IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1299/1/3/18

Victoria House,
Bloomsbury Place,
London WC1A 2EB

12 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 3

A P P E A R AN C E S

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.

Wednesday, 12 June 2019

(10.30 am)

THE CHAIRMAN: Before you start, Mr Holmes, just a little couple of housekeeping points.

Tomorrow, one of us has to go and catch a plane in the afternoon, the evening, sorry. Would it be convenient if we stopped at 4.15? This affects you, Mr Turner, I suspect, mostly.

If we were able to rise at 4.15, could we start at 1.45, have a shorter lunch break? Is that unreasonable?

MR TURNER: Yes.

MR BEARD: That's fine with us.

THE CHAIRMAN: The other thing is I'm informed there is a road to Ardnamurchan lighthouse, but it is long and windy. Not fully understanding the delivery problems.

MR HOLMES: I'm grateful for that clarification. I'm sure we will keep it in mind in the regulation of the sector.

Opening submissions by MR HOLMES

MR HOLMES: It's already apparent, sir, that the tribunal is well familiar with the case and has got under the skin of it. So if at any stage you want to hurry me along, do please do so.

The way in which I propose to structure my opening submissions is as follows. I'll begin with some remarks about the context of the case. I'll then turn to

Royal Mail's conduct and consider it by reference to some of the key documents. Then, finally, I'll address each of the grounds in turn.

As regards the context, the case law shows that this is the right place to start. Every case that Mr Beard took you to referred to the need in one way or another to consider all of the circumstances when determining whether conduct was abusive. You saw the point put in various ways. In Irish Sugar there was the reference to the need for the court to assess the reality of the practices found in the contested decision. In AstraZeneca the focus was on an in concreto assessment of the conduct.

But the underlying message is clear that conduct context is essential to the evaluation under Article 102.

As Mr Beard noted, the Intel judgment makes this fundamental point very clearly. You will recall that Mr Beard in his opening submissions identified three propositions as flowing from Intel. For your note, this is at page 174 of the uncorrected transcript for Day 1.

First, he said it's saying labelling practices is not the way that you assess whether or not they have anti-competitive effects, they have to look at all the relevant circumstances. Well, we agree with that.

His second point was that when you are doing that, the as-efficient-competitor benchmark is highly relevant. The correct position, we say, is that that will depend on a consideration of the circumstances of the case. In some cases the harmful effects of particular conduct will be clear without the need to undertake an as-efficient-competitor test. One needs to consider such matters as the market structure, competitive conditions in the market, the feasibility of an as-efficient-competitor test, given differences between the market participants, as well as the nature of the conduct.

We don't read Intel as requiring a competition authority to apply an as-efficient-competitor test in all pricing abuse cases.

The third point that --

PROFESSOR ULPH: Can I just clarify? When you talk about the feasibility of an as-efficient-competitor test, do you mean the feasibility of there being as-efficient-competitor, or do you mean something about the feasibility of actually conducting a test?

MR HOLMES: It was the latter point and the difficulties of deriving useful information from a test in circumstances where there are some clear and irreplicable advantages of the dominant undertaking, and equally some respects in which a new entrant might be relieved of certain costs that the dominant undertaking needs to bear. Both of those circumstances make an as-efficient-competitor test difficult in the circumstances of this case, as we'll go on to see and as the experts will debate in the hot tub.

PROFESSOR ULPH: Thank you for clarifying.

MR HOLMES: The third point that Mr Beard drew from Intel is that, and I quote:

"where an undertaking submits during the administrative procedure material based on supporting evidence saying that the conduct is not capable of restricting competition, and by 'capable of restricting competition' what is being talked about here is does it have likely restrictive effects, you must proper analyse that."

Now, again, we say that's obviously right. A competition authority must look carefully at the evidence that is before it. We say, as you would expect, that Ofcom did that in the decision.

But we also say that the requirements to consider the evidence put forward does not mean that an authority must undertake an AEC assessment in every case where the dominant undertaking brings forward one of its own.

The next point I want to address is what the purpose of an in the circumstances assessment is. Why do you look at the circumstances and what for?

There's a helpful discussion of this in the opinion of Advocate General Wahl in the Intel case. His opinion explains the purpose of the contextual enquiries urged in the case law. It also helps to explain why in the particular circumstances of Intel the Commission's AEC analysis had to be looked at by the general court.

So if we might go to the Advocate General's opinion, it is in authorities bundle 9 at tab 105.

PROFESSOR ULPH: Which tab?

MR HOLMES: 105.

I would like to pick it up, if I may, at paragraph 41, where the Advocate General makes some introductory remarks. He observes that:

"From the outset EU competition rules have aimed to put in place a system of undistorted competition as part of the internal market, and that protection under EU competition rules is afforded to the competitive process as such and not, for example, to any particular competitor.

"Competitors that are forced to exit the market due to fierce competition rather than anti-competitive behaviour are not protected. Not every exit from the market is necessarily the sign of abusive conduct. This is because competition law aims to enhance efficiency."

The Advocate General is underlining, as the court does in Intel, that vigorous competition is usually a good thing and the fact that may result in market exit is not in itself problematic. The correct focus is upon enhancing efficiency to the benefit of consumers.

But at the risk of stating the obvious, these well-established propositions, which one sees in Post Danmark I, do not mean that competition law should only tackle conduct that harms a competitor as efficient as the dominant firm.

Dominant firms may force less efficient competitors to exit the market by methods that do not amount to fierce competition in the Advocate General's terms of a kind that promotes efficiency and benefits consumers.

In such a case, it may be inappropriate to allow the dominant firm to serve up any strong poison to its competitors provided only that it could itself withstand the effects.

In a situation of monopoly, efficiency, considered in all its dimensions, may be served by the entry of competitors, whether or not their costs match those of the monopolist.

At paragraph 42 of his opinion the Advocate General continues:

"It follows that dominance as such is not considered to be at variance with Article 102. Rather, only behaviour which constitutes an expression of market power to the detriment of competition and thus to consumers is prohibited and accordingly sanctioned as an abuse to dominance."

That focus upon consumers is, we think, the correct one.

At paragraph 43 he notes:

"The logical corollary of the objective of enhanced efficiency is that the anti-competitive effects of a particular practice assume crucial importance. The EU competition rules seek to capture behaviour that has anti-competitive effects to date the form of a particular practice has not been deemed important."

THE CHAIRMAN: These statements are very clear and limpid.

MR HOLMES: Yes.

THE CHAIRMAN: But of course they hide the fact that there has been some disagreement about their ingredients over many years.

MR HOLMES: Indeed. There's been a constant process of debate, sir, that's quite correct.

THE CHAIRMAN: It's nice to see them set out so clearly.

MR HOLMES: Indeed. To be clear, we don't dissent from any of them, subject to the caveats that I've given.

At paragraph 46, there's a consideration of the general court's treatment of rebates in the judgment under appeal in Intel. The Advocate General notes that, because of the conditional character of the rebates offered by Intel, the general court classified them as exclusivity rebates and, relying on the Hoffmann-La Roche line of case law, it considered that:

"In order to determine whether Intel had abused its dominant position, it was sufficient that the rebates were exclusivity rebates. Once that was established, it was no longer necessary to consider all the circumstances in order to verify that the conduct was capable of restricting competition."

That conclusion was under challenge in ground 1 of the Intel appeal, and Intel's argument is summarised at paragraph 49 in the first two sentences:

"As its primary contention Intel, supported by ATC, contends that the general court erred in its legal characterisation of what it termed its 'exclusivity rebates' ... In its view the general court erred in concluding that, unlike other rebates and pricing practices, such rebates are inherently capable of restricting competition and thus are anti-competitive, without any need to consider either the relevant circumstances of the rebate in question or the likelihood that the rebates might restrict competition. In that context, the appellant claims that the general court erred in upholding the finding of an abuse without considering the likelihood of anti-competitive harm, and Intel submits in any event that the general court erred in its alternative finding according to which the rebates in question in this case were capable of restricting competition."

The Advocate General's analysis begins at 52:

"The gist of the approach to the first ground lies in determining the correct legal test to be applied to so-called exclusivity rebates. In other words, the question is whether the general court was justified in finding that there is no need to consider all the circumstances to verify that those rebates are capable of having an anti-competitive effect. Put simply: was the general court correct in holding that owing to their form, not even context can save 'exclusivity rebates' from condemnation."

Then above paragraph 73, turning on, one sees the Advocate General's analysis, beginning with remarks about what the all the circumstances test means:

"The circumstances of the case as a means to determine whether the impugned conduct has a likely effect on competition."

At paragraph 73, the Advocate General States that he will explain:

"... why an abuse of dominance is never established in the abstract. Even in the case of presumptively unlawful practices, the court has consistently examined the legal and economic context of the impugned conduct. In that sense, the assessment of the context of the conduct scrutinised constitutes a necessary corollary to determine whether an abuse of dominance has taken place. That is not surprising. The conduct scrutinised must, at the very least, be able to foreclose competitors from the market in order to fall under the prohibition."

Then at paragraph 74:

"Even a brief perusal of the cases ... shows that the case law does not omit to look at the legal and economic context of the conduct -- or, to employ the standard formula in Article 102 TFEU cases, 'all the circumstances' -- in order to determine whether an undertaking has abused its dominant position."

He then points out that in all cases the court has undertaken an assessment of the circumstances, including Hoffmann-La Roche, cited by the general court as authority for the proposition that the exclusivity rebates per se are unlawful.

Then at paragraph 77 he draws his immediate conclusions:

"What does an assessment of 'all the circumstances' entail?

"As I see it, the analysis of 'context' -- or 'all the circumstances', as it is termed in the court's case law -- aims simply but crucially to ascertain that it has been established, to the requisite legal standard, that an undertaken has abused its dominant position. Even in the case of seemingly evident exclusionary behaviour, such as pricing below cost, context cannot be overlooked. Otherwise, conduct which, on occasion, is simply not capable of restricting competition would be caught by a blanket prohibition. Such a blanket prohibition would also risk catching and penalising pro-competitive conduct. That is why context is essential."

The Advocate General's intermediate conclusion is then stated at paragraph 106:

"Having regard to the above, exclusivity rebates should not be regarded as a separate or unique category that requires no consideration of all the circumstances in order to determine whether the impugned conduct amounts to an abuse of a dominant position. Accordingly, in my opinion, the general court erred in law in considering that exclusivity rebates can be characterised as abusive without an analysis of the capacity of the rebates to restrict competition, depending on the circumstances of the case."

But then he notes that in the specific circumstances of the Intel case, this isn't determinative of the appeal because the general court did proceed in the alternative to assess in detail whether the rebates and payments were capable of restricting competition, and so it did investigate the circumstances. So the question then was whether the alternative assessment discloses any error of law.

The appellant's arguments in the appeal are then explained in paragraphs 109 to 111, and the Advocate General then addresses capability and/or likelihood, and he confirms at paragraph 114 that actually effects do not need to be shown. That's clear from prior case law.

Then in paragraphs 122 and following, he considers the substance of the general court's assessment. At paragraph 123, you see that Intel identifies two particular factors relied on by the Commission. First, that the OEMs took Intel's rebates into account because the rebates were attractive, and secondly, that Intel used two complementary infringements to exclude AMD.

So the Advocate General then proceeds to consider whether those two factors are sufficient to sustain a conclusion that the rebates would give rise to foreclosure effects, and the Commission's first point is dealt with at paragraphs 124 to 126. That's the fact that the rebates influenced OEMs.

The appellants contested the relevance of this consideration and the Advocate General agrees, as he explains in paragraph 126, that in itself is inconclusive:

"An attractive offer, which translates into a financial incentive to stay with the supplier making that offer, may be a factor that points to a loyalty-inducing effect at the level of an individual customer. However, it is unhelpful in establishing that the rebates have a likely anti-competitive foreclosure effect ... it is the essence of competition that customers take lower prices into account in making purchasing decisions. Put differently, the fact that a lower price is in fact taken into account makes the foreclosure effect possible, but, on the other hand, it does not rule out the contrary."

So that factor doesn't support in itself the general court's conclusion.

The second factor is then considered in paragraphs 127 and following.

At 128 there's an observation that the strategy of foreclosure is insufficient on its own, but more fundamentally, the general court assumed what it set out to prove, namely that the two practices were abusive, rather than assessing all the circumstances to determine whether an infringement had been established to the requisite legal standard.

So the two circumstances relied upon were inadequate, and the Advocate General also finds that evidence in relation to the other circumstances of the case is equally inconclusive.

At paragraph 138, he considers the market coverage of the rebate which was approximately 14% during the relevant period. At paragraph 143, he notes that while this cannot rule out that the rebates in question do not have an anti-competitive foreclosure effect, it's simply inconclusive. So again, that evidence doesn't take one to a conclusion.

Then, at paragraph 157, he considers the duration of the infringements, and again he concludes that the evidence is inconclusive. There were multiple short-term contracts. That doesn't show in itself a foreclosure effect.

At paragraph 160, he considers the evidence on market performance of competitors and declining prices in the market. So this was a sector in which during the relevant period, the period under examination, competitors were gaining market share and prices were falling. Again, at paragraph 160, the Advocate General considered that this was inconclusive. These are relevant considerations, but only as part of a detailed assessment of actual potential effects on competition.

Pausing there, the Advocate General's assessment of the circumstances in Intel leads him to the conclusion that the circumstances relied upon by the general court were not sufficient to prove the existence of likely effects. And it was from that perspective that he turned finally to consider what role there was for consideration of the evidence relating to the AEC test.

An important feature of the Intel case in that context was that the AEC test had itself been carried out by the Commission in the decision which was under challenge.

Just going back in the decision to paragraph 26 on page 5, you see that according to the decision at issue, the conditional rebates granted by Intel are described as fidelity rebates. At paragraph 27:

"The decision at issue also proceeds to analyse in economic terms the capability of the rebates to foreclose a hypothetical competitor as efficient as

Intel. The as-efficient-competitor test or the AEC test."

So returning to his analysis, you see at paragraph 161 Intel's submission:

"The Commissioners carried out a substantial analysis of the economic circumstances in relation to allegedly abusive conduct. In that circumstance, it is wrong in law to ignore that analysis simply because it does not help to establish an infringement."

At paragraph 165, the Advocate General notes that in that case:

"In the circumstances, the AEC test cannot be ignored. As the general court noted, the test serves to identify conduct which makes it economically impossible for an as-efficient competitor to secure the contestable share of a customer's demand. In other words, it can help identify conduct that has in all likelihood an anti-competitive effect. By contrast, where the test shows that an as-efficient competitor is able to cover its cost, the likelihood of an anti-competitive effect significantly decreases."

I would just emphasise there, as the tribunal will note, the Advocate General does not suggest that conduct cannot in that case have anti-competitive effects. It's simply that the likelihood of an anti-competitive effect decreases.

That is why, from the perspective of capturing conduct that has an anti-competitive foreclosure effect, the AEC test is particularly useful.

THE CHAIRMAN: Does the Advocate General refer anywhere to the AEC evidence put forward by Intel to the Commission?

MR HOLMES: Sir, I would need to check. But the AEC test, as you see, is defined by reference to the Commission's analysis in the decision. That's why I took you to the paragraph earlier.

At paragraph 166, he turns to consider the case law, and he notes that Post Danmark II shows that an AEC test may prove useful in the context of assessing the rebate scheme.

At paragraph 167, he notes that in Post Danmark II the court was careful to qualify its position on the AEC test. There is no legal obligation to make use of that test.

At paragraph 168, and that's also in line with the court's statements, the same effect in Tomra.

Then at paragraph 168:

"It would therefore be tempting to conclude that in the present case there is no need to have recourse to an AEC test."

At paragraph 169 he says:

"That standpoint overlooks two issues. Unlike in Tomra, the Commission did in fact carry out an extensive AEC analysis in the decision of issue. More fundamentally still, the other circumstances assessed by the general court do not unequivocally support a finding of effect of on commission. In these circumstances, it is clear to me that an AEC test cannot simply be ignored as an irrelevant circumstance."

His conclusion was that it was necessary in the circumstances of the case to consider an AEC because the other evidence didn't support a finding of infringement. That strongly suggests that, from his perspective, a consideration of the circumstances sits above the performance of any AEC test, and whether an AEC test is necessary and what weight should be afforded to the conclusions contained in it, will depend upon the indications that derive from those other circumstances.

At paragraph 172 you have his conclusion:

"The circumstances considered in the assessment cannot confirm effect on competition. At most, the assessment shows that an anti-competitive foreclosure effect is theoretically possible, but the effect as such has not been confirmed. As a matter of principle, an assessment of all the circumstances must at the very least take into account the market coverage and duration of the impugned conduct. In addition, it may be necessary to consider other circumstances that may differ from case to case. In the present case, the AEC test, precisely because that test was carried out by the Commission in the decision at issue, cannot be ignored in ascertaining whether the impugned conduct is capable of having an anti-competitive foreclosure effect. The assessment of the relevant circumstances should, taken as a whole, allow us to ascertain to the requisite degree of likelihood that the undertaking in question has abused its dominant position contrary to Article 102. Absent such a confirmation due to, for example, low market coverage, short duration of the impugned arrangements or a positive result in an AEC test [you will note the disjunctive 'or' there] a more thorough economic assessment of the actual or potential effects of competition is necessary for the purposes of establishing these."

So this really is not definitive, it's not categorical, and it's certainly not suggesting that an AEC test is necessary in all cases. That depends on where the circumstantial analysis takes one.

Where the circumstantial analysis takes one in this case is of course a matter on which the tribunal will hear evidence from the economists in the hot tub. I do

not need to anticipate that discussion.
THE CHAIRMAN: We need to be clear about the dispute. I think, as I said to Mr Beard earlier, I understand what he is putting is that the consideration of all the circumstances, and there doesn't seem to be any dispute that that is the right approach, includes performing an AEC test, particularly where the party has offered one.
I think what Ofcom is saying, if I'm right, is that you actually approach it in a layered way. You look at all the circumstances and if you still need an AEC test, particularly in the sense you are in the position of the commissioners, so the analogy doesn't really work, but then you would perform it if all other things were inconclusive. That's what you're putting?
MR HOLMES: Yes.
THE CHAIRMAN: We need to understand the difference.
MR HOLMES: That's a very helpful encapsulation.
THE CHAIRMAN: It's quite an important issue.
MR HOLMES: Yes, indeed, sir.
I suppose, for the purposes of my present submission, the key point is that we say Advocate General Wahl's position does usefully inform the interpretation of a rather terse judgment.
THE CHAIRMAN: I was going to ask you about that.
MR HOLMES: I'll come to the Intel judgment. What I want to

do, if I may, sir, is take that when I come to the consideration of ground three and now just turn to the context and show you the factors that Ofcom took into account.

THE CHAIRMAN: You are going to invite us to interpret the judgment in the light of the Advocate General's opinion?

MR HOLMES: In the light both of the Advocate General's opinion and other case law.

THE CHAIRMAN: Thank you.

