

21st August 2020

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Dear Marina,

Royal Mail requests that Ofcom confirm the Economy Access service is subject to the access mandation (USPA 1.2) and margin squeeze control (USPA 6)

As you are aware, Royal Mail announced on 26 June 2020 that we are proposing to launch a new Economy Access service for our customers which is currently planned to go live on 4 January 2021. This new service is good for both our access customers and Royal Mail. It will offer customers greater choice by giving them the option of using this new service with a longer delivery span (4 days), or to continue using our current access services which deliver items the day after they arrive at the Inward Mail Centre (IMC). It's also good for Royal Mail since it allows us to achieve efficiency gains. In a high fixed cost network we need to keep volumes in the network and continue to look for ways to realise any efficiencies.

The introduction of this new service is made possible by the implementation of a Delivery to Specification programme (DTS). This programme allows for the sequencing and holding of any letters at the IMC until potentially the last day they can be delivered. This increases the number of items being delivered per address while reducing the number of times we need to visit an individual address. The DTS programme requires IT investment. The investment has and will continue to go ahead regardless of whether the Economy Access service is mandated or not. However, if the service is not mandated then it will result in a lower take up of the service and any efficiency gains will be reduced.

To ensure all customers can benefit from the new Economy Access service and we get sufficient volumes migrating to the new service to enable us to benefit from the efficiency gains, **the volumes transferring to the new service need to retain their VAT exempt status.** If this new service is not VAT exempt, it would render the service unattractive to mailers in the Financial Services and Charity sectors, given their inability to reclaim VAT. This reduces take-up of the service and significantly reduces the efficiency benefits we expect to see from launching this service.

The Economy Access service therefore needs to be covered by both the access mandation condition (USPA1.2) and the regulatory margin squeeze condition (USPA6). **We are not asking Ofcom to widen regulation but to maintain the status quo.** If the new service is not mandated or covered by USPA6, up to a quarter of access volumes will move outside of regulation.

Ofcom has said it is willing to consider making changes to the USPA condition to capture the Economy Access service and to publicly consult on this. **I am writing today to ask Ofcom to proceed with this consultation process at speed.** It is our intention to launch the new service in January and it is imperative, for both us and our customers, that we understand how the new service will be treated from a regulatory perspective before launch. I set out below further details on our new service which Ofcom will hopefully find helpful in expediting the process.



Introduction to the proposed Economy Access Service

The new Economy Access service will be an up to D+5 service (equivalent to D+4 once it enters Royal Mail's network). This compares to the current Standard access service which is a D+2 service i.e. items are delivered the day after they arrive at the IMC and 2 days after the sending customers handed the items to the upstream carrier. We believe the 4-day delivery span provides the best balance between attractiveness for posting customers and cost. A shorter delivery window would not provide the efficiency opportunity for Royal Mail, whilst longer spans diminish the commercial appeal for brands.

There will be five new Economy Access variants for Mailmark Letter format: Advertising Mail; Advertising Responsible Entry; Advertising Responsible Intermediate; Partially Addressed and Business Mail.

The Economy Access service will share all the same attributes in terms of presentation, sortation and content control as the existing Standard access service which is currently regulated under the USPA Condition. It will differ only by speed of delivery, as shown in the table below.

DSA day	Day D	D+1	D+2	D+3	D+4	D+5
DSA Economy	Mailing house hands over to DSA Carrier	Carrier hands over mail to RM at IMC	RM delivers mail, or defers delivery	RM delivers mail, or defers delivery	RM delivers mail, or defers delivery	RM delivers mail to end customer
DSA Standard	Mailing house hands over to DSA Carrier	Carrier hands over mail to RM at IMC	RM delivers mail to end customer			

Assuming the service is mandated, all the terms and conditions of the Economy Access service will also be in line with existing Standard Access services – the terms of the Access Letters Contract will continue to apply, with a new Schedule 30 covering the Economy Access service.

We propose to launch the new service as part of our January 2021 tariff, which must be announced to the market no later than 23 October 2020. The aim being to provide customers with the choice of a price point lower than the Standard D+2 service in exchange for the longer delivery window.

Our customers are very supportive of the new service but the overriding feedback from them is that it needs to be VAT exempt

In the run up to the launch of the Economy Access service, we undertook a series of engagements with our customers to seek feedback. The feedback was overwhelmingly positive. However, there was consensus across the industry that the new service should be VAT exempt.

Our historical volumes with Retail products have also clearly demonstrated an industry demand for a lower price, longer delivery window service.



We are asking Ofcom to confirm that the scope of existing regulation will continue to apply to access volumes that switch to the new Economy Access service i.e. to maintain the status quo (subject to both USPA 1.2 and USPA6)

The new service will give customers the choice of using either a D+5 or a D+2 service to send their mailings. We do not anticipate it will generate significant, if any, new volumes. Instead a proportion of existing mandated access volumes (Standard Access) will migrate to the Economy Access service.

We would like Ofcom to confirm that there will be no change to the regulatory treatment of volumes that are simply migrating from a currently mandated service (Standard Access).

