

## **ROYAL MAIL ACCESS PRICING REVIEW**

– Proposed Amendments to the Regulatory Framework

### **Response from UK Mail Group plc**

In this response the following abbreviations are used:

EtE = end-to-end (mail services including final delivery to destination addresses)

Access = downstream access (mail services where final delivery, but not collection or distribution, is by Royal Mail)

UKM = the mail business of UK Mail Group plc

RM = Royal Mail plc

Review = Ofcom's Royal Mail Access Pricing Review, published on 2<sup>nd</sup> December 2014

CA 2003 = Competition Act 2003

PSA 2011 = Postal Services Act 2011

Question numbers and section references follow the numbering in the Review

**The comments made in this response may be published and attributed to UK Mail.**

#### 1. Background:

- 1.1 UK Mail Group plc is a publically quoted company operating in the UK postal industry, providing express parcel, mail and courier services.
- 1.2 In the last financial year (2014/15), the Group had turnover of £508m and generated operating profit of £28m. The bulk of the group's activities are in express parcels (£220m) and mail (£245m); it operates from more than 50 sites across the UK and provides employment for over 4,500 people. UKM is a leading postal service provider, carrying nearly 3 billion items of mail annually (equating to over 18% of UK mail volume).
- 1.4 UKM uses only RM for delivery of mail and is currently committed to access as the best way to offer the comprehensive service sought by mail users. For as long as access terms and service allow an 'access only' model to be successful, UKM's commitment to access can continue.

#### 2. Summary:

- 2.1 UKM supports the development of effective competition in the UK market and firmly believes existing competition has brought significant benefits to mail users, as well as providing a useful stimulus to RM's efforts to improve efficiency and productivity.

- 2.2 Competition from service providers using access provides a valuable stimulus for RM to become more efficient, without jeopardising the sustainability of RM's universal service provision, and access will always be needed by EtE competitors.
- 2.3 UKM agrees with Ofcom's assessment (given in this Review and set out more fully in Ofcom's "Review of end-to-end competition in the postal sector") that there is not currently a conflict between Ofcom's duties under CA 2003 and PSA 2011, allowing Ofcom to address its CA 2003 duty relating to promoting effective competition.
- 2.4 UKM believes Ofcom has correctly concluded that the existing regulatory regime for access gives rise to concerns and risks, and that intervention is necessary.
- 2.5 UKM is in general agreement with Ofcom on the principles of the proposals set out in the Review, in particular that there is a need to set regulatory obligations which will further encourage RM to improved efficiency, but UKM's comments below include issues with some details of the Ofcom proposals.
- 2.6 However, UKM believes that Ofcom should not focus, to the extent it proposes, on supporting EtE competition and the structure of RM's Zonal access pricing, but also needs more fully to consider the beneficial effects of access competition in general and more directly to address the needs of all access users.
- 2.7 UKM also believes that Ofcom's focus on EtE competition and Zonal access will not achieve the pressure needed on RM efficiency to make universal postal service provision efficient before the end of a reasonable period of time, as required by PSA 2011.
- 2.8 It is UKM's view that the Ofcom proposals may be necessary to address the concerns and risk identified and to achieve Ofcom's aims for RM efficiency – but the proposals are not sufficient.
- 2.9 UKM believes that Ofcom should fully consider either a general access price control which applies direct pressure on RM to improve efficiency, thus benefitting access users generally (through access prices being lower than they would otherwise be) and all users (through better RM efficiency), or explicit efficiency improvement targets for RM.
- 2.10 If Ofcom proceeds to set new access conditions which focus on promoting EtE competition, through controls on RM's Zonal pricing structure, UKM believes the impact may distort the market by favouring some customers of RM at the expense of general access users. If so, the proposals would be unbalanced and not proportionate.
- 2.11 UKM believes Ofcom must ensure it closely monitors the impact of its proposals (if implemented) not only on the future USO provision but also on the future of access competition and the benefits it provides; Ofcom needs to guard against any detrimental and unforeseen effects as a consequence of any focus on encouraging EtE, an as yet scarcely developed form of competition. Ofcom must continue closely to monitor sustainability of USO provision by RM and reduce current market uncertainty by providing much greater clarity on the conditions and timing which would necessitate regulatory intervention, ensuring it is ready to act swiftly to mitigate the potential detrimental impact of EtE competition as and when required.

