

**An investigation into Royal Mail's offering of  
Tailor Made Incentives on Mailsort 2  
products and its compliance with Condition  
21(5)**

**A "minded to" decision document by the Postal  
Services Commission**

**December 2008**

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**Contents**

<b>1.</b>	<b>BACKGROUND</b>	
	<b>A. Purpose of the document</b>	<b>3</b>
	<b>B. The Parties</b>	<b>4</b>
	<b>C. Tailor Made Incentives</b>	<b>5</b>
	<b>D. The Issue</b>	<b>6</b>
	<b>E. Approach to the Investigation</b>	<b>7</b>
<b>2.</b>	<b>LEGAL BACKGROUND</b>	
	<b>A. The Postal Services Act 2000</b>	<b>9</b>
	<b>B. Condition 21 of Royal Mail’s Licence</b>	<b>9</b>
	<b>C. Postcomm’s Enforcement Guidance</b>	<b>14</b>
<b>3.</b>	<b>POSTCOMM’S INVESTIGATION AND ASSESSMENT</b>	
	<b>A. The investigation and information provided by Royal Mail</b>	<b>16</b>
	<b>B. Postcomm’s assessment</b>	<b>23</b>
	<b>C. Postcomm’s initial findings</b>	<b>34</b>

## **CHAPTER 1 – BACKGROUND**

### **A. PURPOSE OF THE DOCUMENT**

- 1.1 This document sets out Postcomm’s “minded to” decision, in relation to its investigation into Royal Mail’s compliance with Condition 21(5) of its licence, through its offering of Tailor Made Incentives (TMIs) on Mailsort 2 products; it is intended to allow Royal Mail the opportunity to respond to the issues it discusses, before Postcomm makes a final decision on those issues.
- 1.2 TMIs are a scheme offered by Royal Mail which it regards as encouraging customers to make further use of postal services for marketing and promotion purposes. If Royal Mail considers that customers are using its services in an “innovative way” (against certain criteria), it offers a rebate relating to the innovative mailing activity in the form of a postage credit.
- 1.3 The access headroom provision in Condition 21(5) of Royal Mail’s licence requires Royal Mail to maintain a minimum margin between the access price and the analogous retail price which the licence requires to be “*reduced by the maximum amount of all discounts available*”. Postcomm believes that Royal Mail must include TMIs as a discount when comparing the analogous retail price and the access price, to ensure compliance with the access headroom provision.
- 1.4 In light of Postcomm’s assessment of the information gathered throughout the course of the investigation, Postcomm is “minded to” find that Royal Mail has contravened and is likely to continue contravening (unless appropriate action is taken) Condition 21(5) of its licence through the offering of TMIs on Mailsort 2 products.

## **B. THE PARTIES**

- 1.5 The Postal Services Act 2000<sup>1</sup> (the Act) established the Postal Services Commission (Postcomm) as the regulatory body for the postal services industry in the United Kingdom. Postcomm's business plan, which can be found on its website [www.psc.gov.uk](http://www.psc.gov.uk), gives details of its duties, functions, objectives and work programme.
- 1.6 Postcomm must exercise its functions in a manner which it considers is best calculated to ensure the provision of a "universal postal service". The universal postal service comprises, amongst other things, the delivery and collection of mail items up to 20 kilograms in weight at least once every working day and the provision of a registered postal service, all at affordable prices that are geographically uniform throughout the UK.
- 1.7 Postcomm is also charged with furthering the interests of users of postal services, where appropriate by promoting effective competition between postal operators. In doing so, Postcomm must have particular regard to the interests of those who are disabled or chronically sick, are of pensionable age, are on low incomes or who reside in rural areas.
- 1.8 Postcomm has a further duty to exercise its functions in a manner which it considers is best calculated to promote efficiency and economy on the part of postal operators.
- 1.9 In exercising its functions Postcomm also must have regard to the need to ensure that licence holders are able to finance the activities authorised or required by their licences.
- 1.10 Royal Mail Group Ltd (Royal Mail) is a wholly owned subsidiary of the government-owned public limited company Royal Mail Holdings plc. Royal Mail has a letters business which trades as Royal Mail, a courier and

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<sup>1</sup> Postal Services Act 2000, 2000, [http://www.opsi.gov.uk/acts/acts2000/ukpga\\_20000026\\_en\\_1](http://www.opsi.gov.uk/acts/acts2000/ukpga_20000026_en_1)

express business which trades as Parcelforce, and a number of subsidiary companies. One of those subsidiaries, Post Office Ltd, is responsible for the network of post offices in the UK. Royal Mail was granted a licence to provide postal services on 23 March 2001. The licence was modified on 1 April 2003, 2 November 2005 and 25 May 2006. The full text of the licence as amended to 25 May 2006 can be found on the Postcomm website ([www.psc.gov.uk](http://www.psc.gov.uk))<sup>2</sup>. Royal Mail is required, by the conditions of its licence, to provide a universal postal service in the United Kingdom.

## **C. TAILOR MADE INCENTIVES**

1.11 TMIs are a scheme offered by Royal Mail which it regards as encouraging customers to make further use of postal services for marketing and promotion purposes. If Royal Mail considers that customers are using its services in an “innovative way” (against certain criteria), it offers a rebate relating to the innovative mailing activity (a percentage of the value of the mailing) in the form of a postage credit. The postage credit is paid into the customer’s Royal Mail credit account after postage and payment of the full price for the TMI-related mailing. The calculation of the postage credit depends on the service that the customer wishes to use (in relation to other services previously used) and Royal Mail’s assessment of the level of commercial risk involved in the proposed activity. Royal Mail awards TMIs across a range of services and they are subject to a minimum claim of £300.

1.12 Royal Mail has been offering TMIs for a number of years. In 2004, following an investigation by Postcomm<sup>3</sup>, Royal Mail agreed to notify Postcomm of individual TMI agreements and of any changes to its TMI

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<sup>2</sup> Royal Mail licence, May 2006, [http://www.psc.gov.uk/postcomm/live/royal-mail-standards-and-prices/Royal\\_Mail\\_Licence\\_May\\_2006.pdf](http://www.psc.gov.uk/postcomm/live/royal-mail-standards-and-prices/Royal_Mail_Licence_May_2006.pdf)

<sup>3</sup> Investigation into Royal Mail’s Catalogue and Advertising Mail Promotion Scheme, 20 January 2005, [http://www.psc.gov.uk/postcomm/live/competition/anti-competitive-behaviour/royal-mail-s-catalogue-and-advertising-promotion-scheme/2005-01\\_Royal\\_Mail\\_catalogue\\_and\\_advertising\\_decision.pdf](http://www.psc.gov.uk/postcomm/live/competition/anti-competitive-behaviour/royal-mail-s-catalogue-and-advertising-promotion-scheme/2005-01_Royal_Mail_catalogue_and_advertising_decision.pdf)

Policy Manual used by sales and marketing staff. Royal Mail did not publish this information, but did publish a brief overview of TMI availability on its website.