MR FRAZER: Just before you do that, is your submission at the moment concerning whether or not Ofcom was obliged to carry out an AEC test, or whether it was obliged to examine the AEC test carried out and presented by Royal Mail?

MR HOLMES: On the first point, my submission is that it is not necessary in all cases to undertake an AEC test of the Competition Authority's own motion.

In this case, there was no need to do so, given the various circumstances which Ofcom had considered which were conclusive of the existence of an infringement to the appropriate standard.

As regards the AEC materials and the test submitted during the administrative procedure by Royal Mail, my submission is that a competition authority is required to consider that and to decide what weight should be attached to it, but I will say that Ofcom did that.

What isn't required is that in all cases where a dominant firm brings forward an AEC assessment of its own, that necessarily triggers an obligation on the competition authority then to perform an AEC test.

MR FRAZER: I see. Thank you. That's very helpful.

MR HOLMES: So with that framework in place, I'll turn, if I may, to consider the circumstances of the case or, in the words of Advocate General Wahl, the legal and economic context.

I would like to start with the economic context, if I may, and I'm going to do this by reference to certain findings in the decision. If you could take up core bundle 1, and turn to tab 1.

THE CHAIRMAN: Can we put the law away for the moment?

MR HOLMES: You may, sir, yes.

There are five particular features of the economic context which were important in informing Ofcom's assessment. The first is that, as the tribunal will have seen, Royal Mail holds and held at the relevant time a position of overwhelming dominance in the market for the delivery of bulk mail in the UK, but that it was faced for the first time with a new entrance procedure in the early stages of roll-out.

I know the tribunal has this well in mind, but dominance is, of course, not simply a jurisdictional requirement for the application of Article 102. The nature and degree of a dominant firm's market power will also be relevant to understanding the likely effects of its conduct for competition and consumers.

Ofcom's market definition and dominance assessment is in section 6 of the statement. If you could turn to page 172 in the external numbering, I would like to pick it up at paragraph 6.84. You see there that before 2012 Royal Mail was the monopoly supplier of bulk mail delivery services in the UK. In April 2012, Whistl announced plans to start delivering its own letters to certain parts of the UK.

In 2013/2014 Whistl delivered around 0.5% of the total letters market volumes.

By quarter 4 of 2013/2014, Royal Mail's share of nationwide bulk mail delivery volumes was over 98% and Whistl's share was 1.2%. The significance of quarter 4 is, of course, that it is the period during which the relevant conduct took place.

So at the national level, Royal Mail was therefore retaining a virtual monopoly in bulk mail delivery, while Whistl was at the very initial stages of launching rival operations.

As well as examining market shares, the decision also considered the barriers to entry and expansion on the delivery market which underpinned Royal Mail's position. The tribunal will see that discussion at paragraph 6.93 of the decision. You'll see that there that Ofcom found that these barriers were significant.

On the one hand delivery involves significant sunk costs which, by definition, would be irrecoverable if entry failed. This raises the risk of any attempted entry.

On the other hand, the incumbent enjoys a series of advantages. Subparagraph (b) refers to advantages resulting from economies of scale.

PROFESSOR ULPH: Sorry to interrupt, could I just go back to your point about sunk costs, because I think it's quite an important issue.

MR HOLMES: Yes, sir. I hope I'll be able to assist. If not, I'm sure Ofcom's economist will.

PROFESSOR ULPH: It's just this argument about there being irrecoverable. So you talk there about swatting machines. Maybe there is a market in which those could have been sold had Whistl decided not to proceed with this roll-out.

MR HOLMES: I'll need to consider what evidence there was. It's possible that some of this material could be redeployed. I imagine sorting machines are primarily of assistance as part of the activity of inbound mail delivery.

PROFESSOR ULPH: I understand that. I understand that.

MR HOLMES: So there may be an international market for them, or they maybe sell them on to Royal Mail.

PROFESSOR ULPH: I have that point.

MR HOLMES: If I may, sir, I'll take that away and see whether there's anything that Ofcom can show you that would shed light on that question.

PROFESSOR ULPH: It's just when you said they were completely irrecoverable, I felt that was a bit of an overstatement.

MR HOLMES: The intangible sunk costs referred there seem more straightforwardly irrecoverable. If you go out and you recruit a substantial workforce, it may be that that's what Ofcom had in mind. That's as far as I can take it for now.

PROFESSOR ULPH: Okay, thank you.

MR HOLMES: I was just touching on the incumbent's other advantages.

At 6.93(b) there's the advantage of economies of scale. There are substantial economies of scale in this sector, given the relatively fixed costs involved in servicing a particular delivery route, which do not vary with the volume of items delivered. So the more you deliver, the more you can recoup the fixed costs across, bringing your unit costs down.

Then also at point (c), economies of scope. Royal Mail delivers many different things, not just bulk mail, but also first class and second class stamped mail and parcels, and we will see that it could therefore be said that Royal Mail derives advantages from its universal service core network, as well as bearing burdens associated with it.

Also, a large retail customer base, established brand, experience and reputation. Lastly, the benefit of a statutory exemption from VAT, giving it an edge with customers who cannot reclaim VAT, including banks who represent an important share of demand on the retail market.

The VAT status is, of course, an unmatchable advantage. It's a statutory benefit conferred upon Royal Mail and not upon any direct delivery entrant.

At paragraph 6.95, Ofcom observe that the timeline for competitive entry supports the view that the entry barriers are high. So you'll see there that entry has been legal since 2006 when the market was liberalised, but Whistl did not launch its roll-out until 2012.

But in 2014, two years down the line, its national market share was still only 1.2%. So the conclusions that Ofcom drew from this was that in the language that is sometimes used as a convenient abbreviation, Royal Mail was not just dominant, it was super dominant. It was not in the position of an Intel with established and effective competitors, it held a long standing and entrenched monopoly, the position of which was protected by entry barriers, and those entry barriers raised substantially the levels of uncertainty and risk that any potential entrant would face when deciding whether to proceed with the roll-out.

There were also irreplicable advantages in the form of a VAT exemption and so an entrant would, as a minimum, begin from a substantial disadvantage, not least given the scale and scope of the incumbent's activities.

The second feature of the market context concerns the other activities adjacent to Royal Mail's core delivery monopoly, which are also involved in conveying mail.

As Ofcom found in the decision, these activities, unlike delivery, are subject to competition. But they represent a much smaller part of the value chain, economically speaking, than delivery does.

The position is as follows. Since 2003, Royal Mail has been required by regulation to offer delivery services on an unbundled basis, separate from the collection, initial sortation and transport of bulk mail.

As a result, these activities have been broken off from the core monopoly and have been opened up to competition.

The graphical depiction of the value chain is at page 15 of the decision at figure 2.2. You'll see that the green half of the diagram is the outward leg of a letter's journey, the postal services pipeline, as it's called. This is the portion in relation to which there is competition.

The red half of the diagram is the inward delivery leg, and this is the core delivery monopoly.

Both green and red legs are necessary wholesale inputs for the retail provision of conveyance services to bulk mail senders. Royal Mail supplies itself with both inputs in order to provide a retail service, but in the absence of any competing delivery provider, Royal Mail's competitors on the green leg must purchase delivery, the red leg, from Royal Mail so that they can offer end-to-end service at the retail stage.

They are both customers of Royal Mail on the wholesale delivery market and competitors of Royal Mail on the retail end-to-end conveyance market.

As the tribunal has seen, these providers are known in the industry as access customers or access operators because they are dependent on access to Royal Mail's delivery network.

Now, while figure 2.2 is helpful in separating out the activities involved in the conveyance of bulk mail, it is in one respect apt to mislead.

In terms of their economic scale, the tribunal will have seen that the red and the green legs are very far from being equal halves of the value chain. This is explained at paragraph 2.32 of the decision.

As is there set out, Royal Mail's access charges make up the vast majority of access customers' costs, and therefore of the prices charged to bulk mail senders on the retail market.

As a consequence, Royal Mail retains approximately 90% of all revenue generated by access operators. Figure 2.4, over the page, shows the position and how it has evolved over time. It shows that while Royal Mail's revenues on the delivery monopoly doubled between 2008 and 2013 -- sorry, I should say it shows that Royal Mail's revenues on the delivery monopoly doubled between 2008 and 2013.

This is due to two factors. On the one hand it reflects rising access volumes, but it also reflects increases in the access prices charged by Royal Mail, particularly in 2011 and 2012, when the growth of access volumes slowed.

By contrast, the tribunal can see that the revenues retained by access operators -- that's the red line at the bottom -- have risen much more gradually.

Operating profit margins for access operators are also low. Turning back to paragraph 2.31, Ofcom reports the 2014 revenue and operating profit figures for the two main access operators. As can be seen, the profits are a small figure by comparison with the overall revenue totals.

Standing back, the overall market structure consists of a monopolised wholesale market for delivery comprising the bulk of the activities involved in conveying bulk mail, 90% of the revenues, an adjacent wholesale market for the collection and initial sortation services, which are easier to contest, but are really peripheral activities conducted at the margin of activity, and below these two are retail market which aggregates the two to provide end-to-end conveyance, bundling the elements and selling them on to bulk mail senders.

As regards the market players, Royal Mail's two largest access customers were and remain Whistl and UK

Mail. To give you a sense of how much these two customers are at the core of Royal Mail's demand, it's useful to turn to paragraph 2.14.

In 2013 to 2014, you will see there the bulk mail accounted for volumes of approximately 10 billion items. As we've seen, those were overwhelmingly, almost exclusively, delivered by Royal Mail.

Paragraph 2.19 shows the breakdown of items handled at the retail level. Whistl handled 3.8 billion items. UK Mail handled 3 billion, and Royal Mail approximately [figure redacted], so Whistl was, by some margin, Royal Mail's largest access customer.

I should say not all of those volumes will have come directly via Whistl, some of them will have come by so-called CDA customers who buy the initial sortation and then buy the access.

MR BEARD: Sorry to interrupt, just broadly, one figure mentioned there was confidential. We'll have it removed from the transcript. According to the version before me.

MR HOLMES: I do apologise. The Royal Mail figure is apparently confidential, and for that I apologise.

MR BEARD: We'll have it removed from the transcript if that's --

THE CHAIRMAN: Thank you. We must be careful.

MR HOLMES: Yes.
THE CHAIRMAN: I'm very keen not to have any closed --
MR BEARD: Mr Holmes is obviously trying to avoid, and we understand that there will be errors, but it's just trying to minimise it and pick them up as soon as possible and as anonymously as possible.
MR HOLMES: That's much appreciated. I'm sure that, Mr Beard, if I'm on dangerous terrain, do shout.
MR BEARD: I will do my best.
THE CHAIRMAN: I don't normally associate anonymity with you, Mr Beard.
MR BEARD: I didn't mean by me. In terms of when there's a correction to be made, if I may, I try and put it in general terms so it's not obvious which one it was.
THE CHAIRMAN: Thank you.
MR HOLMES: A third aspect of the essential market context is the evidence regarding operators' plans to challenge Royal Mail's delivery monopoly. This is considered on page 175 of the decision.
The first point that I wanted to raise is -- sorry, 175 of the decision at paragraph 69.3(d)(i).
The point is that the competitor of Whistl and Royal Mail on the retail market and the substantial access customer, UK Mail, had indicated in 2012 that it did not currently see end to end entry as an attractive

option to pursue. So what this shows is that Whistl's plan was the only realistic prospect of scale entry at the time.

As regards Whistl, its capabilities and roll-out plans were considered by Ofcom in section 2 of the decision. You can turn back to 2.35 on page 19. You will see that Whistl is a wholly owned subsidiary of one of the largest European postal operators and the incumbent provider is Netherlands, PostNL. It was known at the time as TNT, so a number of the documentary references are to TNT rather than to Whistl.

Although Whistl entered the market as an access operator, it intended to develop its own delivery capacity. This is consistent with PostNL's business model for these entrants. You will see that, in Germany and Italy, it has developed active delivery networks with market shares of 7 and 11% respectively. In the case of PostNL's Italian subsidiaries, this established a delivery network with a geographic coverage of 68%.

So this shows that Whistl was a credible entrant to this market, with a track record of achieving successful entry in other Member States.

Over the page at paragraph 2.37, the decision sets out certain essential features of the roll-out plan. For present purposes, there are two points to note.

As explained at subparagraph (c), Whistl's planned roll-out was incremental or phased in nature. It did not seek to enter simultaneously on a nationwide basis at full-scale. Instead, it adopted the more realistic strategy of building its operations gradually over time. Even five years into the 2013 roll-out plan, it expected to cover only 42% of UK postcodes. You see that at the top of page 21. That's point 1, the gradual phased nature of entry.

As explained in subparagraph (a) of 2.37, the hope and expectation of Whistl was to be able to convert its existing retail customers to using its own end-to-end delivery services in the areas where it had rolled out, thereby getting the 90% of the revenue and any associated profits currently handed over to Royal Mail for it to deliver.

However, Whistl didn't expect the conversion to be immediate or complete. In the areas to which it had rolled out in 2013, Whistl had converted 50% of volumes. You see that from the penultimate sentence above table 2.1. It hoped to increase the conversion rate, but even five years in, its forecasts were to achieve a maximum conversion rate of 84.9%. In other words, of its access customers, it hoped to have won 84.9% of them within five years over to its direct delivery network instead of buying delivery from Royal Mail.

It follows that throughout its planned roll-out Whistl would remain dependent on Royal Mail to supply the majority of its delivery needs. The dependency would be particularly pronounced in the early stages of roll-out when it had only limited facilities of its own, but even five years into Whistl's roll-out, in 2018, one sees at subparagraph (c) of paragraph 2.37 that its ambition was to deliver 1.5 billion letters per year, and this is to be compared with the figure of 3.8 billion which it was handling in 2013 as an access operator.

For the remainder of its business, it would remain dependent on Royal Mail as an indispensable trading partner.

If the tribunal turns on --

PROFESSOR ULPH: Can I just ask a question?

MR HOLMES: Of course.

PROFESSOR ULPH: This may not be the most appropriate place to ask it, but were there any plans by Whistl at any point to try to attract customers from other access operators, say UK Mail, and deliver some of their mail?

MR HOLMES: I don't immediately have an answer. It may be that Mr Turner, counsel for -- will pick that point up in his submissions.

PROFESSOR ULPH: Okay, we'll leave it to that.

MR HOLMES: At page 188 of the decision, figure 7.2 provides a graphical illustration of the point I have just been making. This shows the share of Whistl's retail mail that Whistl expected Royal Mail to deliver over the course of the roll-out from 2013 to 2018. Even at the conclusion of the roll-out, Whistl would still be dependent on Royal Mail for 60% of its access needs.

Now, this has two important implications for the case. On the one hand, it gave Royal Mail powerful leverage over Whistl; but on the other hand it makes indications as to Royal Mail's likely response to competitive entry important to a new entrant in Whistl's position when assessing the risks of entry. Indications suggesting an aggressively hostile response from its main supplier and competitor would be bound to affect Whistl's and its investors' appetite to proceed.

The fourth point of market context is that the bulk mail delivery market was and remains in long-term decline. This was a point that Mr Beard drew your attention to yesterday, and it's examined in section 7 of the decision.

If I could ask the tribunal to turn to page 185, this figure shows the trend in overall mail volumes. The top line shows overall volumes and it's common ground in these proceedings that the general trend applies also to bulk mail as a result of such factors as ongoing substitution from bulk mail to electronic communications.

As Ofcom observes at paragraph 7.23, this declining volume trend tends to make the bulk mail delivery market less attractive to enter as time goes on, reducing the overall size of the addressable market and decreasing the volume of mail/time periods over which the fixed and sunk costs of entry can be recouped.

This explains the reference the tribunal may have seen in a few places in the evidence to Whistl's entry being a one-off entry opportunity. It's partly explained by the fact that the other obvious candidate for a jump up from access competition, UK Mail, had ruled itself out, and it's partly explained by the fact that this is an opportunity which is in decline, as everyone in the market understands and recognises.

The fifth and final point of market context concerns the contractual arrangements in place in this sector.

I'm conscious of the time, sir. I don't know if now would be a good moment at which to take a short break.

THE CHAIRMAN: How are you doing?

MR HOLMES: I'm on good track.

THE CHAIRMAN: How long are you going to spend on contractual arrangements?

MR HOLMES: I would say it could be ten or 15 minutes.

THE CHAIRMAN: I think we'll break now.

MR HOLMES: I'm grateful, sir.

(11.30 am)

(A short break)

(11.36 am)

MR HOLMES: The fifth and final point of market context concerns the contractual arrangements in the sector. These were not merely happenstance. They were forged over years through a process of engagement and negotiation between Royal Mail, its customers, and the regulator.

In my submission, if you want to understand the real demand for and value of the contracts to the contracting parties, the history is the right place to start, rather than more abstract justifications developed after the event.

The history of the price plans is explained in section 3 of the decision, beginning at paragraph 3.9. You see from paragraph 3.9 that the first price plan was what is now NPP1. It was concluded in February 2004 with UK Mail and the requirement under the plan was and is to observe Royal Mail's national geographic profile. In other words, you have to send broadly the same proportion of your mail to each of the 83 standard selection codes as Royal Mail does itself, subject to certain tolerances and with surcharges for non-compliance.

The rationale is explained in the quotation at paragraph 3.9. It was to offer a uniform geographically averaged price per item. Royal Mail could be confident that its costs would be covered because mail had to be sent to all areas of the country, high cost and low cost, and any deviation would be subject to surcharges.

There were two problems with this contract from the perspective of Royal Mail's access customers as emerges in the subsequent paragraphs. The first is that the national profile prevented smaller access operators from entering the market, for example on a regional basis. You see this from the first sentence of paragraph 3.14.

"Following the announcement of these agreements, Royal Mail received requests from other potential access operators who were unable to meet the national profile requirements of the early 2004 arrangements."

The solution to this problem was to develop what is now the ZPP3 contract, differentiated cost based pricing by reference to the delivery costs in particular types of delivery area, dividing postcodes into, at that time, five different zones, according to the density of population.

That's explained at paragraph 3.15.

You see at paragraph 3.16 that pricing between ZPP3 and NPP1 was aligned and that the two plans could and can be combined.

The other problem with NPP1 was that it is inhospitable to any access customer that has plans to enter the delivery market in particular areas and can test Royal Mail's delivery monopoly.

Paragraph 3.12 notes that NPP1 was commercially negotiated between UK Mail and Royal Mail, but in the shadow of regulation, so to speak. Otherwise Postcomm would have intervened.

In 2004, Postcomm was already alive to the issues that a national spread requirement might prevent for direct delivery competitors. So it stated that:

"A national profile would not necessarily be a condition for a set of prices equalling those in the UK Mail agreement."

It added that while it had not considered an access request from an operator wanting to handle mailings that didn't reflect Royal Mail's profile:

"... if called upon to do so, Postcomm will not necessarily include a similar condition if not required to make a determination."

Then at paragraph 3.17, one sees that Whistl complained to Postcomm about the combination of national, geographic posting profile provisions, with the related surcharge mechanism and rights of termination, which mean that it is not possible in practice to use downstream access as a launchpad for moving into full end-to-end competition.

