 company's performance? I think you said as much, but
14 I would be grateful for a precise answer to that
15 question.

16 A. (Pause). The Government, our understanding was the
17 Government could not guarantee the rate of return. But,
18 as I said before, it did expect the regulator to ensure
19 that there would be a level playing field which,
20 assuming Royal Mail took action, would enable Royal Mail
21 to ensure that the universal service could be
22 sustainable and achieve returns within this range.

23 Q. I see.

24 If you could please put that bundle to one side and
25 look at a document in bundle C4A, tab 3. Do you see

1 that this is a Royal Mail note of a meeting on
2 19 July 2012 on the subject of measuring the impact of
3 direct delivery competition on the financial
4 sustainability of the USO preliminary modelling results?
5 One of the attendees at the meeting is listed as being
6 yourself. Do you see that?

7 A. Yes.

8 Q. Do you recall this meeting?

9 A. (Pause). I remember many meetings that we had with
10 Ofcom on this topic. I'm not sure I can remember all of
11 the precise discussion during this meeting.

12 Q. That's understood. The note by Royal Mail records at
13 the second bullet:

14 "Ofcom does not 'guarantee' a rate of return for
15 Royal Mail."

16 Do you see that?

17 A. Yes.

18 Q. The fifth bullet states that:

19 "Ofcom wanted to understand the assumptions on
20 efficiency and how they changed when entry occurred.
21 Ofcom expressed the strong hypothesis that efficiency
22 should be higher when there was E2E competition."

23 Then continuing with the next bullet:

24 "Ofcom were concerned that any response by Ofcom
25 would lead to incentive issues and create a moral hazard

1 problem, eg Royal Mail would rely on Regulator to 'solve
2 the problem' rather than taking action."

3 So Ofcom needed to review the plan assumptions for
4 reasonableness, they cannot take them as given and allow
5 them to feed through directly into their analysis.
6 Efficiency is a key area of focus.

7 "Ofcom believe there is legally equal weight on
8 efficiency and financial sustainability. They had
9 intended to monitor our efficiency against the
10 restructuring plan", I think that was the plan you
11 referred to earlier in your answers today, wasn't it,
12 Ms Whalley? "But the significant change in cost levels
13 in the new draft plan raises concerns and Ofcom will
14 need to understand why the costs have changed."

15 So Ofcom was clear that Royal Mail's efficiency
16 needed to be factored into the equation as the Secretary
17 of State had also underlined, wasn't it?

18 A. The company recognised efficiency was important.

19 Q. The company did, but that wasn't my question,
20 Ms Whalley. My question was: Ofcom made clear that
21 efficiency needed to be factored into the equation,
22 didn't it?

23 A. Yes.

24 Q. And Ofcom also made clear that it would not guarantee
25 any particular rate of return, didn't it?

- 1 A. Yes.
- 2 Q. If we could return now -- we can put that bundle away
3 for a moment -- to bundle Royal Mail 2B. It might be
4 worth keeping that bundle to hand, if you have space.
5 I want to show you a document at tab 55, and discuss it
6 with you. So this is a document that you exhibit to
7 your witness statement. As you explain in
8 paragraph 153, it is a proactive submission that
9 Royal Mail made to Ofcom in order to highlight the risks
10 posed by direct delivery. By proactive submission, you
11 mean unsolicited; is that right?
- 12 A. (Pause). Yes, this was a submission we made to Ofcom
13 because of the concerns on the impact of direct delivery
14 on the universal service.
- 15 Q. This document was sent by you to Ofcom under cover of
16 an email on 1 October 2012; do you recall doing that?
- 17 A. Again, there were many documents between Royal Mail and
18 Ofcom. I cannot recall specifically sending this one.
- 19 Q. I see. If you could turn within it to page 4, can we
20 look at the second bullet of paragraph 3.8 together.
21 This states:
- 22 "While Royal Mail understands that a particular rate
23 of return cannot be guaranteed, Ofcom needs to ensure
24 that regulatory and market conditions are such that
25 Royal Mail could be expected to earn a reasonable and

1 commercial rate of return over the medium to long term.
2 As is explained in Oxera's report, in light of the risks
3 currently faced by Royal Mail this means a rate of
4 return at the top end of the 5% to 10% EBIT margin range
5 proposed by Ofcom, possibly even above that range."

6 So that was what Royal Mail was telling Ofcom at the
7 time, wasn't it?

8 A. Yes.

9 Q. At 3.9, Royal Mail continues that it recognises that:

10 "... in performing its duty under section 29 of the
11 Postal Services Act, Ofcom is also required to have
12 regard to 'the need for the provision of a universal
13 postal service to be efficient before the end of
14 a reasonable period and for its provision to continue to
15 be efficient at all subsequent times'. However, the
16 need to ensure that the universal service is provided
17 efficiently is not in itself the reason not to take
18 action under Section 42 [of the] Postal Services Act."

19 So Royal Mail understood that it was not guaranteed
20 any particular rate of return and that it was for Ofcom
21 to assess the reasonableness of its rate of return when
22 deciding whether to take regulatory steps to ensure the
23 financial sustainability of the universal postal
24 service, taking account, among other matters, of
25 efficiency?

- 1 (Pause). Is that correct?
- 2 A. That's a statement. I'm not sure what the question is
3 that you are asking me.
- 4 Q. The question is whether Royal Mail accepted and
5 understood, at the time that it made this submission,
6 that it was not guaranteed any particular rate of
7 return, that it was for Ofcom to assess the
8 reasonableness of its rate of return, and that in doing
9 so Ofcom would take account of efficiency. (Pause).
10 Was that Royal Mail's understanding at the time or not,
11 Ms Whalley?
- 12 A. What I can say is that, at the time, the company
13 understood that the rate of return could not be
14 guaranteed, and that Royal Mail's improvement in
15 efficiency was an important part of the financial
16 performance. However, the company understood that in
17 Ofcom's duties, which were part of the Postal Services
18 Act, that Ofcom's primary duty was to make sure that the
19 universal service was sustainable, and so therefore the
20 regulatory framework needed to take that into account.
- 21 Q. And that was for Ofcom to decide upon, considering,
22 among other matters, your rate of return; that's
23 correct, isn't it? (Pause). You understood that at the
24 time?
- 25 A. Yes.

1 Q. Yes. So the correct position is as set out in the
2 decision in this case. The EBIT margin range is merely
3 one indicative metric among others used by Ofcom in its
4 regulatory role to assess Royal Mail's performance and
5 the financial sustainability of the universal service;
6 that's right, isn't it, Ms Whalley?

7 A. Again, could you phrase it as a question, rather than
8 a statement, please?

9 Q. I did, Ms Whalley. No, it was a question that I put to
10 you. The question is whether you agree that the correct
11 position is as set out in paragraph 8.33 of the
12 decision, that the EBIT margin range is merely one
13 indicative metric among others used by Ofcom in its
14 regulatory role to assess Royal Mail's performance in
15 the financial sustainability of the universal service?

16 A. I don't have the decision document in front of me.

17 Q. That was a direct quote from it. We can go to it if you
18 would like. If it would help you to see it, it's in
19 bundle C1, at tab 1, and the relevant paragraph is 8.33.
20 Page 280 of the rolling numbers.

21 In the light of our discussion, do you accept that
22 final sentence is correct?

23 A. (Pause). As indicated in this paragraph, Royal Mail's
24 position was that an EBIT margin of 5% to 10% was
25 required to make sure that the universal service could

1 be sustainable over time.

2 Q. Thank you very much, Ms Whalley.

3 THE CHAIRMAN: I think that was a no, Mr Holmes.

4 MR HOLMES: It was a no, but she made clear that the
5 understanding of Royal Mail at the time was that the
6 EBIT margin rate was required for the sustainability of
7 the universal service.

8 Can we now turn to consider the position that
9 Royal Mail took in relation to the EBIT returns it
10 considered appropriate, and it took the view that a 5%
11 operating profit margin was inadequate and that
12 a reasonable rate of return would in fact lie in the
13 range of a 10% to 14% operating profit, didn't it?
14 (Pause). Do you recall that?

15 A. Are you asking me to refer to any particular document?

16 Q. I'm just asking you a question about Royal Mail's
17 position at the time, and I'm asking you whether it's
18 correct to say that Royal Mail took the view that a 5%
19 operating profit margin was inadequate, and that
20 a reasonable rate of return would in fact lie in the
21 range of 10% to 14% operating profit? If you can't
22 recall, that's fine.

23 A. So when we were discussing with Ofcom the rate of return
24 to ensure the sustainability of the universal service,
25 the company did consider that a rate more in the range

1 of 11% to 14% might be appropriate. However, we
2 understood and accepted the target range that Ofcom put
3 forward in the regulatory -- new regulatory regime in
4 2011, which was in the range of 5% to 10%.

5 Q. So that was the one -- you regarded the 5% to 10% as
6 required but you would have liked to see a higher range
7 required; is that a fair summary?

8 A. (Pause). We accepted, the company accepted the 5% to
9 10% target range that was documented within the
10 regulatory settlement, and so that was the reference
11 point that the company used.

12 Q. Can you explain in your own words why it was that the
13 company thought a 10% to 14% range was more appropriate?

14 A. One of the reasons why the company thought an 11% to 14%
15 range might be more appropriate was based on some
16 benchmarking of other companies.

17 Q. Well, can we consider your consultation response in
18 January 2012 to the consultation proceeding, the
19 end-to-end statement. That's in Royal Mail bundle 2A,
20 tab 15. You have 2B there; I think it's 2A that you
21 need. Were you involved in the preparation of this
22 response?

23 A. Yes.

24 Q. If you could turn within it to page 5, do you see --
25 sorry, page 4, forgive me. Do you see the heading at

1 the second hole punch: "The EBIT margin should be set in
2 the range 10% to 14% to ensure a financial
3 sustainability of the universal service obligation".

4 Then Royal Mail indicates that it questions the EBIT
5 range proposed by Ofcom:

6 "We believe that the reasonable rate of return
7 should be assessed against the returns that the market
8 would expect to achieve given the risk profile of the
9 company to ensure financial sustainability of the USO is
10 secured."

11 Then there is the point you were just making:

12 "Royal Mail believes a 10% to 14% EBIT range is
13 consistent with the terms other EU private sector postal
14 operators have achieved during their modernisation
15 phases. Setting an EBIT margin within this range would
16 be supportive of the Government's policy and objective
17 to secure access to private capital."

18 Then in the following paragraph:

19 "Royal Mail believes that an EBIT margin set in the
20 range 10% to 14% is supported by an analysis of the
21 returns a credit rating agency would require a company
22 to achieve to obtain an investment grade credit rating.
23 As such, this range would be consistent with securing
24 the financial sustainability of the USO. It would
25 provide confidence to potential investors that

1 Royal Mail has the ability to deliver a reasonable level
2 of profitable growth over the short, medium and
3 long term."

4 So Royal Mail's position was that investors would
5 need an adequate rate of return because of the risk
6 profile of Royal Mail; that's correct, isn't it?

7 A. Yes.

8 Q. That return was required in the short term as well as
9 the medium and the long term? (Pause). Do you see at
10 the foot of --

11 A. Yes.

12 Q. -- page 5?

13 A. Yes.

14 Q. Yes. Based on your experience as a businesswoman, would
15 you agree that the riskier a business venture, the
16 greater the returns that investors would expect?

17 A. (Pause). Could you just repeat the question?

18 Q. Based on your experience as a businesswoman, would you
19 agree that the riskier a business, the greater the
20 returns that investors would expect?

21 A. (Pause). That's probably an overly simplistic way of
22 describing it, because depending on who the investors
23 are and depending on the business, there can be other
24 factors that need to be taken into account.

25 Q. So you wouldn't accept the proposition that a risky

1 business would require higher returns to attract
2 an investor?

3 A. (Pause). As I said, I think different investors have
4 different risk appetites. I'm not sure that you can
5 categorise it that simply, as a one size fits all.

6 Q. But Royal Mail itself took account of the risk profile
7 as a factor in support of its contention that the rate
8 should be in the 10% to 14% range, didn't it? You see
9 that in the second paragraph under the "EBIT" margin
10 heading.

11 A. (Pause). So at the time Royal Mail was undergoing the
12 process of securing investors into the company under
13 Government policy to sell the shares in the Royal Mail,
14 and of course the company was conscious that any
15 investor would want to see a rate of return in its
16 potential investment, of course.

17 Q. Commensurate with risk?

18 A. At the time the company considered that different
19 investors had different risk appetites and risk
20 profiles, but any investor in the company would need to
21 see that it would get a return for its investment, yes.

22 Q. In the short term, as well as the medium and long term?

23 A. From recollection, the discussions with potential
24 investors at the time, the company was looking for
25 investors that would not be looking for a short-term

1 return, but actually investors who would stay with the
2 company over time and actually would see this as a part
3 of their portfolio over time. So no, the focus was not
4 on short-term investment.

5 Q. No doubt you were looking for long-term investors; the
6 question wasn't in relation to the length of the
7 investors' period of investment. The question was
8 whether you considered that a return was required in the
9 short term to give confidence to potential investors.
10 That's what's stated, that's what you were telling Ofcom
11 at the time, on page 4 of the document we have just been
12 looking at. Do you see that? At the bottom of the
13 page.

14 A. (Pause). So at the time the financial performance of
15 the company was just starting to improve from a very
16 perilous position, including discussions with the board
17 on going concern in 2010. The finances were just
18 starting to improve, and the company needed to give
19 investors confidence that there was the potential for
20 improvement and returns in the business.

21 Q. In the short term?

22 A. That's how we thought about it.

23 Q. In the short term, Ms Whalley; yes?

24 A. I don't think this focus on the short term -- that's not
25 how we thought about it at the time.

1 Q. I understand. Very well. Let's move on. The
2 privatisation took place in October 2013, three months
3 prior to the issuance of the CCNs; that's right, isn't
4 it?

5 A. That's correct.

6 Q. And the majority of the company was sold then; is that
7 right?

8 A. That's correct.

9 Q. The company recognised that driving profitable growth
10 was necessary if it was going to obtain ongoing access
11 to external capital, didn't it?

12 A. Growth was clearly important for the company.

13 Q. If you hear a question and you think it can admit of
14 a yes or no answer, it would speed things up if you were
15 able to give that, although do by all means expand upon
16 it subsequently.

17 As you would expect with any company, senior
18 Royal Mail executives received performance pay that was
19 judged in part by reference to the group's revenues and
20 profits; that's the case, isn't it?

21 A. Yes.

22 Q. This aligned the interests of management with
23 shareholders to drive profitable growth; would you
24 agree?

25 A. (Pause). Yes.

1 Q. Great, thank you. That concludes consideration of the
2 financial position. I propose next to turn to deal with
3 the threat posed by direct delivery, the second of the
4 topics we canvassed at the beginning.

5 THE CHAIRMAN: Mr Holmes, we should have a --

6 MR HOLMES: Sir, now might be a convenient moment if that's
7 suitable to the tribunal.

8 THE CHAIRMAN: We are going to have a ten-minute break. The
9 registrar will see that you are looked after, you are on
10 oath obviously and you mustn't talk about the case.

11 THE WITNESS: I understand.

12 THE CHAIRMAN: Thank you.

13 (11.45 am)

14 (A short break)

15 (11.55 am)

16 THE CHAIRMAN: Before we move on, Mr Holmes, Ms Whalley,
17 I don't know whether this would help, but we are
18 obviously very interested in your evidence, we have read
19 your written statement carefully. We don't want you to
20 have to sit in the witness box any longer than is
21 necessary. If, in answer to a question, you try to
22 concentrate on the actual question and give an answer to
23 that, that would probably speed things up. You do not
24 need to restate your case generally, because you can
25 take it that we have read what you have said and taken

1 it very seriously.

2 I don't know whether that helps you, Mr Holmes.

3 MR HOLMES: I'm grateful, sir.

4 THE CHAIRMAN: Please proceed.

5 MR HOLMES: Ms Whalley, the risk of direct delivery emerging

6 had been a matter of growing concern to Royal Mail for

7 several years prior to the CCNs; that's right, isn't it?