- 1.13 Following an application received from Royal Mail in August 2007 to exempt TMIs from some of the publication requirements in Condition 7<sup>4</sup>, Postcomm published a “minded to” consultation letter on 28 February 2008<sup>5</sup> which consulted on a proposed direction to allow an exemption from some of the reporting and publication requirements under Condition 7 in relation to TMIs, but at the same time required Royal Mail to publish more information relating to TMIs than it published at the time. In response to the consultation, one respondent expressed concern that TMIs awarded on Mailsort 2 products may represent a means whereby the headroom protection within Condition 21(5) of Royal Mail’s licence can be breached, by reducing the margins between retail and access services.

#### **D. THE ISSUE**

- 1.14 Condition 21(5) of Royal Mail’s licence sets the minimum percentage level of headroom between the access price and the analogous retail price which the licence requires to be “*reduced by the maximum amount of all discounts available*”, for each weight step for the duration of the 2006-2010 price control. The intention of this restriction is to prevent a margin squeeze between Royal Mail’s retail and access services. Without the headroom control, there would be potential for Royal Mail to reduce the margin between its retail and access prices to prevent access operators from competing in the upstream activities of its business. Royal Mail is

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<sup>4</sup> Condition 7 of Royal Mail’s licence requires Royal Mail to notify Postcomm about the launch of new services, and changes to existing services three months before they are introduced. It also requires Royal Mail to publish information about such changes as soon as practical after notification.

<sup>5</sup> Royal Mail’s application to exempt Tailor Made Incentives from Condition 7 licence requirements, 28 February 2008, [http://www.psc.gov.uk/postcomm/live/policy-and-consultations/documents-by-date/2008/2008\\_02\\_Minded\\_to\\_consultation\\_letter\\_vFINAL.pdf](http://www.psc.gov.uk/postcomm/live/policy-and-consultations/documents-by-date/2008/2008_02_Minded_to_consultation_letter_vFINAL.pdf)

required to take “all reasonable steps” to ensure compliance with the Condition.

- 1.15 Postcomm began a preliminary assessment to consider whether Royal Mail had breached the access headroom provision in its licence through its offering of TMIs on Mailsort 2 retail services, which have access equivalents. Postcomm’s analysis appeared to demonstrate that the access headroom had not been maintained in all cases and that therefore, in accordance with its Enforcement Guidance<sup>6</sup>, Postcomm decided to proceed to a full investigation.
- 1.16 This document presents the findings of Postcomm’s full investigation and forms Postcomm’s “minded to” decision document.

## **E. APPROACH TO THE INVESTIGATION**

### Preliminary assessment

- 1.17 During the preliminary assessment stage of the investigation, Postcomm undertook the following activities:
  - In August 2008 Postcomm began its preliminary assessment and analysed the data then available to it;
  - On 4 September 2008 a letter was sent to Royal Mail<sup>7</sup> asking for data to allow further calculations of the access headroom in relation to a number of TMI offerings identified by Postcomm, to which Royal Mail responded on 16 September 2008<sup>8</sup>; and
  - From 16 to 26 September 2008 Postcomm conducted further analysis.

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<sup>6</sup> Enforcement Guidance for considering and investigating complaints in relation to licence contraventions, A consultation document, 2 August 2007 (see footnote 26 for details of the finalised Enforcement Guidance which was published on 31 October 2008)

<sup>7</sup> Letter from Kate Walters to Luke March, 4 September 2008

<sup>8</sup> Letter from Luke March to Kate Walters, 16 September 2008

## Full investigation

1.18 Postcomm's full investigation included the following activities:

- On 26 September 2008 a Scope of Investigation<sup>9</sup> was published on Postcomm's website;
- On 6 October 2008 a Requirement to Furnish Information (RFI) issued under Condition 17 of Royal Mail's licence was sent to Royal Mail<sup>10</sup>, to which Royal Mail responded in three parts on 13<sup>11</sup>, 20<sup>12</sup> and 27<sup>13</sup> October 2008;
- On 4 November 2008 Postcomm met with Royal Mail to discuss the responses to the RFI<sup>14</sup>;
- On 24 November 2008, Postcomm sent a letter to Royal Mail<sup>15</sup> regarding Postcomm's interpretation of Condition 21(5) and how TMIs apply to the access headroom calculations, in response to a note sent by Royal Mail on 12 November 2008<sup>16</sup>.
- On 27 November 2008 Postcomm met with Royal Mail to discuss Postcomm's letter of 24 November 2008, including its interpretation of Condition 21(5) and how TMIs apply to the access headroom calculations<sup>17</sup>.

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<sup>9</sup> Tailor Made Incentives: Scope of Investigation, 26 September 2008, [http://www.psc.gov.uk/postcomm/live/competition/anti-competitive-behaviour/tailor-made-incentives/2008\\_09\\_TMIs\\_Scope\\_of\\_Investigation\\_vFINAL.pdf](http://www.psc.gov.uk/postcomm/live/competition/anti-competitive-behaviour/tailor-made-incentives/2008_09_TMIs_Scope_of_Investigation_vFINAL.pdf)

<sup>10</sup> Requirement to Furnish Information, 6 October 2008

<sup>11</sup> Response to Condition 17 Requirement to Furnish Information on TMIs, Part 1 response to questions 3.1.2-3.1.11, 13 October 2008

<sup>12</sup> Response to Condition 17 Requirement to Furnish Information on TMIs, Part 2 response to questions 3.1.1, 20 October 2008

<sup>13</sup> Response to Condition 17 Requirement to Furnish Information on TMIs, Part 3 response to questions 3.2.1-3.2.9, 27 October 2008

<sup>14</sup> Note of meeting with Royal Mail on TMIs, 4 November 2008

<sup>15</sup> Letter from Hannah Steel to Paul Dudley, 24 November 2008

<sup>16</sup> A note on Postcomm's direction of 2006 regarding Condition 21(5b), email from Paul Dudley to Hannah Steel, 12 November 2008

<sup>17</sup> Note of meeting with Royal Mail on TMIs, 27 November 2008

## **CHAPTER 2 – LEGAL BACKGROUND**

### **A. THE POSTAL SERVICES ACT 2000**

2.1 Postcomm has a number of statutory duties as set out in paragraphs 1.5 to 1.9 above. Postcomm has the power under the Act to grant licences to allow the conveyance of letters by a person or company from one place to another in the United Kingdom. Postcomm is also required to ensure that licensees comply with the conditions of their licences, in that, if Postcomm is satisfied that a licence holder is contravening any condition of its licence or is likely to contravene any such condition, Postcomm must take steps to ensure that compliance is secured, except in specified circumstances set out in the Act. When non-compliance is suspected, Postcomm may choose to investigate with a view to taking enforcement action.