So this was an impediment to it pursuing the same business model that it had adopted or that its parent had adopted in other European member states to produce a competing delivery operation.

There was then a long and drawn-out wrangle and again, in the shadow of regulation, Royal Mail brought forth proposals to amend its access arrangements which are described in paragraph 3.18.

First, at (a) a simplification of the zones under ZPP3, and second, in relation to the national pricing arrangement, Royal Mail proposed to change the basis for the national profile from a system based on the proportion of mail sent to each postcode area to assist them based on the proportion of mail sent to each of the zones.

In other words, there's a change of the basis for the national profile to a zonal, instead of a geographic system.

This was originally intended as a replacement for NPP1, but as explained in 3.22, not all operators agreed to the change. UK Mail declined to accept the new terms and stayed with NPP1, while Whistl agreed to accept them.

So as explained in the quotation set out in 3.22 from Royal Mail's statement of objections, in the final line:

"The unintended consequence was that, rather than a single national price plan, the zonal plan, Royal Mail ended up with two national price plans."

I should say a zonal national plan, what became NPP2:

"The way in which APP2 works is that there's no requirement for any particular geographic spread. What matters is that an operator's mail observes the same proportional breakdown between rural, suburban, urban and London areas as Royal Mail's."

So subject to the need for some mail to go to London, the mail need not observe any geographic distribution between postcodes falling into these categories. As long as there's the right amount of urban mail overall, for example, it need not be sent to any particular urban area.

Again, a failure to observe the zonal profile will result in surcharges and the zonal division, just for your note, we could turn it up briefly, at page 37 shows the map of the zones, and back at page 36, you can see the 83 SSCs applicable under NPP1.

So APP2 was another way of ensuring that the average price for mail matched Royal Mail's profile and therefore its overall costs base. It was a cost based average pricing mechanism, but just sorting Royal Mail's distribution in a different way.

The change from geographic to zonal distribution was done to accommodate the scope for direct delivery entry by Whistl. The average price per item was, therefore, identical under both plans. This is explained in paragraph 3.47. And can be seen from table 3.1 of the decision.

Now, pulling these strands together, the features identified are, we say, informative, both as to the incentives of Royal Mail to engage in exclusionary conduct on the delivery market, and as to its ability to do so.

The point is discussed in the expert evidence of Ofcom's witness, Dr David Matthew, and his report is in bundle C3 at tab 5.

The discussion is summarised on page 289, using the rolling bundling numbering. At paragraph 17, he states his view that the right place to start when analysing potentially anti-competitive conduct is a consideration of the relevant market context.

THE CHAIRMAN: Can you just let us catch up?

MR HOLMES: I'm so sorry.

(Pause)

THE CHAIRMAN: I'm in the opinion. Where do you want me to look?

MR HOLMES: To page 289 in the external numbering. You see this is the summary of his opinion.

THE CHAIRMAN: Yes, yes.

MR HOLMES: At paragraph 17 he states his view that the right place to start when analysing potential anti-competitive conduct is a consideration of the relevant market context. He then identifies some of the relevant contextual features identified in the decision, which I have just considered, Royal Mail's near monopoly, a one-time prospect of entry, a one-off prospect of entry in this declining market by Whistl, real competitive pressure for Royal Mail if that had succeeded.

At paragraph 18, he observes that this is a context in which the incentives are likely to be particularly strong for the near monopolist to seek to prevent or limit entry if it can find a mechanism for doing so.

To unpack this a little, this is not a case where the incentives to foreclose are debatable, as might be the case where a dominant firm uses its wholesale power allegedly to try to foreclose a neighbouring and competitive retail market, and where a Chicagoan economist might object if there is only one monopoly profit to be taken.

The incentives of a dominant firm to take steps to defend its core monopoly are clear cut.

As Mr Matthew goes on to explain, the market context in the present case also supplies the ability to foreclose. In the present case, this is continuing at paragraph 18:

"Royal Mail had such a mechanism to prevent or limit entry available to it because Whistl would have remained dependent on Royal Mail to deliver bulk mail on its behalf in much of the UK, notwithstanding its entry plans. By raising the access price in a way that discriminated against firms that competed in the core monopoly, in practice Whistl, while reserving lower prices for firms that did not compete, ie access only operators, Royal Mail had the ability to significantly raise the costs to Whistl of scale entry into the wholesale bulk delivery market."

As we've seen, Whistl had to buy from Royal Mail.

It was on a different price plan from pure access operators which had been created for a direct delivery entrant and by applying a higher price to that plan, Royal Mail could deter entry. That is the economic context which informed Ofcom's decision-making.

I would like to turn now to the legal context by which I mean not the legal framework which this tribunal will apply under Article 102, but rather the regulatory backdrop against which the decision needs to be considered.

Royal Mail relies heavily upon the universal service obligation to explain and to justify its behaviour. It's therefore necessary to consider the specific rules applicable to the postal sector.

The position is, in summary, as follows. The applicable legislation provides that Royal Mail no longer enjoys any exclusive rights to provide postal services in the UK. Its legal monopoly has been removed and competitive entry is now permitted.

Liberalisation was achieved in the UK with effect from 2006 and is now enshrined in the Postal Services Act 2011. It is underpinned by European Union harmonising legislation which required complete liberalisation by 2010.

Royal Mail is now a privately owned company, the majority of its shares were sold in October 2013, shortly before the conduct at issue.

The postal sector also involves a public service dimension. There is a longstanding policy commitment to ensuring a universal postal service, and the legislation makes provision to protect the universal postal service.

The current Act follows on from the Hooper reports to which Mr Beard referred in passing. These were the reports from an independent commission, chaired by Richard Hooper, to consider the future of the Royal Mail. I think we should briefly consider those.

The first report was in 2008 and it is in Royal Mail bundle 2A, tab 18.

You will see from the cover sheet that the date is 16 December 2008 and the title of the report was "Modernise or decline: policies to maintain universal postal service in the United Kingdom". So the focus was squarely upon the universal service.

The headline points are recorded at page 6 of the internal numbering, page 560 of the rolling numbering.

The first page:

"This review was established to maintain the universal postal service. The size and scope of the Post Office network -- the country's largest retail and financial chain -- are largely outside its scope.

"The universal postal service is important. The ability to deliver items to all 28 million businesses and residential addresses in the UK is part of our economic and social glue.

"But the universal service is under threat."

There's a reference in particular there to the decline in the letters market.

At paragraphs 4 and 5 there is a reference to the problems arising from Royal Mail's inefficiency. You see that there's a positive future for the postal service, but the only company currently capable of providing the universal service is Royal Mail and it's much less efficient than many of its European peers and faces severe difficulties.

At paragraph 11, there's a reference to the need for the company to take a commercial approach and to modernise quickly and effectively.

At paragraph 13, the proposal at the time was to try to involve a strategic partner from the private sector with experience of transforming a business, ideally a network business, but that given the wider social role, Post Office Limited should remain within public sector ownership.

Then this at paragraph 16:

"Effective competition can help realise a positive future. A new regulatory regime is needed to place postal regulation within the broader context of the communications market."

At page 11, there's discussion of the problem of inefficiency, and in the first bullet it's noted that other companies, including TNT's parent, which is simply referred to as TNT here, achieved profit margins that are higher, although they face greater end-to-end competition than Royal Mail does in the UK.

By contrast, Royal Mail's financial position is precarious, and then the next bullet:

"The introduction of postal competition has had only a limited impact on its profitability. Royal Mail's relatively efficiency is far more significant."

The problem wasn't the competition Royal Mail was facing from access customers, it was inefficiency.

At page 32, paragraph 23 describes the universal service. Consumers value mail, as they do energy or water, not only when using the service, but also because the service is available to use at any time, as and when needed. The universal postal service provides customers with that guarantee.

Two essential features. The price of the service must be affordable. The price of sending a letter must be the same between any two points in the country regardless of the distance covered. The universal service ensures communications across all 28 million business and household addresses in the UK, regardless of their location. The lighthouse point.

At page 33 one sees a box describing them in more detail. I don't think we need to look that, the universal service.

Then turning on to page 87, one comes to the proposals of most immediate relevance, the changes to the regulatory regime.

There is a summary on the front page. I want to concentrate on the first, second and fourth bullets.

"Ofcom should be appointed to regulate the postal sector.

"While regulation and competition can encourage Royal Mail to become more efficient, changes to the regulatory regime alone will not be sufficient to ensure modernisation."

Then at the fourth bullet:

"The regulator should take an approach which balances the benefits of competition with the risks to the universal service. Preserving the universal service should remain the regulator's primary duty."

Then turning forward to page 90, you see the role of regulations discussed:

"Regulation has three main roles in the postal sector."

To ensure the universal service, first bullet. To protect consumers, the second bullet, against excessive pricing. The third bullet -- in the absence of competition, I should say, because competition in some parts of the postal sector is limited, regulation is needed.

Then the third bullet:

"Regulation can play a role in the modernisation of Royal Mail by creating incentives to improve the efficiency of its operations."

How is that to be done? Well, 171 identifies two main instruments.

"Direct ex-ante controls."

And then this:

"By facilitating competition within the postal sector, Postcomm has required Royal Mail to give other postal companies access to its delivery infrastructure, for example. This has enabled the development of competition for bulk mail products which in turn curbs Royal Mail's ability to charge excessive prices or lower the quality of its service in this part of the market."

Then at page 95 I would like to consider paragraphs 186, 187 and 188. 186 emphasises that competition from other postal operators can support the universal service by encouraging Royal Mail to reduce its costs and therefore to become more efficient and also by encouraging product innovation. Innovation creates new streams of revenue which support the universal service. New value added streams.

There's then a consideration of the impact of competition on Royal Mail's revenues, and the report notes that:

"Competition may also bring risks in certain circumstances. Because Royal Mail is currently the only company with the infrastructure required to deliver a universal service, its financial health is critically important to sustain the universal service. Yet the introduction of postal service reduces revenue, whether the introduction of competition will threaten the universal service is an empirical question which depends on various matters, the extent of market share which postal competitors achieve, rate of market decline, and the potential for Royal Mail to deliver efficiency savings."

The report notes that, as at that time, Royal Mail had identified that it could reduce its cost base by 1.2 billion, and the Hooper panel believed that that is more than enough potentially in cost savings at

Royal Mail to make up for the impact of postal competition and market decline in most scenarios.

In its submission to the review, Royal Mail welcomed competition. It argued that by accelerating modernisation, the company could finance the universal service from profits, in spite of liberalisation and structural decline in the delivery of letters.

Then, in paragraph 190, there's a reference to the cherry-picking problem to which Mr Beard referred yesterday. The description is given of cherry-picking. It's been used to describe a situation in which competitors take advantage of Royal Mail's universal service constraint to compete in a way to which Royal Mail is unable to respond.

Box 16 shows how the requirement to charge uniform price across the country could, in theory, lead to cherry-picking and a spiral of events in which unit costs rise and universal service becomes unsustainable. So pausing there --

THE CHAIRMAN: They don't actually call it the graveyard.

MR HOLMES: No, but that is what they have in mind.

The problem arises, as described there, where you have uniform pricing constraints. If you're a monopoly, this was the old model of provision, of course, you can achieve the same price across high end, low cost areas, even pricing below cost in the high cost areas, by cross-subsidy. You don't need to worry about anyone coming in.

But when a sector is liberalised and open to competition for all the good reasons we've seen, competitors will focus on the most profitable areas. That is the areas where costs are lowest by comparison with the uniform price. That's where the opportunity is greatest.

This will compete away the profits in the low cost areas that are used to cross-subsidise the high cost areas. It's merely a paradigm.

This concern would arise, for example, in relation to competition to deliver ordinary post, first and second class letters, which are subject to such a uniform pricing constraint.

At paragraph 191, the report notes that:

"A system of cost-reflective pricing for access products has been introduced by Royal Mail to protect against cherry-picking based on the uniform tariff. In our view, the system represents a reasonable response to the risk."

The point being made here is that Royal Mail's access arrangements relate to bulk mail, and that isn't a universal service product. It isn't subject to any uniform pricing constraint.

Royal Mail can price to reflect cost. All three plans do that. With NPP1 and APP2, the profile requirements and surcharges under each plan already guard against cherry-picking. You have to observe the profile to get the average price. But under ZPP3 there is zonal pricing, which by definition is varying between different types of area to reflect cost.

A direct delivery entrant in particular urban areas would still have to pay, for example, a cost based price to purchase access in other areas of the country.

The problem from competition in relation to bulk mail, once you move away from uniform pricing, isn't so much a cherry-picking problem. Now, that's not to say competition in bulk mail couldn't put Royal Mail under pressure, but it uses the same core network to deliver bulk mail as it uses to deliver universal service products, and it recovers part of the cost of the network from bulk mail.

If bulk mail revenues and profits are pushed down by competition, this could, in theory, present an issue for the financeability of the network. But as we've seen, competition is partly viewed as beneficial because it puts pressure on Royal Mail to become more efficient and to engage in product innovation.

As the Hooper report observed in a previous paragraph, the one I took you to at the preceding page, paragraph 187, the question of whether Royal Mail can finance the universal service is an empirical one. As we'll see, Ofcom has kept this under careful review.

Paragraph 192 also notes that competition is asymmetric in other ways because Royal Mail is obliged to carry out one delivery on six days of the week, whereas other postal companies may in the future opt to provide a service which delivers on just two or three.

Potentially, this would offer Royal Mail's competitors a cost advantage. On the other hand, Royal Mail derives benefits from the universal service. A strong brand, large economies of scale and scope, and an exemption from VAT, all of which are unavailable to competitors.

Whether Royal Mail benefits from the obligation to carry out the universal service or is disadvantaged, depends on the weight given to these factors. The regulator will need to take a balanced view of these issues to ensure fair competition.

An observation there that there are benefits from the universal service for Royal Mail as well as burdens which need to be taken into account. It's a question of balance, and for obvious reasons of vested interest and the need for independence, that question is assigned not to the dominant company itself, but to a regulator to consider.

Then the conclusion at paragraph 193:

"We believe that competition brings benefits for consumers in the postal market, as it has in the wider communications sector. By creating pressure on companies to be more efficient and create new streams of revenue, it will support the universal service. But there are some risks too. Competition reduces Royal Mail's revenue available to support universal service, and some forms of competition may be inefficient if they simply exploit the constraint placed on Royal Mail to provide the universal service."

That's the cherry-picking point:

"We believe these risks can be managed in the foreseeable future if the regulator takes a proportionate approach to commission and if Royal Mail is given the appropriate incentives and freedom to modernise. Our recommendations on partnership are therefore essential."

Then at 195:

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

So a longstop, the regulatory longstop was what Hooper saw as necessary in the 2008 report.

No need, as Royal Mail was at stages lobbying, for immediately position of ex-ante regulation on any new entrants to the direct delivery sector. Instead a policy of wait and see under the stewardship of the regulator to consider these nuanced and empirical questions.

Then there was a delay in introducing legislation, and as a result it became necessary to invite the Hooper review to update its conclusions. The update is in the Royal Mail bundle 2B at tab 32.

MR FRAZER: Which tab are we on?

MR HOLMES: Tab 32.

MR FRAZER: Thank you.

MR HOLMES: The title of this update is: "Saving the Royal Mail's universal postal service in the digital age", an update of the 2008 independent review. You'll see that it was presented in September 2010.

On page --

THE CHAIRMAN: Following a change of government.

MR HOLMES: I'm sorry, I missed that.

THE CHAIRMAN: Following a change of government.

MR HOLMES: Yes, sir.

On page 5, as you have anticipated, sir, in June 2010, it's stated in the second sentence:

"The new Coalition Government asked me to update the report." There was a consultation, and as Ms Sue Whalley, the witness for Royal Mail notes, she's acknowledged in the list of individuals who have contributed.

At page 15, we see that the diagnosis is reviewed, the diagnosis of the problems facing Royal Mail.

The regulatory regime. You'll see:

"The 2008 report concluded that the maintenance of the universal service was at risk because of the state of Royal Mail's finances ..."

Which were being undermined by continuing decline of the market and of Royal Mail's market share, failure of the company to tackle the necessary extent and speed of modernisation, the unsustainability of the pension deficit, and lastly the regulatory regime. Doing nothing wasn't tenable:

"Twenty months on, that diagnosis remains largely true. The consensus around the diagnosis remains as strong amongst stakeholders today as it did in 2008."

Then at page 27, the regulatory regime is addressed. You'll see the heading:

"Posts not like other utilities."

Under that, there's a description of the particular features of the postal sector that may put pressure upon the universal service, decline in volumes, physical infrastructure, very large upfront investment.

Then the last two paragraphs above the heading "Protecting the universal service", state this:

"The more likely strategy ..."

MR BEARD: I'm sorry, just before Mr Holmes goes there, it might be sensible for the tribunal to read the whole of this section.

MR HOLMES: I'm sure they can do so in their own time, but perhaps I might be permitted to take the tribunal to the passages --

THE CHAIRMAN: We have read it several times.

MR HOLMES: Sir, do speed me up if I'm --

THE CHAIRMAN: No, I'm content for you to make your case Mr Holmes.

MR HOLMES: I'm grateful.

What's noted is that:

"The more likely strategy for a competitor ..."

This is more likely than entry in order to displace the entire Royal Mail network, as described in the preceding paragraph, would be selective entry, cherry-picking the most profitable parts of the network, notably delivery in dense urban areas:

"If successful, this undermines the cross subsidies which are at the heart of the universal services viability because of the uniform single price within the UK."

The same problem, uniform price and constraint:

"Cherry-picking cuts into the surplus that is available to finance universal service to areas where delivery costs greatly exceed the uniform price of the universal service, clearly undermining the sustainability of the universal service.

"It is however interesting to report that, despite continued warnings by Royal Mail about the dangers of cherry-picking and the need for regulatory relief to mitigate these dangers, the letters volume delivered by by pass /end-to-end competitors has actually reduced over the past two years. As already noted, the VAT regime and the zonal access pricing structure would appear to be reducing the problem of cherry-picking."

There, zonal access pricing again emphasised in this report as in the preceding report.

Then at the top of page 29, you see:

"Critics of Postcomm assert that historically the regulator has been too encouraging of competition to the detriment of the universal postal service. It can be argued instead that given Royal Mail's refusal to or inability to modernise historically, competition was needed to force the pace. It is insufficient modernisation, not too much competition, that really undermines the universal postal service."

That chimes, of course, with what was said in Hooper in 2008.

Then, on page 30, the final conclusion in relation to the diagnosis of problems in relation to regulation:

"Whichever arguments one finds the more persuasive, and as noted so often the hard evidence is not always there to assess the arguments, the current regulatory framework is clearly no longer fit for purpose.
A regulatory regime must be put in place that has the right regulatory tools and duties in the current market conditions. The regulator has to be able to take effective action to regulate a market which has room for competition with the benefits competition can bring and to deregulate and take other action where appropriate to ensure that the universal service is sustainable."