### 3. Response to Ofcom Questions:

#### **Section 4 – The case for intervention**

##### **Q 1: Do you agree with Ofcom’s analysis of the case for intervening as proposed in this section?**

3.1 UKM notes Ofcom’s assessment (in section 2.14) of its duties under CA 2003 and PSA 2011, such that if there is no conflict between those duties then Ofcom must follow its duty under CA 2003 regarding promoting competition.

3.2 UKM agrees with Ofcom that:

*“There is no national end-to-end network other than that of Royal Mail. Therefore, in order to be able to offer UK-wide services, end-to-end operators are reliant on access to Royal Mail’s network in those areas where they do not have delivery networks of their own.” [3.14]*

and notes that Ofcom report EtE operators delivered less than 0.6% of addressed mail in 2013.

3.3 UKM is strongly supportive of the need for effective and efficient competition in the UK postal market and, UKM strongly believes, mail services offered using access are a vital, valuable and effective form of competition which provide significant benefit to mail users and the development of a competitive market.

3.4 In 2013, 49% of mail was through access, almost as much as through RM end-to-end and more than RM’s retail bulk mail; access revenues to RM provided £1.bn towards provision of the universal service (source: Ofcom’s Communications Market Report 2014). UKM hence agrees with Ofcom’s opinion (given in its March 2012 statement on regulatory conditions and quoted in this Review) that:

*“access competition would provide incentives for the provision of the universal service to be financially sustainable and efficient and that, providing that the charges paid by access operators reflected Royal Mail’s costs, it would do so without threatening the sustainability of the universal service” [3.28]*

3.5 UKM therefore agrees with Ofcom’s conclusion that there is currently not a conflict between Ofcom’s duties under CA 2003 (promoting competition) and PSA 2011 (ensuring USO provision):  
*“we do not consider that there is currently a conflict between our general duties under the CA 2003 and our duty to secure the provision of the universal postal service.” [4.4]*

3.6 UKM notes Ofcom’s comments and concerns (sections 4.11 to 4.60) in relation to the development of EtE competition, with particular regard to Whistl, and does not seek to dispute Ofcom’s assessment.

3.7 Those concerns include the need for universal service provision to become effective *“before the end of a reasonable period”* [4.13]. UKM certainly supports the need for RM to become more efficient, to the benefit of all mail users, and agrees that:

*“Efficiency improvements and innovations in the delivery of bulk mail are highly likely to affect the cost of delivering USO mail because Royal Mail uses the same delivery network for both types of mail” [4.13]*

UKM believes that RM must become more efficient, has not achieved sufficient improvement in the past and that Ofcom needs to act to drive such improvement now.