### **B. CONDITION 21 OF ROYAL MAIL'S LICENCE**

2.2 Condition 21 of Royal Mail's licence sets out the framework for prices for postal services. It was introduced in the 2006-2010 price control, replacing Condition 19 which had been in effect since 1 April 2003. The full text of Condition 21 of Royal Mail's licence is attached at **Annex A**.

2.3 In relation to this investigation, the relevant part of Condition 21(5) states that:

*“Except in so far as Postcomm, (...), may by direction in writing agree otherwise, the Licensee shall take all reasonable steps to ensure that in each Formula Year<sup>18</sup> after Formula Year  $t = 0$  it sets prices for the*

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<sup>18</sup> Condition 21(38)(a) defines Formula Year as:  
“a year ending on any 31<sup>st</sup> March during or immediately before the currency of this Condition and for the purpose of this Condition the Formula Years are numbered as follows-  
t: Year to 31 March  
-1: 2005; 0: 2006; 1: 2007; 2:2008; 3:2009; 4:2010 with 1 added for each subsequent year.

*Controlled Services*<sup>19</sup> in each of Basket A and B so as to meet the following conditions, namely –

- (a) (...) and
- (b) in respect of *Access Services*<sup>20</sup> the following conditions are met –
  - (i) when the service is priced on a uniform national basis, for each *Price Point*<sup>21</sup> in respect of each *Access Service, s*,

$$p_{st} \leq arp_{yt} * \left( \frac{100 - D_{sy}}{100} \right)$$

where –

$p_{st}$  is the price at any time in Formula Year  $t$  for any *Price Point* for any *Access Service, s*,

$arp_{yt}$  is the *Access Reference Price*<sup>22</sup> at the same time for the same *Price Point* for a corresponding end-to-end service in Basket B, numbered  $y$ , and

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<sup>19</sup> Condition 21(38)(a) lists 45 “Controlled Services”, each of which is allocated a number 1-45. The relevant Controlled Services for the purposes of this investigation are listed in Table 1.

<sup>20</sup> Condition 21(38)(a) defines “Access Services” as:

“the Controlled Services numbered 39 to 45” (see table 1 for details).

<sup>21</sup> Condition 21(38)(a) defines “Price Point” as:

“any weight expressed in whole grams by reference to which a price for the conveyance of postal packets for a service may be determined and where a tariff provides for prices to depend also on the format of a postal packet and the same weight gives rise to different prices under different formats that weight shall comprise a distinct Price Point under each format”.

<sup>22</sup> Condition 21(38)(a) defines the access reference price as:

“the price at a Price Point for the conveyance of postal packets by a Controlled Service under the tariff applicable within that service which makes the greatest contribution to total revenue for the service in the Formula Year in which the price is being determined reduced by the maximum amount of all the discounts available at the time of determination irrespective of any qualification conditions for such discounts.”

$D_{sy}$  is a price differential, calculated as at 30 March 2006, between the price at each Price Point for an Access Service,  $s$ , and the Access Reference Price at the same Price Point for its corresponding end-to-end service,  $y$  (...).”

2.4 Condition 21(5) then states that the corresponding Access Services and end-to-end services for the purpose of this condition are as follows:

Table 1: Access Services and the analogous end-to-end service<sup>23</sup>

<b>ACCESS SERVICE</b>	<b>END-TO-END SERVICE</b>
Access 1400 (s = 39)	Mailsort 1400 2 <sup>nd</sup> Class (y = 27)
Access 120 Letter (s = 40)	Mailsort 1400 Residues 2 <sup>nd</sup> Class (y = 28)
Access 120 Flat & Packet (s = 41)	Mailsort 1400 Residues 2 <sup>nd</sup> Class (y = 28)
Access 120 OCR (s = 42)	Mailsort 120 OCR 2 <sup>nd</sup> Class (y = 21)
Access 120 CBC (s = 43)	Mailsort 120 CBC 2 <sup>nd</sup> Class (y = 22)
Access 700 CBC (s = 44)	Mailsort 700 2 <sup>nd</sup> Class (y = 24)
Access Walksort (s = 45)	Walksort 2 <sup>nd</sup> class (y = 36)

2.5 Condition 21(5) then goes on to state the formula for calculating  $D_{sy}$  values and the mechanism for allowing a revision of the  $D_{sy}$  values either following the introduction of Pricing in Proportion (PiP) or following a

<sup>23</sup> The numbers after the named access and end-to-end services in this table refer to the list of Controlled Services in Condition 21(38)(a).

request to review the  $D_{sy}$  values by the Licensee, or from any person to whom the Licensee provides an Access Service:

*“ $D_{sy}$  shall be calculated for each Price Point for each Access Service using the formula –*

$$D_{sy} = \left( \frac{arp_{yt=0} - ppp_{st=0}}{arp_{yt=0}} \right) * 100$$

*where*

*(aa) until the introduction of Pricing in Proportion*

*ppp<sub>st=0</sub> is the price on 30 March in Formula Year*

*t = 0 at a Price Point for an Access Service, s, and*

*arp<sub>yt=0</sub> is the Access Reference Price on that date for the same Price Point for the corresponding Controlled Service, y, and*

*(bb) from the introduction of Pricing in Proportion ppp<sub>st=0</sub>*

*and arp<sub>yt=0</sub> shall have such values at each Price Point as may be set out in or calculated pursuant to such direction as may be made by Postcomm for the purpose of this paragraph,*

*provided that for Formula Years subsequent to Formula Year t = 2, if*

*(aa) Postcomm has received a request to review any of the values of  $D_{sy}$  as calculated above from the Licensee, or from any person to whom the Licensee provides an Access Service,*

(bb) *Postcomm has given not less than three months' notice of its intention to review such values to the Licensee, to all persons to whom the Licensee provides an Access Service and to the Council, and*

(cc) *Postcomm has given to the persons referred to in paragraph (bb) the opportunity in that period to make representations to it in relation to the relevant request, then, to the extent that Postcomm determines that it is appropriate, and if the Licensee consents, there shall be substituted such other value or values for  $D_{sy}$  (if any) as Postcomm may determine by direction in writing.*

*"(...)"*

- 2.6 In October 2006, following the introduction of PiP in August 2006, Postcomm made a direction under Condition 21(5) fixing the price differentials  $D_{sy}$ <sup>24</sup>. The introduction of PiP changed the basis on which Royal Mail's prices were set from being solely related to weight to being related to a combination of weight and size. As a result of this change the price differentials  $D_{sy}$  which applied from 1 April 2006 until the introduction of PiP needed adjusting.
- 2.7 On 10 August 2006 Royal Mail advised Postcomm that it had discussed with all of its users of its Access Services the prices it proposed to apply at each Price Point for each of its Access Services following the introduction of PiP and that these prices were the prices contained in the Excel Workbook supplied to Postcomm by Royal Mail on 5 May 2006. Postcomm's Direction which had effect from 21 August 2006, fixed the

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<sup>24</sup> Direction for the purpose of the determination of the maximum prices for access services, 18 October 2006, <http://www.psc.gov.uk/postcomm/live/policy-and-consultations/documents-by-date/2006/PiPAccessdirection.pdf>

price differentials  $D_{sy}$  at the percentages set out in the Excel Workbook attached to the Direction<sup>25</sup> supplied to Postcomm on 5 May 2006.