Very much the same overall conclusions as were proposed in 2008.

Then, part 3 is solutions. Sorry, the same diagnosis of problems as in 2008, and the same direction of travel.

Then, finally, part 3, the solution reviewed. That begins on page 31. I want to turn to page 37, regulatory -- yes, I want to turn to page 37. You see that a two-stage approach is proposed for adoption.

"Stage 1, focus ex-ante regulation much more tightly on the monopoly and universal postal service in parts of Royal Mail. Put in place a new access regime and deregulate outside the monopoly. Stage 2 would allow Ofcom to use its powers under section 6 of the Comms Act to regulate whether the continuation of any ex-ante access regulation makes the universal service unsustainable."

Still the role for Ofcom in checking on the universal service over time.

Then on page 38 we see a reference to the following principles. They are very similar to those previously proposed.

Primary duty to secure the universal service for the regulator. Competition can be beneficial to users of postal services as long as the universal service is adequately protected.

The fourth bullet:

"Regulation of access should be focused on economic bottlenecks and access prices should reflect costs but users should not pay for inefficiency and competitors should not be subsidised."

Then, finally, on page 39, you will see that there's a reference to the longstop options if it proves that the universal postal service places an unfair and unsustainable burden on Royal Mail. This is for consideration in future years when Royal Mail is judged to be modernised to best in class status using a comparator group of best in class international postal companies.

In those circumstances, there are various options. You could reduce the universal postal service. You could create a compensation fund. You could procure some or all of the universal postal service from one or more of the alternative providers. But these are, of course, all regulatory solutions that arose. No suggestion that it's for the dominant undertaking to take matters into its own hands.

The second Hooper report was followed by the enactment of the Postal Services Act, which makes provision for a universal postal service. I don't think we need to go there. In brief summary, the framework works in this way. Ofcom may designate one or more operators as universal service providers. That's the provision in section 35 of the Act. In the UK, currently only Royal Mail is designated as such.

Ofcom may then impose universal service provider conditions on a universal service provider. That's set out at section 36 of the Act. They may include a requirement on the provider to provide a universal postal service or part of a universal postal service throughout the UK or any specified area.

Section 44 then permits Ofcom to undertake periodic reviews of the costs of the universal service obligation, and section 45 provides that:

"If compliance with universal service obligations imposes a financial obligation on a universal service provider that is unsustainable, Ofcom must then determine whether it would be unfair for the provider to bear the burden in whole or in part."

Then there's a procedure they must submit recommendations to the Secretary of State and the Secretary of State must then decide what actions to take, and they are the potential options identified in Hooper 2010. You could relax the universal service. You could designate additional providers or you could require contributions.

The statutory mechanism provides a particular mechanism for protecting the universal service under the supervision of Ofcom.

Ofcom has considered on a number of occasions, between 2012 and 2014, whether the universal service was at threat from Whistl's proposed end-to-end delivery plans for bulk mail, and if so, what action should be taken.

Its consideration of the issue is summarised in the decision at paragraphs 7.29 and 7.40. I would like to use that as a structure for these submissions.

In core bundle 1, 7.29 begins on page 189 of the rolling numbering. You see above at the heading:

"Ofcom was engaged in regulatory supervision of the financial sustainability of the universal service obligation and the impact of Whistl's end-to-end expansion".

There's a description of the comprehensive regulatory regime to secure the provision of a universal postal service, which we've just discussed, and then above 7.33, the heading:

"Ofcom carried out multiple detailed reviews and consistently found that Whistl's entry did not pose a threat to the universal service".

At 7.34, there is a reference to the March 2012 document issued by Ofcom, securing the universal postal service, decision on the new regulatory framework, and you see the quotation of its overall views at that point in summary:

"End-to-end competition could potentially provide both costs and benefits to the universal service. On the one hand, it would remove business from Royal Mail, challenging its already weak financial position, and in this sense might affect the sustainability of the universal service. On the other hand, it potentially increases the incentives on Royal Mail to reduce cost, innovate and focus on customer service. The effect of end-to-end competition on the provision of the universal service will depend on the entrant's plans and the circumstances which the market and Royal Mail finds itself in at the time. We therefore plan to assess end-to-end competition on a case-by-case basis."

On the threshold of the new regulatory regime just come in, Ofcom is basically saying that it will do what Hooper encouraged it to do. It appreciates that there's a complex balance here, a range of empirical questions, and it will keep matters under review, looking at the beginning specific circumstances of individual entry plans as and when they arise.

Now, in connection with the 2012 decision, Royal Mail emphasises that Ofcom endorsed a margin of 5 to 10% of its earnings before interest and taxation, EBIT, which Royal Mail was not obtaining at the time of the price control.

They say that this helps to explain the actions that they took, and to justify them under Article 106.

We should, therefore, see what the decision said about the EBIT margin. It's at Royal Mail bundle 2A at tab 14. I should say, I'm going to return to the passage of the decision we've just been looking at, so if you have space, I wonder if you might keep that open.

THE CHAIRMAN: Space and tolerance.

MR HOLMES: You'll see this is the document we've just been discussing. I want to turn to page 395 you will see, at paragraph 5.23, the background. Ofcom had proposed, or Ofcom in the consultation, had explained that the Act requires Ofcom to have regard to the need for the universal service provider to earn a reasonable commercial rate of return.

It had explained that:

"Whilst the Act did not provide further guidance on what was meant by a reasonable commercial rate of return, we can draw on significant regulatory precedent in allowing regulated companies to earn and retain a profit. However, we also explained in the context of the new proposed regulatory framework, having a specific target for the rate of return was less relevant."

Ofcom's assessment begins at 5.34, and you'll see there that respondents' comments all broadly agreed that the financial sustainability of the universal service needs to include a reasonable rate of return for its provider, Royal Mail.

At 5.41, you see in the final sentence:

"We have concluded that the range of 5% to 10% remains the most appropriate range to use in assessing medium term financial sustainability."

Then at 5.42:

"We acknowledge Royal Mail's argument that, at least in the short term, its lack of financial track record, coupled with the risks to the business, may require it to seek to earn a level of return above that range. As stated in the October consultation, this is an indicative range for returns consistent with the financial sustainability of the universal service. It does not have a represented implied cap on earnings. We discuss this further in section 7 in the context of the use of this range within the monitoring regime."

Pausing there, the indicative range was the range that Ofcom was indicating it would bear in mind when performing its regulatory functions and among other matters when considering monitoring the position in relation to the universal service.

In terms of the summary over page, 5.47, one sees the second bullet:

"An indicative EBIT margin of 5% to 10% is appropriate and consistent with the need for Royal Mail to earn a reasonable commercial rate of return commensurate with the level of risk within the business. While a certain element of judgment is necessary, we consider this should bring it more in line with its peers and more likely to be consistent with encouraging investment in the network. However, our 5% to 10% range is an indicative range of where we think earnings can go over the duration of the regulatory framework and does not represent a cap on earnings. We remain mindful that short-term finance requirements will necessitate a deviation around any indicative range. Going forward, we will continue to monitor the underlying factors contributing to Royal Mail's earnings and whether these are largely underpinned by improved operational performance and efficiency gains, or whether they are more generally driven by price rises."

Three points to note. This is only an indicative range of medium term profitability. It is for use by

Ofcom in reviewing what steps are needed to protect the universal service. Ofcom will consider it as part of a broader assessment of the factors underlying the profitability performance, including whether it reflects efficiency or changes in pricing, and it is not a guarantee to Royal Mail that its returns will exceed 5% EBIT margin or any kind of authorisation to block competitive entry in order to protect such a margin.

THE CHAIRMAN: It's not a cap, but it's not a floor either, is what you're saying?

MR HOLMES: It's neither of those things.

It's for Ofcom to look at it. It doesn't authorise conduct to deter competition in order to maintain a particular level of profitability.

So returning, if we may, to the decision, and to paragraph 7.36, you'll see that in July 2012 Ofcom issued an update regarding end-to-end competition following Whistl's commencement of its end-to-end delivery trial in West London. So this is the case-by-case assessment which was promised in the March 2012 document:

"The update followed a detailed examination of Whistl's confidential business plans in order to assess their likely impact on the provision of universal service, including its financial sustainability and efficiency. Specifically, Ofcom modelled the likely impact of Whistl's roll-out on Royal Mail's financial position. The model included a sensitivity analysis, which included how the impact would be affected: (i) if Whistl was more or less successful than anticipated in its plans; (ii) if additional competitors were able to enter the market; and (iii) if other key modelling assumptions were to change, such as market volumes or Royal Mail's achieved efficiency levels."

The second point:

"Based on that analysis, Ofcom decided that no regulatory intervention was needed in order to secure the ongoing provision of a universal service postal. This decision took account of Whistl's low projected market share in the early years of its plans, the limited impact that Whistl's plans were expected to have on Royal Mail's cash flow position in the short term, and the degree of uncertainty around Whistl's end-to-end plan given that it was the first of its kind the UK.

"Ofcom also considered that there was significant uncertainty about Royal Mail's commercial reaction to end-to-end entry, and that there were options for Royal Mail to respond competitively. For example, Ofcom suggested that such a response could involve Royal Mail achieving greater efficiency savings because of competitive pressure, or adjusting its national strategy (for example using its commercial freedom to address geographic cost differentials through zonal pricing)."

Pausing there, this obviously links back with the Hooper report and what we saw there. On the one hand, a focus on the benefits that competition might bring in terms of encouraging greater efficiencies by Royal Mail; and on the other hand, the use of cost reflective zonal pricing as a guard against cherry-picking. Those were the two examples of commercial reaction that Ofcom noted were uncertain.

Then:

"Ofcom reiterated that it would continue to assess developments in the market and react to them, if necessary, in a timely manner to address any risk to the universal service. Ofcom also emphasised its ongoing duty to secure the provision of the universal service. It explained that it had considered as part of the scenario analysis instances where it would be possible that intervention might be required to protect the universal service postal service. Consequently, Ofcom committed to continue to monitor the postal market carefully. Ofcom also said that it intended to publish guidance setting out a more detailed framework for assessing the case for intervention in relation to end-to-end competition."

Two points here. This is clearly a detailed and careful evidence-based investigation by the regulator of the kind that the Hooper report considered. It uses the regulator's ability to obtain confidential information from the entrant in order to -- its business plan, in order to assess likely impacts. It does a careful modelling job with sensitivity analyses, adjustments of assumptions, flexing various possible scenarios, and it concludes that there is no need for immediate action.

In March 2013, we see at 7.37, the guidance was published that was referred to in 7.36(d). Ofcom confirmed that it would take into account a range of considerations.

The financial position absent end-to-end competition, the likely scale of end-to-end competition and the incremental impact on Royal Mail's financial position, the potential for commercial responses of the kind that we've just discussed, but in relation to those, Ofcom emphasised that Royal Mail's flexibility to negotiate changes to its contracts was subject to competition law and the ex-ante regulatory conditions on access.

Now, as the tribunal has seen, Royal Mail has placed some emphasis on the reference to commercial responses in these two documents.

The suggestion is, if I understand it correctly, that these references encouraged Royal Mail to develop the price differential or at least that Royal Mail was not clear what it could or could not do. We should perhaps actually turn up what Ofcom said.

Mr Beard, I think, took you there, but there are a few points that I would like to make by reference to it. It is in Royal Mail bundle 2B, page 489; tab 48, page 489.

What Ofcom says there is that to understand fully the potential impact of end-to-end entry, it would be necessary to consider the potential for commercial responses by Royal Mail to mitigate the direct impact of increased competition.

One can readily see why that's the case. If an incumbent knew that the regulator would intervene at the first sign of competition, that would substantially blunt the efficiency incentives that competitive entry was designed to achieve.

Are you where -- sir --

THE CHAIRMAN: Mm-hm.

MR HOLMES: "As discussed in section 3, under the new regulatory framework, Royal Mail has significantly more commercial and operational freedom to set its prices and make product changes in a timely manner than was previously the case."

This is a reference to the relaxation of the regulatory framework which Hooper recommended the removal of ex-ante controls, the deregulation, which gave Royal Mail the ability to set a much larger number of its prices than previously.

"There is a range of ways in which Royal Mail might respond to increased competition ..."

And then the two examples that we've seen already from the previous study in the 2012 document:

"Royal Mail could change its commercial strategy. In particular under the current regulatory regime, Royal Mail has the ability to change the prices it charges access operators. This includes the ability to change how access prices are set for different geographic areas, currently the zonal access pricing regime, to ensure they are reflective of relevant costs."

That's the cherry-picking avoidance that Hooper identified through zonal pricing.

"This is particularly important given that in general an end-to-end competitor will still need to rely on access to Royal Mail's network to offer its customers full coverage of all addresses in the UK. Royal Mail's flexibility in setting zonal access prices can enable it to ensure that end-to-end competitors pay a cost reflective price for Royal Mail delivering mail in the areas where it has chosen not to super."

Royal Mail couldn't come along and say to Ofcom, the universal service is under threat because we haven't set our prices right in rural areas. They're not high enough to reflect our costs. The zonal balance between these areas is wrong. Royal Mail has to get that right.

"In this way, Royal Mail may be able to mitigate the impact on the universal service from an entrant cherry-picking by delivering in lower cost areas and handing over the rest of the mail to Royal Mail to deliver. In addition, Royal Mail has the flexibility to negotiate changes to its contract both with its retail and access customers, subject to competition law and the existing ex-ante regulatory conditions on access."

Now, I think Mr Beard suggested that this was a circular reference, this reference to lawfulness. I may have misunderstood him. If that is the submission, we really don't understand it. It's a statement of the obvious that Royal Mail, as a company, a firm, in the market, subject to the constraints of competition law, must observe the constraints of Article 102, and that its task is to self-assess the lawfulness of its conduct.

MR BEARD: We accept that.

THE CHAIRMAN: We did hear that you said that it was circular.

MR BEARD: In relation to the operation of competition law in the context when we were dealing with justification, I believe. But when we're talking about in relation to grounds 1 to 3, we of course accept that in relation to any conduct, we have to recognise competition.

THE CHAIRMAN: Wise position to adopt.

MR HOLMES: Then the second bullet is again the efficiency point:

"Royal Mail could have a stronger ability and incentive to improve efficiency at a rate higher in the face of end-to-end competition than would otherwise be the case. This in turn could serve to mitigate to some extent the direct impact on Royal Mail's financial position of losing revenue to competitors."

In summary --

PROFESSOR ULPH: Can I ask you a question on this? I just want to really understand better what Ofcom had in mind when they were talking about Royal Mail adjusting zonal prices.

One way I could think about that would be this. If you have a direct delivery entrant, that would take me out of the certain zone. Therefore the proportion of mail that Royal Mail is delivering to those zones will change. Therefore, if you're looking at either NPP1 or APP2, the proportions that Royal Mail is delivering under both of those are going to change. Are you suggesting it's those prices that should be adjusted to reflect the fact that, bar the impact of the entrant, Royal Mail's percentage going to the zones or to the SSCs are changing?

MR HOLMES: I think it's a simpler point than that. I think it's a static analysis, based on not the anticipated impact on costs and prices of entry, but rather looking to check that based on the current pricing position, the costs and revenues are properly cost reflective.

That's particularly important in the higher cost areas, because -- so you would look at the costs of delivering in particular high cost zones, the rural zones, to make sure that there was no potential for cherry-picking because those prices were set too low.

I will, if I may, come back to you on that after discussing with those behind me. That is my understanding of the position.

PROFESSOR ULPH: Okay, thank you.

THE CHAIRMAN: They're not really geographic zones, are they? I thought you described them as defined by density of population, and the map shows a scatter.

MR HOLMES: You're quite right. They're not geographical areas in the sense of contiguous areas, they're just a way of sorting different postcodes all across the country, according to the density of population. Therefore, to reflect the different costs that are obviously involved if you have only a few houses to be served by comparison with a number of houses, and therefore larger volumes of mail and therefore a larger set of volumes to distribute your costs across.

THE CHAIRMAN: Postcodes are geographic.

MR HOLMES: Yes, in that sense.

In summary, we say that the legal context was as follows. At the time of the relevant conduct, Royal Mail was a dominant undertaking subject to the competition rules like any other, as Mr Beard fairly accepts. The scope for competition was a deliberate feature of the regulatory framework because of its potential to bring benefits to consumers, both Hooper 2008 and Hooper 2010 endorsed the benefits of competition and that was in turn reflected in the 2011 Postal Services Act.

Royal Mail could not engage in anti-competitive conduct to defend its delivery monopoly which legislation had provided should be open to competition.

This was the case even if its motives were in part or in whole to preserve the protection of the universal service.

The task of defending the universal service was conferred upon the regulator, Ofcom, and it was provided with a range of specific techniques that could be used if needed. These measures would not exclude competition, they were designed to combine competition with universal service protection, and as I have said, there's an obvious reason why the review was assigned to an independent regulator, rather than left to the dominant company itself to undertake, because even with the noblest of motives, a dominant company cannot be used as an independent arbiter or allowed to decide for itself the extent of competition that would be permitted in the market.

Ofcom kept the situation under careful and constant review and it did not consider any measures were needed.

No attempt was made by Royal Mail at any stage to challenge those multiple regulatory findings by way of judicial review. Mr Beard said he didn't understand how one could challenge Ofcom's reviews. Well, there were multiple decisions being made here about what was the appropriate course to take, and no attempt was made to challenge those.

Finally, Ofcom gave no encouragement to Royal Mail to act so as to deter and restrict entry by a direct delivery competitor.

Sir, that's all I have to say about the context. I'm on track with my submissions. To update you on the road map, I plan now to turn to the conduct at issue and to look at the contemporaneous documents. That, I think, will take most of the afternoon, and then I intend to give you my headline points of reaction to the ground of appeal.

I'm conscious in doing that, sir, that you've carefully read the skeleton arguments and the appeal documents, and so I don't intend to go through those in great length. I really just want to give you the headline points in response, and then we can always develop particular points either in discussion or in our closing submissions.

THE CHAIRMAN: I think that's very helpful.

MR HOLMES: I'm grateful.

THE CHAIRMAN: Do you want to carry on now nor ten minutes?

MR HOLMES: I can do. I am moving to a new topic.

THE CHAIRMAN: I think we could take a new topic; begin.

MR HOLMES: Very good.

So the conduct at issue.

THE CHAIRMAN: Is somebody drawing up a list of all the descriptions of the universal service, how it's protected, preserved, saved, promoted, maintained?

MR HOLMES: Yes.

THE CHAIRMAN: It seems to attract words. Are you running out of suitable words?

MR HOLMES: It's a precious flower that needs to be treated well. I think that is clear from the multiple terminology used.

THE CHAIRMAN: Steer clear of Oscar Wilde, Mr Holmes.

MR HOLMES: Just to stand back and give you the headline points of Ofcom's analysis and the decision, Ofcom found that Royal Mail infringed Article 102 and the Chapter II prohibition by introducing a price differential between NPP1 and the other two plans; APP2 and ZPP3.