- 3.8 Ofcom also has concerns about the impact of uncertainty, in particular regarding the very significant increases in access charges made by RM since 2012 and the prospect of further, similar increases. UKM agrees with Ofcom that:
- “the magnitude of the changes to access charges proposed by Royal Mail has been large, and is more likely to be disruptive in the context of a low margin business where there is little scope to absorb increases in costs.”* [4.50],
- leading to
- “uncertainty over the viability of business models linked to such services”* [4.52]
- and causing it to be
- “difficult for access operators to make long term business plans”* [4.56]
- 3.9 Ofcom indicates it believes that the development of EtE competition is necessary to address the concerns it has set out and its proposals largely focus on EtE competition. In UKM’s view, Ofcom’s proposals need to focus on broader support for encouraging and maintaining future effective competition in general (including through access) and the proposals as they stand are not sufficient to address that need.
- 3.10 UKM agrees with Ofcom that EtE competition), will always be reliant on using access to areas where the EtE operator is not itself delivering mail (which is likely always to mean it uses access for most of the UK).
- 3.11 In focusing on EtE competition and the use by such competitors of Zonal access, where RM’s proposed changes gave rise to particular regulatory concerns and a need to ensure Zonal access pricing is properly reflective of costs, Ofcom has focused on a form of access used for *“only a small minority... of access mail”* [3.19; actual figure redacted].
- 3.12 UKM believes Ofcom should not consider intervention only in relation to Zonal access, but also needs more fully to consider the beneficial effects of access competition in general and more directly to address the needs of all access users.
- 3.13 An EtE operator will (under Ofcom’s proposals) be able to use access even in the areas where it is delivering mail. It is therefore possible (and may be happening in practice) that an EtE competitor is able to divert to access its poor quality mail (mail that is more difficult and costly to process and/or deliver), while keeping high quality mail for own final delivery. The EtE competitor is also able to make decisions on how much mail it will divert to access, rather than delivering itself, on a day-to-day basis; that is likely to hinder RM efficiency, consequently meaning higher access charges for all access users and mail users in general – contrary to Ofcom’s desire to have EtE competition encourage RM efficiency improvement.
- 3.14 UKM believes it may be the case that households and businesses in postcode sectors where EtE competitors use own final delivery are likely to have more than the average number of items per address. Hence the aim of the largest EtE competitor (Whistl) to deliver in a few years to 45% of addresses may well mean it is delivering more than 45% of mail volumes, increasing RM’s delivery costs in all areas, so increasing access prices.
- 3.15 UKM is mindful that Ofcom’s assessment of there being no conflict between its CA 2003 and PSA 2011 duties is of the current position and Ofcom has said:

*“Beyond the next few years, our assessment of the sustainability of the universal service becomes less certain” [“Review of end-to-end competition in the postal sector”, section 3.105]*

While that uncertainty is due to other factors as well as the development of EtE competition, it is true that access-only competition (i.e. without own final delivery) can *“provide incentives for the provision of the universal service to be financially sustainable and efficient and that..... it would do so without threatening the sustainability of the universal service”*.

- 3.16 Given the potential impacts outlined above and Ofcom’s focus on promoting EtE competition, UKM therefore believes that Ofcom must ensure it closely monitors the effect of its proposals (if implemented) as both access users in general and USO provision might be affected in unforeseen ways. Ofcom must continue closely to monitor sustainability of USO provision by RM, reduce market uncertainty by providing clarity on the conditions which would necessitate regulatory intervention and be ready to act swiftly to mitigate the potentially damaging impact of EtE competition as and when required.

**Q 2: 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?**

- 3.17 Ofcom identifies four options to address the concerns and risks it has outlined:

- a) Rely on existing regulation
- b) New retail price controls
- c) New access price controls
- d) Limits on access pricing freedom

- 3.18 UKM agrees with Ofcom that option a) will not address the issues and concerns, and will not achieve the RM efficiency improvement needed.

- 3.19 UKM also agrees with Ofcom on option b), as:

*“such controls would not be effective in encouraging Royal Mail to improve its efficiency and they would also reduce Royal Mail’s flexibility to respond to changes in its costs and in consumer preferences.” [4.97]*

- 3.20 Application of retail price controls might also mean those retail services became VAT exempt, given HMRC’s rulings on VAT liability for RM services. UKM would also not support option b) for these reasons.

- 3.21 Ofcom dismisses new access (wholesale) price controls because setting a minimum or maximum zonal price would mean:

*“Royal Mail may retain sufficient charging flexibility to deter entry/expansion by end-to-end operators” [4.101]*

and

*“We can also envisage practical issues with these options in determining how and at what level to set the minimum or maximum charge” [4.102]*

- 3.22 However, UKM notes that Ofcom does use wholesale price controls for some BT prices in fixed-line telephony and Ofcom says:

*“Controls on the level of wholesale charges can be used to support the emergence of retail competition, by controlling the price that retail competitors pay for key inputs” [4.98]*

UKM cannot see from the Review that Ofcom has explained why it has not considered wholesale price controls for RM, other than dismissing specific minimum or maximum controls only on Zonal access prices.

