



Steven Ball  
Ofcom Riverside House  
2A Southwark Bridge Road  
London  
SE1 9HA

24<sup>th</sup> February 2015

Dear Steven,

**OFCOM'S ACCESS PRICING REVIEW - MAIL USERS' ASSOCIATION'S FORMAL RESPONSE**

**1. Introduction**

- 1.1 MUA is the UK's only independent association of business users concerned wholly with commercially related postal matters. Its members are drawn from a wide range of business interests including direct mail, banking and finance, communications, publishing and postal related industries. Collectively, it is estimated MUA members generate more than 10% of annual postal traffic in the UK, and represent a category of large volume mailers otherwise referred to as *Super Users*.
- 1.2 MUA members believe the development of competition in the marketplace has brought considerable benefit to the postal industry as a whole, and represents an important and necessary transformation from the days of a state postal monopoly.
- 1.3 Effective, efficient and improving competition is, MUA believes, vital to supporting the use of mail as a communication medium, against a background of overall decline in postal volumes and increasing use of alternative forms of communication between businesses and their customers. MUA therefore welcomes the opportunity to respond to Ofcom's proposals, set out in its Review of Royal Mail Access Pricing.
- 1.4 The comments made in this document may be published and attributed to Mail Users' Association.

**2. MUA Responses to Ofcom Questions**

**2.1 Question: *Do you agree with Ofcom's analysis of the case for intervening as proposed in this section?***

- 2.1.1 MUA recognises the consideration Ofcom has given to its statutory duties, including under the Communications Act to "*further the interests of consumers in relevant markets, where appropriate by promoting competition*". MUA does not disagree with the Regulator's assessment that provision of the universal service is not currently



under threat, and does not seek to challenge Ofcom's analysis of the case for intervening in future access pricing.

- 2.1.2 Members also identify with the premise that were the Regulator not to act now to reduce the risks to start up end-to-end competition, there is a plausible argument to suggest such competition may fail to materialise in the short to medium term. In MUA's view, this would remove an important incentive on Royal Mail to continue to make efficiency improvements in the provision of both the universal service and other postal services more generally, to the detriment of consumers.
- 2.1.3 MUA notes the relevance of Ofcom's rationale that the absence of an effective driver for Royal Mail efficiency would risk excessive pricing in the postal market. As major users of both the retail and wholesale services of Royal Mail, excessive pricing would be likely to lead to reduced use of mail by MUA members.
- 2.1.4 Like Ofcom, MUA is concerned that the access pricing freedom currently allowed by the existing regulatory regime can mean large price increases, causing damaging uncertainty for mail users - a further aspect of this being the introduction of bi-annual access price increases, which only serves to add further concern and uncertainty.

**2.2 Question: *Do you agree that the options of doing nothing and of imposing a price control on the level of Royal Mail's prices are not appropriate or proportionate?***

- 2.2.1 MUA agrees with the premise that for Ofcom to do nothing should not be an option. However, members are concerned that the approach proposed by Ofcom has too narrow a focus, limiting its intervention to the area of end-to-end competition. This is based on the fact that members do not believe the economic incentive posed by end-to-end competition is sufficiently strong (either presently, or in the foreseeable future) to support this single strand approach.
- 2.2.2 Some MUA members who produce substantial volumes of mail are doubtful that the present situation will ever lead to circumstances when there will be competition to Royal Mail for their output. This is because regulatory obligations in their sector mean that they are unable to use competing services that do not deliver on every working day. They are concerned that Ofcom, whilst encouraging competition in one sector to constrain prices there, will inadvertently cause prices to increase in their sector where there is inadequate competition (or prospect of competition) meeting their needs. There is already evidence of discriminatory pricing by Royal Mail, in that it has different prices for advertising mail, sustainable mail and business mail.
- 2.2.3 MUA therefore believes that Ofcom should impose a form of price cap regulation on bulk mail in order to ensure that Royal Mail does not accommodate competition in one sector by applying higher prices elsewhere.