The price differential meant that for the first time a difference was introduced between the NPP1 plan, which had been introduced following Whistl's complaint in order to permit it to pursue direct delivery entry on the one hand, and the other two price plans on the other. In particular, the tribunal will recall that NPP1 and APP2 were both designed to reflect Royal Mail's costs by ensuring that the average price reflected the profile of Royal Mail's own post, sorted in two different ways. On the one hand, by geography; and on the other hand, by zones. But the price list per item was identical because that mechanism secured cost reflectivity in each case.

The price differential brought that to an end, and it introduced a difference so that the price plan NPP1, which was a plan that gave Whistl the flexibility to roll out, would be less favourably priced, to put the matter neutrally, than the other two price plans which would be available to it in the event of a roll-out.

On inspection, Ofcom's conclusion was that the price differential showed itself to be a discriminatory surcharge or penalty which was conditioned on whether an access customer sought to compete with Royal Mail on any material scale in the direct delivery market. That was the first main element of Ofcom's analysis.

Secondly, Ofcom found that the differential could not be justified by reference to any legitimate business purpose or cost justification. It found that the justifications were either incoherent as a justification for the basis on which the price differential was reserved exclusively for customers on NPP1 -- that's the case for the cost justification, as we'll see -- or it found that the justification was a justification based upon the very restriction of competition which Article 102 was designed to prevent. That was the difficulty with the value justification.

The third element is that the evidence as to Royal Mail's underlying intent was strong. The aim of the differential was to dissuade Whistl from entering direct delivery at scale, and we'll come to the contemporaneous documents about that.

Now, intent, we accept, is a relevant factor, but is not in itself sufficient to found a finding of anti-competitive conduct. We saw the reference in Advocate General Wahl's opinion to date.

We say that it is certainly and clearly relevant for two reasons, at least two reasons, but the two that are most relevant here are this.

First, conduct which is directed at achieving a given outcome is more dangerous for the process of competition than conduct which has perhaps incidental effects of an unintended nature. That's one reason why regulators and competition authorities need to attend carefully to intent.

The other reason is that when assessing for the purposes of competition law the conduct of a dominant undertaking, part of the task is to determine whether there is a credible strategy, whether the conduct could form part of a credible strategy to undermine competition to the disbenefit of consumers, and that is, in common parlance, the theory of harm; can you see this conduct as serving some inappropriate purpose?

Where the dominant undertaking's documents shed light on its intention, that is a very powerful indication to the competition authority about where it should look, what theories of harm, what strategic considerations it should take into account in deciding whether the conduct should be permitted or whether it should be viewed as likely to affect competition and therefore an infringement of Article 102. We do say that the evidence as to intention is highly relevant.

The fourth point --

THE CHAIRMAN: Just to interrupt you, surely the existence or otherwise of a credible strategy is relevant in both directions, isn't it? If there's a credible strategy, which is not (inaudible) competition, then you look that too.

MR HOLMES: I'm grateful. Absolutely, sir, I agree. In other words, if there were --

THE CHAIRMAN: Indeed, before you look, you don't know what you're going to find.

MR HOLMES: Quite so.

THE CHAIRMAN: You don't throw it away just because it's pro-competitive.

MR HOLMES: No. But the fourth point is that the evidence showed that the ambition to dissuade Whistl from entering direct deliberate scale had good prospects of being realised and that entry was materially less likely to arise in consequence.

Fifthly, and finally, the evidence also showed that the scale of competition foregone would be substantial with significant loss of benefits to customers of bulk mail.

That is the backdrop against which I will turn following the short adjournment to consider Royal Mail's objections to that analysis and also what the contemporaneous documents show.

If that's convenient.

THE CHAIRMAN: At the second time of asking, we'll agree.

(12.58 pm)

(The short adjournment)

(2.00 pm)

THE CHAIRMAN: On we go.

MR HOLMES: Before I turn to the documents, may I give the tribunal two references that I omitted from my submissions this morning?

THE CHAIRMAN: You may.

MR HOLMES: The first is in relation to Ofcom's work on the universal service. In December 2014, Ofcom again considered the risk of end-to-end competition to universal service and it undertook further analysis which is in the defence bundle, OF2, at tab 73.

As part of that assessment, it specifically considered the cherry-picking issue which has been debated in the context universal service, and the tribunal will find that at tab 72, pages 41 to 48. There's a summary of Ofcom's decision at A2/37 to 40. I don't propose to take you there now, but it's simply to show that Ofcom carefully considered all matters relating to the universal service, including the cherry-picking issue, which has arisen on a few occasions in Royal Mail's --

THE CHAIRMAN: Is that the review that's referred to in paragraph 7.40 of the decision?

MR HOLMES: That may very well be the case.

THE CHAIRMAN: If that's quoted from.

MR HOLMES: Yes.

THE CHAIRMAN: "Following the comprehensive review and on 2 December 2014 found that ..."

MR HOLMES: Yes, indeed.

THE CHAIRMAN: That's it, is it? So we've got an anchor point for that.

MR HOLMES: Yes, that's correct.

THE CHAIRMAN: It would be odd if the decision hadn't referred to it, would it not?

MR HOLMES: Indeed, sir.

THE CHAIRMAN: Luckily it did.

MR HOLMES: The second reference is one that arises from relation to a question from Professor Ulph regarding the sunk costs that are involved in entry to the direct delivery market. The question concerned in particular the status of certain capital machinery, the sorting equipment.

I don't have very much to give, but simply for your reference, the witness statement of Mr Wells for Whistl is at bundle C2, tab 4, and at paragraph 21, he gives evidence in relation to the sunk costs, including of capital machinery. It doesn't take matters much further forward, but there is some evidence in relation to it.

PROFESSOR ULPH: I remember reading it, I just wanted to clarify.

MR HOLMES: I'm grateful.

We turn, then, to the documents.

The first document shows the genesis of the strategic review which led to the price differential being adopted. That is in bundle C4A, tab 11. You see from the first line of the table at the top its date is 10 -- the final line of the table at the top it's dated 10 May 2013.

The top two lines of the table show that the document is a project proposal to consider pricing, architecture, options and opportunities. From the next box, taking a strategic look at access price structures.

The paper is for the PSB. You see that from the top right-hand corner, which is the Pricing Strategy Board. A decision-making board within Royal Mail, the membership of which is explained in paragraph 4.11(d) of the decision.

At paragraph 1, a request, it is explained that the paper follows shortly after new access contracts were introduced in April which unlock greater pricing flexibility for the benefit of Royal Mail's commercial and network access division and the group as a whole.

As the tribunal may have seen, this is because the contracts permit unilateral variation of pricing terms subject to the notice provisions which you were shown by Mr Beard yesterday.

Paragraph 1 then refers to a number of threats and challenges, which it says need to be considered in a joined-up way. In addition to the general threat of e-substitution, two further threats and challenges are identified.

The first is direct delivery and the second is the risk of losing our VAT exemption on access. Direct delivery is, of course, an abbreviation to refer to an entrant coming in and starting to offer delivery in competition with Royal Mail.

Paragraph 2 then gives the background. There are confidential portions, but I think we can deal with that.

Several considerations are identified. Paragraph 2.3 is the one that relates to direct delivery. It states that:

"TNT [now Whistl] announced plans in the last week to extend their direct delivery operation to cover all of the southwest London postcodes which is likely to increase their weekly volumes from 600,000 to 1 million."

So taking them up to 50 million letters a year.

"This project was in part triggered by Whistl's direct delivery roll-out plans."

I would just note in relation to paragraph 2.2 that the VAT exemption, which is separately identified, is also, of course, linked to direct delivery. You see the reference to the TNT judicial review. I would just invite you to review the green text to see what light that sheds on the impact on the risk of direct delivery identified in paragraph 1.1.

THE CHAIRMAN: It's hard to see why it's confidential, but yes.

MR HOLMES: I agree. It's out of a surfeit of caution that

I don't want to make a fuss at this stage, but I agree it's --

THE CHAIRMAN: We'll see.

MR HOLMES: Yes.

THE CHAIRMAN: Thank you.

MR HOLMES: Then the commercial strategy is the subject of paragraph 3. 3.1 explains the timing. Recommendations to the Pricing Strategy Board and the Chief Executive's Committee -- that's the core executive committee, for running the group -- in August in time for making price changes in April 2014.

Now, to be clear, April 2014 would require contract change notices in January 2014 or thereabouts. So this is a reference to a timeline that was ultimately adhered to in relation to the price differential.

Paragraph 3.2 then explains the scope of the project. Among other objectives and opportunities, the second bullet states:

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

So two aspects from the outset. First, the zonal balance between the zones; and secondly, optimising the price differential between the national plans.

At the end of July 2013, this project had generated an initial view of pricing options for presentation to the Pricing Strategy Board. This is the slide deck at tab 14 of the same bundle.

You see from the first page that it was again prepared for the Pricing Strategy Board, prepared for the board's meeting, I think, on 23 July 2013, and you see in the title the reference to "Initial view of pricing options".

Slide 1 shows the timeline for the project. You see that in June 2013 and early July, the project team had been at work defining options. That's the initial dark blue arrow.

For wholesale, the options being defined are to address risks from competitive direct delivery. The timeline progresses through an evaluation of options which is aimed to be completed by September 2013. We'll see how matters progress in subsequent documents.

Slide 8 is entitled: "Protect the USO: key business objectives", and you see that the high level objective defined in bold is to defend downstream mail volumes against the threats of direct delivery and VAT. Then there are sub-bullets: to ensure operators pay a fair cost reflective price for cream skimming direct delivery and that the USO is not put at risk from stranded legacy costs. We'll come back to that reference to stranded legacy costs.

Then secondly:

"Avoid consolidation of the upstream market and ensure there is robust competition between several operators."

Then, over the page, the pricing options as they stand. The initial view of pricing options is set out in slide 9, and the most relevant option is at point 1:

"To introduce a price differential between the two national price plans."

The description states that the option is to create financial incentive for providing a national mail distribution. In other words, an incentive to access customers for committing to purchase direct delivery from Royal Mail in all geographic areas.

The possible risks are that it is difficult to cost justify a price difference. Just to note, option 6, increase zonal differential, is the other amendment that was considered as a possibility in that initial document from April 2013, May 2013, the change to the zonal pricing.

The point about the cost justification is expanded upon in a further Pricing Strategy Board document from one month later which one sees at tab 17.

You see that this is a slide deck entitled: "Letters pricing strategy, business objectives and initial view of pricing options".

The right-hand reference shows that it's again a PSB paper, and although this isn't recorded, the date of the document is 21 August 2013.

Page 6 returns to the topic of options to protect the USO. You will see that the proposals at this point are focused upon three. There are three propositions set out in the left-hand column. The middle column asks in relation to each: is there any value to be had? Then the final column concerns whether they are to be prioritised for introduction in April 2014.

The first option, first proposition, is to create a price/financial incentive for committing to a national distribution of mail to all postcodes. This is again the price differential.

Its business rationale is to incentivise purchasing delivery from Royal Mail in all postcodes. As regards whether there is any value to be had, the first bullet says:

"To be confirmed."

The second bullet continues:

"Depends on price difference between each type of access contract and whether this can be cost justified.

Proposition needs to be objectively justified to ensure regulatory co-operation."

Two points to note about this. First, the value of the proposition is said to depend on the price difference arrived at and whether it's sufficient to create the incentive effect described in column 1.

Secondly, this, in turn, depends on arriving at a cost justification, but this is viewed as a separate and subsequent step. The reason that the desirability of the proposition has apparently already been considered, and it isn't yet known whether a justification can be found for a differential that is sufficient.

So whether there is any value to be had depends upon a separate and subsequent exercise of finding a cost justification and under the prioritisation for April 2014, the paper states that Oxera are looking at this.

Now, just to note, another option which is canvassed in this slide at point 3 is other ideas like increasing the price differential between geographical zones and reducing advertising prices by up to 20%. The view about that is that these options will continue to be available, but they are unlikely to drive value to the same extent as the other options canvassed.

THE CHAIRMAN: Your point, Mr Holmes, is that the protractiveness of the proposed measure was decided on before looking for the justification by costs?

MR HOLMES: That's what this document appears --

THE CHAIRMAN: It's not a reason to look for a cost justification.

MR HOLMES: No.

THE CHAIRMAN: Mr Beard told you yesterday that constant dialogue with the regulator was bound to mean that every proposal they made would be subject to scrutiny.

MR HOLMES: Yes.

THE CHAIRMAN: It's not an unreasonable thing in itself, but your point is about the order.

MR HOLMES: The order and the business rationale which explains the proposal, whether it is to defend volumes from downstream delivery competition and to create a price/financial investment for committing to a national distribution of mail to all postcodes, or whether it is because there is a difference of cost which Royal Mail is seeking to capture.

What this slide seems to present is that the cost justification comes afterwards, and they're not, at the point of this slide, sure yet whether a cost justification can be found.

THE CHAIRMAN: So it's not as if the strategy is to make our prices reflect costs, somewhat idealistic anyway, I suspect.

PROFESSOR ULPH: Also, the value is a kind of conditional value, because it depends on the size of the differential, and all that work --

MR HOLMES: That appears to be the case from the document.

PROFESSOR ULPH: Just to be clear.

MR HOLMES: These are obviously matters on which the tribunal will be hearing evidence.

THE CHAIRMAN: Indeed.

MR HOLMES: Again, just to conclude on that, you see that the price differential is prioritised for April 2014.

By 30 September 2013, Royal Mail had identified three particular changes to be implemented in April 2014 alongside planned increases in its access prices, and these are identified in a further slide presentation at tab 25.

The heading is: "Proposed actions on access contracts to protect the USO". The first block of red text on the top left-hand side identifies changes be implemented in April 2014 alongside the tariff increases.

The first is to introduce additional requirements and tighter tolerances on NPP1. The second is to introduce a price differential of up to 3 pence between

NPP1 and the other two price plans. The third is to adjust pricing of different zones under the two zonal plans, the zonal tilt.

Action 2, the price differential, is obviously our main focus. That is covered in more detail at slide 4.

The description is in the upper box on the left-hand side which describes the action in question.

"Customers on the new USP A5 contracts ..."

That's the access contracts:

"... will pay up to an additional 0.3p per item on average if they have a national profile. If they are on a zonal price plan, PP2 or PP3, compared with PP1, representing an average surcharge of 1.5%. Royal Mail might choose to start with a lower differential to minimise the risk of complaint."

We know that in fact the differential was slightly lower than the 0.3p. It's 0.25p. Around 1.2%.

There's then, on the right-hand side, a discussion of objective justification. This is how Royal Mail's efforts have come along to deal with the difficulties in relation to cost justification identified in the previous document.

The first bullet concerns the scope of the cost justification.

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

It appears that there's still a difficulty arriving at a quantified cost justification that can be relied upon.

"The price differential can also be justified in terms of the additional value which customers receive from the zonal price plans. PP2 and PP3 give customers much greater than flexibility compared with the tighter controls on PP1."

Then this:

"For example, a direct delivery operator might expect to pay an additional 0.3p in surcharges if it was on PP1 instead of a zonal plan."

This is the genesis of the value justification, and one sees immediately that the particular and specific example given is of the value of the flexibility to compete with Royal Mail quantified by references to the surcharges which would be attracted on NPP1.

The third and fourth bullets are not so much objective justification, but more an assessment of effects, and the first says:

"Royal Mail might argue that a 0.3p price differential, 1.5%, is immaterial so far as direct competition is concerned compared with their cost advantages against the access price."

That's one potential argument about effects:

"A small scale DD operation, five or less SSCs, could be supported on PP1, and any wider roll-out would be sure to trigger Ofcom intervention in any case."

They're already thinking about how they could show that the effect of the proposed price differential on a direct delivery operator should not be thought to give rise to adverse effects. The arguments that they are mentioning here are, firstly, could be argued to be immaterial, and secondly, that Ofcom would have to intervene anyway if the roll-out went above five SSCs; at which point a direct delivery entrant would start to incur surcharges.

There's then a consideration in the bottom left-hand corner of the slide of the customers impacted and risk of complaint. The table shows -- it's confidential, so I shall not read it -- but the table shows current customers on PP2/PP3 with the impact calculated as a volume on these plans multiplied by 0.3p.

Now, one of the operators whose impact can be seen is Whistl. You'll see that the impact is £9 million based on their volumes per annum.

The other operators I can't refer to, but the tribunal will see the comparative impact on these operators set out and how it relates to the level of impact on Whistl.

If we turn on to page 25 of the slide deck, you see that there is specific consideration of the position of Whistl.

Curiously, this slide records a potential impact of a one-plan only rule, but it doesn't record here the impact of the price differential. You see that the overall impact, that additional sum, plus price difference, which you've seen on the earlier slide.

The likelihood of complaint is then recorded at the bottom. High, as they would need to switch to PP1 to continue to compete with UK Mail, but that would then dent their direct delivery ambitions.

The only other point to pick up is that on returning to page 4 for a moment, in the objective justification box, the tribunal will note the final bullet:

"A regional operator could always switch to a national consolidator to access the lowest prices."

The point here is that some of the other affected customers, Royal Mail is identifying a work-around. They could get NPP1 prices by using a national consolidator, and therefore they wouldn't be exposed to the higher prices on ZPP3.

Do you see that, sir?

THE CHAIRMAN: Yes. You're not going to take us to the discussion of the zonal tilt changes?

MR HOLMES: Sir, they --

THE CHAIRMAN: Because they're not in the decision.

MR HOLMES: I wasn't planning to do so, sir. I'm happy to consider any points the tribunal wants to canvas with me, but you're right that another of the actions is the zonal tilt.

THE CHAIRMAN: Well, I think the point has been made, I think by Whistl, that the change to the London price doesn't appear to be cost reflective and I'm not sure that that isn't demonstrated by this box here. But that may be for another day.

MR HOLMES: It isn't within the scope of our decision, any finding in relation to the adjustment to the zonal prices.

Tab 27 is an Oxera document. You'll recall the slide noting that Oxera has been called in to advise. We should perhaps just briefly look at the proposal which led to this document. That is in Ofcom bundle 1 at tab 5.

The date is August 22, 2013, immediately following the earlier slide presentation I showed you which said Oxera is looking at this. They've been instructed and they've come forward with this proposal.

The first sentence of the background and introduction shows the context in which their advice was being sought:

"Royal Mail is considering a number of options to restructure the existing access contracts in order to respond to the threat of direct delivery competition and has asked Oxera to prepare a proposal to assist Royal Mail in assessing the viability of these options from a regulatory and competition policy perspective."

Over page, you can see the options that have been identified and Oxera have been asked to look at.

Option A, introduce a price discount on NPP1, SSC, without -- and that is, as we understand it, effectively the price differential.

We just note that option E, which we'll return to later, was to consider targeted discounts and adjust the SSCs where direct delivery is emerging. So one option was a price differential. Another one that they were considering at the time was to cut prices selectively where there was direct delivery in order to respond to competition by that method.

Oxera's task is set out in the immediately following paragraph:

"Oxera understands that Royal Mail has undertaken some work in scoping out these options in further detail, including an articulation of the commercial rationale and benefits, as well as outlining potential justifications from economic/regulatory justification."