- 3.23 Having rejected options a), b) and c), Ofcom is left with the option of limits on access pricing freedom, specifically a control on the structure of RM access prices and with a focus on Zonal access.
- 3.24 UKM believes that Ofcom may be wrong to dismiss access price controls in general and has considered only price controls on RM’s zonal access price, and only in terms of explicit minimum or maximum process.
- 3.25 UKM believes that Ofcom should fully consider a general access price control which applies direct pressure on RM to improve efficiency, directly benefitting access users generally (through access prices being lower than they would otherwise be) and all users (through better RM efficiency).
- 3.26 A general access price control need not directly limit access prices to a defined minimum or maximum, but might instead be set:
- to limit future prices rises (for example, by an RPI-X type control as has been effectively used by regulators in other industries with a highly dominant incumbent supplier) and retain a robust protection against margin squeeze; or
  - to require a particular level of efficiency improvement (RM currently sets its own efficiency improvement target, which it has consistently failed to meet).

## **Section 5 – Further detail on proposals**

**Q 3: 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?**

- 3.27 As mentioned above (3.11), Zonal access is used for a small minority of access mail while the great bulk is on National price plans and Ofcom’s focus on Zonal access prices will not directly affect the level of National access prices.
- 3.28 Currently, there is only one large-scale EtE competitor of which UKM is aware and UKM has not seen signs of other imminent large-scale EtE entry. From discussions with major mail users, UKM has learnt that several of them do not see that the current EtE model and service specification meet their needs (indeed, for some of the largest mail users, regulatory obligations applying to them mean that they are unable to use that service and be compliant).
- 3.29 Within access users, there are several very large mail users who have their own access contracts directly with RM (this is often termed Customer Direct Access and is used predominantly by VAT exempt businesses due to the pertaining VAT position on postal services). These users, UKM estimates, account for around 50% of access volumes. However, they use National access rather than Zonal access and so regulatory controls focussed on Zonal access pricing structures will not necessarily offer them any direct benefit.

- 3.30 For these reasons, UKM believes that regulatory intervention focused only on Zonal access pricing structures will not fully address the risks and concerns Ofcom has identified and will not exert sufficient pressure on RM towards meaningful efficiency improvement – which is a core aspect of Ofcom’s duty under PSA 2011.
- 3.31 UKM also believes that Ofcom’s focus on protecting the interests of EtE competitors using Zonal access does not properly address the needs and concerns of access users in general.
- 3.32 UKM therefore believes that Ofcom should fully consider setting:
- a general access price control which applies pressure on RM to improve efficiency and so lead to access prices being lower than they would otherwise be without regulatory intervention; or
  - efficiency targets on RM which will directly require the efficiency improvement needed.
- 3.33 In UKM’s view, regulatory controls on RM’s Zonal access pricing structure may be necessary, but are unlikely to be sufficient to achieve universal postal service provision that is efficient before the end of a reasonable period of time, as required by PSA 2011.

**Q 4: Is our proposed approach to the definition of ‘Zones’ appropriate?**

- 3.34 Notwithstanding UKM’s views outlined above, UKM does not challenge Ofcom’s approach to the definition of Zones.
- 3.35 UKM believes it is important that the regulatory conditions include definitions of the Zones, so that RM can only change Zones through consultation by Ofcom. Freedom for RM to change the nature of Zones significantly increases uncertainty for access users, with detrimental impact on competitors’ business plans, investment in postal service provision and overall use of mail.

