

Price Control – “Interim Review” TNT Post UK Limited response

Background to TNT Post request

The inclusion of access services in the May 2006 price control decision incorporated essential but limited margin squeeze protection for access operators. The Interim Review, therefore, presents the first available opportunity for TNT Post to request Postcomm to redress the progressive margin squeeze which has taken place since the first downstream access agreement was reached in February 2004.

Essential to protect operators from margin squeeze with *ex ante* measures

Postcomm has acknowledged that TNT Post is operating efficiently but has not proposed any measures to create adequate and effective margin squeeze protection. TNT Post has provided considerable data (the reliability of which has not been questioned) to show that margin squeeze has already taken place historically compared with the Mailsort 2 prices. We urge Postcomm to reconsider its proposed decision, in light of its statutory duty to promote effective competition for the benefit of users, by reducing the access prices to a level where TNT Post is able to operate profitably when providing each of the access services i.e. on 120 OCR, 120 CBC and 700 CBC access services.

Access services compete against more than Mailsort 2 services

The proposed decision seems to assume that access services are competing only against Mailsort 2 prices (*paragraphs 4.25 and 5.9 and footnote 45*). That is not the case. TNT Post is also competing against 2nd and 1st class metered, PPI and stamped services and other services such as Presstream and Mailsort Light. The pricing of these last two mentioned services, in particular, is set at such a level that competition is impossible in a considerable number of cases.

Risk of further margin squeeze from re-balancing

If Royal Mail should be permitted to re-balance prices in the way contemplated further margin squeeze from 1st Class PPI and metered mail seems inevitable.

Ex ante measures are needed – ex post regulation is insufficient

We are increasingly concerned that, notwithstanding our having demonstrated margin squeeze in a number of areas, Postcomm is advocating a voluntary, negotiated solution. For the reasons stated below, this is not realistic. It means that Postcomm is effectively narrowing the courses of action available to the courts, the OFT and/or the European Commission. As we have stressed previously, *ex post* remedies against a super-dominant incumbent at this very early stage of market opening are likely to be “too little, too late.” Postcomm, as sector-specific regulator, is best placed, and should therefore, create the mechanisms to prevent margin squeeze, in the first place.

Voluntary solution is not realistic

We recognise that, while it may be desirable to seek to agree more uniform headroom levels over the range of access services, this is not a realistic prospect not least because Royal Mail has recently indicated (a position which we do not accept) that may not be compelled under condition 9 to offer different pricing for an existing

service. Such a loophole (if one exists) leaves access operators with virtually no leverage to secure more uniform terms.

Margin squeeze has been demonstrated by TNT Post – Postcomm needs to act

- a) Although Postcomm has indicated (*at paragraph 2.6 and footnote 16*) that setting prices at a level which prevents an operator from trading profitably may be unlawful margin squeeze, it has not taken the necessary step of requiring all prices to satisfy this test.
- b) Based on the information we have provided in May 2007 (which demonstrated losses of **[BUSINESS CONFIDENTIAL – REDACTED]** pence per item for TNT Post’s unsorted mail services and losses of **[BUSINESS CONFIDENTIAL – REDACTED]** pence per item for TNT Post’s pre-sorted mail services), it is clear that we are currently unable to trade profitably on any service. We see absolutely no justification for this failure to act.
- c) There also appears to be a presumption that increased volumes will lead to a decrease in unit costs. Our analysis would indicate that, while the general trend is that increased volumes leads to a reduction in upstream unit costs, (a) this may be less pronounced in a growing business which is operating at efficient levels from the outset and (b) this overlooks the step increase in unit costs following material investment e.g. in sortation equipment.
- d) TNT Post is, therefore, disappointed that Postcomm has indicated its intention to maintain the status quo in both the depth and breadth of *ex ante* regulation against margin squeeze. Such a decision is regrettable in that it will be potentially damaging to the ability of our business to reach profitability and generate funds for future investment in jobs and equipment.

Access price increases must not reduce headroom – and no increase unless last resort

- a) Postcomm notes that there are a number of areas where Royal Mail could have improved its financial position under the price control. TNT Post is, therefore, very concerned about the implication that Postcomm may allow Royal Mail to increase access prices in the future but without making any such increase conditional upon having exhausted its existing rights under the price control. Such an approach would be to allow Royal Mail to “cherry pick” the parts of the price control it likes and change those it does not in an effort to undermine new competition. Given the damaging effect any such a move could have on competition and, thus, on customer choice, Royal Mail should take all these alternative measures before it should be entitled to raise access prices.
- b) And even then, if there is an increase in access prices, there must be a corresponding increase in the retail prices to redress margin squeeze to date and to avoid further margin squeeze.

All Royal Mail prices must cover costs – currently, they do not

The margins in postal services, generally, are extremely tight or negative. It is entirely unacceptable that Royal Mail should keep (and be allowed to keep) prices below costs for fear of losing out the competition – as is apparently suggested in paragraph 5.32. Where prices offered by (super) dominant Royal Mail are below

fully allocated cost they are predatory, according to the recent Postcomm decision in the Business Mail Secure complaint. Postcomm must, therefore, insist that all of Royal Mail's prices are above fully allocated costs: all the more so where the concern about raising prices is that Royal Mail may lose business, be it to a rival operator or alternative media.

Summary:

Reliable data from TNT Post has demonstrated that it cannot operate profitably so headroom needs to be increased on all current access services, particularly 120 OCR; 120 CBC and 700 CBC)

A voluntary settlement involving lower access prices (and thus, increased headroom on the three mentioned services) is unrealistic.

Royal Mail must be required to demonstrate that all prices are above fully allocated costs **[BUSINESS CONFIDENTIAL – REDACTED]**

Margin squeeze from services other than Mailsort 2 is already evident (e.g. Mailsort Lite, Mailsort 3, Presstream, Cleanmail Advance) yet there is no regulatory protection.

When examining the Royal Mail re-balancing request, Postcomm must be extremely vigilant – and carefully consult with competitors – to understand the retail services against which access operators are competing and to ensure that none of the retail price reductions will result in margin squeeze of access operators.

For the foreseeable future, competition will be primarily from access competition. In the medium term (in addition to tackling the existing margin squeeze), Postcomm needs to create greater regulatory certainty through *ex ante* measures about the permitted level of headroom between all relevant retail prices (taking into account all direct and indirect discounts, incentives and commission schemes) and wholesale prices.

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**TNT Post UK Limited
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