- 2.8 The  $D_{sy}$  values are the fixed differentials that set the minimum percentage level of headroom between the access prices and the analogous retail prices, as described in paragraph 1.14 above.

### **C. POSTCOMM'S ENFORCEMENT GUIDANCE**

- 2.9 In October 2008 Postcomm published its Enforcement Guidance<sup>26</sup>. This guidance describes the enforcement procedures applied by Postcomm when considering complaints, conducting investigations, taking enforcement action and imposing financial penalties in relation to suspected licence contraventions.

- 2.10 The Enforcement Guidance states that if Postcomm is satisfied that a licence holder is contravening or has contravened a licence condition or is likely to contravene a condition of its licence, the licence holder will be sent a "minded to" decision document which is, in effect, a proposal to make a finding that there has been or is likely to be a licence contravention. This document will notify the recipient what Postcomm is minded to decide and set out the basis on which Postcomm has reached its "minded to" decision.

- 2.11 The Enforcement Guidance also provides that the licence holder will be invited to make written and oral representations in response to the "minded to" decision document.

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<sup>25</sup> [Spreadsheets for the determination of prices for Royal Mail's access services following the introduction of Pricing in Proportion](http://www.psc.gov.uk/postcomm/live/policy-and-consultations/documents-by-date/2006/DSA_Headroom.xls), 18 October 2008, [http://www.psc.gov.uk/postcomm/live/policy-and-consultations/documents-by-date/2006/DSA\\_Headroom.xls](http://www.psc.gov.uk/postcomm/live/policy-and-consultations/documents-by-date/2006/DSA_Headroom.xls)

<sup>26</sup> Enforcement Guidance for considering and investigating complaints in relation to licence contraventions, A decision document, October 2008, [http://www.psc.gov.uk/postcomm/live/policy-and-consultations/consultations/postcomm--enforcement-guidance/2008\\_10\\_Decision\\_Document\\_vFINAL.pdf](http://www.psc.gov.uk/postcomm/live/policy-and-consultations/consultations/postcomm--enforcement-guidance/2008_10_Decision_Document_vFINAL.pdf)

2.12 Finally the Enforcement Guidance states that following a consideration of any representations made, Postcomm will make a decision as to whether it is satisfied that the licence holder under investigation is or has contravened a licence condition or is likely to contravene a licence condition.

## **CHAPTER 3- POSTCOMM'S INVESTIGATION AND ASSESSMENT**

### **A. THE INVESTIGATION AND INFORMATION PROVIDED BY ROYAL MAIL**

#### Preliminary assessment

- 3.1 During the preliminary assessment, Postcomm reviewed the TMI notifications that it received from Royal Mail between April 2006 and August 2008. Of the TMIs offered since April 2006, Postcomm identified 33 TMI offerings which were made on retail services which have an analogous access service (the relevant TMIs) and therefore for which the minimum headroom is required to be maintained. For these offerings the access headroom available following the application of all discounts applied was calculated and compared with the access headroom that should be available in relation to these products (as set by Condition 21(5)).
- 3.2 The analysis appeared to demonstrate that the headroom had not been maintained in 30 out of the 33 instances when taking into account the TMI discounts awarded.
- 3.3 Postcomm wrote to Royal Mail on 4 September 2008 requesting Royal Mail to provide data to allow further calculations of the access headroom, in relation to the relevant TMIs identified by Postcomm. Royal Mail responded on 16 September 2008 providing the data requested.
- 3.4 In addition, Royal Mail made the following principal points in its response:
  - Royal Mail did not believe that there had been a breach of Condition 21(5);
  - However, Royal Mail had suspended (for three months from 16 September 2008) offering TMIs on Mailsort 2 services to “allow

*Postcomm's concerns to be fully understood and for a way forward to be considered*';

- Royal Mail claimed that TMIs do not breach Condition 21(5) because:
  - TMIs are not included in the access reference price as they are ad-hoc short term incentives (as opposed to the continuous application of discounts published within the Tariff Guide (such as sortation discounts and volume related discounts)); and
  - the definition of the access reference price does not apply to TMIs as the wording of the definition only applies to the discounts available at the time of the determination i.e. the resulting headroom requirement applies to the tariffs notified to Postcomm in December each year.
- Royal Mail stated that TMIs are short term incentives designed to stimulate new postal activity;
- Royal Mail submitted that if Postcomm has concerns about the impact of TMIs, Postcomm should consider this through the application of Condition 11 and by carrying out a competition law analysis. However, Royal Mail claims that the effect of TMIs are in competition law terms *de minimis*<sup>27</sup> and do not have an anti-competitive impact.

3.5 Following its preliminary assessment, Postcomm considered that it had reasonable grounds for suspecting that there had been a contravention of Condition 21(5) of Royal Mail's licence through the awarding of TMIs in relation to some Mailsort 2 retail services, and therefore that it had sufficient reason to proceed to a full investigation.

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<sup>27</sup> Royal Mail stated that the total amount of postage credit paid in relation to the TMIs under consideration is only £51,200 which Royal Mail claimed is minimal in relation to overall Mailsort 2 revenues.

## Full investigation

- 3.6 On 26 September 2008 Postcomm published on its website a Scope of Investigation, which stated that to determine whether a breach of Condition 21(5) had taken place, in addition to what it had already considered, Postcomm would consider two key issues:
- whether the access reference price as defined under Condition 21(5) and Condition 21 more generally allows for the consideration of TMI discounts when calculating the percentage of access headroom to be maintained; and
  - what “steps” Royal Mail has taken and was taking to ensure compliance with Condition 21(5) in relation to TMIs.
- 3.7 Due to Royal Mail's three month suspension of offering TMIs on Mailsort 2 services, Postcomm stated in the Scope of Investigation that it had decided not to issue a provisional order in this case at that time, although it would not preclude Postcomm from issuing a provisional order at a later date in relation to this matter, should the need arise.
- 3.8 Postcomm served a RFI on Royal Mail on 6 October 2008. Royal Mail submitted its response to the RFI in three parts.
- 3.9 In order for Postcomm to understand whether the minimum level of headroom had been maintained in relation to the relevant TMIs, Royal Mail was required to submit the customer TMI agreements, invoices and other supporting documentation for the relevant TMIs, and explain some of the data and calculations in the TMI notifications and the spreadsheet that had been submitted during the preliminary assessment stage<sup>28</sup>. In order to

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<sup>28</sup> Postcomm sent Royal Mail a spreadsheet annexed to its letter of 4 September 2008, which contained its analysis of Royal Mail's compliance with the access headroom provision. On Postcomm's request, Royal Mail added further data to the spreadsheet in its response of 16 September 2008 and sent an amended version, containing minor corrections, on 24 September 2008 (referred to as the “corrected spreadsheet”).