- 2.2.4** MUA would state that whilst it would support Ofcom's proposal to limit access pricing freedom (Option D), these measures need to be taken in conjunction with other safeguards. Members would therefore recommend Ofcom also considers the implementation of a more general access pricing control, applying to Royal Mail's National Price Plan and Average Price Plan, as well as Zonal Price Plan. Such a control would not only apply a brake to excessive access price increases going forward, but would also serve to incentivise Royal Mail to make meaningful efficiency improvements for all its services. Members would suggest this could be designed in such a way as to allow maximum access prices to be set at an allowed margin over costs.
- 2.2.5** Were a general access price control to be applied, for example perhaps in the form of a 'CPI-X', 'return on assets' or other constraint with sound and relevant regulatory precedent, there would be clear onus on Royal Mail to achieve general efficiencies, which should benefit users of Royal Mail access and retail services as a whole.
- 2.2.6** MUA notes Ofcom's reference to its use of a general price control in regulating some of BT's wholesale prices in fixed-line telephony. Members would suggest a similar control may work equally well for the postal industry, and so should be considered by Ofcom in addition to the specific controls proposed for Royal Mail's access pricing structures.

**2.3 Question: *Do you agree with our approach to focus on existing Royal Mail zones to develop our response to the threats to end-to-end competition? If not, please set out your reasons?***

- 2.3.1** As mentioned above, MUA is concerned that a narrow focus by Ofcom on the threats posed to end-to-end competition will serve to address only part of the problem. Members recognise that zonal price controls should protect those using zonal access, however, they believe only the addition of general access price controls to Ofcom's proposals will directly address the concerns of access users in general.
- 2.3.2** From members' own experience and wider understanding of the access market, MUA believes use of the Zonal Price Plan is a small element of access use more widely, while access use as a whole is now larger than use of Royal Mail's bulk mail retail services. While the mechanisms Ofcom proposes to link Zonal and National access prices would mean efficiency-based reductions in Zonal prices will also result in National price reductions, there seems to MUA members to be no overall pressure on access prices as a whole.
- 2.3.3** MUA therefore believes Ofcom's approach should be to widen its proposals and address the need to improve access terms for the great majority of users, rather than only the small amount of access mail that is Zonal. Members consider direct access users are an important feature of the market – so regulation to ensure downward pressure on access prices in general is seen as beneficial to the market, and to users.



**2.3.4** MUA would also note Ofcom seeks to use addressing Zonal pricing freedom as a means to achieve the necessary drive for Royal Mail efficiency. In the view of members, while that may be necessary, it is unlikely to be sufficient to achieve benefits for all users.

**2.4 Question: *Is our proposed approach to the definition of 'Zones' appropriate?***

**2.4.1** MUA would generally support Ofcom's proposed approach to the definition of 'Zones', providing there is a safeguard process in place whereby Royal Mail is required to notify Ofcom of planned changes to its zonal structure (to number of Zones or in revised basis for categorisation of postcode sectors to Zones), and the reasons for those changes being necessary. Members also believe an acceptable level of information pertaining to any changes should be made available to the market for public scrutiny.

**2.5 Question: *Do you agree with our proposals regarding Zonal charges to address our competition concerns? If not, please explain why.***

**2.5.1** MUA is in general agreement with Ofcom's proposals regarding the tilt of zonal prices to accurately reflect underlying zonal costs. MUA would also support the use of the more robust 'Fully Allocated Cost by Format' costing model in the interim. However, members would recommend Ofcom moved to a LRIC model in the medium-term, once it is satisfied Royal Mail's costing model stands up to scrutiny.

**2.5.2** MUA would also support Ofcom with its proposal to make the 'Zonal ratio rule' apply to every service.

**2.5.3** However, members would request Ofcom provides clear statements regarding rules around National Price Plan surcharges. Also, were Royal Mail able to show cost efficiencies from assured volumes from customers, or from forecasting requirements, members would welcome the availability of price incentives to make such commitments (on all access price plans).