8 A. Yes.

9 Q. The overarching concern was that direct delivery

10 competition had the potential to accelerate the decline

11 of postal volumes flowing through Royal Mail's network,

12 thereby significantly reducing profitability; is that

13 right?

14 A. (Pause). Yes.

15 Q. One sees that from an Oxera slide presentation made to

16 Ofcom on behalf of Royal Mail, which is in Royal Mail

17 bundle 3, at tab 11. Ms Whalley, you recall the

18 July 2012 meeting note which I showed you a few minutes

19 ago. These are the slides that were presented at that

20 meeting. I would like to turn, within the document, to

21 page 7. You will see that this is a slide setting out

22 the view of Royal Mail's board. I would like just to

23 draw your attention to the final bullet and see if it

24 matches with your own recollections of the sentiment

25 within the company at the time:

1 "The impact of direct delivery competition presents
2 a significant threat to securing a sustainable profit
3 and cash margin."

4 Do you see that, the final bullet on the left-hand
5 side? Do you recognise that sentiment from the time?

6 A. Yes, it was a significant threat, in the order of
7 £200 million.

8 Q. Yes. To understand the commercial context, can we now
9 go -- we have finished with that bundle, I don't think
10 we will need to look at it again, at least for now -- to
11 a document in bundle C4A with me, tab 13. This is
12 a document about Royal Mail's letters strategy that was
13 prepared for Royal Mail Group's board, and is dated
14 26 May 2013. Do you see that?

15 A. 26 June?

16 Q. 26 June, apologies, did I misspeak? 26 June 2013.
17 Royal Mail informed Ofcom that this document was first
18 reviewed by the Chief Executive's Committee on
19 15 May 2013, as is recorded at paragraph 4.16 of the
20 decision. Were you a member of the Chief Executive's
21 Committee at the time?

22 A. I was, yes.

23 Q. Do you recall this document?

24 A. (Pause). So --

25 Q. I don't obviously expect you to recall its detailed

1 contents, I just wonder whether you recall the --

2 A. I recall the document, I don't recall -- and it's not
3 part of my witness statement, so I don't recall every
4 slide in this document, but --

5 Q. No, that's understood. There is an executive summary on
6 page 4. A first headline point on the left of the page
7 is that letters are crucial to the plan, and the
8 adjacent bullet explains that:

9 "This letters strategy describes the approach and
10 initiatives which we will deploy in order to deliver the
11 core letters revenues for the business plan. Letters
12 are crucial to achieving the required revenues to drive
13 our overall business plan EBIT."

14 Now, the plan and business plan that is being
15 referred to there is a forward looking business plan
16 prepared by Royal Mail on an annual basis; is that
17 right?

18 A. Yes.

19 Q. Given the timing of the slide deck, this would be
20 a reference to the 2013 business plan; is that correct?

21 A. (Pause). So I can't -- typically we did the business
22 plans and finalised them in the first quarter --

23 Q. Yes.

24 A. -- of the year.

25 Q. If it assists, if you turn forward to slide 49, you will

1 see that there is a consideration of recent business
2 plans, do you see that, in order to test the accuracy of
3 the modelling outputs for general letters decline. The
4 graph is confidential, so I won't describe what it shows
5 or what conclusions are drawn from it, but do you see
6 that there are three business plans shown in the chart?

7 A. Mm.

8 Q. Do you see that the black text refers to BP 2013?

9 A. Mm.

10 Q. So that is the current business plan at the time of
11 re-sizing --

12 A. Yes.

13 Q. -- 2013 business plan; do you agree?

14 A. Yes.

15 Q. The plan would aim to forecast the performance of the
16 business over at least the following three years; is
17 that right?

18 A. Yes.

19 Q. Returning to the executive summary on page 4, and
20 continuing the first bullet, or returning to the first
21 bullet, the final sentence reads that:

22 "Letters are crucial to achieving the required
23 revenues to drive our overall business plan EBIT."

24 So the performance of the letters business was key
25 to achieving the planned levels of profit for the

1 business; that's right, isn't it?

2 A. It was right, because letters were half the business,
3 but they were in structural decline.

4 Q. Yes.

5 A. And therefore the company was very focused on trying to
6 ensure that, as a market, there were as many letters
7 that could be kept in the market as possible.

8 Q. Yes.

9 A. Because of e-substitution, the letter market was in
10 structural decline.

11 Q. Yes, and those are the points that are made in the first
12 two bullets of the context below. You see at the first
13 bullet:

14 "... more than half of UKPIL revenues today."
15 The second bullet:

16 "The letters market is in structural decline ..."

17 The letters were also important because of growing
18 competition in the parcels sector slowing parcel revenue
19 growth; is that correct?

20 A. Yes, the parcels market was becoming increasingly
21 competitive.

22 Q. So you were not making as much revenues -- the revenues
23 weren't growing as fast there as they had been the
24 preceding years; is that right? I think it's a point
25 that you discuss at paragraph 14 of your witness

- 1 evidence, if that assists.
- 2 A. Yes. One of the major challenges for the company was to
3 sustain revenues when the letters revenues were in
4 structural decline. Parcels were growing, but the
5 parcels market was extremely competitive and so it
6 was ... it was a very significant challenge for the
7 company.
- 8 Q. Yes. So parcels, very competitive; your core delivery
9 monopoly losing volumes as a result of e-substitution.
10 That's the context, isn't it?
- 11 A. Those are important contextual factors.
- 12 Q. Yes. The fourth bullet under "Context" identifies four
13 risk drivers which could materially impact on letters
14 revenue. So the first is additional e-substitution; the
15 second is lack of economic growth; the third is further
16 consolidation in the wholesale market which triggers
17 direct delivery competition; and the fourth is broader
18 regulatory or legislative change.
- 19 So one of the risks that Royal Mail had to address
20 was the risk of triggering direct delivery competition;
21 is that right?
- 22 A. (Pause). Yes, one of the risks was that direct delivery
23 competition would -- was something that we needed to
24 take account of in how we planned the business. So,
25 yes, the risk of direct delivery competition was there.

- 1 That was a risk.
- 2 Q. And you needed to do that to meet planned profitability
3 targets?
- 4 A. Well, we needed to take account of the risk of direct
5 delivery in considering our plan and what our plan was.
- 6 Q. Yes. As the "Context" on the left-hand side, the
7 general "Context" heading shows, you needed to mitigate
8 the inherent risks in order to meet the plan; that's
9 right, isn't it?
- 10 A. So those words are written there, but actually at the
11 time the way we really thought about this was: how could
12 we balance needing to meet the obligations of the
13 universal service with the risk of increased delivery
14 competition in the market, and how could we try and make
15 sure that we could deliver the universal service in
16 a sustainable, financially secure way and at the same
17 time recognise that there was increased competition in
18 the market. That was -- that was the core of the
19 discussion in the company.
- 20 Q. There is then a confidential bullet at the bottom of
21 that group of bullets under "Context", which I won't
22 read out. Could I ask you just to read it to yourself.
- 23 (Pause)
- 24 A. Yes.
- 25 Q. So business mail includes the bulk mail services which

1 are the subject of this case; that's correct, isn't it?

2 A. Yes.

3 Q. For the reason given in the bullet, business mail was
4 an important part of the mix in achieving the required
5 revenues to drive the overall business plan EBIT?

6 A. Yes, they were an important part.

7 Q. Yes.

8 There are then three themes shown on the left-hand
9 side. The first is "Price to achieve plan revenues",
10 and the first bullet explains how that will be achieved.
11 So again I won't read it, but you can see how the plan
12 contends to achieve plan revenues.

13 Turning back to page 2 of the slide deck, you see
14 some defining questions for discussion with the board.
15 The second question is the one I want to discuss with
16 you:

17 "Have we got the right balance between capturing
18 value and increasing the risk of accelerating decline or
19 Direct Delivery competition?"

20 Capturing value here means getting the best level of
21 profitability for the business; that's right, isn't it?

22 A. (Pause). Yes, it was about the financial performance of
23 the company.

24 Q. Yes, and there were two considerations to balance
25 against maximising profitability. The first is a risk

1 of accelerating decline, and that's a concern that if
2 you push prices too high, demand for letters will
3 decline as a result of e-substitution; is that right?

4 A. Yes.

5 Q. The second balancing consideration is the risk of direct
6 delivery competition, and that's a concern -- the
7 concern that if you increase access and retail prices
8 there will be a higher incentive for direct delivery
9 entrants to come into the market; that's right, isn't
10 it?

11 A. Yes.

12 Q. So it follows that if Royal Mail were able effectively
13 to deter direct delivery competition, it might then be
14 able to capture more value from letters, doesn't it?

15 A. (Pause). That's not how the company and how we
16 discussed it at the time.

17 Q. But it --

18 A. The core part of the discussion, faced with a declining
19 market and the potential for a new entrant into
20 delivery, was what could the company do to try and get
21 a balance to protect the universal service and at the
22 same time have another player in the market, because we
23 knew, the company knew that it could not turn off
24 a competitor in the market.

25 Q. So capturing value in slide 2 was for Royal Mail

1 synonymous with protecting the universal service for
2 these purposes; is that a fair summary of the point you
3 have just made?

4 A. I think that's fair. This was -- the focus was on: how
5 did we make sure that the universal service could be
6 protected?

7 Q. Equally when we come across the phrase "protecting the
8 universal service", we need to understand that it is
9 a reference to capturing value?

10 A. Well, in our mind protecting the universal service was
11 commensurate with ensuring that the company could
12 deliver a reasonable EBIT margin, and we have had
13 a discussion around EBIT margin, and in our mind that
14 was at least in the range of 5% to 10%.

15 Q. Thank you, Ms Whalley. If you could turn on to page 5
16 of the presentation, you see at the top of the page the
17 strategic intent for letters, and two strategic intents
18 are identified. The first is:

19 "Successfully manage the letters decline. Secure
20 value from letters over the medium term and in line with
21 the Business Plan. Mitigate the risk of greater than
22 forecast decline."

23 So securing value from letters meant achieving the
24 returns predicted in the business plan; that's right,
25 isn't it?

1 A. Yes.

2 Q. The returns would be reduced if the decline in
3 Royal Mail's letters volumes exceeded forecasts?

4 A. (Pause). Yes, they would be.

5 Q. You were particularly concerned at this time about
6 declines in volumes resulting from competitive entry by
7 direct delivery competitor?

8 A. That was one of our concerns.

9 Q. The second strategic intent is to remain the carrier of
10 choice for delivery of letters in the UK, and the launch
11 of a rival delivery operator would, by definition,
12 threaten that intent, wouldn't it?

13 A. (Pause). It might have done, depending on the success.

14 Q. Well, if you remained the only carrier, you would be the
15 carrier of choice by default, a Hobson's choice; that's
16 right, isn't it?

17 A. However --

18 Q. Well, could you answer the question before ...

19 A. If we were the only player in the market, that is
20 correct. But I might draw an analogy with parcels,
21 where there were many, many players in the parcels
22 market and Royal Mail had the ambition to be the carrier
23 of choice, and in this context we reflected that if
24 there were to be another player in delivery of letters,
25 then it remained our ambition to be the carrier of

1 choice for delivery of letters, even if there were
2 another player in the market --

3 Q. Yes.

4 A. -- akin to our ambition in parcels.

5 Q. Yes. So to summarise, you would remain the carrier of
6 choice and achieve the strategic intent if there were no
7 entry at all, but if a new entrant did come in, you
8 would fight hard to remain the carrier of choice against
9 that entrant; is that right?

10 A. Yes, we would want to respond so that we could be the --
11 seen as the best deliverer of letters in the market.

12 Q. Yes. Well, not just the best; the carrier of choice?

13 A. Yes.

14 Q. The biggest. If you could turn --

15 A. That doesn't say the biggest, but yes, the carrier of
16 choice.

17 Q. The carrier of choice. Turning on to page 18, you see
18 a slide that identifies four themes which the risks to
19 the letters revenue forecast are said to span. You see
20 that from the title at the top of the page?

21 A. So which slide are you on?

22 Q. Page 18.

23 A. 18.

24 Q. So a further explanation of the risks to the letters
25 revenue forecast spanning four themes.

1 The columns consider each of the four risk drivers
2 that need to be mitigated. You see the second column is
3 "Direct competition", and the second row records the
4 plan assumption. So that is the assumption made in the
5 main line forecast of the business plan, isn't it, in
6 relation to each of these risks?

7 A. (Pause). That was the assumption in the core plan.

8 However, there were multiple scenarios that were done at
9 the time related to the potential impact of delivery
10 competition.

11 Q. But --

12 A. So --

13 Q. Yes, apologies, I didn't mean to cut you off.

14 A. No, that's ...

15 Q. So the core plan assumed, in the case of direct
16 competition, no significant direct delivery competition;
17 you see that from the second column?

18 A. But at the time --

19 Q. Well, do by all means qualify your answer, but first of
20 all could you give me a yes or a no answer to the
21 question which I am asking you?

22 A. So the core plan had no direct delivery competition.

23 Q. Thank you.

24 A. At the time ... if I can take a step back. At the time,
25 we were starting to see the emergence of direct delivery

1 competition, and it was unclear at the time the full
2 extent of what that might constitute, but within the
3 plan and our thinking around the plan, the company was
4 working on a number of different scenarios as to what
5 the impact of that might be on the business.

6 Q. Yes. But to return to the first of the strategic
7 intents that we have considered, securing value from
8 letters in line with the business plan, it's clear that
9 in order to achieve that intent, securing value from
10 letters in line with the business plan, it was important
11 to avoid any significant direct delivery competition
12 from emerging; that's clear from the assumption that we
13 have just looked at. That's right, isn't it?

14 A. (Pause). Sorry, could you just repeat the question?

15 Q. Perhaps if I take it in stages. The plan assumption is
16 that no significant direct delivery competition will
17 occur; that's on the central case, the main line
18 forecast. If significant direct delivery competition
19 did emerge, that would present an obvious threat to the
20 achievability of the forecasts in the business plan;
21 would you agree with that?

22 A. Yes, and that's something we were very concerned about.

23 Q. So in order to achieve the strategic intent that we saw
24 a moment ago of securing value from letters in line with
25 the business plan, it was important to avoid any

- 1 significant direct delivery competition from emerging?
- 2 A. In theory, yes, but in reality the company recognised
3 that that's not something that it could do, that was not
4 within its gift, that the market was very competitive
5 and that there was a real prospect that there would be
6 increased competition in the market, and that that
7 was ... that was a risk to the business and to the
8 universal service that we needed to address. Indeed,
9 going back to Hooper, Richard Hooper had identified, way
10 back in 2008 and again in 2010, the potential risk and
11 threat to the universal service of direct delivery
12 competition.
- 13 Q. The next slide analyses further how the direct delivery
14 risk might emerge. It sets out various scenarios and
15 potential influence on direct delivery risk business
16 plan. That's ways in which Royal Mail might be able to
17 influence direct delivery risk; is that right?
- 18 A. (Pause). I have not seen this slide, it was not part of
19 my witness bundle, so I haven't seen it for a long time,
20 so I need to take time to look at it.
- 21 Q. Certainly. I won't ask you to interpret the document,
22 let me just draw your attention to particular features
23 of it and get your reactions, if I may.
- 24 The "Market structure today" box on the left-hand
25 side identifies as a third factor that a direct delivery

1 investor was being sought by TNT, now Whistl. So
2 Royal Mail knew in May and June 2013 that Whistl needed
3 external investment, didn't it?

4 A. Yes.

5 Q. Throughout 2013 it was monitoring closely Whistl's
6 direct delivery plans?

7 A. Royal Mail did not have access to Whistl's direct
8 delivery plans, up until the point at which Whistl
9 announced its direct delivery plans.

10 Q. Of course not.

11 A. However, what Royal Mail was experiencing in 2013 was
12 the start of Whistl's roll-out of direct delivery into
13 different parts of the country.