- understand what “steps” Royal Mail took to ensure compliance with Condition 21(5) of its licence in relation to its offering of TMIs on Mailsort 2 services, the RFI also required Royal Mail to explain the systems and processes that it has in place to monitor compliance with Condition 21(5).
- 3.10 The first part of Royal Mail’s RFI response, dated 13 October 2008, provided explanations of its calculations and data in relation to its TMI notifications, the additional information received on 16 September 2008 and the corrected spreadsheet of 24 September 2008. Its response included access prices for letters and large letters from 2006 onwards, the spreadsheet that was attached to the October 2006 Direction and a revised spreadsheet that contained a TMI that had previously been omitted from the corrected spreadsheet.
- 3.11 The second part of Royal Mail’s RFI response, dated 20 October 2008, contained the available TMI agreements, invoices and supporting documentation relating to the relevant TMIs. The response noted that several of the TMI agreements were missing although the TMI system, which also generates the notification that is sent to Postcomm, holds the customer specific details for each TMI that is approved. The response stated that all approved TMIs are issued with the standard agreement that is completed using information taken from the system (a generic TMI template agreement was annexed to the response). Where customer claim forms had been received, they were provided with the associated invoices and credit notes.
- 3.12 In the third part of Royal Mail’s RFI response, received on 27 October 2008, Royal Mail explained that compliance with Condition 21(5) is monitored and reviewed on an annual basis as part of Royal Mail’s overall tariff process, which includes an assessment to ascertain whether the new prices are consistent with the original  $D_{sy}$  values. Royal Mail’s response referred to the Direction issued by Postcomm in October 2006 on the

maximum prices for access services and the accompanying Excel spreadsheet. Royal Mail argued that the prices in the spreadsheet set the values for  $D_{sy}$  under Condition 21(5), taking the end-to-end service and related access service prices. The end-to-end service prices in that file excluded any adjustment for TMIs, and therefore the calculation of the  $D_{sy}$  values excludes TMIs. Royal Mail explained that in its view the October 2006 Direction set a precedent for excluding TMIs from the original access reference price and derivation of  $D_{sy}$ , and this approach has been adopted when setting prices since 2006. The annual check to ensure compliance with Condition 21(5) involves Royal Mail retail populating a headroom file with the access reference prices, which is then populated with Royal Mail Wholesale's access prices. It is reviewed at Royal Mail Group level and then submitted to Postcomm. Consistently with Postcomm's October 2006 Direction, TMI discounts are not considered.

- 3.13 Royal Mail explained in its third response that for non standard proposals, there is an additional check whereby they are reviewed under the Promotion Approval Procedure (PAP). Following the 2006 licence modifications, Royal Mail claimed that the PAP was adapted to include specific consideration of implications under Conditions 7 and 21. Therefore, headroom implications for non-standard proposals are picked up during the PAP reviews. Royal Mail noted that TMI proposals are not subject to this check under the PAP review since Royal Mail does not believe that they are part of how  $D_{sy}$  is calculated.
- 3.14 Royal Mail's third response noted that Condition 21(5) was considered as part of the overall PAP review of the new TMI policy which was notified to Postcomm in December 2006. As part of this review, the Compliance Director raised Condition 21(5) and highlighted that without formal assurance from Postcomm that there was risk in this area [of whether TMIs should be included in the access reference price]. The response

noted that Royal Mail's marketing department had informed the Compliance Director that the definition of the access reference price remained uncertain and while the understanding was that Postcomm had accepted the methods, Royal Mail awaited Postcomm's issuance of a direction to confirm its methodology. Royal Mail argued that when Postcomm issued the October 2006 Direction, it accepted in full the methodology proposed by Royal Mail and clearly set out how  $D_{sy}$  was calculated. As this calculation did not consider TMIs as part of the calculation, it was considered that the concern had been alleviated.

3.15 Royal Mail noted in its third RFI response that its TMI policy has numerous checks and balances in place to ensure that there are no anti-competitive effects resulting from Royal Mail issuing TMIs.

3.16 Royal Mail attended a meeting with Postcomm, held on 4 November 2008 to discuss its response to the RFI. At the meeting, Royal Mail reiterated its view that the Direction published by Postcomm on 18 October 2006 and the accompanying spreadsheet<sup>29</sup> set a precedent and provided Royal Mail with clarity regarding the calculation of the  $D_{sy}$  values. Specifically Royal Mail noted that the access reference prices contained in the spreadsheet excluded any adjustment for TMIs, and on that basis therefore, Royal Mail asserted that TMIs should be excluded from the assessment of compliance with the access headroom provision. Postcomm believes that its principal points ran as follows:

- It is required to maintain a minimum margin,  $D_{sy}$  between the price of access service  $p_{st}$  and a corresponding access reference price  $arp_{yt}$ ;

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<sup>29</sup> Royal Mail acknowledged that it had proposed the PiP prices in the spreadsheet attached to the October 2006 direction, and the preceding weight-based prices noted in Postcomm's Initial and Final Proposals documents (June 2005 and December 2005 respectively).

- The access reference price is the lowest available price for the Mailsort service which is equivalent to the access service in question;
- In calculating the access reference price, although the definition of that term appears to mean that TMI discounts should be deducted from the undiscounted Mailsort tariff (along with other discounts), Postcomm, by direction, approved a set of initial access reference prices in which that deduction was not made;
- In other words, Postcomm set the initial access reference prices on the basis that TMI discounts did not have to be considered when calculating the access reference price and it follows that the definition of access reference price has to be applied without regard to the existence of TMI discounts. To apply any other interpretation would be inconsistent with Postcomm's approach in its determination;
- Moreover, Postcomm was well aware of the existence of TMIs at the time it drafted the condition;
- It also follows that if, contrary to this interpretation, TMI discounts were intended to be deducted in the calculation of the access reference price, then the access reference prices approved by Postcomm in August 2006 should be recalculated and the outcome would be that there is no contravention of the access headroom condition.

3.17 A further meeting was held between Royal Mail and Postcomm on 27 November 2008, at which Postcomm explained to Royal Mail the content of Postcomm's letter of 24 November 2008, including its interpretation of Condition 21(5) and how TMIs apply to the access headroom calculations.