I just note again the distinction between the commercial rationale and benefits on the one hand and the potential justifications on the other:

"As part of this project, the Oxera team would work with Royal Mail to further refine these options before undertaking an assessment of their viability."

In the final bullet, you will see that:

"The ultimate work stream would be to compare the strengths and weaknesses of the options and compile a final shortlist worth progressing further. This would include identifying any additional analyses, work packages that would be required to finalise the practical details of the options and prepare a robust case to defend the proposals in the event of a regulatory or competition decision."

That's why Oxera was brought in.

Returning, if I may, to C4A, you will see that this is a note prepared for Royal Mail by Oxera dated October 3, 2013. It's entitled "Economic assessment of the proposed actions on access contracts". The executive summary explains in the first paragraph that the note contains Oxera's economic assessment of the actions that Royal Mail is considering undertaking:

"The focus of the assessment is on the strength of the arguments and evidence that has been developed so far to defend the initiatives in the event of a regulatory or competition investigation by Ofcom."

There are some high level observations which we'll no doubt return to during the course of the trial, but for now I would like to show you the discussion of the price differential, action 2.

I think Mr Beard took you to the executive summary. I would like to look at the underlying analysis which begins on page 8 at paragraph 3.2.

THE CHAIRMAN: This document is marked "legally privileged".

MR HOLMES: No privilege is claimed in relation to this document, as I understand it.

MR BEARD: No, legally privileged in relation to these materials -- it has not been claimed. That's why Ofcom has them, because obviously legally privileged material would not be --

THE CHAIRMAN: Was it claimed and waived?

MR BEARD: No, it wasn't waived. I think this is when it was reviewed as to materials that should be disclosed to

Ofcom when it was requesting documents.

THE CHAIRMAN: I'm aware that this is standard practice to write this on the top of economic advice. It doesn't actually make it privileged, necessarily but it is --

MR BEARD: I think that's what happened here. It may be that the macro included that --

THE CHAIRMAN: We shouldn't attach any significance to it?

MR BEARD: No, you shouldn't attach any significance to it. I'm sure Mr Holmes will confirm that this was disclosed by Royal Mail in the course of responses to requests for documentation, and so a review is done of that documentation to see whether or not any of it actually fulfils the criteria of legal professional privilege, notwithstanding what's put in the header, in those circumstances --

THE CHAIRMAN: Where we see a black line with "privilege", that really is privileged.

MR BEARD: That is really privilege as being reviewed as such, whereas this is not.

THE CHAIRMAN: Very good.

MR HOLMES: There is, of course, in this document some black lining, so to that extent --

THE CHAIRMAN: Even in my copy, you will be pleased to know.

MR HOLMES: You have no privileged access beyond ourselves, as you put it.

THE CHAIRMAN: Such a pity.

MR HOLMES: It will be interesting.

There are still redactions for privilege at page 9. But I want to pick this up on page 8. The action 2 is under discussion, 0.3p price differential between PP1 and PP2/PP3.

I think we can cut straight to the Oxera assessment. Oxera begins:

"Is there a coherent set of arguments and robust evidence to support them?"

Oxera's view is that:

"The rationale ... when articulated as a discount offered in return for a commitment from customers to post in every single SSC of the UK according to the national fall-to-earth profile, is clear, simple to articulate and intuitively appealing. Customers would have a choice as to whether they wished to commit to this profile (and receive a benefit for doing so) or use the flexible pay-as-you-go zonal variants. This would be an argument that Ofcom would be compelled to take seriously. However, whether Ofcom would be willing to accept this argument as an objective justification for an action which has the potential to restrict competition in the downstream market is difficult to predict."

Then it continues:

"It would have been ideal to have a cost justification for this price differential, as this would provide a compelling and a more 'mainstream' objective justification (in a competition law sense) for an action that can have a potential anti-competitive effects (see below our understanding of the nature of the competition complaint that this action is likely to trigger).

"However, we understand that it has not been possible to articulate and quantify a 'pure' cost differential on the basis of the planning benefits that Royal Mail would derive if all access customers were on PP1 rather than PP2 or PP3. The discussions with operations staff suggest that if Royal Mail could have sufficiently early indication from its customers about its posting profiles, Royal Mail could derive considerable planning benefits."

Pausing there, they haven't found a cost justification as such, but they have noted, following discussions with the operations staff, that there might be a cost justification resulting -- there were cost benefits of knowing in advance what customers were going to do, and this is the genesis for the forecasting requirement which was introduced in parallel, the two-year forward forecast which was introduced as part of the changes introducing the price differential. It then continues:

"This, however, appears to provide support for profile commitment of any kind, but not exclusively linked to the national fall-to-earth profile of PP1. For example, if TNT Whistl shared its plans in advance with Royal Mail and committed to this profile, Royal Mail would in theory derive considerable value from this information."

In other words, the value of being able to plan in particular localities to adjust for cost changes resulting from a sudden drop in volumes isn't connected with the NPP1 requirement to post everywhere. In fact, if you want to know about volume drops, what Oxera is saying to Royal Mail is: Whistl would be an obvious person to ask. And you can achieve that by giving the price differential to customers that were prepared to make a profile commitment of any kind, identifying particular SSCs where they're prepared to provide forecasting information.

As a justification for the price differential considered in its practical context, Oxera is identifying a potential difficulty or ground of challenge.

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

Then there's some redacted privileged text and we don't know what advice Royal Mail was getting because they have chosen, perfectly properly, not to waive their privilege.

The point about volume loss not constituting a competition law justification isn't difficult to understand. A dominant firm that is exposed to competition may well lose volume loss. Its factories may well be less utilised. It may well be more exposed to the risk of costs in consequence, but that is part of the process of competition, that can't supply an objective justification of blocking the entry of a direct delivery competitor.

The text then continues:

"On the other hand, the principle of customers paying a premium for flexibility (alternatively, being rewarded for commitment) is a commercially rational and well understood practice in many industries (eg mobile phone pay-as-you-go prices are more expensive compared to customers on contracts; flexible rail tickets are more expensive than economy basic tickets, etc)."

This is the value justification. There's then some redacted text and the page continues:

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

"Oxera has not been provided with evidence showing the impact of the price differential of this magnitude would have on TNT's incentives or its direct delivery business plan."

They haven't looked at this yet. They don't know how TNT would be impacted:

"However, we understand that while small relative to the overall access price, 1.3%, 0.3 is a substantial proportion of the upstream margin ..."

That's the to say the margin on the initial collection and sortation and transport services, the green part of the leg of the value chain.

"0.3 is a substantial proportion of the upstream margin that access operators compete on, between 15% and 60%, depending on whether it is measured on the basis of Royal Mail upstream costs or the margin available for some individual customer contracts.

In the short run, we have been told by Royal Mail that TNT would migrate to PP1 to avoid being placed at a competitive disadvantage."

You remember on the earlier slide there was the reference to rolling out to five SSCs. I think that's what this is referring to:

"This would allow ..."

You will note the language to avoid being placed at a competitive disadvantage:

"This would allow them to continue their current level of roll out and to reassess whether they would be prepared to make the step change in their roll-out required to compensate for the additional 0.3p per item that it would have to pay for the mail it would continue to send via Royal Mail. Hence an argument could be made that while the price difference could have some impact on TNT's decision-making process, in the short run TNT would suffer no financial impact because it would have switched to NPP is for five SSCs, whereas in the medium to long term, if TNT decide to roll out on a large scale as originally announced, profit margins earned would more than compensate the 0.3p difference and would, in any event, likely trigger an investigation by Ofcom into the effects of this roll-out and the financial sustainability of the USO."

We'll see from a subsequent slide what Royal Mail's understanding of TNT's likely reactions was.

On the basis of this straw man, which would need to be confirmed by detailed modelling, we consider that Royal Mail has a fighting chance of successfully arguing to Ofcom that a price differential of this magnitude would not have the effect of restricting genuine end-to-end competition. Needless to say, this is no guarantee of a successful defence and Ofcom may take a different view faced with similar facts.

Finally, in relation to the modelling which has been undertaken to justify the 0.3p value based differential, we have the following comments:

"We consider that the modelling approach is sound and the value business derived from it is real as it is based on the current parameters and terms and conditions as written in the contracts.

"However, because the value obtained is dependent on the terms and conditions and the parameters of each individual contract, it can be perceived as being highly subjective and circular in the sense that it is within Royal Mail's gift to alter the terms and conditions of the contracts and either increase or reduce the perceived value based differential between the different plans. An example of this circularity is the different value that can be obtained in the model from changes to the zonal tilt, action 3. It is at least theoretically possible that a zonal tilt exists, whether based on the four zones or not, which could fully eliminate the model's value differential between the plans. Similarly, the changes in the terms and conditions of PP1 being proposed as part of action 1 are likely to increase the value-based differential."

The value is modelled by reference to the surcharges that would be incurred on NPP1 from a direct delivery roll-out, among other matters. We'll see that when we come later to a later document.

Of course, what those charges are depends on how

Royal Mail configures its own NPP1 contract. Hence the suggestion of subjectivity or circularity as a possible concern or a possible argument that might be raised against this value-based justification.

Then just above the next heading, the penultimate paragraph on the page:

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

Royal Mail's commercial perspective, as understood by Oxera, is that they would like to produce an exclusionary effect. That's how we read that passage.

It's therefore counter-intuitive to do modelling to show that there was -- to produce modelling that would show there would be no such effect.

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

THE CHAIRMAN: Understood. This is a very extensive and candid piece of advice, but we are going to hear evidence from them.

MR HOLMES: We are, indeed, yes.

At tab 30, Oxera repeats its concerns in relation to the cost justification. So this is an email. The sender -- apparently his name was confidential, although we struggle a little with that -- is an individual employed at Oxera.

He is writing to a number of Royal Mail employees on 10 October --

THE CHAIRMAN: Who are also confidential?

MR HOLMES: Whose names are also confidential, apparently.

MR BEARD: I'm sorry, just picking up before Mr Holmes moves on, the reason why names are confidential is because they are treated as confidential in Ofcom decisions in other regulatory decisions and we've maintained them as confidential for the purposes of these proceedings. We have had discussions with Ofcom about who should be in open. If there are concerns about this, fine, we're willing to consider those issues. But I think some sort of suggestion that we're trying to keep names confidential for any --

THE CHAIRMAN: No, we're just puzzled. There will be the need to consider the extent to which the claims of confidentiality have been made.

MR BEARD: We're absolutely content with that.
THE CHAIRMAN: When it comes to saying what -- we are aware of the GDPR as well.
MR BEARD: I'm particularly concerned about this suggestion that we've been keeping names under --
THE CHAIRMAN: I'm not suggesting anything, Mr Beard. I'm just chatting.
MR BEARD: It's always nice to join in.
MR HOLMES: To be clear, I wasn't suggesting there was any improper motive for redaction of the names, it just makes dealings in open court just slightly more cumbersome in circumstances where names, as such, don't appear to have any confidential obvious quality of confidence.
THE CHAIRMAN: The email from X to Y and others.
MR HOLMES: Indeed.
THE CHAIRMAN: On we go.
MR HOLMES: So you see in the first paragraph that they "reviewed some documents provided by ops." That's operations:

"Please find below our views and comments on how this can be used to provide a robust cost justification for a price differential between NPP1 and NPP2/PP3."

I should say references in the documents are sometimes to NPP2, rather than APP2. It's simply that the nomenclature was changed with the amendments to the access contracts in April 2014. They were previously both referred to as national price plans.

"In summary, we consider that there is a lot of useful information contained in these documents which point directionally to there being a cost classification for why NPP1 is less costly and more valuable for Royal Mail than NPP2 or NPP3. All of this will be helpful in order to prepare an argument that applies to differentials objectively justified.

However, we also consider that in order to be able to provide robust justification to a competition law standard, further work and evidence would be required. There are two aspects that we would highlight in this regard. Below we explain these two points and provide some ideas on how to overcome them."

We will come to those in a minute. Just pausing, this continues to show that the commercial perspective identified in the previous document has driven the adoption of a price differential, and the exercise which is now being undertaken, after the value of the price differential has already been worked out, is the amount of the price differential has already been worked out -- is to try and find a basis in Royal Mail's costs to support that. The submission is just that this is ex-post justification.

Then the two propositions are then set out:

"1. The 'value' for Royal Mail resides in getting advance knowledge of volume profiles, [ie forecasts], but these profiles do not necessarily have to be in accordance with NPP1.

"A common theme across both documents coming out of the detailed discussion with ops is that Royal Mail derives considerably more value from the receipt of timely information on the volume profile of access customers, whatever this profile is, rather than from any intrinsic benefit from an ops perspective that a national profile by SSC (NPP1) has over other profiles that are possible under NPP2/PP3. In other words, if Royal Mail customers on NPP2 or PP3 were able to commit to post mail according to pre-specified profile of mail and shared this information with Royal Mail one to two years in advance, the value for Royal Mail from a planning perspective would be very large. For a very large customer, such as [Whistl], the value of this information could be the same, if not greater, than the value coming from the implicit commitment made by most customers on NPP1."

I think you have the point.

THE CHAIRMAN: Mm-hm.

MR HOLMES: Put differently, the value is in the information and commitment to a particular volume profile that customers would be willing to provide, rather than on the fact they happen to post in mail on the basis of national or other profile."

I see this point is raised repeatedly in these two documents and by Ofcom subsequently with Royal Mail, but they stick with a price differential between NPP1 and APP2, ZPP3. That's because of the commercial perspective identified in the Oxera note and the concern to protect downstream volumes against direct delivery competition identified in earlier slides.

Over the page:

"Based on the discussion above, Royal Mail may wish to consider introducing the concept of profile commitment discounts within NPP1 along the lines of the previous discussion. The benefits of this would be twofold. First, the rationale for the discount provided by NPP1 would now be much more closely tied with the internal evidence that these documents have uncovered and secondly, would help defend against the likely accusations from Whistl, but a price differential between NPP1 and PP2 and PP3 amounts to a de facto exclusive purchasing obligation with clear exclusionary effects. This is because Whistl will now be able to benefit from the discount if they are too willing to provide information to Royal Mail on building the profiles that will help it plan the network more efficiently. Crucially, they would not necessarily have to commit to the national fall-to-earth profile by SSC."

Turning to tab 33, this is a presentation prepared for Chief Executives Committee dated 1 November 2013, and you will see that the presenter he is Ms Whalley, who will be giving evidence.

The objective is -- sir, on page 9, you will see that there is a slide "Our agenda". The key objective is "Safeguard the USO in the face of increasing competition."

THE CHAIRMAN: This is safeguarding now?

MR HOLMES: Yes, another one.

"Current position, TNT plan forecast 40% of UK coverage by ..." The date isn't given here. A subsequent slide presentation contains the same slide with the date inserted subsequently, but it doesn't much matter.

"Ofcom review and potential intervention not currently scheduled until 2015. The delays inherent in its current approach are likely to mean that any intervention would be too late to be effective."

So they don't place any hope of regulatory intervention. Then:

"Significant legal and competition law risks should Royal Mail take commercial action to respond to the threat. Ofcom has the ability to change certain aspects of the current scope of the USO, eg removal of first class."

THE CHAIRMAN: What does the green shading mean in that paragraph?

MR HOLMES: That is confidential material, but not privileged material. I hope that none of that was shaded on yours. The material I have just read.

THE CHAIRMAN: No, no. Some of the shaded stuff looks quite relevant. We're not going to talk about it.

MR HOLMES: I'm happy to -- it may be hard to deal with --

THE CHAIRMAN: You might like to take slide 8 away and think about it.

MR HOLMES: Yes, I'm grateful. We shall do that.

THE CHAIRMAN: Please carry on.

MR HOLMES: Then the final bullet under current position:

"Ofcom has the ability to change certain aspects of the current scope of the USO, eg removal of first class."

Then key initiatives and timings:

"Develop best case commercial response which does not reduce revenues, eg zonal price plan differential.

Need union agreements to enable Royal Mail to take out costs."

So concern to find a commercial response which doesn't reduce revenues:

"Review with Ofcom ahead of communication to understand their stance in economic, regulatory and legal issues raised, engage prospects for a competition case, move to implementation or re-affirm in case for conditions."

Then:

"Understand the real cost value to the network of certainty in volumes and national posting profile to support differential access."

Again, the point is just the cost justifications comes off. They still need to understand the real cost value of the network of certainty and volumes.

Argue that Ofcom should take a more proactive approach to direct delivery competition and continue to promote benefits of RM versus alternative forms of delivery.

Then the final bullet is confidential, so I will not go through that.

THE CHAIRMAN: Mm-hm.

MR HOLMES: The next document I would like to show you is at tab 35. This is a discussion document from October 2013 entitled -- you can't see it on the document, but this is what we understand -- "Options for protecting the USO prepared for presentation at the 13 November meeting of the chief executives' committee."

THE CHAIRMAN: It's on the cover sheet of mine.

MR HOLMES: Is it? I may be missing a page from my bundle.

The management summary on the second page begins with direct delivery competition which is said to have the potential to deliver circa 10% of addressed mail volumes within five years:

"Mail volumes are also under threat from e-substitution both at a national level and also at the local level where there are pockets of accelerated decline.

"Volume decline on this scale would damage Royal Mail's ability to deliver the USO which Ofcom has an obligation to protect.

"Ofcom has stated that they would expect Royal Mail to take commercial and cost reduction actions to protect the USO before they take regulatory steps.

"This presentation includes an immediate set of commercial actions which recognise the value to customers who commit to a national profile of mail without damaging current revenues."

Again, the package aims to achieve a commitment to a national profile without damaging current revenues:

"We would look to implement these actions in April 2014 alongside the new tariff.

"In addition, we are considering a further set of actions that we would discuss with customers as soon as possible and look to implement later in 2014."

Turning on to page 4, the slide here expands on the direct delivery threat in London and beyond. It sets out Whistl's roll-out to date and their volumes in the areas where direct delivery operations have been launched.

At the bottom it states:

"If they achieve their stated ambition of direct delivery across 42% of delivery points, our lost revenues would be circa £220 million per annum."

Turning to slide 7, there's then an overview of the different strategic options presented. We see at the top row it shows the option. The second describes it, and the third sets out what Royal Mail would have to believe to adopt the action.

The first column is "Do nothing (status quo)". We see that would involve no proactive commercial response.

To do that, Royal Mail would have to believe that direct delivery will roll-out slowly, if at all, with no imminent investor.

To decide to do nothing, they would have to be confident that there would not be direct delivery roll-out.

The actions by implication are to address the risk of a greater direct delivery roll-out, although there are other possibilities:

"Alternative options and RM actions would dilute revenue/reduce margins."

They might think that it's not commercially sensible to take other options because of revenue dilution or reduction of profitability or they would have to believe that Ofcom will intervene soon to protect the USO.

Option 2, ask Ofcom to intervene now. There is again things that they would have to believe to do that, the last of which is that we can convince Ofcom that no other options available on revenue or costs address USO risk.