14 Q. And it was watching closely how that roll-out --

15 A. Yes.

16 Q. -- developed?

17 A. Yes.

18 Q. Yes. Looking across the slide, there are various
19 possible developments considered. You see that the
20 boxes that are higher up are described as representing
21 a reduced risk to plan, that's reference to the business
22 plan, and those further down the slide are described as
23 an increased risk to plan. The greatest risk to plan is
24 direct delivery risk increasing; do you see that in the
25 bottom right-hand corner?

- 1 A. Mm.
- 2 Q. And the reduced risk to the plan is if TNT remained
3 "focused on upstream only (as-is)"; do you see that in
4 the top right-hand box? (Pause). So, as you would
5 expect from our previous discussion, the greatest risk
6 to the plan is direct delivery continuing, and the
7 lowest risk is if TNT remains as an access operator;
8 that's right, isn't it?
- 9 A. That's right.
- 10 Q. If we could just pick up one further point, we have seen
11 that Royal Mail was aware that Whistl was looking for
12 a direct delivery investor; can I ask you to consider
13 the box in the middle at the top:
14 "Ofcom guidance on Direct Delivery undermines
15 potential investor partner confidence."
16 So Royal Mail was aware that the scope for TNT to
17 enter depended upon events not undermining potential
18 investor partner confidence; that's right, isn't it,
19 Ms Whalley?
- 20 A. (Pause). All I can say on that is at the time we knew
21 that Whistl was looking for an investor, but we had no
22 further information on who the investor was or what the
23 nature of the investment would be.
- 24 Q. Thank you, Ms Whalley.
- 25 Can we now turn to consider -- we can leave the

1 strategic letters slide pack for the moment, although we
2 will return to it. Can we consider the third of the
3 points that I canvassed with you at the outset, which is
4 how Royal Mail set about responding to the direct
5 delivery threat.

6 Would you agree that Royal Mail pursued a twin track
7 approach of lobbying for regulatory intervention on the
8 one hand and on the other hand of developing
9 a commercial response?

10 A. (Pause). The Royal Mail lobbied the regulator very hard
11 from late 2000 -- well, during 2012, because of the
12 potential threat of direct delivery to the universal
13 service. As I mentioned before, Richard Hooper, in his
14 work, had identified the risk of direct delivery to the
15 sustainability of the universal service. Royal Mail had
16 quantified that impact at around £200 million,
17 £220 million of revenue, and Royal Mail's view was that
18 the regulator needed to provide guidance on the access
19 regime in terms of fair and reasonable, which it had
20 said it would do in 2012. And on the basis of this
21 lobbying, the regulator in 2013 said in its guidance on
22 end-to-end delivery that it believed that Royal Mail had
23 the commercial freedoms in order to be able to mitigate
24 the risk and threat of end-to-end competition, and that
25 it expected Royal Mail to use those freedoms and indeed

1 would not make any further intervention until Royal Mail
2 had used those freedoms and the regulator had had the
3 opportunity to see the impact of those initiatives,
4 commercial initiatives on behalf of Royal Mail on the
5 market.

6 So it was in that context that Royal Mail then
7 really focused on the commercial initiatives to be taken
8 in order to use the commercial freedoms that it had been
9 given by Ofcom and Ofcom said that the company should
10 use to try and mitigate against the risk of the direct
11 delivery competition.

12 Q. So, sorry, is your evidence that Royal Mail focused on
13 commercial responses after the publication of
14 Royal Mail's guidance -- sorry, Ofcom's guidance in
15 2013?

16 A. Royal Mail was already thinking about commercial
17 responses before Ofcom published its final guidance in
18 March 2013.

19 Q. So I think you were agreeing that there was a twin track
20 strategy, including regulatory engagement on the one
21 hand and commercial response on the other. Can we turn
22 within the cross-examination bundle which I handed you
23 at the outset to tab 16 --

24 THE CHAIRMAN: Before we do, could I ask Ms Whalley: you
25 used the word "mitigate" several times, twice I think.

1 Can you just explain to us what you mean by it?

2 A. (Pause). So, when direct delivery takes place in part
3 of the market alongside Royal Mail, what happens is that
4 the volumes on delivery routes disappear and it happens
5 very quickly, and in the case of Manchester, for
6 example, it was about 14%/15% of volumes overnight that
7 are taken out of the Royal Mail system. So that has
8 a significant impact on the cost per item --

9 THE CHAIRMAN: I understand that.

10 A. -- of ... so when we were looking at commercial
11 responses, what the company was focused on was pricing
12 responses, both in terms of the zonal as well as the
13 access prices, that would enable Royal Mail to ensure
14 the universal service could be as sustainable as
15 possible by helping to balance the volumes to the hours
16 in the operation at the same time as making the zonal
17 costs as cost-reflective as possible.

18 THE CHAIRMAN: So by mitigate what you mean is lessen the
19 effect of, or lessen the impact of; is that right?

20 A. Lessen the impact. Lessen the impact which we saw as
21 £200 million, so lessen the impact of that.

22 THE CHAIRMAN: But not abolish altogether?

23 A. Absolutely not. Absolutely not, and that's not
24 something --

25 THE CHAIRMAN: Thank you.

1 A. -- that we could do. What was in our mind the whole
2 time was: how could we balance needing to try and ensure
3 the universal service was sustainable and yet at the
4 same time recognise there would be a delivery player in
5 the market who had their own ambitions to create
6 a business, and it was: how could we balance those two,
7 in a declining market.

8 THE CHAIRMAN: Thank you.

9 MR HOLMES: Thank you.

10 So I was taking you to tab 16 of the
11 cross-examination bundle. You will see that this is
12 Royal Mail's Annual Report and Financial Statements for
13 2012 to 2013, or excerpts from it. At page 24, you see
14 that there are set out business risks. The first
15 business risk which is listed is:

16 "Changes in customer preferences and competitor
17 activity."

18 The second paragraph, in the first column, states
19 that:

20 "Customer and competitor actions could trigger
21 significant volumes of physical mail bypassing
22 Royal Mail."

23 Pausing there, "bypass" is a term used by Royal Mail
24 to describe direct delivery competition, isn't it?

25 A. Yes.

1 Q. The next subparagraph reads:

2 "Postal operators and other third parties may set up
3 discrete delivery networks in urban areas."

4 This is again a reference to direct delivery, isn't
5 it?

6 A. Yes.

7 Q. "The impact is stated to be that the market and our
8 share of it may shrink more rapidly than we expect,
9 leading to lower growth rates and profitability."

10 So unpacking, that, the emergence of direct delivery
11 competition may dent profitability by comparison with
12 the business plan; is that right?

13 A. Yes.

14 Q. In the "Mitigation" column, you see the third bullet
15 states:

16 "We have held discussions with key stakeholders, and
17 continue to do so, on the risk to the universal service
18 if direct delivery competition is allowed to develop
19 unchecked."

20 So that is the regulatory lobbying strategy aimed at
21 blocking unchecked direct delivery competition; is that
22 right?

23 A. It was the regulatory strategy, but it was not to block
24 direct delivery competition, because we knew we couldn't
25 do that.

1 Q. As I say, block unchecked direct delivery competition;
2 that's right, isn't it?

3 A. Yes.

4 Q. The next bullet reads:

5 "We are developing proposals to maximise commercial
6 opportunities from the freedoms we have gained."

7 That bullet encompasses the commercial response; is
8 that right?

9 A. Correct.

10 Q. Which is again aimed at checking direct delivery
11 competition?

12 A. (Pause). I don't think the word "checking" is how we
13 thought about it. The commercial response was what
14 Ofcom had said that Royal Mail should do, which was to
15 use its commercial freedoms in order to address the risk
16 and take action to ensure that the universal service
17 could be sustainable, and Ofcom had said it would not
18 take any further action until it had seen the responses
19 from Royal Mail. So those were the commercial
20 opportunities referred to here.

21 Q. Yes, I see. So if we could look first of all at the
22 lobbying efforts: by 2010 Royal Mail was already
23 lobbying Government in relation to direct delivery
24 competition; that's right, isn't it?

25 A. Yes, Royal Mail was concerned about the potential for

1 direct delivery competition and, as I've said before, it
2 was also a risk that was highlighted in the Hooper
3 report looking at the future sustainability of the
4 universal service.

5 Q. We see the lobbying efforts from a slide deck which you
6 exhibit to your witness statement, which is in
7 Royal Mail bundle 2B at tab 49.

8 PROFESSOR ULPH: Sorry, which tab?

9 MR HOLMES: It is at tab 49, sir.

10 If you turn within that document to the third page,
11 you will see that this was a regulatory workshop in
12 which the BIS, the Department of Business, Industries
13 and Skills was involved.

14 If we could turn within the document to page 550,
15 you see some headlines are quoted, and the first two
16 relate to the concerns about volume decline and reduced
17 profitability that you have been describing, and the
18 third states:

19 "Unfettered competition -- on non-equivalent
20 terms -- is inconsistent with securing financial
21 sustainability of the universal service obligation."

22 So Royal Mail was lobbying Government against
23 allowing unfettered direct delivery competition, wasn't
24 it?

25 A. Yes, it was, and the reason for that is that at the time

1 this document was written the company was in a severely
2 loss-making position, and going back to the earlier
3 discussion, the access regime which had been put in
4 place by the previous regulator, Postcomm, had led to
5 a much more rapid evolution of competition in the market
6 and access volumes than the regulator had ever imagined,
7 and that together with the access headroom regulation --
8 which we also discussed earlier on -- had contributed to
9 the financial perils of the company and of the universal
10 service. And at the time, the UK was the only country
11 in Europe which had such a large and competitive access
12 market.

13 And it is right that Royal Mail was extremely
14 concerned at the time, back in 2010, that if competition
15 was going to come into the market -- and Royal Mail
16 welcomed competition, we always said we welcomed
17 competition, but we did think that it was right that
18 competition should be on a fair basis. So therefore it
19 was appropriate that there were some consideration of
20 what might be required in order to ensure that the
21 competition was on a fair and reasonable basis, and that
22 it was of a level playing field.

23 Q. Yes. So just unpacking that for a moment, you felt that
24 the current access competition you were facing was
25 unfair; is that right?

1 A. We did think that there was some unfairness.

2 Q. And one word -- you have explained your reasons, I just
3 want to explore them, and if you are able to give a yes
4 or no answer, that would be much appreciated.

5 You thought that the access competition created
6 a risk of direct delivery entry; is that right?

7 A. Yes, we did, because at that time, between 55% and 60%
8 of upstream volumes were held by access players, and
9 because those volumes were held by access players there
10 was an increased ease, as we saw it, of access customers
11 being able to take those access volumes and converting
12 them to direct delivery volumes.

13 Q. By reason of these elements, you felt under threat and
14 you considered that competition by direct delivery
15 operators should be fettered to achieve a fair outcome;
16 is that right?

17 A. We thought that the regulatory framework needed to take
18 account of the risk of unfettered direct delivery
19 competition on the sustainability of the universal
20 service, which was the regulator's primary duty.

21 Q. And your specific proposal can be seen at the foot of
22 the next slide:

23 "Royal Mail's proposed solution is for the draft
24 bill to include provisions to protect against
25 inefficient entry to the delivery market by placing

1 obligations on entrants to:

2 "Provide a service ... every working day in [the]
3 ... areas covered ...", and:

4 "Where such delivery services are provided to, or in
5 respect of, substantially less than all of the delivery
6 points in the UK, to provide delivery of mail items and
7 postal packets every working day to the address of every
8 individual [or] other person located in their area of
9 operation."

10 Those were the specific obligations that you were
11 proposing to impose; is that right?

12 A. So --

13 Q. If you are able to answer yes or no before expanding,
14 that would be much appreciated.

15 A. So, yes, these were the thoughts at the time.

16 Q. Yes. Thank you.

17 A. Can I add a bit of context, however, for this document?

18 This was a discussion document with the Treasury and
19 with Government at the time that the Government was
20 putting together the legislation in the Postal Services
21 Act.

22 Q. Yes.

23 A. And this was part of a dialogue with the Government
24 around the sustainability of the universal service and
25 seeking to secure some safeguards in the legislation to

1 ensure that there would be a level playing field if
2 direct delivery did indeed emerge, which we fully
3 expected it to. So these were ideas at the time.

4 Q. And the Government rejected your suggestion, didn't it?
5 There was no provision made in the Postal Services Act
6 imposing obligations on direct delivery operators of the
7 kind sought?

8 A. So I don't have the Postal Services Act in front of me,
9 and I don't know whether the Postal Services Act is
10 available, but there was a reference in the Postal
11 Services Act to the need for the universal service to be
12 sustainable and ensure there was a return on the costs
13 of providing the universal service, and there is one
14 other clause which I wonder whether we could get access
15 to that related to this.

16 Q. This isn't an important point. The assessment of
17 whether such obligations were needed was left to the
18 industry regulator, wasn't it, Ms Whalley? If you don't
19 know, it doesn't matter, I can canvass it in
20 submissions. Do you know the answer to that question or
21 not?

22 A. So I believe that there was a reference in the Postal
23 Services Act around competition. As I say I can't
24 remember exactly what it was, we couldn't find it.

25 Q. The specific question, the specific -- related to these

1 obligations, universal service obligations. There were
2 none imposed in the Postal Services Act and the task of
3 deciding whether they were needed was left to the
4 industry regulator, Ofcom?

5 A. Yes.

6 Q. Thank you. In April 2012 Whistl then launched a direct
7 delivery service in west London, and Royal Mail
8 responded by asking Ofcom to consider imposing
9 regulatory conditions on Whistl; that's right, isn't it?

10 A. Yes.

11 Q. One sees that at tab 52 of this same RM2B bundle. This
12 is Ofcom's July 2012 E2E update. If you turn to
13 page 598, paragraph 1.12, it records representations
14 from stakeholders including Royal Mail on the impact of
15 end-to-end competition. Do you see at the bottom of the
16 page -- sorry, at the bottom of the paragraph, the
17 penultimate sentence:

18 "Royal Mail has asked Ofcom to consider imposing
19 regulatory conditions to apply to all entrants including
20 Whistl in light of its view that end-to-end competition
21 may severely affect its ability to continue to provide
22 the universal service. Information and analysis that
23 Royal Mail has provided to us is also highly
24 confidential and commercially sensitive."

25 So Ofcom looked at Whistl's plans and didn't agree

1 that they warranted intervention; that's right, isn't
2 it?

3 A. (Pause). That was Ofcom's view at the time.

4 Q. Yes. In October 2012, Royal Mail tried with Ofcom again
5 by means of the proactive submission which you referred
6 to in your witness statement, seeking to persuade Ofcom
7 to intervene by imposing a range of regulatory
8 obligations on Whistl. Can we turn that up? It's again
9 in 2B, at tab 55. You see it's a response to Ofcom's
10 upcoming consultation on direct delivery competition in
11 the universal postal service, and the "upcoming" shows
12 why it's proactive. The consultation hadn't in fact yet
13 been launched.

14 Can we turn within it to page 7 of the internal
15 numbering. Do you see at paragraph 5.3 royal Mail
16 identifies a range of conditions which it might be
17 appropriate to impose on a direct delivery entrant:
18 quality of service requirements, requirements as to
19 labour conditions, requirements as to geographic
20 coverage, the requirement to deliver to each individual
21 mailbox rather than leaving mail at the entrance of
22 multi-occupier residences.

23 So a wide range of regulatory conditions sought by
24 Royal Mail as potential ways of addressing unchecked
25 direct delivery competition; that's right, isn't it?

- 1 A. Yes.
- 2 Q. Ofcom again didn't agree that this intervention was
3 required; that's right, isn't it?
- 4 A. That is right that Ofcom did not agree. However, from
5 Royal Mail's point of view, Royal Mail was under
6 obligations to deliver to 29, 30 million addresses six
7 days a week, one price goes anywhere, and Royal Mail's
8 concern was that a direct delivery player could choose
9 where to deliver, which parts of the country, it could
10 choose how many days to deliver, it could have
11 a different labour model, and so Royal Mail's concern
12 was that a direct delivery entrant could cherry-pick the
13 more economic parts of the country to deliver and leave
14 Royal Mail to be delivering more, relatively, in the
15 more expensive areas. And Royal Mail's concern was that
16 Ofcom should use its powers upfront to put some
17 obligations on a direct delivery player as opposed to
18 leaving it until after the entry had taken place, and
19 that was the thinking behind what was in here, to
20 protect against the cherry-picking direct entry.
- 21 Q. Why didn't zonal prices protect you against
22 cherry-picking, Ms Whalley? You have different access
23 prices for the higher cost areas than the lower cost
24 areas, so that if an entrant continued to use your
25 higher cost services it would pay a price that reflected

1 the cost to Royal Mail that those delivery services
2 would impose, wouldn't it?