3.18 At this meeting, Royal Mail stated that the access reference price is defined in Condition 21(5) as follows:

$arp_{yt}$  is the access reference price at the same time for the same Price Point for a corresponding end-to-end service in Basket B, numbered y, and that must be calculated according to the formula:

$$D_{sy} = \left( \frac{arp_{yt=0} - PPP_{st=0}}{arp_{yt=0}} \right) * 100$$

which clearly requires a value for  $arp_{yt=0}$ .

- 3.19 Postcomm's understanding of the meeting is that Royal Mail claimed Postcomm has acted inconsistently in the way in which it has attributed a value to the access reference price at formula year t=0, in that prior to the October 2006 Direction taking effect, the calculation of the access reference price did not take account of TMIs, yet now Postcomm is of the view that it should.
- 3.20 At the meeting, Royal Mail also reiterated its view that TMIs are postage credits to be redeemed against future mailings, and does not believe that they can be construed as discounts.

## **B. POSTCOMM'S ASSESSMENT**

- 3.21 Following its assessment of the information submitted by Royal Mail, Postcomm believes that before it can assess whether a breach of Condition 21(5) has taken place, it must address the key arguments in relation to the treatment of TMIs in the access headroom calculations that have been presented in Royal Mail's submissions:
- whether or not TMIs can be construed as discounts; and

- whether or not Postcomm’s October 2006 Direction set a precedent for excluding TMIs from access headroom calculations for the remainder of the 2006-2010 price control.

3.22 The first part of this section sets out Postcomm’s response to these questions. The second part of this section discusses Postcomm’s assessment of the information provided by Royal Mail during the investigation in relation to whether a breach of Condition 21(5) has taken place.

#### Can TMIs be construed as discounts?

3.23 The Royal Mail template TMI agreement<sup>30</sup> entitles customers (that use a relevant Royal Mail product to trial mailings) to a “postage credit” that may be redeemed against future mailings. The total amount of the postage credit may not exceed £150,000 and must be claimed within 6 months of the end of the trial mailing. The credit may be applied against any future mailing, including against a continuation of the Royal Mail product that the customer has trialled.

3.24 The Royal Mail Policy Manual for Account Handlers<sup>31</sup> states that in calculating the maximum postage credit available in respect of any TMI, “Royal Mail will take into account the *overall cost of the TMI mailing* to the customer” (emphasis added). It then sets out a table detailing the range of “rebate” for the different retail services, stating that the maximum rebate available is 30%, although this percentage is different depending on the service used.

3.25 The customer TMI agreements, invoices and other supporting documentation provided as part of Royal Mail’s RFI response indicate that Royal Mail allocates the TMI credits to the particular mailing for which they

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<sup>30</sup> Tailor Made Incentives Policy Manual for Account Handlers (Version 2), date of issue 12 March 2007, Appendix C.

<sup>31</sup> *Ibid*, Section 4, paragraphs 1-2.

- are awarded, and not across any subsequent posting made by the relevant customer. Postcomm therefore believes that it is appropriate to assess whether the access headroom condition has been breached through Royal Mail's offering of TMIs on Mailsort 2 products on the basis of the original mailing for which they were awarded, and not across further postings made by the relevant customer that claims the postage credit.
- 3.26 A discount is essentially a reduction in the price paid by the customer. Postcomm believes that the effect of a postage credit, if applied, is to reduce the price of the relevant service: the resulting price that a TMI customer pays is discounted against the price a non-TMI customer pays for the same service for the same volumes. This price reduction effect is expressly recognised in the TMI template agreement itself. It refers to TMIs not being able to be "used solely for the purpose of reducing the price of a Royal Mail service<sup>32</sup>", which implies that part of the purpose of the TMI is to reduce the price of the TMI related retail service.
- 3.27 The fact that a TMI customer may not actually redeem the postage credit and the discount therefore does not "crystallise" appears to Postcomm to be irrelevant given that the discount is *available* and likely to influence the decision of a purchaser when agreeing to make a mailing with Royal Mail.
- 3.28 Equally, the fact that the discounts are ad-hoc and not accessible to all customers again seems irrelevant. Just as a volume related discount is only accessible when certain criteria are met (i.e. a minimum volume is sent), a TMI credit is only available when certain criteria are met. Again, the important point is that TMI discounts are available.
- 3.29 Postcomm's "minded to" consultation letter of 28 February 2008 consulting on a proposed direction to allow an exemption from some of the reporting and publication requirements under Condition 7 in relation to TMIs did not challenge Royal Mail's claim that "the postage credit is not a discount on

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<sup>32</sup> *Ibid*, Section 3, paragraph 1

the TMI-related mailing, but is a credit that can be redeemed against any future mailing with Royal Mail<sup>33</sup>. It is important to note, however, that the very reason for considering TMIs under Condition 7 in the first place is that they are discounted tariffs and therefore fall under the remit of the Condition.

Did Postcomm's October 2006 Direction set a precedent for excluding TMIs from access headroom calculations for the remainder of the 2006-2010 price control?

- 3.30 Throughout the investigation Royal Mail has argued that TMIs are not to be included in the access reference price for the purposes of calculating available headroom. Postcomm believes that its key arguments are that Postcomm has acted inconsistently pre and post the introduction of the new PiP structure and that Postcomm's October 2006 Direction set a precedent for excluding TMIs from the original access reference price and the derivation of  $D_{sy}$ , an approach that Royal Mail has consistently adopted in its annual price setting since 2006.
- 3.31 Before the implementation of PiP, there was a period between 1 April 2006 and 21 August 2006 during which the calculation of  $D_{sy}$  would require a value to be attributed to  $arp_{yt=0}$ . There is no doubt, however, that following the October 2006 Direction (which took effect from 21 August 2006), the values for  $arp_{yt=0}$  are as stated in the Direction.
- 3.32 When the discussions were taking place between Postcomm and Royal Mail about the current licence, much of the attention focused on how it would work post-PiP. The licence was meant to cover a four year period from April 2006 and PiP had already been approved for implementation from August 2006. With the benefit of hindsight Postcomm acknowledges that the licence could have provided more clarity in terms of how the

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<sup>33</sup> Royal Mail's application to exempt Tailor Made Incentives from Condition 7 licence requirements, page 3, paragraph 11

licence would apply in the pre-PiP period. By so doing, the argument of inconsistency would fall away. It is important to note, however, that Condition 21 was drafted to apply in the event of a change to pricing structures that was foreseen. Crucially, Condition 21(5) must be read in its entirety. In its argument, Royal Mail has focused simply on the definition of  $arp_{yt}$ .