**Q 5: Do you agree with our proposals regarding Zonal charges to address our competition concerns? If not, please explain why.**

- 3.36 UKM does not challenge the principle of Ofcom’s proposal to require the ratio of Zonal Access prices to mirror the ratio of zonal access costs.
- 3.37 However, UKM questions whether allowing RM no degree of flexibility in that requirement may be unreasonably denying RM the normal competitive response for a commercial business of being able to price at a lower margin over cost in particular parts of its market where it faces the strongest competition.
- 3.38 UKM believes Ofcom should consider allowing RM some freedom, within specified limits, to price other than with the price ratio for all zones exactly matching the cost ratio.
- 3.39 UKM supports the use of LRIC rather than FAC for zonal costing, but recognises Ofcom’s concerns with RM’s LRIC model. If Ofcom decides that LRIC cannot be used for the introduction of the proposed regulatory obligations, UKM believes Ofcom should set a ‘flight path’ to use of LRIC within two years.
- 3.40 Ofcom has said that:

*“it would be inconsistent with the rule for Royal Mail to offer a discount in relation to a minimum volume of items being sent to one particular city or a lump sum rebate in exchange for a minimum spend by the access operator” [5.31]*

However, the price plan changes notified by RM for April 2014 (and since suspended) did not (as far as UKM understands them) offer a lower price for either a minimum volume of mail to a specific city or a rebate for a minimum volume.

UKM saw the notified changes as requiring (in addition to requirements on matching RM’s national profile of mail) specific forecasting obligations and volume commitments. UKM assumes the lower access prices offered by RM for customers accepting and meeting these obligations were based on RM having lower costs for such mail, by allowing RM to have greater confidence in the volume of mail it would be handling and the geographic profile of that mail, as so able to plan efficiency improving operational capacity and investment.

- 3.41 UKM believes it would be attractive to access users to have the option of accepting forecasting and volume obligations, in return for a lower access price, not least because such an approach could support efficiency improvement by RM.
- 3.42 Subject to the views outlined above, UKM does not challenge Ofcom’s approach to the definition of Zones.

**Q 6: Do you agree with the proposed weighted average rule? If not, please explain why.**

- 3.43 UKM does not argue against Ofcom’s proposals on the weighted average rule.
- 3.44 UKM welcomes Ofcom’s confirmation that under the proposals RM would still be:  
*“subject to compliance with.... the margin squeeze test currently in place” [5.44]*

**Q 7: 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?**

- 3.45 UKM does not argue against Ofcom’s assessment and proposals regarding tolerances and profile requirements.
- 3.46 UKM welcomes the fact that Ofcom does not have issue with the “all reasonable endeavours” requirement for National Price Plan 1 (provided that this requirement is fair, reasonable and not unduly discriminatory).

**Q 8: Do you agree that it is appropriate to prohibit non-Zonal subnational pricing plans at this time? If not please state your reasons.**

- 3.47 UKM does not itself argue against Ofcom’s proposed prohibition on subnational pricing plans, as UKM is a fully national operator.
- 3.48 However, UKM is aware that some access users (in particular some access users with direct access contracts) have issues with meeting the profile requirements of the two National Price Plans, because their legacy customer base has a geographic skew or because their business is

necessarily subnational. These access users have also expressed difficulty in meeting RM's requirements for Zonal access (e.g. the need to apply a zone indicator on every item and to submit additional mailing data).

- 3.49 Such access users are likely to welcome a subnational access price plan, which could still comply with Ofcom's proposed principle of the plan price structure always mirroring the cost structure.
- 3.50 While Ofcom's proposals may not prohibit subnational plans indefinitely, the introduction of such plans would require change to regulatory conditions through Ofcom consultation and the time required by that process could disadvantage such access users, to the detriment of their use of mail and, perhaps, to RM's ability to achieve efficiency improvement.

## **Section 6 – Implementation and other issues**

**Q 9: 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.**

- 3.51 As mentioned above (3.39), UKM supports the use of LRIC rather than FAC for zonal costing. If Ofcom decides that LRIC cannot be used for the introduction of the proposed regulatory obligations, because of the structure of the current Zonal Costing Model, UKM believes Ofcom should set a 'flight path' to use of LRIC within two years.