3 A. At the time, the zonal prices -- and I talk about this
4 in my witness statement -- the zonal prices were not
5 cost-reflective, and it was an element of the CCNs to
6 adjust the zonal prices to be more cost-reflective to
7 ensure that operators using parts of the zonal contract
8 were paying a more cost-reflective price.

9 Q. So can we take it then that the zonal tilt proposals
10 that were formulated and then included in the contract
11 charge notices were intended to address the risk of
12 cherry-picking?

13 A. The zonal prices were part of the CCNs and they were one
14 element and indeed an element that Ofcom had indicated
15 in its guidance that they expected Royal Mail to look
16 at.

17 Q. And they dealt with cherry-picking?

18 A. They played a role in cherry-picking, addressing the
19 cherry-picking.

20 MR HOLMES: Thank you, Ms Whalley.

21 If that were a convenient moment, sir, perhaps we
22 can resume after the short adjournment.

23 THE CHAIRMAN: Certainly. We will resume at 2 o'clock. The
24 usual rules apply.

25 (1.00 pm)

1 (The short adjournment)

2 (1.55 pm)

3 MR HOLMES: Ms Whalley, we were discussing before the lunch
4 break the repeated lack of success by Royal Mail in
5 persuading policymakers and the regulator to impose
6 ex ante obligations on direct delivery.

7 Can we now turn to consider the commercial levers
8 that Royal Mail was considering deploying. You deal
9 with this at paragraph 157 of your witness statement.
10 Can you turn that up, please. You refer to Ofcom's
11 end-to-end statement in which Ofcom stated that it would
12 want to observe Royal Mail's response to the challenge
13 from end-to-end competition and how effective these
14 measures have been before deciding ... (Pause).

15 So in paragraph 157 of your witness statement you
16 refer to the end-to-end statement published on
17 27 March 2013 in which Ofcom stated that it would want
18 to observe Royal Mail's response to the challenge from
19 end-to-end competition and how effective these measures
20 have been as one element in assessing whether regulatory
21 intervention was needed.

22 At the top of the next page, you note that Ofcom
23 identified two possible responses at (a) and (b),
24 firstly changing how access prices are set for different
25 geographic areas, the zonal tilt, to ensure that

1 end-to-end competitors pay a cost-reflective price and
2 so mitigate the impact on the universal service of
3 cherry-picking, the point we were discussing before the
4 luncheon adjournment, or improving efficiency to
5 mitigate to some extent the direct impact on
6 Royal Mail's financial position of losing revenue to
7 competitors.

8 Now, the second point we can take very quickly. It
9 has always been clear that Royal Mail's efficiency
10 efforts would be an important part of the equation. We
11 saw that from the BIS letter and the July 2012 note
12 which we discussed earlier. That's right, isn't it,
13 Ms Whalley?

14 A. Yes, we took efficiency very seriously.

15 Q. Yes, and Royal Mail had been liaising closely with Ofcom
16 in relation to its efforts to improve efficiency?

17 A. That's correct. We were in the middle of a very
18 significant transformation programme, and we kept Ofcom
19 informed of our progress on that transformation
20 programme. It included closing half of the mail
21 processing facilities as well as redesigning the 60,000
22 delivery routes, and it was focused on taking out cost
23 as well as improving service, and from 2010 to 2013 we
24 took out 12,000 people from the company, 12,000 people
25 lost their jobs, and that was part of it.

1 Q. And managing a full scale national delivery network
2 would present a significant logistical challenge to any
3 operator?

4 A. Yes.

5 Q. Do you agree? Yes. The other potential adjustment
6 identified by Ofcom, which you referred to in
7 paragraph 157(a) of your statement, was changing how
8 access prices are set for different geographic areas,
9 the zonal tilt.

10 Again, this was not a revelation to you to see this
11 in the March 2013 end-to-end statement, was it? It had
12 already been reflected in an Oxera report which
13 Royal Mail submitted to Ofcom as part of its
14 October 2012 proactive submission, well in advance of
15 that statement. That's right, isn't it, Ms Whalley?

16 A. Yes.

17 Q. The report in question is in bundle RM2B at tab 39. So
18 this report was sent by you on October 1, 2012 to Ofcom
19 together with the proactive submission of that date.
20 That's right, isn't it?

21 A. Yes.

22 Q. The report contains modelling by Oxera to assess and
23 measure the risk to Royal Mail's profitability posed by
24 direct delivery competition; that's right, isn't it?

25 A. Yes.

1 Q. The three steps of the modelling are explained on
2 page (iii) in the executive summary. Do you see there,
3 below the figure, first:

4 "... to determine the distribution of returns in the
5 current Business Plan ..." taking account of various
6 risks and opportunities, GDP, e-substitution, as well as
7 risks around the delivery of costs savings as part of
8 the modernisation plan.

9 The second step is:

10 "... to measure the expected financial impact of
11 direct delivery entry before commercial responses by
12 Royal Mail ... The third and final step is to identify
13 the potential commercial responses that Royal Mail could
14 implement to mitigate the impact of direct delivery
15 entry, and measure the expected return after these
16 responses are assumed to have been successfully
17 executed."

18 So Royal Mail was committing through its economists
19 to Ofcom in October 2012 that the appropriate framework
20 for analysis needed to take account of Royal Mail's
21 commercial responses in deciding whether regulatory
22 intervention was appropriate; that's right, isn't it?

23 A. Yes.

24 Q. The final paragraph on page (iii) states that:

25 "The assessment of the medium- to long-term

1 financial sustainability of the USO must take account of
2 the effectiveness of the responses that Royal Mail could
3 implement to mitigate the impact of direct delivery
4 entry."

5 Then two dimensions are identified along which
6 Royal Mail could respond to the threat of direct
7 delivery competition. The first is:

8 "Price changes to key mail products, subject to
9 competition law and existing regulatory conditions."

10 And the second is:

11 "Cost reductions in response to volume losses across
12 the delivery network."

13 So Royal Mail, through its economist Oxera, was also
14 indicating to Ofcom the two broad forms that its
15 commercial response might take, which were then picked
16 up and set out in the March 2013 guidance; that's right,
17 isn't it?

18 A. Yes. Royal Mail, as any proactive management team would
19 do in the face of a significant risk to its business,
20 was considering the actions that it might be able to
21 take in response to that very real commercial threat.

22 Q. Yes.

23 A. And as you can see on Oxera's chart at the top of
24 page (iii) in this document, the red line, which was the
25 expected EBIT with no commercial response after direct

1 delivery, there is a range of outcomes, but you can see
2 from that that there is a trend in that line towards
3 zero. So we were looking already starting to think
4 about commercial responses that could protect the
5 universal service in the face of that risk, which
6 I highlight in my witness statement at paragraph 155.

7 Q. You are slightly anticipating lines of questioning that
8 I will come on to, in your eagerness to ensure that
9 the tribunal considers particular points, Ms Whalley,
10 and I understand that you want to give the evidence in
11 the best way that you can, but do be aware that lines of
12 questioning will cover the material, and if you then
13 feel that I haven't addressed a point, do by all means
14 follow up in your answers.

15 In response to the price change -- sorry, in
16 relation to the price changes type of response, can we
17 look at the second and third sentences of the following
18 paragraph on page (iv) beneath those two bullets. You
19 see there that:

20 "... the two pricing responses that are expected to
21 be most effective at mitigating the impact of direct
22 delivery entry are: (a) rebalancing (ie tilting) the
23 prices of zonal access contracts; and (b) targeted price
24 reductions in retail and access advertising mail
25 products."

1 So the first point, as we've agreed, the suggestion
2 of adjustments to the zonal tilt referred to in the
3 March 2013 end-to-end statement was already being
4 canvassed by Royal Mail at this point; yes?

5 A. Yes.

6 Q. Secondly, as is clear from the bullet at the top of
7 page (iv), Royal Mail and Oxera both understood the
8 price changes were subject to competition law and
9 existing regulatory conditions; yes?

10 A. Yes, of course.

11 Q. Thirdly, the particular pricing responses that are
12 identified in the paper were selected on the basis that
13 they would be compatible with competition law; would you
14 agree?

15 A. Yes.

16 Q. Both of the pricing responses that Royal Mail was
17 prepared to share with Ofcom at this point involve price
18 reductions in response to competition, don't they?
19 Vigorous retail and access price cuts for advertising
20 mail, and cost based zonal tilt adjustments to lower
21 prices in the areas where direct delivery entry is most
22 likely to occur; would you agree?

23 A. Yes.

24 Q. The fourth point is that these two price cutting
25 responses were not thought to be sufficient to protect

1 Royal Mail's profitability. One sees that if you turn
2 to the executive summary, page (iv), the second
3 paragraph under "Modelling results":

4 "As can be observed, the results of the modelling
5 exercise confirm that unconstrained direct delivery
6 competition would be expected to have a significant
7 impact on the profitability of the Reported Business,
8 pushing its expected returns considerably below
9 a reasonable commercial rate of return for the
10 foreseeable future."

11 So these competition law compliant solutions that
12 are being proposed, price cuts, are not adequate, on the
13 basis of the modelling by Oxera, to achieve the level of
14 EBIT margin that you regarded as expected, that's to say
15 5% or more; that's right, isn't it?

16 A. (Pause). That is right, that at the time these were the
17 options that had been looked at and, based on this
18 modelling, they delivered the orange line between the
19 red and the purple lines, so that is right.

20 Q. Royal Mail was already, therefore, in the process of
21 formulating another line of commercial response, wasn't
22 it, Ms Whalley?

23 A. (Pause). So at the time, Royal Mail, as I lay out in my
24 witness statement, was also looking at options to
25 modernise the access contracts.

1 Q. And you see that from footnote 11, where it's stated
2 that:

3 "Oxera has worked with Royal Mail to identify the
4 range of viable commercial responses that are currently
5 open to Royal Mail to implement, and which could be
6 expected to mitigate the impact of direct delivery entry
7 on the financial sustainability of the universal
8 service. The modelling exercise has not sought to
9 capture the hypothetical impact of other commercial
10 responses for which, at this stage, there is uncertainty
11 about Royal Mail's ability to execute them, and which
12 are therefore considered to be more speculative in
13 nature -- for example, commercial responses that may
14 become available as a result of Royal Mail's ongoing
15 initiative to reform the nature of access contracts."

16 Can you just expand upon the uncertainty about
17 Royal Mail's ability to execute these other options;
18 what does that mean?

19 A. So one example of that is that we were not able to make
20 any changes to the access contracts without agreement
21 from the industry, and at this time, in the autumn of
22 2012, we were working on changes to the access contracts
23 to modernise the access contracts, which I do explain in
24 my witness statement, and an element of the uncertainty
25 was the extent to which there would be agreement from

1 the industry to the changes to the access contracts that
2 we were seeking to make. So that's an example of the
3 uncertainty.

4 Q. So is the point that you would expect your customers to
5 agree to price cuts, as are being modelled by Oxera, but
6 not to adjustments that might involve a price rise?

7 A. (Pause). I don't think any customer would react
8 negatively to a price cut.

9 Q. Thank you, Ms Whalley.

10 If we could now turn to the slide presentation that
11 was made prior to that October report, in July 2012, by
12 Oxera, to see what insight that provides as to the
13 design parameters that Royal Mail applied to the other
14 commercial response. It's at Royal Mail 3, tab 11.
15 This is an exhibit to Dr Jenkins' evidence. You will
16 recall that this slide deck sets out the preliminary
17 modelling results that were then crystallised in the
18 October 2012 paper we have just been considering.

19 If you look at page 16, at the second bullet, the
20 slide deck explains that:

21 "Royal Mail is currently developing and assessing
22 a number of commercial responses to direct delivery
23 competition, however, the fact that the existing
24 business plan is already challenging and delivers
25 a return at the low end of Ofcom's range for

1 a commercial rate of return in five years' time, means
2 that any commercial response -- unless it is costless
3 and/or completely eradicates the risk of direct delivery
4 entry -- is unlikely to achieve a reasonable commercial
5 rate of return, and hence secure financial
6 sustainability of the USO, over the medium and
7 long term."

8 So Oxera's results pointed you to the need to find
9 a commercial response that was costless and/or
10 completely eradicated the risk of direct delivery entry,
11 didn't they?

12 A. (Pause). Sorry, could you repeat the question?

13 Q. Oxera's results pointed you to the need to find
14 a commercial response that was costless and/or
15 completely eradicated the risk of direct delivery entry;
16 that's right, isn't it?

17 A. Well, Royal Mail knew that, whatever we did, we had to
18 stay within the parameters of competition law and our
19 legal obligations, and we knew that we could not do
20 anything that would eradicate the risk of direct
21 delivery entry. We were absolutely sure of that. So
22 whilst this was an Oxera finding, as we evolved our
23 thinking, we were always mindful of our obligations and
24 that anything that we did, any commercial response that
25 we had, stayed on the right side of the line.

1 Q. Just so that I'm clear about your answer there: did you
2 regard it as acceptable to deter entry so that it
3 remained and stayed on a small scale? Was that
4 something that Royal Mail considered would be acceptable
5 at the time?

6 A. (Pause). Our thinking was that we needed to take
7 actions that were within the bounds of competition law
8 and the legal framework, and we considered that TNT,
9 then Whistl, would have different options as to the
10 actions that it could take and the extent and speed to
11 which it could roll out its operation.

12 Q. I'm not sure that directly answered my question. Did
13 you consider it acceptable in your planning to confine
14 Whistl's roll-out through your actions to a small number
15 of SSCs, if that was what eventuated?

16 A. No, we did not think that we could constrain it in that
17 way.

18 Q. I see. Can we now turn to consider the proposals to
19 amend the access contracts which Royal Mail launched
20 exactly in parallel with its submission of the
21 October 2012 Oxera paper to Ofcom, although it didn't
22 model the consequences.

23 As you explain in paragraph 167 of your witness
24 statement, Royal Mail published a discussion document on
25 proposals for the reform of access contracts in

1 October 2012; that's right, isn't it?

2 A. Yes.

3 Q. And that was put out for consultation with your
4 customers; is that right?

5 A. That is correct.

6 Q. A key proposal was to offer a lower price to access
7 customers who committed to send a particular volume of
8 post over a defined future period; that's right, isn't
9 it?

10 A. Yes.

11 Q. We can see that from the discussion document which is at
12 bundle C4A, tab 4. If you could turn within it to
13 page 18, you see there paragraph 5.14:

14 "The commitment to volume will be the total number
15 of Letter and Large Letter items a customer commits to
16 send over a defined period."

17 But the proposal was also to offer the lower price
18 only to customers who observed a national mailing
19 profile, that is to say a distribution of volumes across
20 Royal Mail's standard selection codes. That's right,
21 isn't it?

22 A. Yes.

23 Q. You see that from paragraph 5.19:

24 "If we were to include a commitment to volume and
25 profile in New National terms, it would be vital to

1 introduce an effective methodology to measure Access
2 customers' posting profiles in relation to Royal Mail's
3 national fall to earth profile. At present, we are
4 considering using SSC volume data for this purpose."

5 But you knew, didn't you, that direct delivery
6 entrants, by rolling out in particular areas of the
7 country, would not be able to meet national
8 fall-to-earth conditions of this kind; that's right,
9 isn't it? (Pause). I don't think the answer is in the
10 documents, Ms Whalley.

11 A. No, it's not. So ... (Pause). In 2012, when we
12 consulted on this ... sorry, let me -- sorry, can you
13 repeat the question?

