



**ACQUISITION BY BAI OF CERTAIN ASSETS OF P&O  
DEPLOYED ON THE PORTSMOUTH/LE HAVRE ROUTE –  
FURTHER SUBMISSION BY P&O IN RELATION  
TO PRICE SETTING AND FREIGHT AND TOURIST SWITCHING**

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## PRICE SETTING

### TOURIST

#### 1. Introduction

P&O sets tourist prices by reference to two key parameters: the actions of competitors; and changes in the level of booking rates (picking up fluctuations in demand). While competitor prices on the Short French Sea and Western Channel are carefully monitored (see P&O's response to the OFT's specific question on price monitoring) the considerable array of promotional and non-promotional prices at any one time and the impossibility of direct comparisons with certain competitor pricing (for example, the low cost airlines, see further below) means that there is no exact correlation between price monitoring and price setting.

#### 2. Competitor pricing

P&O sets prices by reference to the following competitor prices:

- **BAI Western Channel tourist prices** (as a rough yardstick, [**CONFIDENTIAL – CONTAINS BUSINESS SECRETS**]);
- **Short French Sea competitor tourist prices** (Eurotunnel, SeaFrance, Hoverspeed, Speedferries, Norfolkline). P&O is acutely aware (in particular after the introduction of the 2004 peak season Short French Sea £100 return fare) of the need for Western Channel tourist prices to be competitive to those on the Short French Sea. P&O records competitor pricing on the Short French Sea (and Western Channel) by means of specially prepared pricing matrices recording the range of day, short and long stay offers of a competitor. An example was submitted by P&O in response to the Office's recent price monitoring question. P&O does not automatically apply Short French Sea prices on the Western Channel. It could not afford to do so, given the different economics of operating longer Western Channel routes with lower rates of vessel utilisation, higher fuel costs and less attraction for short stay traffic. Instead, P&O sets Western Channel prices by reference to a differential between Western Channel prices and those on the Short French Sea. There is no bright line as to where this differential must sit – it necessarily must reflect changing market circumstances, including (see further below) the impact of the low cost airlines and high speed rail. In contrast to standard tourist fare setting, P&O, as a rule, will match Western Channel promotional prices to promotional prices offered on the Short French Sea.

#### 3. Fluctuations in tourist bookings

As noted in the introduction, downward movements in bookings, subject to duration and materiality, will prompt a marketing analysis and, frequently, a sales response in the form of a promotion or price adjustment. A downward movement in bookings will pick up the

impact of competitor actions on the Anglo/French tourist market as well as wider/non-ferry competitive forces such as the competitive impact of low cost airlines and high speed trains. Because of factors such as the current complexity and spread of tourist ferry pricing; the operation by airlines of automatic dynamic pricing models; and the wide array of airline and high speed train origin and destination pairings (not comparable to port-to-port ferry origin and destination pairings), it is impossible to build up systematic pricing comparisons between tourist ferry operators and low cost airlines or high speed train operators. Yet, and as extensively explained in the parties' joint main submission, low cost airlines and high speed trains represent a very real competitive constraint upon tourist ferry activities that analysts, the specialist press and operators **all** recognise. This constraint (which is part of a wider competition for the tourist customer's selection of destination) is picked up by downward variations in bookings and responsive pricing actions will typically be set once a non-immaterial shift has been identified.

## **FREIGHT**

### **4. The setting of freight rates**

Freight prices for account customers (explained below) for the following year (commencing January) are typically set (through a process of bilateral negotiation) in the Autumn (October/November) of the preceding year. P&O negotiates its Portsmouth/Le Havre account freight prices primarily by reference to:

- **Channel Freight Ferries' ("CFF") freight prices** on Southampton/Radicatel, CFF being a very close geographic substitute;
- **Transmanche's freight prices** on Newhaven/Dieppe, equally a proximate geographic substitute;
- **freight prices on the Short French Sea** (where excess capacity, a rates war and improved French motorway connections (and a number of other switching drivers described in P&O's remarks on freight switching) provide a strong draw for Western Channel freight); and
- **BAI's Western Channel freight rates.**

Competitor price data is captured by P&O's freight department in Dover and by its Continental freight sales agents, all of whom have regular contacts with "account" customers (either at the time of the annual rates negotiation or upon an *ad hoc* basis in the event of a loss, or the threat of a loss, of business). Account customers are customers with an account number, credit facilities and a bilaterally negotiated rates agreement. Non-account customers will pay the "spot" cash price in the port – such customers make up a small proportion (less than five per cent.) of the total. Rates will vary per customer according to the volume that is committed to be shipped over a given period and by reference to peak and off-peak (essentially day and night time) sailings. Competition in

the Western Channel freight sector is dynamic with a continuing competitive threat from the high volume, high convenience, turn up and go Short French Sea sector and from successful new entrants such as Channel Freight Ferries and Transmanche. The competitive process is characterised by the practice of road hauliers having accounts with all ferry operators and by price "quoting" and price "matching", in which customers quote competing freight rate offers to an operator such as P&O and invite P&O to match or better the offer or risk losing the business.

## **FURTHER EVIDENCE IN RELATION TO FREIGHT AND TOURIST SWITCHING**

### **1. FREIGHT SWITCHING**

#### **Introductory remarks**

1.1 P&O has a range of empirical evidence which indicates the nature and extent of the switching to which its Western Channel freight business is subject.

1.2 **[CONFIDENTIAL – CONTAINS BUSINESS SECRETS]**

1.3 **[CONFIDENTIAL – CONTAINS BUSINESS SECRETS]**

#### **1.4 The competitive pull of the Short French Sea freight sector**

The very fierce competition from Short French Sea freight operators, fuelled by excess capacity and a price war, coupled with materially improved French motorway networks (detailed in the parties' joint main submission), provides a continuous competitive Short French Sea "pull" against the longer and more marginal Western Channel freight routes.