The third column, which is highlighted in yellow, that's not because it's confidential or cannot be referred to, it's because on the original slide this was the option that was highlighted, and indeed the one that was proceeded with in broad terms.

THE CHAIRMAN: Not because it's thought to be the most hazardous?

MR HOLMES: We'll come on to see another colour coded slide in a moment and we will see further why this is highlighted. The strategic option is to launch a package of initiatives without reducing average prices:

"Introduce revised PP1 terms and conditions and price recognition for a national profile ..."

That's the price differential:

"... and revised zonal price list."

That's changes to the zonal price. What do we have to believe? First bullet:

"No revenue dilution because average prices will increase at or above plan.

"Direct delivery operators will move to PP1 to avoid surcharges."

For this option, Royal Mail's belief, according to this slide, would have to be that direct delivery operators will move to PP1 to avoid surcharges. Then the next bullet:

"Direct delivery will not expand to point of damaging commercial return."

Ofcom will intervene if, when there is a tipping point on volumes, and Royal Mail has done as much as it can.

"Tipping point might become more likely if direct delivery operator receives external investment."

Then, finally:

"Proposals defendable to Ofcom/the CAT".

THE CHAIRMAN: That's us.

MR HOLMES: They're already looking ahead.

THE CHAIRMAN: We're famous.

MR HOLMES: Not only to the Ofcom procedure, but to this appeal.

THE CHAIRMAN: Long drawn out, as I recall.

MR HOLMES: Yes.

Then the alternatives, the other alternatives, canvassed: reduce average access prices to protect the USOs. This would be a price cut. So the price differential, bring your prices down in response to competition.

The suggestion in the description is:

"Reduce price selectively to retain volume."

Then:

"What do we have to believe?"

To do this, they would have to believe that Ofcom would expect revenue diluting initiatives as part of a response before they intervene.

"Selective discounts reinforce economics of access versus direct delivery to other players in the market to defend access market share.

"That reducing revenues would not harm our ability to provide the USO."

Consideration of price cuts with some considerations that would need to be in place before that action was to happen. Then the final suggestion:

"Change requirements on how we provide access.

"Seek changes to access conditions, eg restrict access to direct delivery operators."

Now, if any document were needed to put beyond any shadow of a doubt the point about the commercial perspective, in our submission this one would do it. All of the options are looking at what would be done to direct delivery.

For the yellow highlighted, the beliefs that would justify could not adopting the package, Royal Mail's beliefs are stated to be:

"DD operators will move to PP1 to avoid surcharges. DD will not expand to the point of damaging commercial return."

There's then on slide 8 the description of the proposed changes to access contracts to be implemented in April 2014 alongside the tariff. The left-hand column sets out the proposed actions; the right sets out a business rationale.

So at 2:

"Recognise the benefit to Royal Mail of a national posting profile by creating up to a 0.3p differential for PP1 customers compared with zonal price plan customers."

Then these are described as business rationales, but the tribunal will see what it thinks. They look somewhat more like justifications to me or lines of defence. The first bullet:

"The price differential is very small at just 1.5% but it could be argued as being material in terms of margins in the upstream market."

A reference back to the Oxera point that this represents a large portion of the margins that are available on the end-to-end market. PP1 provides greater certainty to Royal Mail in terms of medium/long-term volume forecasting.

"Though this is difficult to quantify in terms of cost benefits."

They're still struggling to get a cost justification that works:

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

That's why we say the flexibility is the flexibility to compete.

The final bullet under that part for that option:

"This option does not prevent direct delivery competition, although a roll-out beyond six SSCs would attract surcharges."

Then the evaluation of proposed solution for April 2014 on slide 9:

"Our proposal is to combine a series of actions, each of which has a rational commercial and business justification. Taken together, the combined package of actions will address most of the immediate problems with access contracts and send a clear signal to the market that we will compete effectively to protect the USO."

A clear signal to the market that we will compete effectively to protect the USO:

"Introducing a small price incentive (less than 1.5%) for customers committing to a national profile of mail is likely to be attractive to almost all customers and will not exclude direct delivery competition. The market share in delivery we might expect to lose within the permitted tolerances of [PP1] is 1.4% representing £30 to £40 million of revenue."

In preparation for a subsequent slide, you'll see that their expectation for loss, of market share loss and revenue loss, is confined as a result of the price differential to 1.4% representing 30 to £40 million in revenue.

Then the next slide:

"A larger scale direct delivery operator would need to move to a zonal price plan to minimise surcharges."

As they rolled out, they would have to move off NPP1 to get off the surcharges:

"This would involve a trade-off between short-term losses to achieve longer term profits. Our zonal pricing tilt has an impact on how a DD operation might develop (see next slide)."

Turning over, we then see a slide which will be familiar to the tribunal already because it's reproduced in the decision. The headline:

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

You see that there are then various combinations of measures of varying degrees of aggressiveness or degree. Let's say degree, to use neutral language.

THE CHAIRMAN: Moderation, I thought you were going to say.

MR HOLMES: Or moderation, yes.

Option zero, scenario zero, is do nothing and wait for the market to develop without defending universal service obligation. You will see that the expectation there is that the likely outcome for the direct delivery operator is to stay on PP2 and grow to 20 plus SSCs. That would involve 9.4% of market share loss by 2017 and 240 million of lost revenues to Royal Mail.

The first scenario is to apply moderate value justified incentive on PP1 and moderate zonal tilt.

The price incentive for the national price plan proposed there is 0.3. The zonal price difference, the tilt, versus the national average price is then set out, and the likely outcome for direct delivery operators of that combination is still to end on PP2 and grow to 20 plus SSCs.

The market share loss is 5.9% by 2017, and is 160 million. So a little less of a loss to the direct delivery competitor than doing nothing, but it's not the best option. The best scenario, the green scenario, is to apply moderate value justified incentive on PP1 and significant zonal tilt, and they've modelled a 0.2% price incentive, which is slightly lower than the one that was ultimately adopted, and their particular zonal price difference, and the likely outcome for the direct delivery operator, the likely outcome, is said to be to switch to PP1 and stay there.

It says at the bottom:

"It is not profitable for [direct delivery] operator to switch back to PP2 at any point."

Now, this is an assumption, the likely outcome that's considered is a limited, a very limited roll-out, as we'll see from the next slide.

The market share loss there is confined to 1.4%. You'll recall that Whistl was already on 1.2% in the first quarter, so scarcely any growth. By 2014 -- and then the revenue loss to Royal Mail confined to 40 million.

The other options are variations on the theme. No changes to zonal tilt which will allow stretch value. Again, the consequences are set out. Not as favourable in terms of reducing the loss of revenue and market share to a direct delivery competitor. Four, similarly less favourable, in fact, it's a red option, it's as bad as doing nothing.

Then the final column is an interesting one. It's just to note.

The fifth option is do not offer PP1 incentive and just change to the zonal tilt.

That would involve no price differential.

But you'll see that this would produce an outcome that was less favourable for Royal Mail in terms of retaining market share and volumes by 2017, and that the direct delivery operator would still be expected to end on PP2 and grow to 20 plus SSCs.

Now, you'll recall that there's a debate about whether and to what degree one can disentangle the effects of the zonal tilt changes on the one hand and the price differential on the other in order to be able to show actual effects linked to Whistl's suspension of its roll-out and LDC's suspension of its investment.

What column 5 suggests, in my submission, appears to suggest on its face, is that the PP1 incentive was important to the selection that Royal Mail made of its chosen commercial strategy. The use of a zonal tilt alone was on Royal Mail's own internal modelling insufficient to achieve the desired outcome.

Option 2, which combined moderate value justified incentive with a significant zonal tilt, was expected to produce a more significant impact as the likely outcome for the direct delivery operator.

The next slide shows several possible scenarios in terms of the impact -- sorry, several possible -- the proposed actions of scenario 2 impact Whistl's published expansion plans from quarter 3, 2014.

The top row shows what would happen if there were no changes to price plans and Whistl expanded at a steady pace at steady profits.

THE CHAIRMAN: We are overrunning. I know I'm letting you finish this slide.

MR HOLMES: I'm grateful, and then perhaps we could take a -- in terms of my timing we're --

THE CHAIRMAN: For the benefit of the shorthand writers.

MR HOLMES: Indeed. Just very briefly to finish on this slide, you have the top box showing what happens if there are no changes to price plans and Whistl expand at a steady pace at steady profits. In other words, that's scenario zero on the preceding slide, and you see they grow to over 40% market -- in terms of the premises covered, and the overall market share grows accordingly by 2017.

There's then the changes to the price plans and TNT funds expansions through profits and requires a reasonable rate of return in each year. In that scenario, you see you get the result which is regarded as the likely outcome for the direct delivery operator in scenario 2 of the preceding slide. Whistl's expansion is curtailed. It stays small with a market share shown on the left of around 1.4%, as set out in scenario 2, as the likely outcome for the direct delivery operator.

Then there is also an alternative. Changes to price plans, Whistl foregoes reasonable rate of return for two to three years, to build economies of scale. So the assumption here is that Whistl and its investors are prepared to go without any profitability in the early years and the modelling suggests -- this is of course modelling based on Royal Mail's own assessment of Whistl's costs. They have developed an entrants' cost model, so they were watching Whistl very carefully, and modelled everything based on their own expectations of Whistl's costs.

In those circumstances, the slide suggests that there could be growth, and there could be an increase in overall market share to levels with a faster roll-out and plateauing at an earlier point than the no action scenario.

We see from the preceding slide what the likely outcome of direct delivery operator was which drove the decision to adopt the green column in that table.

Sir, if that's a convenient moment.

THE CHAIRMAN: Just to say on the next slide, 12, TNT appears to be on the high risk of complaint category.

MR HOLMES: Yes, indeed.

THE CHAIRMAN: Thank you. That will be a convenient moment.

(3.28 pm)

(A short break)

(3.36 pm)

MR HOLMES: The tribunal saw in slide 9 of the presentation we've just been considering the reference at the first bullet to sending a clear signal to the market that we will compete effectively to protect the USO.

The next document I want to show picks up on the same theme and it's at tab 46.

Now, although some of the names on this slide have been highlighted in green, there is agreement between the parties that confidentiality has been waived in relation to senior personnel. So I can state without a problem that this is an email from Stephen Agar, the Managing Director of Consumer and Network Access, to Sue Whalley, the Royal Mail lead witness, recording an indication given by Matthew Lester, the Chief Financial Officer and board member, to Ms Whalley and other executives at Royal Mail.

THE CHAIRMAN: Presumably we can refer to Ms Whalley as she, which has also been lifted.

MR HOLMES: Yes, without the need to disguise.

THE CHAIRMAN: Very good.

MR HOLMES: The emails refers to an approach that Mr Lester made to Mr Agar at the end of November/start of December to made it very clear that he expected the PSB to be presented with an option which was more assertive than the 0.2p price differential, which is the current recommended option.

As we know, the option was somewhat more aggressive than 0.2p, but it didn't go so high as something more like what I think must be 0.05p, not 5p, as suggested in the email.

He was fairly relaxed about the legal risks, provided that what we were doing was reasonable and arguable. He was very keen for us to send to give the market a very assertive signal. He suggested that Moya -- that's Moya Greene's -- risk appetite had changed in recent days and she was willing to be bolder.

Now, we quoted the reference to a very assertive signal in our defence and in the decision, and a point that's taken against us is that this document is referring to a more aggressive signal as a possibility that was ultimately adopted, 0.5p. Although, of course, 0.25 is more aggressive than what is being modelled at this stage.

What we rely upon this document for is more to show the market signalling that was going on here. You saw the reference to clear signals to the market in the last presentation, and here we have a reference to a very assertive signal.

The tribunal, of course, will have noted that the slight curiosity that we have a very sophisticated commercial outfit here, with very experienced people, who have spent a long time devising these changes that they put forward, in the knowledge that they would be -- the expectation that they would be suspended. We think that this signalling, and its potential consequences for a new entrant, even before suspension and even following suspension is apparent from these documents.

THE CHAIRMAN: Are you suggesting that where this document talks about being relaxed about the legal risks provided, what was done was reasonable and arguable, that that indicates in some way that the suspension is foreseen?

MR HOLMES: I will show you that the suspension was foreseen in a subsequent document.

THE CHAIRMAN: You cannot adduce that from this document.

MR HOLMES: I can't adduce that, indeed. That's quite correct. Of course, we can't know what legal advice was given at any stage, because although Royal Mail refers to having taken legal advice, they've declined to reveal it, so the tribunal can't know what the advice was or whether it was acted upon.

THE CHAIRMAN: There is nothing wrong in declining to reveal it.

MR HOLMES: No, indeed, but it nonetheless means that there is a limit to the extent to which the tribunal can attach weight to the argument which is made in mitigation, in particular in relation to penalty, that Royal Mail was acting advisedly. It was acting on the basis of advice, but we don't know what advice that was. We know we've seen the economic advice.

THE CHAIRMAN: We do know they took economic advice, yes.

MR HOLMES: But the legal -- anyway, you are quite right, I don't mean to imply that there's anything improper in refusing to disclose it, it's simply that it limits the scope to which reliance can be placed upon it as a basis for mitigating the level of the penalty.

At tab 45, we see that a signal had somehow already got out to Whistl's customers ahead of any formal announcement of the price differential. You see that this is an email from a person at TNT to another person at Royal Mail:

"Hi [name expunged]

"Wonder whether you can help? It has come to my attention that customers are being approached by one of our key competitors and stating that there will be a differential price coming April 14 in the above contract rates."

We see the NPP1/NPP3 price differential in the subject line:

"Please can you give us your absolute assurance that no Royal Mail employee has been authorised to make any announcement about there being a price differential between NPP1 and NPP2 access terms; in addition, can you please confirm that Royal Mail will not introduce differential pricing between NPP1 and NPP2 in April 14?

"Very much appreciate your help on this and thanks once again for confirming on the LL front that reversions will be the same in retail and wholesale.

"Kindest regards."

Customer approached by a key competitor who knows something about a price differential and they ask for confirmation that no Royal Mail employee has been authorised to make any announcement.

There's then a privileged part of a document, presumably seeking advice, who knows, but in any event that's been redacted.

The response is at tab 48. You'll see that it is an email from Stephen Agar, the Royal Mail Managing Director of Consumer and Network Access. He is responding to Whistl employee and so he says:

"Dear [name expunged]

"[name expunged] has forwarded on to me your email of 27 November. As [name expunged] raised a similar issue with me on the telephone on 25 November, I thought it more appropriate for me to reply.

"I can confirm that no employee has been authorised to make any announcement about there being a price differential between NPP1 and NPP2 access terms. I can go further and say that at the time of writing a final decision has not been taken as to the scale of the access tariff changes we will announce in early January.

"Having said that, there is clearly some speculation as to when our intentions are. We have made no secret of the fact that we have actively considered introducing such a differential and we raised the prospect of such a change last year.

"Therefore, in response to your email, I think it is fair that I should let you know that following careful consideration to ensure compliance with our regulatory and legal obligations, we have made a decision in principle to introduce a price differential between national price plan 1 and national price plan 2 and the average of zonal pricing from next April.

"The price difference has not yet been finally decided ...

"We will publish our new access tariff no later than 7 January 2014."

The signal to the market has now been sent directly to the direct delivery competitor that Royal Mail has been considering in these internal documents for some months.

At tab 47, you then see a little later the same day that a signal was sent formally marketwide:

"Dear Customer

"We are aware that there has been recent speculation in the market concerning whether or not Royal Mail would be introducing a price differential between NPP1 and NPP2 next April as we recently received a letter from one customer asking us to confirm what our position is.

"Although the final details of the access tariff charges have not yet been finalised, we have confirmed to that customer that we have made a decision in principle to introduce a price difference between NPP1 and NPP2, the zonal price plan from next April."

Then, that concludes my consideration of the documents for now in core bundle 4A. If we could now take core bundle 4B and we can pick up the story a little further on, tab 60.

This is the note of a meeting between Ofcom and Royal Mail officials on 10 December at which Royal Mail presented its plans to Ofcom.

For your note, although we don't need to go there, there is Royal Mail's note of the meeting at the immediately preceding tab, and a copy of the presentation made to Ofcom at tab 58.

The document I want to show you is Ofcom's note of the meeting and you will see that it's from Chris Rowsell, updating various Ofcom people on the meeting with Royal Mail regarding end to end and proposed access prices, 10 December 2013. You'll see that Royal Mail gave two presentations which are attached to the email:

"The first (action to protect the USO) set out Royal Mail's modelling of [Whistl's] future end-to-end activities, the impact of this on [Royal Mail's] sustainability and the need for Ofcom to intervene. In particular, they said Ofcom would take 12 to 21 months to implement universal service conditions and therefore couldn't intervene sufficiently quickly."

There's then a discussion about the modelling assumptions, and then the second presentation is described in the fourth large paragraph. This concerned April 2014 access pricing and it set out their plans for changing access prices in April 2014. And specifically their proposals to respond to direct delivery competition by establishing a differential between their national price plans and by changing zonal pricing.

They said that the price differential was justified by greater value of flexibility and therefore a higher price to reflect this value, and the cost savings due to changing resources based on the forecasting required by price plan 1. Then in relation to (b), Mr Rowsell continues:

"I asked whether an operator on price plan 2 could also provide forecasts which would presumably generate the same cost savings benefits."

This is the point that Oxera raised on several occasions:

"Royal Mail said that this wasn't how the price plan 2 worked."

Then he also asked Royal Mail how this was consistent with the Ofcom's March 2012 statement on the new regulatory framework which said that the weighted average of zonal access prices should be broadly comparable to the national access price.

Royal Mail said that things had changed. On the change to zonal pricing Royal Mail said they planned to reduce the zonal price for London to reflect their estimate of Whistl's costs.

Then finally, Stuart McIntosh, a senior Ofcom official:

"... thanked Royal Mail for the presentation and said it was important that they had satisfied themselves they were fully compliant with their obligations."

THE CHAIRMAN: I'm not quite sure what that means.

MR HOLMES: It's actually developed -- a description of it in slightly fuller form in the note -- the Royal Mail note, which I can take to you in the preceding tab, at paragraph 12:

"Ofcom set out that they did not have a view on the proposals. TNT has already contacted Ofcom setting out that they believed Royal Mail's proposals were likely to be exclusionary behaviour. Ofcom emphasised that Royal Mail must undertake its own due diligence on the price proposals and that this was not just a regulatory issue but also likely to be on a competition issue. Ofcom indicated that it would expect Royal Mail to discuss the proposals with all access customers not just NPP1 customers as customers may switch between price plans."

That's what light the documents can shed.

THE CHAIRMAN: It only means it was important that they should satisfy themselves.

MR HOLMES: I think that must be correct, yes. Indeed, yes. I think particularly in the light of the other document.

The next document I would like to show you is at tab 79 of this bundle. This is the paper prepared for the disclosure committee on 6 January 2014. This is the

Royal Mail team, executive team, getting internal approval for the contract changes.