14 Q. The question is: you knew, Royal Mail was aware at the
15 time, that direct delivery entrants, by rolling out in
16 particular areas of the country, would not be able to
17 meet national fall-to-earth conditions of this kind?

18 A. But there were options --

19 Q. Before you come to tell me the options, can you tell me
20 whether the answer is yes or no: did Royal Mail know at
21 the time that direct delivery entrants, by rolling out
22 in particular areas of the country, would not be able to
23 meet national fall-to-earth conditions of this kind?

24 It's a question of pure fact.

25 MR BEARD: I'm sorry, I think it's only fair, although

1 Mr Holmes seeks to put the answers as only yes and no,
2 some of his questions are not admitting only yes or no
3 answers, and it's quite right that if the witness wishes
4 to qualify an answer or put it in terms of options,
5 she's entitled to do so.

6 MR HOLMES: I'm very happy, sir, for the witness to qualify
7 the answer. I was just hoping that we might first of
8 all get clarity as to what --

9 THE CHAIRMAN: I have to say, Mr Beard, I think Mr Holmes is
10 being very patient.

11 A. So, no, we did not know that.

12 MR HOLMES: You did not know that. Can we turn to the Oxera
13 October 2012 paper at RM2B --

14 A. I thought there were options.

15 Q. Tab 39.

16 A. Just ...

17 Q. Page 24.

18 THE CHAIRMAN: Sorry, Mr Holmes, which volume?

19 MR HOLMES: Royal Mail 2B, tab 39, page 24.

20 Can you read the paragraph at the foot of that page
21 under "Zonally tilted access contracts"?

22 (Pause)

23 A. 3.1.1?

24 Q. 3.1.1.

25 A. Yes:

1 "Direct delivery entrants are expected" --

2 Q. You don't need to read it aloud, I'm sorry.

3 A. Okay. You just want me to read it. Okay, yes.

4 Q. You see there that Oxera, your economic consultants,
5 were aware that by entering in particular areas, direct
6 delivery entrants will "no longer be able to meet the
7 national 'fall-to-earth' conditions specified in
8 national access contracts, and would therefore need to
9 pay access prices in line with the level specified in
10 zonal access contracts".

11 Was Oxera aware of something that Royal Mail wasn't
12 at this time?

13 A. (Pause). As we progressed our thinking further in 2013,
14 we considered that it was feasible and there were
15 options for a direct delivery player to continue its
16 roll-out, albeit recognising that it might incur some
17 surcharges on the -- depending on the precise volumes
18 and profile of mail.

19 Q. Well, here we're talking about a proposal in
20 October 2012 issued at exactly the same time that you
21 submitted this paper to Ofcom, and that proposal was to
22 give a price discount which was associated with
23 a national mailing profile. Are you suggesting to me
24 that you did not know that direct delivery entrants, by
25 rolling out in particular areas of the country, would

1 not be able to meet the national fall-to-earth
2 conditions on which the price, the lower price was
3 premised? It was being proposed in that October 2012
4 discussion document.

5 A. Sorry, could you repeat the question.

6 Q. Of course. So are you telling me that, having just
7 reviewed that passage from the Oxera report and what it
8 says, that you did not know when you issued a proposal
9 for a price difference that was premised on the lower
10 pricing option being available only to national -- those
11 with a national fall-to-earth profile, that this would
12 exclude direct delivery entrants who rolled out in
13 particular areas of the country? It's a question of
14 fact, it really isn't a question that turns on that
15 document, Ms Whalley.

16 A. So at the time we were consulting on moving to one
17 national price plan with the benefit of knowledge of
18 volumes and certainty of volumes. That's what we were
19 consulting on at the time. We weren't consulting on two
20 different price plans.

21 Q. Well, we were just considering the proposal, and we
22 agreed that the proposal was that the pricing would be
23 differentiated between those who were able to get the
24 lower price, and that required them to have a national
25 fall-to-earth profile, and those that would be left with

1 the higher price, which would be those that lacked
2 a national fall-to-earth profile. I am asking you
3 whether that differentiation in pricing that was
4 proposed in October 2012 was not something that you were
5 aware would impact direct delivery entrants, would
6 impact them more severely by denying them the
7 opportunity to get the lower price? It doesn't matter
8 whether there were two plans or one plan afterwards.

9 A. Well, as I said before, we thought there were options
10 for a direct delivery player.

11 Q. Let's leave that there.

12 Can we also agree that the proposal in October 2012
13 was intended by Royal Mail to serve as a response to the
14 threats posed by direct delivery competition? (Pause).

15 Again, I don't think the document will provide you
16 with an answer to that. It's based on your knowledge of
17 events at the time. If you don't know the answer,
18 please feel free to explain that to the tribunal.

19 A. So the proposals to modernise the access contracts in
20 2012 were not only in response to the threat of direct
21 delivery competition. The access contracts had not been
22 changed for --

23 Q. Were they partly in response to the threat of direct
24 delivery competition?

25 A. They were in response to the changing nature of the

1 market, which included an acceleration in letters volume
2 decline as well as changes in the competitive situation
3 in the market.

4 Q. I think it's fair that I show you the evidence of
5 Dr Jenkins on this point so that you can give your
6 comment on it. It's in RM3. Just to situate you within
7 the statement, have you seen this document before?

8 A. Yes.

9 Q. Have you reviewed it?

10 A. I have reviewed it.

11 Q. On page 15 at point 6 there is a heading "Oxera's advice
12 from November 2012 to March 2013". Do you see that?

13 A. Yes.

14 Q. Turning over the page to 16, at 6.5, you see:

15 "At the beginning of November 2012, Oxera was asked
16 by Royal Mail to provide an economic analysis of
17 a number of options for the reform of the access
18 contracts and price plans, following proposals that
19 Royal Mail had consulted on with its customers in
20 a discussion document of 8 October 2012."

21 There is then a reference to the profile and volume
22 commitments that we were considering.

23 Then at 6.6:

24 "Oxera's role was to advise from an economics
25 perspective on the compatibility of the pricing

1 proposals being considered by Royal Mail in response to
2 the threats posed by direct delivery entry, with
3 competition principles and applicable ex ante
4 regulations."

5 So her understanding at the time, it appears, was
6 that Oxera's role was to advise on proposals contained
7 in the October 2012 discussion document that were in
8 response to the threats posed by direct delivery entry.
9 Had she misunderstood the position?

10 A. (Pause). We certainly wanted advice from our economic
11 advisers as to whether proposals that we were
12 considering were consistent with competition law, and as
13 I mentioned before, one of the factors we were
14 considering was the impact of direct delivery.

15 Q. If I may say so, with respect, that was an evasive
16 answer. What paragraph 6.6 states is that the proposals
17 being considered were in response to the threats posed
18 by direct delivery entry. Is that or is that not the
19 case?

20 A. As I said before, they were in part in response to
21 direct delivery.

22 Q. Thank you. I'm grateful.

23 Now, unsurprisingly, Whistl objected in the
24 strongest terms to Royal Mail's proposal for national
25 commitment based pricing, didn't it?

1 A. Yes.

2 Q. To refresh your memory, in response to -- its response
3 to Royal Mail is in the cross-examination bundle at tab
4 18. Thank you, I'm grateful to Mr Beard. You see that
5 Whistl described the proposals as illegal, and as
6 a deliberate and obvious attempt by Royal Mail to
7 foreclose competition in the downstream delivery of
8 letter mail.

9 Do you see that?

10 A. That was Whistl's view.

11 Q. Yes. So Whistl was telling you that the act -- it also
12 said that it had evidence, you see, carrying on in that
13 paragraph, that:

14 "... the existence of the proposal in the discussion
15 document itself is having an impact in the market and on
16 customer behaviour. We have no doubt that this effect
17 is fully intended by Royal Mail."

18 So Whistl was there telling Royal Mail that the act
19 of publishing the discussion document was affecting
20 Whistl's position in the market; that's right, isn't it?

21 A. I had no evidence of that.

22 Q. And Whistl suspected that this was an intended
23 consequence of publication. Can you comment on that?

24 A. That might have been Whistl's view.

25 Q. Was it the case --

1 A. I had no evidence of that.

2 Q. So you are not aware that anyone within Royal Mail was
3 intending to disrupt Whistl with this proposal?

4 A. No. No one was intending to disrupt Whistl with that
5 proposal.

6 Q. Whistl's lawyers expanded on the last point in a letter
7 to Royal Mail of 6 November 2012, which is at tab 17.
8 It's a lengthy document, but if you turn within it to
9 page 6, you see they expand at paragraphs 28 and
10 following on the point that we have just been
11 considering:

12 "Though the section 5 proposals will in law be void
13 if they form part of Royal Mail's access contract, the
14 mere fact of Royal Mail's consultation has caused and
15 continues to cause TNT to suffer commercial detriment
16 until it is withdrawn. This is due to the uncertainty
17 that Royal Mail's section 5 proposals have created
18 amongst industry investors and its parent company,
19 PostNL.

20 "First, as it is obvious that the offending section
21 5 proposals target TNT [now Whistl], the proposals have
22 had the effect of creating uncertainty in the market, in
23 particular amongst Whistl's CDA customers, about the
24 prices and services that Royal Mail would be able to
25 offer them if they used TNT for some of their service

1 deliveries. Uncertainty creates risk which TNT's
2 customers will no doubt not want and be planning to
3 avoid.

4 "Secondly, the uncertainty has a consequential
5 freezing effect on TNT's plans for expansion and
6 investment in the UK."

7 So Whistl was here pointing out to Royal Mail the
8 2012 proposals had the effect of creating uncertainty in
9 the market, harming Whistl's position with investors as
10 well as with customers. Do you see that?

11 A. I see what's written here, but I have no evidence myself
12 of that.

13 Q. Four months later, in January 2012, Royal Mail announced
14 that it would not be proceeding immediately with its
15 commitment based pricing proposal; that's right, isn't
16 it?

17 A. Yes.

18 Q. Can we turn up that letter, it's in C4A at tab 9. If
19 you look to the fourth paragraph, underneath the heading
20 "Pricing" in the middle of the page, the letter states:

21 "We believe that there is merit in the introduction
22 of a price structure that allows customers greater price
23 stability in return for committing volume. However,
24 customer feedback revealed that while many customers are
25 attracted to this concept, more time is needed before

1 the industry would be in a position to implement
2 proposals of that sort due to the complexity of the
3 arrangements. Therefore, we will continue to work with
4 the industry during 2013 with a view to introducing some
5 form of volume commitment pricing (or other incentives
6 connected to volume) into the new contracts. We will
7 announce further proposals in due course."

8 So you let it be known to market participants that
9 some variant on the proposal of October 2012 might well
10 reappear within the next year; is that right?

11 A. We did.

12 Q. Effectively, Royal Mail postponed the competition law
13 fight that Whistl was threatening, and it did so because
14 it wanted to avoid a regulatory/legal dispute and
15 mitigate reputational risk until privatisation was out
16 of the way, didn't it?

17 A. I think that really is not a fair characterisation of
18 where Royal Mail was.

19 Q. So you don't accept that?

20 A. I don't accept that premise.

21 Q. Can we turn, then -- sorry, if there was more to say,
22 forgive me, I think Mr Beard thought you might not have
23 finished your answer.

24 A. Royal Mail, and I have covered some of this before, but
25 Royal Mail was looking at a 200 million additional

1 impact of competition, and a 200 to 250 million impact
2 of letters volume decline, which is a total of
3 450 million impact on revenue, and as part of the new
4 regulatory framework was looking at steps that it could
5 take, as any management team would do, with a universal
6 service obligation, to try and work through what steps
7 could be taken to try and protect the business and the
8 universal service in the face of these very difficult,
9 really difficult and challenging market conditions.

10 Royal Mail knew that we could not do anything that
11 was the wrong side of the line on competition law or its
12 legal and regulatory obligations, and we were trying to
13 work through what the different options were that we had
14 to try and protect the universal service. And this was
15 a debate that was ongoing from 200 -- well, it had been
16 ongoing since 2006/7, but really started again with
17 Ofcom in 2011. And I think it is absolutely not right
18 to say or to indicate at all that the privatisation in
19 2013 had an impact on that.

20 Q. So it had no impact on withdrawing the proposal for
21 volume-based pricing based on a national commitment?

22 A. When we consulted in 2012, there was a range of response
23 from access customers, and I think it is important to
24 remember that there were different kinds of access
25 customers that Royal Mail has.

- 1 Q. Is that a no, Ms Whalley?
- 2 A. I think it -- sorry, repeat the question again and I'll
3 give you a --
- 4 Q. The question I originally put was: Royal Mail postponed
5 the fight with Whistl because it wanted to avoid
6 a regulatory/legal dispute and mitigate reputational
7 risk until privatisation was out of the way. You gave
8 a very general answer to that. My question is whether
9 the postponement of differentiated pricing was because
10 of a desire to get privatisation out of the way?
- 11 A. It wasn't a postponement and it wasn't because -- any
12 proposal we made in 2012/13 was not because of the
13 privatisation.
- 14 Q. Okay. Can we consider a few documents that shed light
15 on this. If you could turn on to tab 13 --
- 16 THE CHAIRMAN: Sorry, just before you do, in the passage
17 that Mr Holmes drew your attention to it does actually
18 say "We will announce further proposals in due course".
19 Is that not a postponement?
- 20 A. So in 2012, when we were consulting, we saw real
21 benefits to having indication of volumes and a degree of
22 volume certainty in order to plan the resources to
23 deliver the universal service. We recognised at the
24 time, based on the feedback from customers, that we
25 could not move to one price plan with volume commitment

1 and volume certainty in 2012 and when we --

2 THE CHAIRMAN: So the further proposals might have been
3 different proposals, is that what you are saying?

4 A. Yes, so what we said and what we said to the industry
5 was that we still believed that there was real value to
6 the business from having the volume information to help
7 plan the operation and that we would be in effect doing
8 further work on that and consulting with the industry
9 around that. So we did -- so we expected to do further
10 work on it during 2013.

11 THE CHAIRMAN: That would result in further proposals?

12 A. That would result in further proposals. But we always
13 knew those proposals had to be on the right side of the
14 line.

15 MR HOLMES: Thank you, sir.

16 THE CHAIRMAN: Thank you.

17 MR HOLMES: If you could turn within bundle C4A to tab 13,
18 this is the letters strategy, and turn to page 24. This
19 is a discussion of changes to access mail contracts, the
20 changes that did get made in October 2012, which I shall
21 discuss with you in one moment. Do you have the page?

22 A. Page 24?

23 Q. Yes.

24 A. Yes.

25 Q. I just want you show you the final bullet on the

1 right-hand side, "Impact of changes". It states there:

2 "Avoided regulatory/legal dispute during
3 a transaction, and mitigated reputational risk."

4 "A transaction" there is the IPO, isn't it?

5 A. Yes.

6 Q. Thank you. So by not proceeding with the proposal, you
7 avoided regulatory/legal dispute during privatisation
8 and mitigated the reputational risk to Royal Mail;
9 that's correct, isn't it?

10 A. But it was not the main driver.

11 Q. No. I wasn't asking you about what was the main driver.
12 I was asking you whether that was a reason why there was
13 a postponement, and you now accept that that was
14 a reason, I think?

15 A. (Pause). It was an additional factor, but it was not
16 the reason.

17 Q. Okay. Could we turn to bundle C4B, to tab 72.

18 Do you see that this is Whistl's note of a meeting
19 on 17 December 2013, at Royal Mail's offices. Various
20 people were in attendance including Stephen Agar, the
21 Royal Mail managing director of consumer and network
22 access.

23 I want to draw your attention to a passage on the
24 middle of page 198, and you will see that an individual
25 from Whistl asked how the differential that was being

1 proposed in the contract change notices in 2013 could be
2 justified. Mr Agar replies:

3 "... that the pricing was not final and so could not
4 go into the reasoning but the proposals had been
5 [I think it should be] 'looked at carefully' by lawyers
6 and economists, both internal and external. RM is not
7 in the business of doing rash things from a legal
8 perspective and RM had legally considered the positive
9 carefully." I think that should be "position
10 carefully". "The withdrawal of the proposal in 2012 for
11 differential pricing had been withdrawn because of the
12 political sensitivity around privatisation."