3.33  $D_{sy}$  is expressed to be calculated in accordance with the formula set out in paragraph 3.18 above. Following this formula in the licence, the licence goes on to state that values for  $arp_{yt=0}$  shall be acquired in two ways: either pre-PiP (in which case Condition 21(5)(b)(i)(aa) applies) or post-PiP (in which case Condition 21(5)(b)(i)(bb) applies). The licence clearly states in Condition Condition 21(5)(b)(i)(bb) that “*from the introduction of Pricing in Proportion...arp<sub>yt=0</sub> shall have such values at each Price Point as may be set out in or calculated pursuant to such direction as may be made by Postcomm*”.

3.34 In stating values for  $arp_{yt=0}$  in the Direction, there is no restriction in the Condition as to how such values should be assessed. In separating the approach to be used pre- and post-PiP, Postcomm believes that it is arguably more of a signal that the methodology to attributing values to a variable may have changed.

3.35 In relation to whether the October 2006 Direction set a precedent, Postcomm believes that at the time of agreeing the current price control with Royal Mail, it was clear that all discounts were relevant when assessing observance of the access headroom provision. The access headroom condition was intended to ensure that the minimum differential which was required to be maintained between access and Mailsort 2 services was not to be eroded by any discounts. As noted in footnote 22, Condition 21(38)(a) defines the access reference price as:

“the price at a Price Point for the conveyance of postal packets by a Controlled Service under the tariff applicable within that service which makes the greatest contribution to total revenue for the service in the Formula Year in which the price is being determined reduced by the maximum amount of all the discounts available at the time of determination irrespective of any qualification conditions for such discounts.”

3.36 In addition, the policy intention was stressed by Postcomm in correspondence with Royal Mail during April and May 2006. Although this related to Royal Mail’s proposals to introduce “Contract Pricing”, at the time of the licence modification consultation for the current 2006-2010 price control, Postcomm’s policy intent was clear. A letter from Postcomm’s Chief Executive Officer (CEO) to Royal Mail’s CEO dated 27 April 2006<sup>34</sup> stated:

“As I understand it, Royal Mail’s current interpretation of Condition 19<sup>35</sup> would allow the introduction of new types of discount schedules that could reduce the minimum headroom between access products and retail products below current levels. *This would undermine the clearly stated policy aim of the policy of providing certainty for operators regarding the minimum level of headroom between access and retail products. We believe such an interpretation would be completely contrary to the spirit in which the Licence modifications were negotiated*” (emphasis added in italics).

3.37 When assessing the differential between  $p_{st}$  and  $arp_{yt}$ , at any time in the course of the application of the control, it is important that  $arp_{yt}$  is clearly defined so as to ensure that the available access headroom is not eroded. Postcomm believes that the access reference price is defined in this

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<sup>34</sup> Letter from Sarah Chambers to Adam Crozier, 27 April 2006

<sup>35</sup> Condition 19 was what became Condition 21 as part of the 2006-2010 price control.

- manner (in Condition 21(38)(a) of the licence): the corresponding Mailsort price “*reduced by the maximum amount of all the discounts available at the time of determination, irrespective of any qualification conditions for such discounts*”, thereby affirming that TMI discounts are taken into consideration when deciding if the access headroom condition is being observed.
- 3.38 Postcomm believes, therefore, for the purpose of calculating the differentials which actually existed at any time after the control starts to apply between access prices and Mailsort 2 prices, the access reference price,  $arp_{yt}$ , is defined in a way which is consistent with Postcomm’s intention.
- 3.39 The resulting differential is to be compared with  $D_{sy}$ , which was calculated at the beginning of the control, and applies throughout. In doing the once-only calculation to determine  $D_{sy}$  the licence sought to apply what Postcomm considered was the appropriate level of headroom that should be available throughout the period of the control. It was Postcomm’s intention to omit TMIs from the access reference price when performing the once-only  $D_{sy}$  calculations at the beginning of the control. Had TMIs been included in this calculation, they would not have been subsequently restrained by the Condition, as was intended.
- 3.40 The Direction made under the power in paragraph 5 of Condition 21 sets the values  $arp_{yt=0}$  to be used to calculate the value of  $D_{sy}$  to apply post-PiP and it does so entirely arithmetically, without the need to refer to the definition of access reference price. Royal Mail put forward the prices to be included in the tables which were incorporated into the Direction and the prices it put forward in those tables were entirely consistent with what Postcomm expected, given its clear policy intention. If the licence was understood by Royal Mail to operate as Royal Mail now contends, Royal

Mail would have put forward different tables with prices for equivalent Mailsort services reduced by TMI discounts.

- 3.41 Had Royal Mail put forward such prices for equivalent Mailsort 2 services reduced by TMI discounts, the available headroom would have been lower, and in some cases even negative. This would not have been reflective of Postcomm's policy intention underpinning the access headroom condition and Postcomm would not have made a direction including these prices. Moreover, Postcomm would most probably have been challenged by access operators had it approved such a set of prices on the basis that if Royal Mail chose to reduce or remove TMIs it would be able to increase the access price, given the lower levels of  $D_{sy}$ .
- 3.42 Postcomm notes from Royal Mail's third RFI response, that Royal Mail was uncertain as to whether Postcomm intended TMIs to be restrained by the access headroom condition. Its conclusion that Postcomm's Direction resolved that uncertainty in the way Royal Mail now contends overlooks two points: that the Direction contained precisely the prices that would have been expected to give effect to Postcomm's clear policy intent, and that the Direction sets values  $arp_{yt=0}$  on an arithmetic basis which stands apart from the definition of access reference price.
- 3.43 All values of  $D_{sy}$  were crystallised in Postcomm's October 2006 Direction. The Direction set the  $D_{sy}$  values through the equation in paragraph 3.18 above and it did so in a way which did not require reference to the definition of the access reference price, since the values were listed in the spreadsheet tables.
- 3.44 Postcomm's view is that when setting the  $D_{sy}$  values for the period of the control after the introduction of PiP, the access reference price definition was not relevant: the  $D_{sy}$  values were those contained in the October 2006

Direction, without any qualification. Royal Mail has argued<sup>36</sup> that in order for the TMI values to be restricted by the access headroom condition, the  $D_{sy}$  values need to be recalculated such that the definition is applied consistently. Postcomm believes that this is not appropriate, firstly because the  $D_{sy}$  values were set at an appropriate level by the October 2006 Direction and secondly because Postcomm does not agree that there is any inconsistency.

3.45 During its analysis Postcomm also considered the counterfactual, Royal Mail's view that TMIs are excluded from access headroom calculations. In effect this would allow Royal Mail to offer any level of TMI discount, and circumvent the access headroom condition. The counterfactual therefore results in a situation which contradicts with both the letter and spirit of the licence.

3.46 Therefore, in summary, Postcomm believes that its October 2006 Direction did not set a precedent for excluding TMIs from the access headroom calculations for the remainder of the 2006-2010 price control and believes that when considering the letter and the spirit of the licence and October 2006 Direction, TMIs can be considered when assessing compliance with the access headroom provision.

