ABUSE OF DOMINANT POSITION (PARCELS) THE DEUTSCHE POST CASE

Subject: Abuse of dominant position
Predatory pricing
Rebates
Fines

Industry: Parcel services
Postal services
(Some implications for other industries)

Party: Deutsche Post AG (the German Post Office)

Source: Commission Statement IP/01/419, dated 20 March 2001

(Note. Postal services are financed on the principle of cross-subsidisation; but there is a limit to the extent to which post offices may cross-subsidise services which are of a more commercial character, such as business parcel services, and thereby threaten competitors in that market. The interest of this case lies in the way in which the Commission has said that the line must not be crossed and in the economic considerations supporting its conclusions.)

Commission Decision

The Commission has concluded its antitrust investigation into Deutsche Post AG (DPAG) with a decision finding that the German postal operator has abused its dominant position by granting fidelity rebates and engaging in predatory pricing in the market for business parcel services. As a result of the investigation, DPAG will create a separate legal entity for business parcel services. The system of transparent and market-based pricing between DPAG and the new entity for products and services they might provide to one another is a suitable safeguard for DPAG's competitors in business parcel deliveries that revenues from the monopoly in the letter market will not be used to finance such services. Furthermore, in the light of the foreclosure that resulted from a long-standing scheme of fidelity rebates granted by DPAG to all major customers in the mail-order business, the Commission has imposed a fine of €24m. This is the first formal Commission decision in the postal sector under Article 82 of the EC Treaty, which prohibits abuses of a dominant position.

Competition Commissioner Mario Monti commented: "Today's decision establishes clear rules on the issue of cross-subsidies which postal monopolies who are also engaged in activities open to competition must respect. The winner clearly is the public at large: pricing below cost must be paid by somebody and that 'somebody' usually is the monopoly's customers. Moreover, pricing below cost forecloses market entry by efficient competitors and therefore prevents a wider offer at better prices and service conditions. I am particularly pleased that in this case we have not simply sanctioned anti-competitive practices but achieved a forward-looking result, in the form of Deutsche Post's commitments in the parcel delivery market which are of great importance to the development of electronic commerce."

In 1994 United Parcel Service (UPS), a private operator in the business parcel sector active in Germany lodged a complaint with the Commission, alleging that Deutsche Post was using revenues from its profitable letter-mail monopoly to finance a strategy of below-cost selling in business parcel services, which are open to competition. Without the cross-subsidies from the monopoly, UPS alleged, DPAG would not have been able to finance and survive these below-cost prices for a very long time. UPS therefore called on the Commission to prohibit DPAG's below-cost selling in the business parcel sector and impose a structural separation of the reserved area and commercial parcel services.

For the first time in the postal sector, the Commission's decision sets forth a standard for measuring those cross-subsidies between the monopoly area and competitive activities which result in predatory prices in the latter: any service provided by the beneficiary of a monopoly in open competition has to cover at least the additional or incremental cost incurred in branching out into the competitive sector. The Commission considers that any cost coverage below this level is predatory pricing which falls foul of Article 82 of the EC Treaty. The investigation has revealed that DPAG, for a period of five years, did not cover the costs incremental to providing the mail-order delivery service. No fine was imposed for this infringement because the economic cost concepts used to identify predation were not sufficiently developed at the time the abuse occurred; in addition, DPAG has now tackled the issue in a satisfactory way.

Transparency of financial relations between the monopoly and parcels services which are open to competition is indispensable to guarantee that revenue of competitive services covers the incremental cost of producing that service. To ensure the requisite level of transparency of financial relations between its monopoly and business parcel services, DPAG has given an undertaking to the Commission that it will create a separate company (Newco) to supply business parcel services. Newco will be free to procure the inputs necessary for its services (these inputs include, for example, sorting, transport and delivery services) either from DPAG or from third parties or produce these inputs itself. Should Newco choose to purchase the inputs from DPAG, the latter will have to provide to Newco all goods and services at market prices. In addition DPAG has undertaken that all inputs it supplies to Newco will be supplied to Newco's competitors at the same price and on the same conditions. Thus, DPAG, in the future, will have no incentive to charge prices below market prices when selling inputs to Newco.

Effect of Decision

This formal decision under Article 82 of the Treaty clarifies the Commission's position on the costs to be covered by a multi-product monopoly operator that offers an additional line of products in markets open to competition. It also provides competitors active in mail-order parcel delivery services with the ensuing legal security. This is particularly important should electronic commerce create additional mail-order delivery volume in Germany.