13 Do you see that?

14 A. I see that.

15 Q. So there, two points. Firstly, you had said that this
16 was a single national plan that was being proposed in
17 2012 and that it didn't contain a price differential.
18 Here it appears from this note that Mr Agar regarded the
19 differential pricing --

20 THE CHAIRMAN: I'm not sure you should have named him.

21 MR BEARD: Yes, Mr Agar can be named, yes.

22 MR HOLMES: Thank you.

23 So some of the senior personnel have been released.

24 THE CHAIRMAN: Thank you. Sorry, just keeping us on track.

25 MR HOLMES: I'm grateful. I have no doubt Mr Beard is in

1 any event attentive as he knows my capacity to slip.

2 THE CHAIRMAN: I am sure he will wait until you have
3 slipped, and then come in!

4 MR HOLMES: So the point that I am making is, firstly, that
5 Mr Agar regarded the 2012 proposal as involving
6 differential pricing, didn't he? That's for the common
7 sense reason that there were two prices under the plan,
8 one for those who had the national fall-to-earth profile
9 and one for those who didn't under the October 2012
10 proposals. That's right, isn't it, Ms Whalley?

11 A. Yes.

12 Q. Thank you. Equally, the reason why that proposal for
13 differential pricing wasn't progressed in 2012 is said
14 to be because of the political sensitivity around
15 privatisation; that's right, isn't it?

16 A. I was not at this meeting, I --

17 Q. Let's turn to a meeting at which you were present.

18 A. -- don't know what Stephen said and --

19 Q. No.

20 A. -- what I can say is that there were many factors in
21 that decision not to progress with that proposal at the
22 beginning of 2013.

23 Q. I think you have suggested it was quite unfair as
24 a suggestion, when I first put it to you.

25 If we could turn now to C4A, tab 5, this is a note

1 of a Royal Mail meeting with Ofcom on 19 December 2012,
2 and you can see that both Mr Agar and yourself were
3 present at that meeting. Yes? The note is prepared by
4 the other individual there, who is attached to Royal
5 Mail Group Legal. One sees that on the second page.

6 Yes?

7 A. Mm.

8 Q. Could you review paragraph 4, please.

9 (Pause)

10 It's the final sentence I want to draw your
11 attention to:

12 "With the prospect of privatisation Royal Mail did
13 not want to 'rock the boat' with customers."

14 So do you want to reconsider the answers that you
15 have given to me about the reasons for the withdrawal of
16 the proposal?

17 (Pause). Ms Whalley, I'm conscious of the time. If
18 it's not an answer you feel you are able to give --

19 A. I realise that.

20 Q. -- then I'm happy to move on.

21 A. So Royal Mail thought that there was significant value
22 in progressing these proposals. Given the range of
23 customer views it was considered not the right thing to
24 do in April 2013, but we indicated to all of our
25 customers that this was a -- we continued to believe

1 that this was valuable and an area that we wanted to
2 progress, because there was significant benefit to the
3 business of having volume certainty in forecasts, and
4 equally there was significant benefit to some of our
5 customers from having the flexibility not to have to
6 adhere to a national profile.

7 THE CHAIRMAN: Ms Whalley, I understand that you are saying
8 that, but the point that's been put to you is whether it
9 had anything to do with the imminent privatisation, and
10 you are putting to us that it had nothing to do it, is
11 that right, and that's what you'd been asked to
12 reconsider. I think you should think very carefully.

13 A. There were many factors that were at play at the time.
14 We were working with the Government on privatisation at
15 the time, and it was one of the factors that we had to
16 consider in what we did.

17 THE CHAIRMAN: Mr Holmes may well be content with that
18 answer.

19 MR HOLMES: I am content, thank you, sir, I'm grateful.

20 Another proposal which was contained in the October
21 2012 discussion document was to allow Royal Mail to vary
22 pricing terms unilaterally on 70 days' notice. That's
23 right, isn't it?

24 A. Yes.

25 Q. Royal Mail decided to go ahead with this proposal and

1 offered customers a price incentive of 2.44% to persuade
2 them to switch to the new proposals; is that right?

3 A. For the new access contracts in 2013?

4 Q. Yes.

5 A. Yes.

6 Q. Most customers took the offer up, didn't they?

7 A. Most customers did take up that offer.

8 Q. Yes. If we could turn within C4A again to the letters
9 strategy and return to the slide we were looking at on
10 page 33.

11 THE CHAIRMAN: Which tab is that?

12 MR HOLMES: It's in tab 13 of C4A, sir.

13 A. Sorry, which page?

14 Q. Page 33. This isn't in fact the slide we have
15 considered before. Do you see the heading:

16 "We have already completed a number of mitigating
17 actions with respect to Direct Delivery."

18 You can see that this is within the part of the
19 presentation on managing the risk of direct delivery;
20 you see that from the yellow box at the top of the page.
21 Do you see that?

22 A. Mm.

23 Q. If you consider the top red-hand (sic) headed box, that
24 concerns other relevant and related actions, and the
25 first heading is "Uptake of new access contracts", and

1 the two bullets then follow:

2 "New access contracts (which over 89% of wholesale
3 volumes are now on) enable Royal Mail to modify price
4 levels and price structure more easily in response to
5 market developments."

6 So the process we have been discussing had the
7 benefit that it enabled Royal Mail to respond to market
8 developments. Now, given the slide that we are on,
9 managing the risk of direct delivery, would it be a fair
10 assumption that the market development that you were
11 unable to respond to was the roll-out of Whistl's direct
12 delivery entry?

13 A. Yes, that in conjunction with other changes in the mail
14 market, in particular e-substitution. Those were the
15 two market developments.

16 Q. And the October 2012 changes, the changes that flowed
17 from the October 2012 consultation, cleared the way for
18 the CCNs, they enabled you to proceed with the next
19 stage of your commercial response?

20 A. However, we did include --

21 Q. Sorry, does that "however" mean that your answer is yes?

22 A. Well, it's in part yes with a however.

23 Q. Thank you.

24 A. So am I able to articulate the "however", please?

25 THE CHAIRMAN: Yes. Be as brief as you can, please.

1 A. I will try and be brief, but this is complicated.

2 THE CHAIRMAN: It's a complicated case, Ms Whalley, we're
3 used to complexity. Please carry on.

4 A. I know, I realise that.

5 We introduced into the new access contract
6 a suspensory provision, so that any proposals that we
7 put to the market, if there was not agreement with those
8 proposals, it enabled a player to raise an objection to
9 those proposals, and our original proposal was that if
10 any player did that, then we would suspend those
11 proposals. It was actually Ofcom who encouraged us to
12 tighten that to say if any player made an objection to
13 one of those proposals, and Ofcom chose to investigate,
14 then those proposals would go on hold. So, yes, whilst
15 there was some increased flexibility, the suspensory
16 provision was included because we recognised that there
17 was an array of access players in the market, and that
18 we could not impose changes onto the market.

19 THE CHAIRMAN: I think that was not too complicated for us.

20 Thank you.

21 MR HOLMES: The next bullet concerns the other strand of the
22 October 2012 process:

23 "The wholesale access contract consultation sent
24 a signal to the market that we were investigating
25 options on commitment based pricing."

1 So another mitigating action to manage the risk of
2 direct delivery was to put the market on notice of the
3 possibility of some form of commitment based pricing in
4 the future; that's right, isn't it?

5 A. Yes.

6 Q. If you turn back to page 24, you see that at the bottom
7 left-hand corner there is a box "Future opportunities
8 enabled" and you see from the top left-hand side they're
9 enabled by changes to access mail contracts.

10 Among the future opportunities enabled by the 2012
11 changes was different pricing for different price plans;
12 do you see that?

13 A. Yes.

14 Q. That's the price differential, isn't it?

15 A. Yes.

16 Q. So that was another commercial response that you saw as
17 enabled by the ability to make unilateral contract
18 amendments; that's right, isn't it?

19 A. Potentially, yes, subject to what I have just described.

20 Q. Subject to a complaint and an investigation. Price
21 differential is another way of achieving the same thing
22 as the October 2012 commitment pricing proposal, it has
23 the same effect of exposing a direct delivery entrant to
24 higher prices than apply to pure access operators;
25 that's correct, isn't it?

- 1 A. Potentially, yes.
- 2 Q. It's another way of mitigating the threat posed by
3 direct delivery competition?
- 4 A. (Pause). Potentially, yes.
- 5 Q. Thank you. Can we now turn to consider the 2013 plans
6 for a commercial response, and we can stay within this
7 slide deck. The one I want to note is at slide 34.
8 Now, this contains confidential material, so Mr Beard
9 will be reassured that I am alive to that risk. You see
10 from the heading at the top of the page that four areas
11 were being considered "... to mitigate Direct Delivery
12 risk further, but we do not anticipate making
13 pre-emptive price reductions."
- 14 The point is developed in confidential material at
15 point 2, the "Price to market or geography" proposal.
16 I won't read the first adjacent row, but you see that
17 this option is described on the right-hand side of the
18 page as "reactive or last resort and with medium
19 effectiveness"; do you see that?
- 20 A. Mm.
- 21 Q. What would you describe as the effectiveness that is
22 being considered here? What does effectiveness mean in
23 this context?
- 24 A. (Pause). Protection of the USO.
- 25 Q. How is the USO protected? (Pause). Is it by limiting

1 loss of volumes to a direct delivery competitor, for
2 example?

3 A. It's a combination of volumes and being able to align
4 the cost base particularly in the operation to the
5 volumes that are being carried through the network.

6 Q. Now, well, I can see how that justification might be
7 offered in relation to the price differential, but
8 I don't think price to market or geography is -- that's
9 relevant to price to market or geography, is it?

10 A. (Pause). Well, the operation is very sensitive to
11 volumes at the local level.

12 Q. So the operation is protected by not losing volumes; is
13 that the point?

14 A. No, the -- at the local level, the ability to match the
15 resources to the volumes is critical to the economics of
16 the business.

17 Q. Does that mean that you need enough volumes to spread
18 the costs at the local level as widely as possible?

19 A. In an ideal world, yes, because it's a fixed cost
20 business, and if you take volumes out then the cost per
21 unit goes up.

22 Q. So as you put -- sorry.

23 As you put the volumes matching to resources point
24 just now, it collapses, therefore, into the concern
25 about protecting volumes, doesn't it? They amount to

1 the same thing: you can spread your operational costs
2 more widely across a wider number of units of product if
3 your volumes are higher; is that right?

4 A. Yes.

5 Q. Yes. I'm grateful.

6 A. Clearly.

7 Q. Thank you. So the price to market or geography option
8 at point 2, which is reactive or a last resort, the
9 option that you don't propose to do pre-emptively is
10 effectively the price cutting proposal that the Oxera
11 report modelled for Ofcom as one of the commercial
12 responses in October 2012; that's right, isn't it?

13 A. That is right, and the reason for that is that it takes
14 revenue out of the universal service.

15 Q. You mean successful direct delivery entry takes revenue
16 out of the universal service --

17 A. No, any across the board price change, for example one
18 particular type of mail, takes revenue out of the
19 universal service which exacerbates the challenge of the
20 universal service profitability and sustainability.

21 Q. You said earlier that "effectiveness" was effectiveness
22 in sustaining the universal service, and this option is
23 described as "medium in its effectiveness".

24 A. (Pause). We did not consider at the time that reducing
25 prices across the board was a very effective way of

- 1 sustaining the universal service, that's correct.
- 2 Q. It would stop you capturing the value of letters.
- 3 A. Well, we were already losing £200 million to
- 4 £250 million a year because of the e-substitution in the
- 5 market, and this would add to that problem.
- 6 Q. The point you are really making here is the one made in
- 7 the Oxera slide deck from July 2012 to which I took you,
- 8 that an effective solution to achieve your 5% or above
- 9 EBIT range would need to be costless to the business; is
- 10 that right?
- 11 A. Of course in an ideal world it would have been costless,
- 12 but we recognised that it was very unlikely that any
- 13 option that we undertook would be costless to the
- 14 business, because of the dynamics in the market.
- 15 Q. But price cuts would be costly?
- 16 A. Price cuts in and of themselves would be costly because
- 17 they would take revenue directly out of the business, in
- 18 addition to the revenue that was already being lost
- 19 through e-substitution.
- 20 Q. So in order to maintain your 5% profitability target or
- 21 in the hope of achieving it, you ruled out vigorous
- 22 price competition?
- 23 A. (Pause). I think that's a slightly misleading
- 24 statement. What we ruled out was direct price
- 25 reductions on types of mail, because that would go

1 directly to the bottom line of the business.

2 MR HOLMES: Sir, I'm conscious --

3 THE CHAIRMAN: You may have to be content with that. Might
4 we pause for another ten minutes?

5 MR HOLMES: I think so. I am grateful, sir.

6 THE CHAIRMAN: Thank you very much.

7 (3.15 pm)

8 (A short break)

9 (3.25 pm)

10 MR HOLMES: Ms Whalley, I would like now to turn, if I may,
11 to consider the development of the CCNs. Before we go
12 to the documents, can we first look at your evidence
13 about this to make sure that I have correctly understood
14 what it is that you are saying.

15 So can you take your witness statement in RM2, and
16 turn to paragraph 177. You see that it falls under the
17 heading "Development of the CCNs", and you note in
18 paragraph 177 that at the time that the CCNs were being
19 considered Whistl was "extending its direct delivery
20 network into southwest London and to Manchester".

21 So you accept, I think, that the CCNs were a direct
22 commercial response to that development; is that right?

23 A. Yes, the CCNs were in response to the changing market
24 conditions.

25 Q. To Whistl's direct delivery expansion?

1 A. And to the additional changing market conditions which
2 included the ongoing decline of letter mail, including
3 at the time e-substitution and initiatives being taken,
4 for example, by the banks to move more customers on to
5 e-statements as well as some digital initiatives by
6 Government. So there was a lot of change in the market
7 which was impacting total letter volumes as well as the
8 changing market conditions in terms of competition.

9 So it was in response to both of those factors that
10 we were looking at the CCNs as part of the commercial
11 response which Ofcom had told us, back in March 2013,
12 that we needed to undertake in order to protect the
13 universal service and to manage the additional risks
14 that there were in the market.

15 Q. And you see at paragraph 201 that you say that the
16 pricing and other changes ultimately announced in the
17 CCNs were:

18 "... intended to adapt the existing price plans and
19 bring them up-to-date to reflect changes in the market,
20 as well as to respond to the threat posed by direct
21 delivery."

22 So they were in part --

23 A. Yes.

24 Q. -- a direct commercial response to the threat posed by
25 direct delivery.

1 Specifically, they were a commercial response to the
2 adverse impact on volumes delivered by Royal Mail that
3 would result from direct delivery; that's right, isn't
4 it?

5 A. In part, but there were the other changes to the market
6 as well, which meant that Royal Mail was facing up to 4
7 or 500 million of revenue decline, at the same time as
8 needing to ensure that the universal service was
9 financially sustainable. So this was a very complex and
10 challenging position for the business.

11 Q. You say in your witness statement that, in preparing the
12 statement, you reviewed the notice of appeal; that's
13 right, isn't it?

14 A. Where is the --

15 Q. Let me ask you: did you review the notice of appeal when
16 you were finalising your witness evidence?

17 A. I have looked at the notice of appeal.

18 Q. So, just to make good the point, you see at paragraph 4,
19 when you came to give your witness statement you say:

20 "I have read a copy of the decision, Royal Mail's
21 notice of appeal and the witness statement of
22 Mr Stuart Simpson."

23 A. Yes.

24 Q. If there was anything incorrect in the notice of appeal,
25 as a senior official within Royal Mail at the time, you

1 would have taken steps to correct what was stated there;
2 is that correct?

3 A. (Pause). I'm not sure where you are going with that
4 question.

5 Q. It's not a question that you need to look behind,
6 Ms Whalley, it's a question of fact, and I'm asking you
7 whether, if there were errors, you would correct them in
8 the notice of appeal? (Pause).