**Q 10: Do you agree with our proposal to use historic cost data rather than forecast data? If not please state your reasons.**

- 3.52 UKM believes Ofcom should use forecast costs, rather than actual costs.
- 3.53 The core objective of Ofcom's proposals is to drive RM efficiency improvement (which it intends to achieve through a focus on promoting EtE competition). Efficiency improvement will mean lower costs and, UKM believes, access users should benefit as soon as possible from lower access costs.
- 3.54 Using actual costs is likely to mean a delay in RM efficiency benefitting mail users through lower prices, as it will be actual costs which RM must use to show the zonal price ratio mirrors the zonal cost ratio (and hence determine the National access price). Currently the lag between the Zonal Costing Model data and RM's access prices seems to be two years, a significant delay to reduced costs being reflected in lower prices.
- 3.55 Ofcom already relies on RM's forecast data on revenues and costs for the access price squeeze protections, so it would not seem unreasonable for Ofcom to similarly rely on RM forecast zonal costs to set access prices.
- 3.56 Ofcom says that it has assessed the extent of distortion from using historic costs rather than forecast costs, including in that assessment some modelling for the impact of EtE competition, and found:

*“that the distortion from using historic costs and volumes is not significant, with the difference in Zonal cost ratios ranging from 0.1% in the Urban Zone to 4.2% in the London Zone.<sup>173</sup> This is not considerably different from the changes in Zonal cost ratios that were observed in the normal course of business from 2011/12 to 2012/13” [6.16]*

Ofcom uses this low level of distortion to support its proposal to use historic costs, but it would seem to UKM to be as much an argument to use forecast costs.

- 3.57 Historic cost data would still be very important and Ofcom must continue to ensure correct and consistent cost reporting, as historic cost information would provide the benchmark against which the achievability of forecast costs would be checked.

**Q 11: 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.**

- 3.58 As UKM favours the use of forecast, rather than historic costs, this question would not arise.
- 3.59 However, if Ofcom does decide to use historic costs, UKM does not argue against the proposal to use the existing Zonal Costing Model.
- 3.60 Given the importance which would be placed on the Zonal Costing by Ofcom's proposals, it is clearly very important that the model is as fit for purpose as practical and UKM supports the need for Ofcom to review the model and require RM swiftly to implement any changes Ofcom finds necessary.

**Q 12: Do you have a view on the appropriate volumes to use as weights in the weighted average rule? Please provide reasons for your view.**

- 3.61 UKM agrees with Ofcom's view that RM volume loss to EtE competition will not be even geographically or across Zones, and so there will be an increasing distortion between RM's zonal volume profile and the actual profile of mail.
- 3.62 That distortion is likely to mean the average of RM's zonal costs is higher than if the true mail profile were used (as RM would be likely to lose more volume to EtE competition in lower cost zones) and that will mean a higher National access price.
- 3.63 UKM believes it is therefore important for Ofcom to use a volume profile that minimises such distortion and UKM hence supports Option 2 (including USO volumes).
- 3.64 Ideally, to minimise or eliminate distortion, it would be better still to use the profile of all mail delivered by all operators. Ofcom should consider the benefits and difficulties of requiring all final delivery operators to report to it their volume profile.

**Q 13: 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.**

- 3.65 UKM does not argue against Ofcom's assessment that the format level volumes should be used for the weighted average.

**Q 14: 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.**

- 3.66 UKM does not argue against Ofcom's proposal on when the regulatory conditions will come into force.
- 3.67 UKM understands that Ofcom plans to issue its decision in June and the six months proposed for the new conditions to come into force would therefore be January 2016. However, RM has now moved to January for its main access price changes and RM must give 70 days' notice of price changes (and 90 days' notice for contract changes required by Ofcom, such as changes to the contract terms of the access price plans).
- 3.68 UKM is, therefore, uncertain as to how the new conditions can apply for January 2016 access prices (as it assumes Ofcom intends) and asks Ofcom to provide clarification on this.

**Q 15: 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?**

- 3.69 UKM does not argue against Ofcom's proposed scope for reviewing Zonal costing methodology.

**Q 16: 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?**

**Q 17: If we were to establish a compliance process what form should it take?**

- 3.70 UKM believes it is very important for access users to have confidence in the correct operation of the proposed regulations and so for there to be sufficient public visibility of RM's compliance with them.
- 3.71 UKM believes RM (or Ofcom) should, as a minimum, publish information showing compliance with the conditions on zonal cost and zonal price ratios and on the relative zonal volumes (which will determine the National access price paid by the great majority of access users).