This means that the volumes continue to be covered by the mandate requirement as set out under USPA 1.2 and therefore by the wider provisions of the USPA Condition. If this is not the case, then a significant proportion (up to a quarter) of access volumes currently covered by the USPA condition will move outside of regulation entirely.

It is also important that the Economy Access service retains the VAT exemption status that applies to the Standard Access service. If the regulatory treatment in terms of mandate applies to the Economy Access service then it would be appropriate for it also to be covered by the regulatory margin squeeze condition (USPA6), as is currently the case for the Standard Access service. This requires the equivalent retail services, i.e. Economy Mailmark Advertising and Business Mail letters, to be brought within USPA6. These retail services share the same attributes in terms of presentation and sortation as the existing Second-class retail services already defined within the condition but differ only by speed. **We would therefore ask Ofcom to confirm that the relevant Retail Economy Mailmark letter equivalents are substantially similar to the existing second-class retail services defined under USPA6, and to direct Royal Mail to include those services for the purposes of USPA6.**

The new service has a number of positive benefits for both Royal Mail and our customers. We set out further information below, demonstrating that the new service meets the tests set out in the Postal Services Act (PSA 2011, Section 38 (4)) i.e. (a) promoting efficiency, (b) promoting effective competition and (c) conferring significant benefits on the users of postal services.

This new Economy Access service will be an enabler of efficiency through the DTS Programme

The DTS programme achieves efficiency gains by sequencing and holding the mail at the IMC until potentially the latest day it can be delivered. This increases the number of items being delivered per address, reducing the time required for a post person's walk. Over time this will enable consolidation of walks across the country. Reducing the total number of walks enables more efficient delivery of letters, through reducing the number of addresses we need to visit on any given day.

In order to achieve these efficiency gains, we need to undertake delivery route revisions. Our ability to revise routes to reduce cost is dependent on having sufficient mail with a longer delivery window. It is therefore, in part, dependent on the take-up of the Economy Access service by the access customers. Achieving the maximum efficiency gains is dependent on access customers using the service to the fullest extent possible. We need to have a sufficient volume of mail with a longer delivery window to be able to consolidate mail items, improving our call rate.

To achieve the maximum efficiency savings possible, we will need sufficient access volumes to transfer to the new service. This will only occur if the Economy Access service is VAT exempt. For that to be the case it must be subject to the same regulatory conditions as the Standard Access service today, otherwise sufficient volumes will not migrate to the new service.



Whilst the full impact on competition is difficult to assess, we believe it has the potential to promote effective competition

If the Economy Access service is mandated, as a minimum it will maintain the existing state of effective competition. If not, a quarter of existing access volumes could fall outside of the regulatory regime. This would lead to reduced regulation and a “dual system” would be in place whereby the USPA condition and competition law apply to Standard access volumes, but only competition law applies to Economy Access volumes.

In contrast, if the existing volumes moving to the new Economy Access service continue to be subject to the existing regulations whilst offering access customers greater choice, there is the potential for increased opportunities and competition in upstream offerings.

If this new Service is not VAT exempt, the application of VAT to this Economy Access service would render the service unattractive to mailers in the Financial Services and Charity sectors, given their inability to reclaim VAT. These customers send over 40% of all access volumes. They would experience a 20% increase in the price they have to pay relative to companies in other sectors who can reclaim VAT. In our opinion there will be no take up from these sectors, and a significant proportion of the in-scope volume would not be available to Royal Mail for efficiency realisation. As far as access customers are concerned, a carrier with a higher proportion of customers in these sectors might not be able to use the new service to realise any of their own upstream efficiencies that might be available, which might impact their own competitiveness.

The introduction of an Economy Access service confers significant benefits on the users of postal services and will help to secure the provision of an efficient and financially sustainable universal postal service

The introduction of an Economy Access service provides **customers with greater choice**. Postal users can benefit from a lower price than the D+2 service, providing they are prepared to accept a wider delivery window. Giving customers the option of a lower priced alternative relative to the standard access service could also help maintain volumes in the network, keeping overall prices lower than they might otherwise need to be. This could help to maintain mail volumes. Supporting mail volumes will in turn help to secure a financially sustainable universal postal service.

It could also provide the opportunity for access customers to innovate and introduce new offerings to the market.

It is important that we launch the service in January

We need customers to take up the service as quickly as possible, so we have sufficient volumes in the network to test and then rapidly roll out the DTS process. Without sufficient volumes we will be unable to deploy the necessary operational changes and test the processes. Customers will also need to undertake their own IT developments so we need plenty of time to get them on board with the new service. They need clarity on the VAT status of this service. If we delay the launch, not only will customers not have the option of a lower priced service in our January tariff but we will also have to go through another tariff process later in the year as the Economy service is brought in.



I hope this letter is helpful in summarising our position and our ask of Ofcom. Please do not hesitate to contact me if you have any questions.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'P. Allsop', with a horizontal line underneath.

Pamela Allsop
Director of Regulation and Competition Policy