9 Very well, if you feel unable to answer that
10 question --

11 A. I feel unable to answer that question.

12 Q. Very well. If you could take up bundle C1, and turn to
13 tab 2, do you see that this is Royal Mail's notice of
14 appeal in these proceedings? If you could turn to
15 page 8, 346 in the rolling numbering, you see that
16 section 3 concerns the context. Do you see that?

17 A. Mm.

18 Q. If you turn on to page 15, rolling numbering 353, do you
19 see that at paragraph 3.49 the notice of appeal states
20 that:

21 "Contrary to Ofcom's attempts to portray
22 Royal Mail's announcement of the CCNs as conduct aimed
23 at limiting competition from Whistl, a proper assessment
24 of the context, as set out in this Section, shows that
25 the CCNs, of which the price differential formed part,

1 were a commercial response to the adverse impact on
2 volumes delivered by Royal Mail that would result from
3 direct delivery."

4 Do you see that?

5 A. Mm.

6 Q. So can we now agree that the CCNs were a commercial
7 response to the adverse impact on volumes delivered by
8 Royal Mail that would result from direct delivery, or
9 was the notice of appeal incorrect in making that
10 statement?

11 A. As I said, the impact of direct delivery was part of the
12 rationale behind the CCNs. We had been told by the
13 regulator we needed to take action to respond to
14 competition.

15 Q. But specifically it was a response to the adverse impact
16 on volumes delivered by Royal Mail; that's what this is
17 saying.

18 A. Well, by definition, if another player was going to be
19 starting to deliver letters at scale, then those volumes
20 were not being delivered by Royal Mail, and they were
21 going out of the Royal Mail network into another
22 player's network.

23 Q. So --

24 A. By definition.

25 Q. Yes, quite. So entry of a direct delivery competitor at

1 scale would take volumes out of the Royal Mail network,
2 and that was the concern?

3 A. Yes, there was a concern about that.

4 Q. Yes, thank you.

5 A. Because of the impact on the universal service.

6 Q. Can I then turn to some subsequent paragraphs of your
7 witness statement to clarify two points, please. Could
8 we first look at paragraphs 178 and 190 of the witness
9 statement. These are slightly involved but I do need to
10 understand exactly what you are saying. At
11 paragraph 178 you say that:

12 "A significant part of the review of the price plans
13 was to revisit options for securing greater certainty of
14 future volumes from customers which we had initially
15 considered in the October 2012 discussion document.

16 "In the context of year on year declines in letter
17 volumes, being able to predict future volumes in
18 particular areas with greater certainty was desirable,
19 as this would assist Royal Mail in taking costs out of
20 the business to help secure the financial sustainability
21 of the universal service. Advance forecasts from
22 customers allow Royal Mail to more accurately predict
23 its future workload, revise delivery routes, and so
24 resource accordingly. Accurate forecasts therefore
25 allow the business to take costs out of the business,

1 for example where Royal Mail knows that volumes are
2 declining, thereby increasing efficiency."

3 Then at paragraph 190 you return to this theme, and
4 you say:

5 "A key part of the work done in preparing the CCNs
6 was identifying and modelling the quantifiable value to
7 Royal Mail of having the volume forecast information
8 specified in the CCNs."

9 Now, just pausing there, the volume forecast
10 information was specified in the CCNs because, as well
11 as introducing the price differential, they also
12 introduced a two-year forward forecast requirement
13 exclusively for NPP1 customers; that's right, isn't it?

14 A. Yes.

15 Q. "This focused in particular [that's the modelling] on
16 Royal Mail's ability to remove costs from the business
17 earlier if it was given advance notification of the
18 mailing intentions of access customers. If Royal Mail
19 knew in advance the volumes it would be handling for
20 each SSC, it could undertake resource planning for
21 significant drops in volume in advance of the volume
22 reduction occurring by planning revisions to delivery.
23 This takes time. Advance forecasts would therefore
24 enable Royal Mail to undertake a more timely cost
25 response than would be possible without this

1 information."

2 So you were there emphasising in those two
3 paragraphs that the price differential and the
4 associated forecasting requirement were together
5 designed to increase predictability of volume losses
6 from direct delivery roll-out and thereby enable
7 Royal Mail to mitigate the costs of lost volumes; is
8 that right?

9 A. In doing this modelling work, yes, that is right, but in
10 doing this modelling work it was not only volumes that
11 we might lose from direct delivery; there were other
12 factors which could result in volume loss, for example
13 a customer deciding to move more significantly to
14 e-substitution, for example online bank statements or,
15 indeed, if another player decided to give its volumes to
16 a direct delivery competitor.

17 So the information around volumes and forecasting
18 was pertinent not only to a direct delivery competitor
19 but to any customer, because we envisaged that we could
20 see volume reductions and losses from a number of
21 different sources.

22 Q. But would you accept that the modelling was done in
23 relation to the experience relating to Whistl's direct
24 delivery roll-out?

25 A. When we did the modelling work, we did use Whistl's

1 direct -- what we understood of how Whistl might evolve
2 its direct delivery as a scenario to understand and
3 quantify the cost benefits to the company of having the
4 advance information. It could have been done using
5 a different volume forecast. We happened to use the
6 Whistl -- what we understood of the Whistl plans as the
7 way to model what the cost benefit impact would be.

8 Q. And you were specifically interested in significant
9 drops in volume in advance of the volume reduction
10 occurring; that's right, isn't it?

11 A. Yes.

12 Q. And those --

13 A. If I may just add.

14 Q. Of course.

15 A. The operation was able to withstand relatively small
16 variations in volume, because we could match the volumes
17 to the workload and to the hours by, for example,
18 tweaking overtime or other areas of variable cost.
19 However, once there was a significant, more than 10%
20 decline in the volumes, then more structural action
21 needed to be taken in order to better match the hours in
22 the operation to the volumes. And planning for that
23 level of structural change, which included, for example,
24 changing the mix of fixed and variable contracts,
25 changing the length of delivery routes, changing the

1 duty structures in the in-door delivery, that needed
2 time to be planned for, and therefore having the advance
3 information enabled the operation to plan for those more
4 significant volume reductions such that when they
5 occurred then the operation was more easily able to
6 adjust the hours to the volume and reduce the risk of
7 stranded costs and increased costs per item.

8 And of course that was important because -- for many
9 reasons, but we have talked about efficiency, and
10 increasing efficiency was an ongoing imperative for the
11 business, and therefore being able to align the costs to
12 lower volumes was absolutely essential for the company
13 in progressing efficiency.

14 Q. Would you accept, Ms Whalley, that the entrant of
15 a rival direct delivery provider in a particular area
16 would give rise to significant drops in volume in that
17 area?

18 A. Yes.

19 Q. Would you accept also that the only party that was
20 making any significant plans to roll out direct delivery
21 operations in the UK was Whistl, which was on APP2 at
22 the relevant time?

23 A. Yes, at the time, but of course we didn't know whether
24 other players might choose to enter the market for
25 direct delivery as well --

- 1 Q. Come on, Ms Whalley.
- 2 A. -- over time. But at the time it was Whistl.
- 3 Q. Please. It's all over these documents, isn't it? It's
4 all over your witness statement, it's over every
5 document we've looked at that Whistl was the entrant.
- 6 A. That's right. Whistl was the entrant at the time.
- 7 Q. Yes. The consequence of tying the forecast requirement
8 to the national profile commitment under NPP1 was that
9 the one player that could supply, very clearly,
10 information about significant drops in volume was not
11 being asked to provide forecast information and was not
12 being offered the price savings that were calculated by
13 reference to its own roll-out plans.
- 14 A. Sorry, what's the question? That's a statement.
- 15 Q. The question is this: would you accept that under the
16 arrangements that Royal Mail was planning and then
17 introduced through the CCNs, the forecast requirement
18 was tied exclusively to NPP1, thereby excluding the
19 party, the customer that had the most obvious source of
20 valuable information about sudden drops in volume over
21 the two-year forward period, which would enable you to
22 take the costs out, and on the basis of which you
23 modelled the price differential?
- 24 A. I don't think I would accept that, because we thought at
25 the time that Whistl would most likely move to NPP1.

1 The APP2 contract was a very different contract from
2 NPP1. The APP2 contract was -- the requirements for
3 APP2 were that customers met a profile across four
4 zones, whereas the NPP1 contract required customers to
5 meet requirements in 83 SSCs.

6 We did not have bespoke contracts, and indeed what
7 we had -- what the company had sought to do over the
8 years was to have types of contracts which would meet
9 needs of different customers, recognising that there
10 were very different types of customers in the market,
11 and APP2 was chosen by customers who wanted the
12 flexibility -- and it was significant flexibility -- to
13 give Royal Mail mail that complied to four zones which
14 was very different from NPP1.

15 And those players did not plan their business in
16 SSCs. It was not helpful for Royal Mail to have
17 information by zone. A zone -- Manchester, Leeds,
18 Liverpool, Bristol would all be in the same zone. It
19 was not helpful for Royal Mail to have information by
20 zones. It was only helpful to have information at the
21 level of an SSC which is a much smaller geographic area
22 that could be used to better undertake the operational
23 realignment that I spoke about before.

24 And we considered at the time that Whistl had
25 options and would be most likely to move to NPP1, and

1 indeed in a meeting that we had with Whistl we proposed
2 to them that we would help them move to NPP1 and we
3 considered that they were eligible for NPP1.

4 Q. So some follow-up questions arising from that. First,
5 you accept that Whistl could provide localised SSC by
6 SSC information, don't you?

7 A. We thought they probably could, yes.

8 Q. You also accept that Whistl represented the overwhelming
9 proportion of volumes that were on APP2 at this time;
10 that's right, isn't it?

11 A. I think that's right.

12 Q. So by far the largest APP2 customer, representing the
13 lion's share of APP2 volumes, Whistl was not offered the
14 opportunity to give forecast information and obtain
15 a more favourable pricing while remaining on APP2;
16 that's right, isn't it?

17 A. That is right, and we proposed and offered to Whistl
18 that they could move to NPP1 and gain the benefits of
19 the price on NPP1, and indeed we expected that that is
20 what they would do.

21 Q. What effect did you think moving to NPP1 would have had
22 on their direct delivery plans?

23 A. At the time, we considered that there were options that
24 Whistl would have to continue its roll-out of its direct
25 delivery under NPP1.

1 Q. What were they?

2 A. (Pause). Well, we thought that Whistl could move to
3 NPP1 and continue to roll out, we recognised that
4 depending on the volumes and the SSCs there might be
5 surcharges, but we certainly considered that, and we
6 thought that Whistl would and could continue its
7 roll-out on that basis.

8 Q. On NPP1?

9 A. On NPP1.

10 Q. To what scale?

11 A. We were not sure, because there were other factors we
12 didn't know at the time, you know, and we don't -- would
13 never know the economics of Whistl, the investment.
14 There were so many different moving parts that we were
15 not able to model or understand the, you know, different
16 scenarios and options that Whistl would have. But we
17 thought that they could continue their roll-out, and
18 indeed that's what we thought they ... they would do.

19 I guess the other factor was that if Whistl made
20 a complaint, then the CCNs under the suspensory
21 provision went on hold and, at that point, there was
22 an expectation that Ofcom would review and make a fast
23 decision, and we expected that that decision would be in
24 Royal Mail's favour because we were on the right side of
25 the line.

1 Q. So you say that you weren't able to model Whistl's
2 reactions to the price differential, but you did in fact
3 attempt to model Whistl's reactions in your internal
4 decision-making documents at the time, didn't you?

5 A. Yes.

6 Q. What level of roll-out was expected on NPP1 in your
7 central case prediction? You can't recall?

8 A. Well, I'm -- we did a number of different scenarios, and
9 I'm just trying to --

10 Q. We will go to the documents.

11 A. -- take you to the document. (Pause). Is it in my
12 witness statement bundle?

13 Q. Ms Whalley, I will come to all of the documents with
14 you. So at this point your evidence is, I think, that
15 you can't remember what scale was expected; is that
16 right?

17 A. We thought that there was an option with investment, and
18 it is on a chart in one of the documents, that we
19 thought that Whistl could continue its roll-out and,
20 depending on levels of investment and approach, that it
21 could continue the roll-out and reach I think it was 30
22 or 31 SSCs, and that is in one of the documents.

23 Q. Did you expect that to be the outcome?

24 A. We didn't know.

25 Q. You didn't know. Well, we will see what the documents

- 1 show about that.
- 2 A. But we thought it was a possible outcome.
- 3 Q. It was a possible outcome. The focus of the paragraphs
4 in your witness statement we have just been considering
5 is upon managing volume losses to reduce costs through
6 accurate forecasting. So in other words the cost
7 justification. That's right, isn't it?
- 8 A. Yes, I talk about the cost justification.
- 9 Q. But would you accept that the price differential in fact
10 had as its aim to affect the incentives of a direct
11 delivery entrant to roll out on any material scale at
12 all?
- 13 A. Sorry, could you just repeat that question?
- 14 Q. Would you accept that in fact the price differential had
15 as its aim to affect the incentives of a direct delivery
16 entrant to roll out on any material scale at all?
- 17 A. No, I would not accept that. The focus of the price
18 differential was for -- there was real value to the
19 business of having the advance information where there
20 was a significant volume decline to enable the business
21 to better plan and match the resources in the business
22 to the volumes. That was the key objective and the
23 underlying purpose behind the cost justification.
- 24 Q. The cost justification, yes, but what about the price
25 differential?

- 1 A. Well, it was the cost justification which underpinned
2 a price differential.
- 3 Q. So your evidence is, before we consider the
4 contemporaneous documents, that the aim was to manage
5 the costs consequences of the roll-out and not in fact
6 to discourage such roll-out altogether; is that a fair
7 summary? (Pause). Do you understand the question I'm
8 putting to you, Ms Whalley, because it's very important?
- 9 A. Well, if you can just repeat the question.
- 10 Q. So is your evidence that the price differential was
11 introduced with the aim of managing the cost
12 consequences of a direct delivery roll-out and not to
13 discourage such roll-out from occurring?
- 14 A. (Pause). Yes, the price differential was part of the
15 commercial response that the company considered that we
16 could take within our legal and regulatory obligations,
17 in order to try and mitigate the risks to the business,
18 which were very considerable, of the direct delivery
19 entry.
- 20 Q. So I take it that the "yes" there, the subsequent
21 language was ambiguous, but the "yes" I think was
22 a confirmation that your evidence, before we canvass the
23 contemporaneous documents, is that Royal Mail was not
24 seeking to discourage roll-out from occurring; it was
25 only seeking to manage the cost consequences of the

- 1 roll-out. Is that your evidence?
- 2 A. We knew we could not stop a direct delivery entrant.
- 3 Q. But were you trying to limit it to a small scale
- 4 roll-out?
- 5 A. What we were trying to do was to develop a commercial
- 6 response which would help us to sustain the universal
- 7 service. That's what we were trying --
- 8 Q. That's an evasive answer, Ms Whalley. You haven't
- 9 answered the question that I put.
- 10 A. I apologise if it's -- but that is what we were trying
- 11 to do.
- 12 Q. There are two ways in which you could theoretically be
- 13 approaching this. One is to manage the cost
- 14 consequences of a roll-out that you expected to happen,
- 15 and the other is to stop the roll-out from happening on
- 16 any scale by deterring it. I want to know which of
- 17 those two genuinely informed Royal Mail's
- 18 decision-making at the time? (Pause). I don't think
- 19 this should require a pause, Ms Whalley.
- 20 A. I think it's not ...
- 21 Q. Is it a question you don't feel able to answer until we
- 22 see the documents?
- 23 A. Let's go through the documents.
- 24 Q. Let's go through the documents then. Before we do so,
- 25 one final point on your witness evidence. At

1 paragraph 193 you refer to the:

2 "... extensive economic modelling (including using
3 the entrant cost model, which modelled an entrant's
4 likely costs of setting up its own downstream delivery
5 network ...) to understand the impact of the proposals
6 on its various customers, including Whistl."