The disclosure committee is explained at paragraph 4.11 of the decision. It's a subcommittee of the Chief Executive Committee, consisting of the CEO, CFO and six senior executives.

The title is: "Changes to access pricing plans: explanation and justification of Royal Mail's approach".

1.1 explains that Royal Mail is making changes to prices for access customers as a response to changes in the market and to reflect up-to-date information on costs.

1.2 identifies three main elements.

"An increase in the base tariff for all access customers in line with our business plans."

So they were increasing prices.

"(b) the introduction of a price differential of 0.3p between customers on national price plan 1 and those on national price plan 2 to reflect the cost benefits to Royal Mail of receiving advance information about posting volumes at the local geographic level which NPP1 customers provide but NPP2 customers do not which allows us to plan resources more efficiently, and the value to customers of the greater flexibility which they enjoy under NPP2."

Just pausing there, you notice that this is a more aggressive rate now than the 0.2 that was previously being discussed, but ultimately they settled somewhere in the middle.

Then (c):

"Changes to zonal access prices in response to changing market conditions and to make the prices more reflective of Royal Mail's and new entrants' costs of delivery in the different zones".

At paragraph 1.5, we see the statement:

"These changes represent a proportionate commercial response to the position in which Royal Mail finds itself, where 'cherry-picking' competition from direct delivery operators is clearly increasing in the larger urban areas, leaving Royal Mail exposed to stranded costs and threatening the viability of the universal service."

You have seen the advice that was given in relation to the stranded costs point, but it recurs here, the economic advice. Then the threatening the viability of the universal service.

At 1.6:

"Royal Mail welcomes competition, but believes it needs to be on a level playing field. We want competition authorities and regulators at the national and European level to take action to put in place a 'fair competition' framework for postal services, recognising the social and economic importance of a viable universal service for customers."

They don't like the current regulatory framework. They want tougher protections in place. Then:

"In the absence of this, and as suggested by Ofcom, we are implementing these cost-reflective pricing changes which we believe are compliant with our regulatory conditions and competition law."

They're taking matters into their own hands, given the lack of a regulatory response that they would like to have seen.

Then at paragraph 2.1, you see that the key justification for a price differential between NPP1 and NPP2 has now come to be Royal Mail's ability to remove costs earlier if given advance notification of the mailing intentions of access customers. This is the central justification, one can see from 2.10, over the page. The justification of price differential is solely based on the calculations of the cost differential between the two scenarios, not the value to customers of the additional flexibility. They're not relying on the value justification. The cost justifications where they're staking their -- they've decided that's where they're hanging their hat. Annex B provides more detail on the cost differential. We'll come to that in a moment.

Returning to paragraph 2, the justification, cost justification is explained. 2.2:

"If Royal Mail knows in advance the volumes it will be handling for each standard selection code, it can plan ahead and size its network to fit with those volumes. Without such advance notice, sudden reductions in volumes in particular localities can leave Royal Mail with high costs, which it will take longer to remove.

"Customers on NPP1 will be posted on a national posting profile and providing information two years in advance of significant changes in volumes of mail they expect to hand over to Royal Mail in specific localities."

You will note the "will be posting". That's of course because there was no actual forecasting requirement as at the time of this document. It was introduced in parallel with the price change, but it was confined to NPP1, customers couldn't opt in from any other plan.

By contrast, customers on NPP2 will not provide volume forecast at specific locality or SSC level, because they weren't be asked. Having advance notice of significant changes in forecast volumes at the SSC level, it is critical that it drives the ability to remove costs in different delivery areas.

Now, I'll come back to the value to customers, but first of all, you see in quantifying the cost differential there's a summary of what was done:

"We have undertaken detailed analysis with the operational teams within Royal Mail to understand what the cost differences are in the two circumstances set out above, ie with or without advance notification of significant changes in volumes at the SSC level.

The key difference is that with advance information, staff costs and some capital costs can be reduced earlier as delivery processes and capacity can be re-engineered sooner.

Our analysis has also sought to understand what level of volume change we should predict over the coming years. This has taken into account stated plans for roll-out of direct delivery from other mail providers and survey evidence from Ipsos Mori, looking at changes in the London markets."

Just to interpolate there, the Ipsos Mori survey was in the area where Whistl was rolling out. What Royal Mail did was it basically recruited households to keep a record of their post to see what was delivered by

Whistl and what was delivered by Royal Mail, and that was a method of assessing what Whistl's market share was in the small number of areas where it had rolled out.

The headline assumptions are, and then you will see that those are set out. But the key point here is Royal Mail knew that Whistl was on APP2. They knew that APP2 was the plan under which any large scale direct delivery roll-out would need to take place, but they didn't seek any information from Whistl, although it was obviously likely to result in significant changes in forecast volumes in those SSCs where it rolled out. You see that the cost saving in 2.2 relates to sudden reductions in volumes, in particular localities. You see from 2.3:

"Advance notice of significant changes in forecast volumes."

Whistl was the party that was going to produce potential significant reductions in volumes, and sudden reductions in volumes and significant changes. Indeed, the modelling that was done to quantify the cost differential was based on Whistl's roll-out plans and information about the market share that Whistl was acquiring.

Yet, Royal Mail, in implementing their price differential and the associated forecasting requirement, chose not to make a forecasting requirement or offering a forecasting option to Whistl, but to confine the forecasting requirement and the price differential to NPP1 customers.

There's a particularly striking fact about APP2 which I think I should show you now because it's relevant to this point. It's a confidential figure, so I need to show it to you by reference to the defence. But if you could pick up C1 and turn to tab 3, you'll see at paragraph 125(a) that two points are made.

The first is the confidential percentage of the volumes which Whistl represented on APP2. The second is to note that Whistl was by some margin Royal Mail's largest single customer.

It was the one that could roll out plans and yet for this cost differential there was no attempt to gain the information which was said to drive the cost savings from Whistl.

THE CHAIRMAN: Put the defence away?

MR HOLMES: Yes, you may, sir.

THE CHAIRMAN: Are we still on the papers for the disclosure committee?

MR HOLMES: Yes.

THE CHAIRMAN: Is it a draft, I notice?

MR HOLMES: It does say "draft".

THE CHAIRMAN: We have the paper as presented?

MR HOLMES: I shall check.

We'll come back to you on that, sir.

THE CHAIRMAN: Just to make the point that it's again marked "Legally privileged and strictly confidential".

MR HOLMES: Yes.

THE CHAIRMAN: That means it was run past somebody.

MR HOLMES: Yes, and interestingly, I don't think that there are any redactions from this document.

The last point just on the cost justification is that we say there is an obvious reason why, notwithstanding the logic of the cost justification, Royal Mail was unwilling to offer the option of a more favourable pricing to Whistl in exchange for information on its forecast volumes. The reason for that is that the underlying commercial rationale was to deter Whistl from rolling out its direct delivery operations beyond the small scale.

THE CHAIRMAN: You're suggesting this is all an elaborate charade to cover commercial intentions?

MR HOLMES: This document is setting out what the cost justification that Royal Mail intended to present was. I'm suggesting that these documents, taken together, show very clearly that the real concern was to avoid loss of volumes and revenue as a result of direct delivery competition.

THE CHAIRMAN: I think you're also suggesting that this document sets out the cost justification in the best possible light.

MR HOLMES: Yes. Yes. There are other documents that we will see which show that Royal Mail was quite careful in curating the documentary record.

THE CHAIRMAN: Curating has a technical meaning, I think.

MR HOLMES: I don't want to anticipate discussion with the witnesses.

THE CHAIRMAN: It means arranging the exhibits at a museum in a way that is most attractive to the visitor.

MR HOLMES: I was using it in a slightly more -- it's perhaps not the right word to have chosen.

What I meant was that Royal Mail was alive to the consideration of the documents that might find their way ultimately to a competition authority or to the CAT.

THE CHAIRMAN: That was just the point that Mr Beard made yesterday, which was continuing the scrutiny from a dedicated and professional regulator, they would expect their documents to be examined and their justifications to be questioned.

MR HOLMES: Yes, sir, indeed. They took care in consequence in the presentation of their plans and proposals at the time.

You will see that the value for customers which isn't relied upon as the basis for the extent of the cost differential is canvassed in 2.4 and 2.5:

"In addition to the cost justification, the change in access pricing also reflects the greater levels of flexibility that customers on NPP2 enjoyed, just as in other markets customers opting for a more constrained contract under NPP1 will pay less than customers with a more flexible contract under NPP2. A parallel could be seen in rail tickets where a time limited return is cheaper than an open return. More details of the value justification are set out in annex C."

Then on paragraph 4.3:

"We have taken advice from external legal and economic advisers. We believe that there are strong arguments that our pricing changes are fair and reasonable. They do not constitute either an abuse of prominence, undue discrimination or a breach of a margin squeeze test. More detailed economic analysis on these points is attached to annex A and in separate legal advice."

We obviously don't have the separate legal advice:

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

Any investigation is likely to take some time. We would expect the Competition Act complaint to take around two years with a shorter time period under Ofcom's regulatory provisions."

That's the period that Royal Mail were expecting uncertainty to exist in the market in the event of a Competition Act complaint and a subsequent investigation. It's not clear whether that two years also contains the time for the CAT appeal.

THE CHAIRMAN: Clearly not.

MR HOLMES: As matters have turned out, clearly not.

THE CHAIRMAN: It's wrong on a number of respects.

MR HOLMES: Then at annex A, you see an economic analysis of competition and regulation issues. Introduction. Paragraph 1.1:

"The access pricing proposals involve price discrimination ie Royal Mail is choosing to charge different customers different prices for the same service. Even for a firm deemed to be dominant in the market, price discrimination is allowed under competition law if it can be objectively justified."

Now, there are two points here. The first is we're inclined to say "quite", this is, as Ofcom has found, price discrimination with different customers being charged different prices for the same service. At that point, Royal Mail and Ofcom would have been ad idem.

Even if a firm is deemed to be dominant, there's the possibility of justification. That's true. But it's because of a risk under competition law that there has been this focus on finding an objective justification in the documents that we've considered.

Then at paragraph 1.4:

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

That is now ground 2 of this appeal.

In annex B, there's a discussion of the cost justification. You see again the point at paragraph 6:

"We have used a number of scenarios to illustrate the potential impact on our costs. Given the risk to the USO from direct delivery competition, these are focused on scenarios involving a direct delivery entrant."

Then the scenarios are set out over the page.

The first is the Whistl communicated plan, the second is Royal Mail modelling of Whistl roll-out with a £50 million investment, and the third is the Royal Mail modelling of Whistl roll-out with £100 million investment.

Then you see in the table the key assumptions used to assess potential cost savings due to advanced notification of significant volume changes under NPP1. Those are significant volume changes resulting from direct delivery roll-out.

They've used that to calculate, you'll see at 10:

"We have adopted a conservative approach in adopting and identifying the appropriate price differential for use in 2014. We are proposing a price differential of 0.3p per item, which is at the bottom end of the modelled range of potential cost differences."

The cost justification was to see how volumes would be affected by direct delivery roll out, and yet Whistl was not invited to offer volume forecasts or to benefit from the more favourable pricing that was being introduced.

I won't discuss this in detail now given the time, but you will find also in this document in annex C at page 22, a description of how a justification could be arrived at for a value based price difference, but for whatever reason, we've seen this isn't relied upon to justify the extent of the differential. I just note that what they've done is they've worked out the difference -- you see in the second paragraph:

"We have calculated the value to customers based on a variety of volume scenarios calculating the different surcharges that customers would pay on NPP1 compared to NPP2. The analysis is sensitive to the underpinning assumptions, but we estimate the value to customers to range from 0.23p to 0.57p."

Then, in the background, you see that they've worked out why it is that a customer might value the greater flexibility under NPP2 by reference to the driver of the volume decline. There are two reasons for volume decline. The first is e substitution:

"We would expect this impact to be broadly the same across different areas of the country. As such, this is unlikely to lead to surcharges under either plan."

Just pausing there, you've heard the suggestion from Mr Beard that the cost justification might work as a result of individual customers being involved in e-substitution. You've seen here that the impact is assumed not to be great enough from e substitution to lead to surcharges under either plan, and that raises a question about how realistic it is that the kind of significant and sudden volume drops, which were the basis for the alleged cost justification, would really be the result of e-substitution by a customer as a result of direct delivery competition.

MR BEARD: I think I was very clear. The cost modelling was done on the basis of direct delivery.

MR HOLMES: I'm grateful for that.

MR BEARD: I think I made it clear.

MR HOLMES: I'm grateful for that confirmation.

Then, just to complete the story, C4B/84 is an email to the board of Royal Mail -- and again this name is not now confidential -- Jon Millidge, the Company Secretary. You see that:

"There had been a discussion in the December meeting at which Moya Greene, supported by Stephen Agar and Sue Whalley talked you through our approach to wholesale pricing. A copy of the paper and the draft minute are attached as a reminder.

We will be making announcement tomorrow on this subject by way of press release in a stock exchange announcement. Huge amount of work. We have also continued to have discussions with Ofcom at policy, technical and CEO to CEO levels as recently as this morning."

So they're completely aware of what they're doing.

"In summary, our proposal was concluded at the meeting y5esterday and its content is ..."

Then you see there's the increase in prices. There's the price differential, and the changes to the zonal access plans, prices to make prices more reflective of costs and to respond to changing market conditions.

"We expect that proposals 2 and 3 will be contentious. We have conducted a lot of work with our economic advisers, Oxera, and legal advisers."
A different firm of solicitors from those acting in these proceedings. Is that name still confidential? Apparently we can reveal that they were advised at that stage by Herbert Smith Freehills:

"A high level summary of their legal advice is attached."

We do not have that.

"Please note this document is legally privileged and confidential. Moya has undergone a rigorous review with these parties this week. We believe that our proposals are proportionate, reasonable and necessary to support the sustainable provision of the USO in light of changes in market conditions, including the growth of direct delivery competition."

Then over the page, the final two sentences:

"We believe the measures discussed at the board and outlined above are the only commercial measures we can sensibly take. They do, however, carry some legal and regulatory risks as outlined in the note from Herbert Smith Freehills."

They expect to receive complaints from some customers, they have already received a letter of complaint from Whistl.

You see, further down the page, the two-line paragraph:

"We fully expect the access price charges to be suspended pending the outcome of the Ofcom investigation."

That's why I say that they expected suspension. Then underneath the two ways in which that could happen:

"We think Whistl's claims about the harm they will suffer are exaggerated but it is possible that they may find it difficult to attract new customers given the market uncertainty that may be created by their complaint. It is also possible that Whistl's financing may be conditional on there being no regulatory or competition law dispute ongoing."

I put it no higher than that than this. Royal Mail was aware at a senior level of the possibility that the signalling to the market, the announcement and then the issuance of the CCNs, might have effects on Whistl notwithstanding the suspension that they expected to see.

Then at C4B, at tab 86, there is the announcement of the 2014 access prices with a high level summary of changes, and you see item 2, the introduction of the price differential of 1.2%. Ultimately, they went for the Goldilocks option between 0.2p and they were originally modelling and 0.3p that they were considering after the suggestion of a more aggressive approach:

"The introduction of a price differential of 1.2% between national price plan 1 and the national average price plan 2, this reflects the costs benefits to Royal Mail of receiving advance information about posting volumes at a local level which NPP1 customers provide but APP2 and ZPP3 customers do not. As well as the value to customers of the greater flexibility they enjoy under APP2 and ZPP3."

Then finally changes to the differential between zonal access prices in response to changing market conditions.

That is the documents.

In the little time remaining, let me draw a few key conclusions, if I may.

THE CHAIRMAN: I would like to see the final version of the paper given to the disclosure committee, if it's available. At least give me the reference.

MR HOLMES: Ms Morrison helpfully draws my attention to paragraph 222 of Ms Whalley's witness statement, which confirms that the draft paper that I have shown to you was considered at the 6 January 2014 disclosure committee meeting, and it's also at RM, Royal Mail bundle 2C, tab 78, and is identified as exhibit -- Ms Whalley's statement, SW1/7J.

THE CHAIRMAN: Is that in draft form?

MR HOLMES: 74, apologies.

THE CHAIRMAN: It is that in draft form or in single form?

MR HOLMES: I understand that both documents are marked "draft", but Ms Whalley's evidence confirms that the document was considered at the disclosure committee meeting.

THE CHAIRMAN: So there isn't some other version?

MR HOLMES: Not that we're aware of and on the basis of the evidence, we take it that that is the final version.

MR BEARD: We will confirm the position, but we think that there may not be a further version than the draft that has been exhibited, hence Ms Whalley's statement.

THE CHAIRMAN: Forgive my natural suspicion.

MR BEARD: Perfectly understandable. Marking can be so misleading on documents.

MR HOLMES: Key conclusions from the documents.

The first is that Royal Mail was motivated to introduce the price differential by Whistl's direct delivery roll-out plans. The measure was from the outset targeted at Whistl.

Secondly, Royal Mail's intention was to discourage Whistl from pursuing its direct delivery plans by imposing a price penalty upon it if it did so.

Thirdly, Royal Mail expected Whistl to abandon its direct delivery plans following a low level of roll out and to stay on NPP1 to shelter itself from the price differential.

Fourthly, Royal Mail adopted the package of measures which it expected most profoundly to limit Whistl's roll-out. For this its modelling indicated that it was required to combine both the price differential and the zonal tilt. The price differential was therefore a necessary component of Royal Mail's strategy.

Fifthly, Royal Mail expected other customers on APP2 to be able to mitigate the adverse effects of the price differential, either by switching to NPP1 or routing their mail through a national aggregator.

Sixthly, Royal Mail selected the price differential over other options in order to avoid revenue dilution. It rejected the option of competing on price, whether generally or in particular areas.

Seventhly, Royal Mail's internal view was that the price differential amounted to price discrimination.

Eighthly, it therefore sought to develop objective justifications for the differential with the assistance of Oxera, but they were not the true commercial reason for introducing the differential.

Eighthly, Royal Mail chose to rely on a cost justification. The cost justification was determined by reference to Whistl's roll-out plans, but Royal Mail rejected the idea of giving favourable pricing to Whistl in exchange for volume forecast. Those are the documents.

Sir, I propose tomorrow to run through and give you my high level responses to the grounds. I believe Mr Turner has a request to make in relation to the conduct of proceedings tomorrow.

MR TURNER: Sir, the request is whether it's possible to start slightly earlier tomorrow, either at 10.00 or 10.15.

THE CHAIRMAN: Yes, if that would help you. We can start at 10.00 if that helps.

MR TURNER: Yes, I'm obliged.

THE CHAIRMAN: Are you still happy to finish at 4.15?

MR TURNER: Yes. We will be co-ordinating, but that should help. We understand that that's a hard stop for the tribunal.

THE CHAIRMAN: That's a hard stop, I'm afraid.

MR HOLMES: I shall cut my cloth.

THE CHAIRMAN: We will start at 10.00.

MR HOLMES: I'm grateful. Thank you.

THE CHAIRMAN: Thank you very much.

(4.27 pm)

(The hearing was adjourned until the following day)

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