#### Assessment of whether a breach of Condition 21(5) has taken place

3.47 Following Postcomm's conclusion that TMIs are to be considered as a discount and that their exclusion from the October 2006 Direction did not set a precedent for their treatment for the remainder of the control, in order to determine whether a breach of Condition 21(5) has taken place, Postcomm's full investigation has been divided into two work-strands, in order to determine whether a breach of Condition 21(5) has taken place:

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<sup>36</sup> Meeting between Royal Mail and Postcomm on TMIs, 4 November 2008

- i) a consideration of the 'available headroom' following the offering of the relevant TMIs on Mailsort 2 services; and
- ii) a consideration of the 'steps' taken by Royal Mail to ensure compliance with the licence condition.

### **A consideration of the "available headroom"**

3.48 Condition 21(5) sets the minimum percentage level of headroom between the access service price and the analogous end-to-end service price reduced by the maximum amount of all discounts available, referred to in the licence as the access reference price, for each weight step for the duration of the 2006-2010 price control. As stated in paragraph 1.14 above the intention of this restriction was to prevent a margin squeeze between Royal Mail's retail and access services.

3.49 Following a review of all the information gathered, Postcomm believes that it has identified 31 (out of 34<sup>37</sup>) instances where, through the offering of a TMI on a Mailsort 2 product, Royal Mail has not maintained the headroom at the percentage level required by Condition 21(5). The table in **Annex B** lists these TMI offerings and demonstrates the extent to which the percentages have not been maintained (these TMIs are highlighted yellow). The table also shows TMIs offered on retail services with an analogous access equivalent where the percentage margins do appear to have been maintained.

3.50 In the instances where the access headroom has been breached, Royal Mail has earned a net revenue of approximately £2.2 million on the Mailsort 2 mailings for which the TMIs were awarded. Royal Mail claims,

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<sup>37</sup> This document has previously referred to 30 out of 33 TMIs instances where, through the offering of a TMI on a Mailsort 2 product, Royal Mail has not maintained the headroom at the percentage level required by Condition 21(5), based on Postcomm's analysis of the TMI notification emails. The information gathered during the investigation has indicated that the actual number of TMIs offered on Mailsort 2 products between April 2006 and August 2008 is 34 and that in 31 of these instances, the headroom percentage required has not been maintained.

however, that the total postage credit claimed for the TMIs is £51,000<sup>38</sup> (from a possible total of £350,000), suggesting that the issue is insignificant.

3.51 In Postcomm's view Royal Mail is overlooking that it offers TMIs to obtain the benefit of those mailings which are much greater in value than the discount offered to generate or attract them. Postcomm sees the benefit to Royal Mail of TMIs (and the potential loss to competitors who might otherwise have conveyed the mailing) as much better reflected by the value of mailings than by the amount of claimed TMI discounts. On this basis TMIs do not appear to Postcomm to be *de minimis*. In any event, Royal Mail's claim relates to the consequences of non-compliance, rather than to the significance of non-compliance *per se*. It is important to note that Royal Mail has breached the access headroom condition through its offering of TMIs on Mailsort 2 products in 91 percent of the possible instances.

#### **A consideration of the 'steps' taken by Royal Mail to ensure compliance with Condition 21(5)**

3.52 Postcomm believes that Royal Mail's adherence with its internal procedures to ensure that account handlers follow procedures correctly and complete TMI agreements and postage credit forms as set out in the TMI Policy Manual, is questionable. It is apparent from the second RFI response that the required checks on both TMI agreements and credit forms are not always consistently applied. While this demonstrates a breakdown in Royal Mail's wider process, it is not reflective, however, of the reasonable steps that it has taken to ensure compliance with Condition 21(5).

3.53 It can be concluded from the summary of the information provided by Royal Mail in paragraphs 3.12 to 3.15 that it has not taken "reasonable

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<sup>38</sup> Letter from Luke March to Kate Walters, 16 September 2008

steps” to ensure compliance when awarding TMIs on Mailsort 2 products. As noted above, Royal Mail argues that TMIs should not be included in the access reference price, and should not therefore be included in the access headroom calculations.

- 3.54 In Postcomm’s consideration of what reasonable steps Royal Mail should have taken, and should be taking to ensure compliance with Condition 21(5) of its licence, Postcomm would expect to see a robust set of controls in place at key stages of the TMI process, from initial set-up of the contract through to the delivery of the service to the customer. There should be an appropriate level of checks and balances throughout the process in order to ensure compliance with Condition 21(5), which should be supported by ongoing monitoring and review of policy and process such that potential or actual areas of non-compliance, and also improvement opportunities can be identified.
- 3.55 Postcomm notes that these steps, or any similar ones, have not been put in place and adhered to as part of Royal Mail’s internal compliance procedures.

### **C. POSTCOMM’S INITIAL FINDINGS**

- 3.56 Postcomm believes that TMIs are discounts which should be included in the access reference price for the purposes of assessing compliance with the access headroom differential. Postcomm rejects Royal Mail’s view that by the exclusion of TMIs from the October 2006 Direction, a precedent had been set for the remainder of the control.
- 3.57 Postcomm is minded to find that through the offering of the 31 out of 34 TMIs on Mailsort 2 services during the period April 2006 to August 2008 and by not having put in place all reasonable steps to ensure compliance with Condition 21(5), Royal Mail has contravened Condition 21(5) of its licence.

- 3.58 Postcomm is also minded to find that with the ending of Royal Mail's three month self-imposed suspension of offering TMIs on Mailsort 2 services which began on 16 September 2008, Royal Mail will be likely to continue to contravene Condition 21(5) by awarding TMIs on Mailsort 2 products until Royal Mail takes the steps required to put in place appropriate compliance procedures.
- 3.59 In summary, in the light of Postcomm's assessment of the information gathered throughout the course of the investigation, Postcomm is minded to find that Royal Mail has contravened and is likely to continue contravening (if it ended its suspension) Condition 21(5) of its licence through the offering TMIs on Mailsort 2 products.
- 3.60 In accordance with Postcomm's Enforcement Guidance, Royal Mail should submit written representations to this document no later than **5pm on 8 January 2009**<sup>39</sup> to:
- Hannah Steel  
Business Analyst  
Postcomm  
Hercules House  
6 Hercules Road  
London  
SE1 7BD  
hannah.steel@psc.gov.uk
- 3.61 Also in accordance with Postcomm's Enforcement Guidance, Postcomm is offering Royal Mail the opportunity to attend an oral hearing in the week commencing 12 January 2009. On receipt of this document Royal Mail should contact Hannah Steel to suggest convenient times and dates for such a hearing.

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<sup>39</sup> Royal Mail should note that Postcomm has allowed additional time for Royal Mail to respond to this document, taking into account the Christmas holiday period.