**Q 18: Do you consider there are reasons we should extend the access obligation to the crown dependencies? If so please state your reasons.**

- 3.72 UKM would strongly object to the removal of the crown dependencies from RM's access service.
- 3.73 While there is little access mail volume for the crown dependencies, those delivery destinations are very important for many access users and their removal would have a material impact on the suitability of access services for those mail users. Mail users expect access services to give the same geographic coverage as RM's retail services, and choose to use access on that basis.
- 3.74 In concluding the first access contract in 2004, UKM and RM agreed that the crown dependencies would be included in the access service specification for as long as they were included as domestic destinations for RM's bulk retail contracts, which they currently are.
- 3.75 Were Ofcom to allow RM to create such a material difference between its access and retail services, UKM strongly believes that would create clear, undue discrimination by RM between retail and access customers and UKM would seek to challenge such action on that basis.

- 3.76 UKM also believes that the legislation establishing Ofcom’s powers to set access conditions refers to the infrastructure used by RM to provide the universal service. As the crown dependencies are included within RM’s specifications for the domestic universal service, that would seem to mean they are part of the universal service infrastructure and so can be included in the Ofcom access obligations.
- 3.77 It is also the case that the points of access to the universal service infrastructure are in the United Kingdom (Derby Mail Centre for the Isle of Man and Dorset Mail Centre for the Channel Islands).

### **Section 7 – Provisional conclusions**

#### **Q 19: 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?**

- 3.78 Subject to the points made above on some of the detail of the proposals, UKM does not seek to argue that Ofcom’s proposals would not address the risks and concerns identified or are not necessary.
- 3.79 However, for the reasons outlined above, UKM strongly believes Ofcom’s proposals are not sufficient fully to address the risks and concerns and that they are not sufficient to achieve benefit for all access users and to be effective in driving RM efficiency improvement.
- 3.80 UKM believes that a general access price control, specifically related to efficiency improvement, or regulatory targets for efficiency improvement are needed.

#### **Q 20: Do you agree with our assessment of the impact of our proposals? If not, please explain why.**

3.81 Ofcom say that

*“senders of bulk mail are likely to benefit from lower retail prices”* [7.24]

and

*“End-to-end operators are likely to benefit from our proposals”* [7.55]

while

*“Access operators are likely to face greater competitive pressures arising from the downward pressure on retail prices. To some extent this may be offset by reduced access charges”* [7.55]

- 3.82 Those statements suggest Ofcom expect the proposals will benefit RM’s Retail customers and EtE competitors, while access operators and direct access users may or may not see lower access charges.
- 3.83 In UKM’s view, this means that the proposals may distort the market by particularly favouring only some customers of RM Retail and EtE competitors, but not access users in general, when zonal (i.e. EtE) use of access is only a small proportion and access mail is a larger part of the market than bulk contract retail mail. If so, the proposals would seem to be unbalanced and not proportionate.

3.84 UKM believes that to ensure it is acting in a balanced and non-discriminatory way, Ofcom must properly consider a general access price control or efficiency improvement targets.

**Q 21: Do you agree with our proposals, if not please explain why?**

3.85 Please see comments above.

**Q 22: 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.**

3.86 Subject to comments UKM has made, UKM does not challenge the proposed conditions as they have been drafted as failing to reflect the proposals made or being unclear.

**Annex 6: Proposed modifications – detailed drafting**

**Q 23: Which of our proposed two alternative definitions of ‘Relevant Postal Services’ discussed above do you prefer and what are your reasons for your preference?**

**Q 24: 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.**

**Q 25: Do you have any comments on our proposed new concepts and their definitions discussed in this Annex?**

**Q 26: 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)?**

**Q 27: 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.**

3.87 Regarding Q23, please see the response to Q12 above (3.61-3.64)

3.88 On the other questions, UKM does not argue against Ofcom’s proposals (UKM does not consider it has sufficient expertise to comment)