7 You said earlier you were not able to model Whistl's
8 incentives, but this paragraph shows that you did model
9 how the price differential and zonal tilt plans would
10 affect the entrant's incentives to roll out, didn't you?

11 A. Just to clarify, we tried to do the modelling in the
12 best way that we could. What I was trying to say before
13 is that obviously we did not know all of Whistl's
14 numbers, nor indeed how it was thinking about its plan
15 and its return and investment levels, et cetera. So we
16 did modelling in the best way that we could, but it was
17 modelling.

18 Q. Is your evidence that the modelling described in
19 paragraph 193 of your statement was done to minimise the
20 impact of measures on Whistl, or for some other purpose?

21 A. (Pause). So the main objective of what we were trying
22 to do was to develop a set of responses which, on the
23 one hand, minimised the risk and impact to the universal
24 service and at the same time would enable a direct
25 delivery player to progress its plans; and it was

1 a question of balance between those two objectives.

2 That is what -- that is what we were focused on.

3 Q. So are you saying that the modelling sought to find
4 a market outcome which greatly limited Whistl's direct
5 delivery ambitions but allowed it scope to maintain some
6 small scale of direct delivery operations? Is that what
7 the modelling sought to achieve?

8 A. No, that is not what I'm saying.

9 Q. So was the modelling to minimise the impact on Whistl or
10 for some other purpose?

11 A. The modelling was to find a way to sustain and preserve
12 the universal service and its financial and economic
13 stability at the same time as not doing anything that
14 would inhibit the progress of another player in the
15 market, because we knew we couldn't do that.

16 Q. So what outcome of the modelling would be most
17 beneficial from the perspective of protecting the
18 universal service, in relation to Whistl's responses to
19 the price differential and other aspects of the CCNs?

20 A. (Pause). Sorry, could you repeat the question?

21 Q. What outcome of the modelling -- you have explained that
22 the modelling is in part to understand the impact on the
23 universal service and find a solution which minimises
24 the impact on the universal service. What outcome of
25 the modelling of Whistl's reactions to your proposed

1 measures would be most beneficial to the protection of
2 the universal service, on your evidence?

3 A. (Pause). Well, certainly having -- it was important to
4 have information that would enable Royal Mail to plan
5 the operation. We thought --

6 Q. That's not what the modelling --

7 A. -- there were options for Whistl, and so therefore we
8 thought there were a range of potential outcomes.

9 Q. Okay, well, I think we'll leave it there and consider
10 this in the context of the documents.

11 Could I ask you now to open bundle C4A, and turn to
12 tab 11. This is the document setting out a project
13 proposal that initiated the process leading to the
14 introduction of the CCNs including the price
15 differential, and you were one of the sponsor/directors
16 responsible for the project; that's right, isn't it?

17 A. Mm.

18 Q. The other was Stephen Agar. One of the threats listed
19 in paragraph 1.1, threats and challenges, is direct
20 delivery. That's right, isn't it?

21 A. Correct.

22 Q. Paragraph 2.3 refers to Whistl's announcement of its
23 plans to extend roll-out, doesn't it?

24 A. Yes.

25 Q. This was a specific trigger of the project being

1 considered here.

2 A. (Pause). I wouldn't say that that particular
3 announcement was a trigger. Whistl had been starting to
4 roll out its direct delivery before this particular
5 event.

6 Q. So you were well alive to the threat of direct delivery
7 by then?

8 A. Absolutely, and as we talked about before, the threat of
9 direct delivery on the USO was not a new issue, it had
10 been identified as early as 2008 in terms of the
11 potential risk and impact on the universal service, and
12 so it was not a new issue or a new threat.

13 Q. Section 3 sets out the commercial strategy project that
14 was being -- or the commercial strategy that was under
15 consideration. Paragraph 3.2 lists the objectives and
16 opportunities, and the second bullet is the relevant
17 one. It is said that the objective, one of the
18 objectives, is to:

19 "Conclude preliminary work on zonal access pricing
20 to ensure we charge a fair price to customers who do not
21 present us a national profile of mail, and secondly to
22 optimise the price differential between the national
23 plans."

24 So first point, the zonal access pricing adjustment
25 is a continuation of the theme canvassed with Ofcom in

1 the Oxera modelling of October 2012; that's correct,
2 isn't it?

3 A. Mm.

4 Q. That is specifically associated with dealing with
5 customers who do not present us a national profile of
6 mail; that's right, isn't it?

7 A. Mm.

8 Q. Then the other objective identified in this bullet is to
9 optimise the price differential between the national
10 plans, and that is the price differential that was --
11 that is the idea of a price differential which was then
12 taken forward in the development of the CCNs; that's
13 right, isn't it?

14 A. Yes.

15 Q. There is no reference in this document to achieving
16 certainty through obtaining forecasts, is there?

17 A. There is not in this document, but in the early work
18 around the consultation in 2012 for the access
19 contracts, part of the rationale was a recognition of
20 the real benefits to the business and to the operation
21 of having volume certainty and forecasts that could help
22 the business plan better in the face of volume
23 uncertainty and volume declines. So that theme of the
24 importance of the volume forecasting for planning the
25 operation was not a new theme; that had been there in

1 our thinking for quite some time.

2 Q. But in the case of the consultation, the volumes were
3 guaranteed by a requirement to commit to certain forward
4 volumes; that's right, isn't it?

5 A. I think that's right in the 2012 consultation, but of
6 course quite some time had passed between that and this
7 document, and our thinking was evolving throughout that
8 time period, and the date of this document is May 2013,
9 following on from the March 2013 document from Ofcom
10 which was the document on the end-to-end guidance where
11 Ofcom stated that they expected Royal Mail to use the
12 commercial freedoms that it had given to Royal Mail to
13 manage the risks in the market. And one point in that
14 was that Ofcom recognised that the market, including
15 Royal Mail, was looking for guidance on what fair and
16 reasonable meant and --

17 Q. I think we are straying, Ms Whalley.

18 A. I may be but it's a very important point.

19 THE CHAIRMAN: If you are straying, perhaps don't.

20 A. Okay, I won't stray, but it is an important point
21 perhaps we will come back to.

22 MR HOLMES: The price differential, on your evidence that we
23 looked at before, would enable costs to be removed from
24 the business through having a requirement to provide
25 forecasts; that's correct, isn't it?

- 1 A. Yes.
- 2 Q. There is no reference in this document to applying
3 a requirement to have forecasts, is there?
- 4 A. Not in this document, no.
- 5 Q. Is there any other document from this time, of which you
6 are aware, in which there is a reference to forecast
7 requirements, when the price differential is first
8 appearing, in May/June 2013?
- 9 A. (Pause). I don't recall whether it's in the documents.
10 What I can say is that it was in our thinking and in our
11 discussions at the time.
- 12 Q. It just doesn't happen to feature in any of the
13 documents in May 2013, June 2013, when a price
14 differential is first being canvassed?
- 15 A. The thinking around the price differential in the
16 discussions at the time was based around the concepts of
17 volume certainty.
- 18 Q. Can we turn on to tab 14 in the same bundle. This is
19 the paper prepared for the 23 July pricing strategy
20 board, to which you refer at paragraph 184 of your
21 witness statement. Do you recall that document?
- 22 A. Yes.
- 23 Q. We can see from page 1, on the timeline, that we are
24 moving from the defining options stage, "Options to
25 address risks from competitive direct delivery", to

1 "Review[ing] options and assessing the legal/regulatory
2 risks and cost justification analysis". Do you see that
3 in the second, under "Wholesale", the second bullet
4 across?

5 A. Mm.

6 Q. If we can turn to internal page 8, the goal is to
7 "Defend downstream mail volumes against the threats of
8 Direct Delivery and VAT". Do you see that?

9 A. Mm.

10 Q. So the "Protect the universal service: key business
11 objective" recorded there is not to manage the process
12 of taking costs out of the business as a result of
13 volumes lost to a direct delivery entrant, it's to
14 defend the downstream mail volumes against the threat of
15 direct delivery, you want to stop them from being lost
16 altogether, don't you, Ms Whalley?

17 A. Well, I think if you look at the first dot point.

18 Q. Yes?

19 A. "... the USO is not put at risk from stranded legacy
20 costs."

21 That is an important point.

22 Q. So --

23 A. Which is this point about if we were going to lose
24 volumes, then being able to at least be in a position to
25 match the hours and the resources in the operation to

- 1 the different volume levels.
- 2 Q. But nonetheless the headline point proposes a defence of
3 downstream mail volumes; you see that, don't you?
- 4 A. Yes.
- 5 Q. Turning over to page 9, the pricing options under
6 consideration are then set out. You see that the first
7 one is described as "Introduc[ing] a price differential
8 between the 2 national price plans", and the description
9 is:
- 10 "Create financial incentive for providing a national
11 mail distribution."
- 12 Do you see that?
- 13 A. Mm.
- 14 Q. So you are trying to create a financial incentive to
15 your customers to route all of their mail nationally
16 through Royal Mail, aren't you?
- 17 A. (Pause). There are clearly benefits to Royal Mail from
18 having a national distribution of mail, because it
19 reduces the risk of stranded costs, and therefore for
20 customers ... yes, so, indeed, there was a value to the
21 company from having a national distribution of mail.
- 22 Q. That's not about managing the removal of costs as
23 a result of lost volumes; it's about keeping customers
24 incentivised to purchase on a national basis from
25 Royal Mail, isn't it?

1 A. (Pause). Yes, it would be misleading of me to say that
2 there weren't benefits in having national distribution
3 of mail. However, if there were going to be volume
4 declines, it was beneficial for the company to have
5 knowledge of those volume declines in order to be able
6 to manage the risk of those declines.

7 Q. And that's because of the cost justification we
8 canvassed; is that right?

9 A. Yes.

10 Q. So two points arising from that. First, if you look at
11 the top of that column, it's the description of the
12 measure being proposed; yes? If the option of the price
13 differential were intended to manage volume declines and
14 to reward forecast information, wouldn't you have
15 expected the description to state, instead of "Create
16 financial incentive for providing a national mail
17 distribution", "Create financial incentive for providing
18 forecast information to enable us to take costs out of
19 the network in a timely fashion"?

20 A. One point I would like to say is that --

21 Q. Do say it, but first answer my question.

22 A. Well, I think some of these questions are trying to
23 simplify, and I can understand why, but they're trying
24 to simplify the situation as it was. And --

25 THE CHAIRMAN: Well, Ms Whalley, if you disagree with the

1 question, please say so.

2 MR HOLMES: Yes.

3 THE CHAIRMAN: Then we know where we are. At the moment
4 we're not quite clear whether you're accepting what
5 Mr Holmes is saying and then qualifying it, or whether
6 you are rejecting it and then adding further comments.
7 I think it would really help us if you were a bit
8 clearer.

9 A. Okay. So maybe you can repeat the question.

10 MR HOLMES: So the question is this: the "Description"
11 column -- I'm going to reformulate it, I'm afraid,
12 because I do not have it in the precise terms in which
13 I asked it, but I hope that this captures the gist.

14 The description of the measure is given as "Create
15 financial incentive for providing a national mail
16 distribution". The point I was putting to you was
17 simply this: if the measure aimed to provide certainty
18 by requiring forecast information in advance in exchange
19 for a favourable pricing that reflected the value of
20 that information, you would have expected the
21 description to state as much, and it doesn't. That's my
22 point. It states instead "Create financial incentive
23 for providing a national mail distribution".

24 Do you agree with me that that's a fair observation?

25 A. That might be a fair observation, but what I would say

1 is that, at the time, there was a significant amount of
2 thinking and debate and discussion, because this was
3 a very complex and difficult issue that the business was
4 facing, and there was a lot of ... we recognised that it
5 was -- these objectives, of protecting the USO, and
6 making sure that we were not doing anything which would
7 deter another player in the market, were two things that
8 were very challenging to reconcile. And so our thinking
9 was developing and evolving all of the time, and these
10 documents -- and there are a number of documents --
11 none -- you know, this document was not a final
12 document, it was a document in a series of documents
13 that the company prepared during this time whilst it was
14 trying to work out what commercial responses it could
15 take in order to protect the universal service and at
16 the same time not do anything which would deter
17 competition. And it was very difficult and very
18 challenging.

19 Q. So I think what you are saying is that part of the mix
20 at some point in this process was a cost justification
21 based on the reasoning you have set out in your
22 statement, obtaining advance forecast information in
23 exchange for favourable pricing to reflect the costs
24 that could be taken out of the network; is that right?

25 A. Yes.

- 1 Q. At some point in this process?
- 2 A. Yes.
- 3 Q. But you see at this point a price differential is
4 already on the table, it's already been proposed. If we
5 look at the final column:
6 "Possible risks. It is difficult to cost justify
7 a price difference."
8 So at the time, when Royal Mail was already thinking
9 about a price differential, it thought that a cost
10 justification would be difficult, and that was
11 a possible risk. Do you see that?
- 12 A. I see what's written on the page here, yes.
- 13 Q. So that rather suggests to me, but by all means tell me
14 if you disagree, that the price differential was
15 justified internally by some reason other than the cost
16 justification which later came to be developed. The
17 cost justification was an ex post justification. Is
18 that fair?
- 19 A. I don't think that is a fair reflection. If we go back
20 to the two types of contracts, there was considerably
21 more flexibility for customers on APP2 than on NPP1, and
22 conceptually that increased value and flexibility to
23 a customer on APP2 we considered supported a price
24 difference. The question then became, which we get
25 into, precisely how to quantify and articulate that cost

1 justification.

2 Q. Well, I think you are shifting your ground now,
3 Ms Whalley, because the value to customers isn't
4 a consideration that relates to Royal Mail's costs, is
5 it?

6 A. The value to Royal Mail of having the certainty of the
7 volumes which came with NPP1 was a benefit, versus APP2
8 where the volumes were much more variable in terms of
9 location and quantum.

10 Q. But I think --

11 A. And that's what underpinned the cost justification.

12 Q. Yes, but your last answer related to the value to
13 customers, not the value to Royal Mail. It's true that
14 the value to Royal Mail is about costs, but I have
15 debated that with you already and you have my points on
16 that. Are you suggesting that there was another
17 justification floating around that was in your mind at
18 the time of this document?

19 A. There was a discussion at the time as to whether there
20 was a value to customers from having greater flexibility
21 as to where and how they chose to post through
22 Royal Mail, yes.

23 MR HOLMES: Thank you, Ms Whalley.

24 If that's a convenient moment, sir?

25 THE CHAIRMAN: So we will resume tomorrow at 10.30. Are you

1 still on track timing-wise?

2 MR HOLMES: I believe we are, sir. We expect Dr Jenkins'

3 oral examination to be shorter. This is the key

4 witness.

5 THE CHAIRMAN: When do you expect Dr Jenkins' examination to

6 start?

7 MR HOLMES: That I'm afraid I can't be sure of. Mr Turner

8 may be able to assist. I suspect that I have another

9 morning of material.

10 THE CHAIRMAN: Can you shed any light?

11 MR TURNER: It's likely that Dr Jenkins may not get on

12 tomorrow, because I also will have about, say, at least

13 half a day for Ms Whalley.

14 THE CHAIRMAN: So we are eating up Dr Simpson's (sic) time,

15 are we?

16 MR HOLMES: The timetable was always flexible on the

17 understanding that, as Mr Beard noted, Mr Simpson was

18 likely to be a very short witness.

19 THE CHAIRMAN: Mr Simpson. I gave him an unintended

20 doctorate.

21 MR BEARD: There has been an exchange following

22 the tribunal's comments about the possibility of trying

23 to move things forward. I'm not holding Mr Turner or

24 Mr Holmes to anything. I think the likelihood is we're

25 going to end up sticking to the timetable as it was in

1 broad terms.

2 THE CHAIRMAN: We are at your disposal, as you know.

3 Thank you.

4 MR HOLMES: I am grateful.

5 THE CHAIRMAN: You must not talk about the case to anybody

6 overnight.

7 THE WITNESS: I understand, yes.

8 (4.35 pm)

9 (The hearing adjourned until 10.30 am

10 on Tuesday, 18 June 2019)

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