**2.6 Question: *Do you agree with the proposed weighted average rule? If not, please explain why.***

**2.6.1** MUA would not seek to challenge Ofcom's proposals on the matter of a weighted average rule, other than to say that were Royal Mail to be able to provide the Regulator with evidence that the costs of handling mail with a defined profile (size, format, machinability, or full geographic), when compared to general Zonal mail, then a price difference could arguably be permitted.



**2.7 Question: *Do you agree with our assessment of and proposed approach towards tolerances and profile surcharges on national contracts? If not, what alternative would you propose?***

**2.7.1** MUA believes the current structure of tolerances and profile surcharges in the national contracts and Royal Mail's interpretation of the contracts can be unfair. National Plan contract holders agree to make all reasonable endeavours to comply with the profile requirements of those contracts. Where they are doing this, in the same way that they have been doing for many years, they are now being penalised for failure to adhere to the national contract.

**2.7.2** Whilst contract holders agree that Royal Mail should be fairly compensated for the cost of delivery everywhere, they are concerned that the surcharge system currently over-compensates the operator. There are two aspects to this concern:

- Firstly, if a national contract holder is not giving the operator mail for delivery in a certain area where there is no delivery competition then someone else (perhaps Royal Mail's retail operation) is. Why then should the contract holder be penalised for not giving Royal Mail mail that it already has? The contract holder's only option is to win upstream volume from other contract holders in the areas in which it is short. This option is not available to direct access customers (i.e. those with their own access contracts and arranging separate up-stream services) and is, in any case, inefficient;
- Secondly, the surcharges are asymmetric. Contract holders are surcharged if they deliver too much mail into Royal Mail's costly areas but are not credited if they deliver disproportionate amounts of mail into Royal Mail's cheap areas. Members would argue this seems clear exploitation by Royal Mail.

**2.8 Question: *Do you agree that it is appropriate to prohibit non-Zonal subnational pricing plans at this time? If not please state your reasons.***

**2.8.1** Within MUA membership there is a number of members whose customer base have a particular geographic nature, for example due to legacy or organisational structure. MUA is therefore of the view that Royal Mail should have the flexibility/commercial freedom to offer sub-national pricing plans, providing they are fair, transparent and offered on equivalent terms to National or Zonal contracts.

**2.9 Question: *Do you agree that the appropriate measure of cost in relation to our proposals is Zonal FAC by format? If not please state your reasons.***

**2.9.1** MUA would defer to Ofcom's better technical knowledge of this area, and does not offer comment.



**2.10 Question: *Do you agree with our proposal to use historic cost data rather than forecast data? If not please state your reasons.***

**2.10.1** MUA would support Ofcom on its proposals to use historic cost data rather than forecast data. Members consider such a proposal will preclude any potential for manipulation in the setting of zonal prices based on inaccurate forecasting.

**2.11 Question: *Do you agree that we should require Royal Mail to use the 2012/13 ZCM, subject to a power for Ofcom to specify by direction that a different model be used? If not please give your reasons.***

**2.11.1** MUA would support Ofcom's proposal that the existing (2013/14) zonal cost model should be used in the interim, until such time as the Regulator directs Royal Mail to move to an alternate model in 2014/15.

**2.12 Question: *Do you have a view on the appropriate volumes to use as weights in the weighted average rule? Please provide reasons for your view.***

**2.12.1** MUA considers Royal Mail will not lose volume to End-to-End competition evenly across all zones, so there will be likely to be a distortion of the zonal volume profile. Members consider this distortion will be less if USO volume is included as well as access and retail bulk volume, and on this basis would support Option b) Access + Retail Bulk + USO Volumes, in the interim.

**2.12.2** However, MUA would make the point that it believes the most accurate method to use in the weighted average calculation would be the profile of all relevant mail delivered by all operators. To this end, members would suggest Ofcom considers whether all relevant carriers should be providing fall to earth information, in future.