In its decision the Commission also condemns DPAG's long-standing scheme of fidelity rebates in mail order parcel deliveries. The Commission's investigation revealed that, from 1974 through October 2000, DPAG gave substantial discounts to its large mail order customers on condition that the customer sent its entire mail-order parcel business or at least a sizeable proportion thereof by DPAG. Such a system of fidelity rebates forecloses competition. The fidelity rebate scheme has essentially precluded any private competitor from reaching the critical mass (estimated at an annual turnover of 100 million parcels) to enter successfully the German mail-order delivery market. This is borne out by the fact that between 1990 and 1999 DPAG had a stable volume-based share of the mail-order parcel market exceeding 85%.
In the light of the fact that fidelity rebates given by an undertaking in a dominant position have repeatedly been condemned by the Community courts, and given the long duration of the scheme in the case at issue, the Commission considers that a fine of €24m is appropriate for this abuse.

Economic aspects of Decision

Mail-order parcel services (definition)

By reason of their characteristics, costs and uses, mail-order parcel services form a relevant product market. They are distinct from over-the-counter parcels on the one hand and business-to-business (B-to-B) parcels on the other. Mail order parcels are not processed through the postal counter system but are collected by DPAG directly at the customers' premises; and DPAG only offers special prices to customers who do not use the postal counter. Although they share the infrastructure at the sorting and transport stages, final delivery to private addressees makes much greater use of vehicles and postal delivery staff than do B-to-B services. In the case of mail-order services the dispersed addressee structure produces a very low stop factor (that is, the number of parcels delivered per delivery vehicle stop), one parcel per stop being the rule. In the case of parcel services between business customers, the stop factor is much higher, as here several parcels are normally delivered whenever the delivery vehicle stops.

Mail-order parcels (cost coverage)

During the investigation, it emerged that parcel services which DPAG provides to mail-order firms have the lowest percentage of cost coverage. Cost coverage in mail order parcel deliveries was significantly lower than that achieved in B-to-B deliveries. In Germany, there is competition in B-to-B deliveries.

Mail order parcel services (legal framework)

All parcel services, including mail-order parcel services, are open to competition in Germany. Nevertheless, only B-to-B deliveries are marked by actual competition.

Mail order parcel services (geographic market)

The relevant geographic market in mail-order parcel services is Germany. All the services provided by DPAG on the relevant product market are provided in Germany, using the nation-wide parcel infrastructure.

DPAG's dominant position in mail order parcels

DPAG is the only significant provider in Germany of nation-wide parcel and catalogue delivery services which meet the specific requirements of the mail-order trade. Neither UPS nor the other competitors providing B-to-B services, namely, Deutscher Paket Dienst and German Parcel, provide mail-order parcel services to any appreciable extent. Until 1999 inclusive, Hermes Versand Service (Hermes) delivered only parcels for Otto Versand. Apart from Hermes, there is no alternative nation-wide infrastructure for the mail-order trade. Between 1990 and 1999 DPAG had a stable volume-based share of the mail-order parcel market exceeding 85%.

Competitors of DPAG in the parcel sector

Since about 1976 there have been competitors in Germany who have been supplying parcel services, mainly between business customers (B-to-B services). But none of the competitors who have been successful in the B-to-B sector have been able to carry their success over into mail-order parcel services.

The standard based on additional or "incremental" costs

To establish predatory prices the decision proposes to distinguish between costs for network capacity and network usage. The Commission considers the costs incurred for providing network capacity to give everyone an option to ship parcels at a uniform rate as part of DPAG's universal service obligation. Economists refer to this kind of universal service obligation as the obligation to serve as the carrier of last resort. Requiring a firm to serve as a carrier of last resort forces this firm to hold capacity in reserve in order to meet demand at peak load. These costs are appropriately treated as common fixed costs for DPAG. On the other hand, the Commission proposes to hold that the costs for actual usage of the network for offering product X are long-term variable or incremental costs. If prices for a particular product or service are not to be deemed predatory, they must cover at least the incremental costs of producing that service.

Incremental costs and the universal service

Prices below the incremental costs cannot be justified as necessary to fulfil DPAG's universal service obligation. This is because the additional sales at this price make no contribution to maintaining the network capacity necessary for DPAG to perform its universal service obligation. On the contrary, such prices actually endanger the financial equilibrium necessary to fulfil the universal service. ■