#### **1.5 The competitive pressure from Western Channel freight new entrants**

There is clear evidence, considered further below, that Transmanche (Newhaven/Dieppe) and Channel Freight Ferries (Southampton/Radicatel) are diverting business away from P&O's Western Channel freight services, in particular its Portsmouth/Le Havre service.

1.6 **[CONFIDENTIAL – CONTAINS BUSINESS SECRETS]**

#### **1.7 The introduction of deeper freight rate discounts in return for meeting strict minimum volume commitments**

Eurotunnel have introduced deeper Short French Sea freight discounts and guaranteed capacity availability upon condition that customers meet strict annual minimum volume commitments. Since a high proportion of Western Channel customers also use the Short French Sea, and since freight haulier volumes are invariably far higher on the Short French Sea, this has led (and is expected to continue to lead in increasing proportions) to hauliers switching Western Channel traffic to the Short French Sea in order to avoid losing very valuable Short French Sea volume discounts.

#### **1.8 The increasing control by multiple retailers of the freight transport costs chain**

UK multiple retailers have increasingly (over the last 2-3 years) exercised control over the freight transport costs of goods by buying ex-works in countries such as Spain, Portugal, Italy and France and using their volume-related purchasing power to secure lower freight ferry rates. This process has caused an increasing migration of freight from the Western Channel to the Short French Sea where multiple retailers (and others) enjoy far deeper volume-related freight rate discounts.

## **Evidence of switching**

### **1.9 The evidence of increases and decreases in Western Channel and Short French Sea freight carryings indicates switching between the two sectors**

Annex 11 to the parties' joint main submission set out details of increases and decreases in P&O's Western Channel and Short French Sea freight carryings for the years 2002 and 2003. P&O has no record of the reasons for the changes in carryings between the two sectors, though considers the data to amount to, *prima facie*, evidence of switching in view of:

- (a) the many external drivers of switching set out in the introductory remarks in paragraphs 1.1 to 1.8 above;
- (b) the large number of customers using both the Western Channel and Short French Sea sectors; and
- (c) the very dynamic rates of fluctuation between the two sectors that can be observed.

P&O attaches in **Annex 1** to this submission, a further breakdown of volume changes on the Western Channel for the first nine months of 2004 (versus the first nine months of 2003) with, this time, and bearing in mind the recent occurrence of the changes, management's view of where and in some cases why, the freight switched.

### **1.10 Additional examples of switching to the Short French Sea**

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### **1.11 The competitive constraint of Channel Freight Ferries**

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### **1.12 The competitive constraint of Transmanche**

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### **1.13 Conclusions**

P&O does not systematically monitor/explore the reasons for rises and falls in Western Channel and Short French Sea freight volumes. It could not do so, practically or economically speaking, bearing in mind that thousands of individual freight consignments are involved. The evidence of switching that has been put forward is therefore, by necessity, drawn from a variety of different sources and **must** be considered in the round:

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- the decreasing cost and high convenience of Short French Sea freight services creates a continuous competitive pull against Western Channel services;
- multiple retailers (taking control of all logistics costs) are exploiting very low rates on the Short French Sea to switch former Western Channel traffic to that sector;
- Short French Sea operators (for example, Eurotunnel) are offering deep discounts in return for meeting strict volume commitments – hauliers are switching traffic to the Short French Sea from the Western Channel in order to ensure that such high volume and high value (in aggregate terms) discounts on their traffic are not lost;
- independent agents find that heavily discounted Short French Sea freight rates enable them to offer better deals on the Short French Sea than on the Western Channel;
- since the late 90s, Spanish freight has been migrating to the Short French Sea;
- there are a number of specific examples of switching to the Short French Sea (despite the difficulties of capturing this sort of data);
- there are a number of specific examples of switching to Channel Freight Ferries (despite the difficulties of capturing such data);
- there are a number of specific examples of switching to Transmanche (despite the difficulty of capturing such data).

## 2. **TOURIST SWITCHING**

P&O does not possess tourist switching data in relation to individual customers. With a highly fragmented purchasing base, it would not be practicable to record such data. However, in relation to ITX **trade** buyers of tourist services, it does have evidence of the incentives that ITX operators require in order to promote more marginal Western Channel tourist routes and in order not to switch their tourist ferry purchases to lower priced/higher convenience Short French Sea services. **Annex 5** contains full details of the supporting copy correspondence, but the following elements are highlighted in summary form:

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The above types of incentive, designed to ensure the promotion and sale of less attractive/more marginal Western Channel tourist services and to prevent the switching of Western Channel tourist business to the Short French Sea, have been a feature of the ITX industry for a considerable number of years. However, with the increasing level of Short French Sea excess capacity and fierce price competition, they have become increasingly important .

**ANNEX 1**

**DECREASE OF WESTERN CHANNEL FREIGHT UNITS 2004 V 2003 (NINE MONTHS COMPARATIVE)**

**[CONFIDENTIAL – CONTAINS BUSINESS SECRETS]**

**ANNEX 2**

***[Note: provided separately in electronic version.]***

**[CONFIDENTIAL – CONTAINS BUSINESS SECRETS]**

**ANNEX 3**

***[Note: provided separately in electronic version.]***

**[CONFIDENTIAL – CONTAINS BUSINESS SECRETS]**

**ANNEX 4**

***[Note: provided separately in electronic version.]***

**[CONFIDENTIAL – CONTAINS BUSINESS SECRETS]**

**ANNEX 5**

***[Note: provided separately in electronic version.]***

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