**2.13 Question: *Do you agree that it is appropriate to use format level volumes as the weights in the 'weighted average rule'? If not please give your reasons.***

**2.13.1** MUA would defer to Ofcom's better technical knowledge of this area, and does not offer comment.



**2.14 Question: *Do you agree with our proposal that the legal instrument implementing our proposed regulatory changes will come into force six months after the publication of the final statement on this review? If not please give your reasons.***

**2.14.1** MUA would make the point that Ofcom's six months timeline would appear to be very constricted, in relation to Royal Mail's access pricing announcements. Given that Ofcom proposes to issue its final decision in June 2015, it follows that implementation would become effective in January 2016. However, as Royal Mail are obliged to give the market 70 days notice of access price changes, and if possible 90 days notice for contract changes required by the Regulator, this would seem to make an announcement of access price changes for January 2016 very tight.

**2.14.2** Members would therefore seek clarification on how Ofcom proposes the timing would work in this matter.

**2.15 Question: *Do you agree with the proposed scope of our review of the Zonal costing methodology to take place following the publication of our Statement? Are there any other issues that it would be appropriate to consider as part of the review?***

**2.15.1** MUA wonders whether Royal Mail's zonal costing methodology continues to be relevant a decade or so after its introduction. Outside the London zone it is based on an analysis of delivery point and business densities, which are assumed to be the sole, or principal, drivers of delivery costs in postal sectors. Apart from London the methodology does not mirror the pattern of competitive entry and resultant efficiency improvements in the areas targeted by competition. It does not, therefore, appear to allow efficiency improvements to be passed through to customers.

**2.15.2** MUA would also point out, aspects of the Zonal contracts such as the need to put zonal identifiers on individual items, inhibit their use by many customers.

**2.15.3** MUA members would also wish to raise the issue of Mailmark. As Royal Mail's recently introduced system for uniquely identifying individual items of mail in both retail and access mailstreams, Mailmark may be the dominant mail channel by the end of 2016. The introduction of Mailmark raises new opportunities and challenges for the market, given the wealth of data at house/street level that is not available now and the exacting nature of the product specification, which includes an 'e-manifest' of item level data for all items within each mailing.

**2.15.4** MUA would make the point that Mailmark could be used by Royal Mail to replace Zonal Access as a product with much more granular and accurate pricing, well beyond the current zonal structure. Mailmark requirements may mean Royal Mail forces extra cost into end-to-end mail production e.g. billing solely on the e-



manifest, which would drive up cost in mail production (and mail users with legacy systems will struggle to take advantage of Mailmark, notwithstanding the price benefits available from 2016)

**2.16 Question: *Do you consider that there is a need for a structured compliance process with respect to the proposed remedies? If so, why and what would be the value of such a process, if not why not?, and:***

**Question: *If we were to establish a compliance process what form should it take?***

**2.16.1** MUA considers transparency in compliance is an important factor, and members would argue it seems sensible for some compliance information to be published (such as the zonal cost ratios and volumes), so that the zonal and national prices could be scrutinised by the industry.

**2.17 Question: *Do you consider there is are reasons we should extend the access obligation to the crown dependencies? If so please state your reasons.***

**2.17.1** For many MUA members, an important part of their customer base is in the crown dependencies (being, in this context, Jersey, Guernsey and the Isle of Man, these are often termed the '3 Islands') and their inclusion within the specification of access services is an important requirement. Should these destinations be excluded from the mandate on Royal Mail to provide access services, this will have a material impact on how access based services are viewed by business mailers, and would impose significant additional costs in mail preparation and production (especially for those either using legacy systems, and/or constrained by relevant regulatory requirements). Essentially, Royal Mail would be at liberty to exclude these destinations, or to set price and other terms for their inclusion, at its own discretion and without constraint.

**2.17.2** MUA would also note that the '3 Islands' are included as destinations for Royal Mail's bulk retail services and, were they to be excluded from access services (or subject to special terms), it would create clear and undue discrimination in the market. Members are, therefore, strongly of the opinion that their exclusion would be detrimental to the interests of UK mailing industry, and should not be permitted.

**2.17.3** MUA would also point out the 3 islands are included in RM's universal service specification, and the points of access to the USO infrastructure are within the United Kingdom (Dorset mail centre for the Channel Islands, and Derby mail centre for the Isle of Man).



**2.17.4** MUA would state this concern applies also to the exclusion of mail going to BFPO destinations, which raises the cost of sending mail to members of the armed forces. Royal Mail has agreed a proxy postcode system with BFPO so that army, navy and air force personnel can avail themselves of e-commerce services, and the MUA would like to see similar initiatives extended to access services. Not least, given BFPO mail is delivered by Royal Mail not to the actual location of the BFPO address, but to the BFPO centre in Northolt, for onward transportation and delivery by the Ministry of Defence. Members would therefore argue mail to BFPO's is no different to any other 'inland' mail, and for Royal Mail, has the advantage of a single bulk delivery point.

**2.18 Question:** *Do you agree that our proposals are likely to address the concerns we have identified? Are there ways that Royal Mail could take action which would undermine the effectiveness of our proposals?*

**2.18.1** As identified previously in this submission, MUA would again highlight concern over Ofcom's narrow focus in stopping short of proposing general access price controls as part of its intervention package. Members are concerned this may leave the door open to as yet unseen loopholes in other access terms and conditions.

**2.19 Question:** *Do you agree with our assessment of the impact of our proposals? If not, please explain why.*

**2.19.1** MUA would make the point that Ofcom's expectation of resultant increases in end-to-end competition have yet to be proven to materialise, and that this assumption relies on business mailers' ability to move volumes to competitors. Members believe that Ofcom over-estimates the extent of this ability.

**2.19.2** MUA would also note its understanding of these proposals is that Ofcom believes they will be beneficial to retail customers and end-to-end competitors, whilst having a less beneficial impact on access operators, and that as a result access charges may, or may not, reduce in the longer term. Members would therefore argue that the proposals as they stand could distort the market by favouring some competitors and some customers of Royal Mail at the expense of other competition and general access users, and as a result could be seen as unbalanced and not proportionate given the small extent of end-to-end competition, and the small proportion that zonal use of access represents in the overall market.



**2.20 Question: *Do you agree with our proposals, if not please explain why?***

**2.20.1** MUA has nothing more to add to the comments it has made previously.

**2.21 Question: *Does the way in which we have drafted the proposed modified access condition appropriately reflect the proposals and in particular do you find it sufficiently clear? In your response, you should suggest alternative wording if you have drafting concerns.***

**2.22 Question: *Which of our proposed two alternative definitions of 'Relevant Postal Services' discussed above do you prefer and what are your reasons for your preference?***

**2.23 Question: *Do you agree with our proposal to base the concepts related to the concept and definition of 'Zones' on Royal Mail's own methodology (as referred to above)? If not, please explain in detail why.***

**2.24 Question: *Do you have any comments on our proposed new concepts and their definitions discussed in this Annex?***

**2.25 Question: *Do you have any comments on our proposed corrections to the USPA Condition discussed in this Annex that are unrelated to our proposed new remedies in USPA 2.1A, USPA 6A and USPA 6B (and their associated new expressions)?***

**2.26 Question: *Do you agree with our thinking and proposals for the rounding (decimal places) to assess compliance with our proposed new remedies in USPA 6A and USPA 6B? If not, please explain in detail why.***

**2.26.1** On these questions, MUA would defer to Ofcom's better technical knowledge of these areas, and does not offer comment.

---

I hope that you find the above useful in your deliberations. Should you have any questions, do not hesitate to get in touch.

Yours sincerely,

A handwritten signature in black ink, which appears to read "Ian Paterson". The signature is written in a cursive style and is positioned above a horizontal line.

Ian Paterson,  
Chairman,  
Mail Users' Association  
E-mail: [ian@mailusers.co.uk](mailto:ian@mailusers.co.uk)